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The impact of EU economic governance on the composition of public expenditures in the Member States

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1. Introduction

This chapter provides an overview of the overarching objective of the thesis: assessing the relationship between the EU economic governance framework at the supranational level and the composition of fiscal policy at the national level. The contribution of the analysis extends beyond the mainstream focus on the impact of the Stability and Growth Pact (SGP) on the size of the budget (or the consequent deficit and debt levels) to consider the distributive effect across different categories of public expenditures. From such premises, the overall research question considers the neutrality of EU economic governance to the national budget structures.

Fiscal policy and EU economic governance have been at the forefront of the debate, well beyond the academic arena. Yet their relationship has often been neglected. That is especially the case for the composition of national spending, a domain itself that could benefit from an additional systematic assessment. Domestic budget structures are highly political matters, having a direct impact on the life of citizens. Through its influence on the domestic fiscal policy mix, EU economic governance may as well have extensive distributional implications. Unsurprisingly the EMU has attracted a non-trivial level of controversy over the years with copious and at times conflicting criticism.

"Since its inception in 1997, the Stability and Growth Pact (SGP) has lived through times both good and bad. It has been berated by politicians, academics, trade unionists and many other participants in the public debate. It has been called simultaneously too rigid and too lax, harmful to economic growth and outright stupid" (Heipertz & Verdun, 2010, p. ix).

Additionally, EU economic governance and national budget structures are not only contested in view of the strong and divergent interests at play, but also quiet complex and multidimensional. Specifically, EU economic governance - unparalleled as an unprecedented experiment in the supranational pooling of decision making within such a vital domain for national sovereignty - can hardly be reduced to a single and simple concept, both intrinsically and in its evolution over its lifetime. Similarly, the analysis of the budget structure is also far from straightforward due to its composite nature. Moreover, the relationship between the national and supranational levels hardly occurs in a void but instead takes place within an ecosystem of potentially interacting factors. Consequently, a deep understanding of the mechanisms at play not only within the dependent and independent variables but also among the former and domestic determinants of the fiscal policy is at the core of this work.

The thesis brings together the literature on the domestic determinants of national fiscal policy with that on the Economic and Monetary Union. Firstly, the disaggregate assessment of where the bite of the EU economic governance framework lands back at home sheds some light on how the Pact fulfils its policy objectives of promoting at the same time fiscal discipline and inclusive growth. Within this context, it contributes to the rich debate on the subordination of social objectives to economic ones at the hand of the EU fiscal surveillance regulatory framework. At the same time, it evaluates the claim of a detrimental effect of the Pact on investment and growth, linked in extant literature to the lengthening and worsening of the Great Recession and Eurozone crisis and the divergence between core and periphery. Finally, the dissertation provides robust evidence disputing the irrelevance of the SGP for national budgetary dynamics based on the poor track record of compliance with the supranational fiscal rule and empirical studies which may however come short of capturing heterogeneities within such a complex ecosystem.

Building on the well-established findings on the interplay between (national) fiscal rules and the political, institutional, and economic context, the analysis provides a *causal empirical assessment over the panel of the EU28 from 1995 to 2018 of whether and under which conditions the EU economic governance framework impacts the structure of the budgets of the Member States*. In considering both a synthetic indicator of changes to the budget structure, disaggregated impact on all budget lines (e.g. health, education, social protection, etc.), and on broad components associated with investments, transfers, and the mitigation of inequalities, the analysis provides a rare comprehensive picture of which elements are affected at all and where comparatively the highest toll emerges within the components of national spending. *Results refute the irrelevance of the SGP for national spending and its neutrality for budget composition. Conversely, for countries under EDP surveillance, the supranational fiscal rule is a powerful force constraining if not cancelling powerful budgetary pressures such as that of the recession, demography and ageing.* The heterogeneous effect of the Pact at a geographical – to the detriment of the periphery – and sectorial level – hitting disproportionally investments – increases over time culminating with the Fiscal Compact and is highly pro-cyclical, strengthening rather than disappearing during the Great Recession.

The introductory chapter briefly presents the research objectives and research questions, situating them in the broader academic and policy context. Section two proceeds to outline the relevance and implication of the work, together with the significance of its contributions. Section three provides a synthetic overview of the data and methodology. Section four follows with the main findings before concluding with mapping how the work proceeds throughout the chapters to follow.

1.1 The research objectives and hypotheses

The topic of the impact of EU economic governance on domestic budget structures is complex and intertwined nature, requiring a multifaceted understanding of the many mechanisms at play in the relationship between the supranational regulatory framework and the highly sensitive and political domain of national fiscal policies. The framing of the research question in parallel accounts for the intricate dynamics at EU and domestic level and how they may interplay in shaping budgetary outcomes. This section illustrates the aim of the dissertation and briefly situates the work within the state of the art grounding the general claims supported by the analysis of (i) *non-neutrality of the EU economic governance to national budget structures* and (ii) *heterogeneity of the effect of the Pact on the domestic fiscal policy mix.*

Research objectives

The thesis investigates the impact of European Economic governance on the fiscal policies of the Member States. Within this context, the topic has received non-trivial attention at the aggregate level, that is to say in relation to overall size of national public expenditures (e.g. deficits and debt levels of the Member States). However, the debate is far from resolved. Contradictory claims accuse the SGP both of ineffectiveness and of a harsh negative impact on national budgets and the sovereignty of the Member States. At the same time, the focus on aggregate dynamics fails to appreciate the potential for distributional consequences of EU economic governance and substantial heterogeneities in its fiscal impact. Moreover, a higher level of granularity is necessary to evaluate the SGP against its own policy objectives of conciliating fiscal discipline with inclusive growth – a function of the precise resulting budget structure. From such premises, the research goes beyond the mere consideration of the effect of the supranational fiscal rule on budget sizes to pinpoint the implications of the EU regulatory framework on the allocation of resources across budget lines.

In this context, the relevant background situates itself in the intersection of two key areas of the literature investigating on one side the dependent variable – the composition of public expenditures – and its (domestic) determinants, together with the EU fiscal surveillance framework and its evolution. Starting from the first element, fiscal policy has been one of the main protagonists of the political economy literature. In this context, extensive work on key determinants of aggregate fiscal dynamics at the national level provides indications on key domestic factors, how EU economic governance fits in and potential interactions between the supranational and national arena. Within this domain, the work, drawing also on the extensive literature on budget deficits and fiscal consolidation, furthers the significantly sparser theoretical and empirical understanding on the composition of public expenditures. On the second account, much attention has been devoted to the Economic and Monetary Union, both from the perspective of understanding and explaining European integration and in assessing its functioning and impact. However, the EU economic governance framework – far from a stable and homogeneous regulatory framework – is often over-simplified to the sole membership to the Union and Eurozone. The thesis contributes a more sophisticated account of the causal mechanisms through which the EMU affects national budgetary choices, considering potentially heterogeneous effects which may be hidden behind an underwhelming average impact on fiscal policies.

The state of the art

The analytical framework rests on an extension of the theoretical conceptualisation of the supranational fiscal surveillance architecture parallel with a concomitant account of how budgets are shaped by the multitude of domestic factors at play. The approach allows to additionally uncover potential channels of interaction between the national determinants and the supranational regulatory infrastructure.

The leading factors impacting national budgets and their structures can be distinguished at the country level across three key domains: the (i) political, (ii) economic and (iii) institutional arena (Franzese, 2002). Chapter two, building on theoretical expectations and previous empirical findings, presents the prime determinants within each sphere. Suffice to say, without delving into the details, that determinants of aggregate dynamics generally hold distributional implications for the composition of public spending. At the same time, there is limited comprehensive cross-country accounting – with coverage extending to recent years – on how political, economic and institutional factors affect the fiscal policy mix. Nevertheless, previous partial accounts of national fiscal rules – central to the analysis as the Stability and Growth Pact (SGP) – represent in broad terms a parallel at the supranational level. Their compliance and impact on spending – likewise often lacking disaggregation at the budget line level – is well established as dependent on the political, institutional and economic context in which they operate (e.g. Debrun et al., 2008; Hallergber et al., 2009; Forenmy, 2014; Reuter, 2019). Similarly, one may expect heterogeneity also in the scope of the impact of the SGP on the budget structure. In a nutshell, the domestic arena indicates several mechanisms across the political, economic and institutional sphere that may affect both national fiscal policies directly and in interacting with the effectiveness of the supranational fiscal rule to be accounted for in uncovering the specific configurations under which EU economic governance shapes budgetary choices.

Along the theme of heterogeneity, complexity also applies to EU economic governance. In its most basic simplification, the framework consists of a supranational numerical fiscal rule capping national deficits. However, the intricacies of the multidimensional nature of the EU regulatory framework in the domain of national fiscal policies coordination have been widely recognised (e.g. Heipertz & Verdun, 2010). Furthermore, EU fiscal governance has not maintained a stable architecture over time, undergoing two major reforms with diverging trajectories, firstly weakening the supranational 'bite' of the framework and then radically strengthening it while increasing its invasiveness into the national budgetary process. Especially the latest iteration of the framework has transposed supranational commitments into the domestic regulatory framework of the Member States, culminating in the requirement to translate EU fiscal rules into national legislation with the introduction of what has been considered the "climax" of the 2011-2013 reform, the Fiscal Compact (Creel et al., 2012, p. 538). An additional complexity in the assessment of the supranational framework hinges on how mechanisms within the domestic arena deriving from EU policy may capture the most constrictive device for impacting budget structures.

In addition, within the architecture of supranational fiscal surveillance, the instruments available to affect Member States fiscal policies differ sharply according to the relevant legal basis. The preventive arm of the framework consists primarily of the soft instrument of policy coordination toward supranational budgetary targets, while the corrective arm addressed to those in violation of the supranational fiscal rule can avail itself of the hard instrument of sanctioning (Heipertz & Verdun, 2010). Within the corrective arm, the Excessive Deficit Procedure has been considered as the "cornerstone" of the EU economic governance framework (Hallerberger et al., 2009, p. 171). From such a perspective, the accounting of the SGP in most quantitative work through a simple pre-post dummy of EU and/or Eurozone membership seems potentially problematic. That is especially the case as empirical work on the impact of the SGP on (aggregate) spending dynamics has yielded to mixed results, generally failing to uncover a significant disciplinary effect of EU economic governance (e.g. Dahan et al., 2013; Reuter, 2015, 2019; Tòth, 2019; Franek & Postula, 2020; Jalles et al., 2020; Losoncz & Tóth, 2020). Against this backdrop, such results may not capture the failure of EU economic governance to affect national budgets but rather the necessity to account for its heterogeneity and its most powerful component – EDP surveillance – as well as changes over time. The same reasoning may also apply to the economic cycle, as the Pact aims to foster counter-cyclical fiscal policy through escape clauses granting the Member States some leeway in times of crisis.

In addition, the latest policy evolutions have brought about additional complexity. Specifically, the framework for economic cooperation and convergence has burgeoned over time, in parallel improving its integration with the core (fiscal) rules of the SGP, culminating with the introduction of the European Semester process (Verdun & Zeitlin, 2018). In this context, the European Semester and the Country Specific Recommendations (CSRs) hold the ambition to orient national spending more directly. Nevertheless, the EU budgetary surveillance infrastructure remains principally a (fiscal) rule-based framework, entrusted with the most powerful instruments for compliance and sanctioning. While the Semester has quickly become a topic of high interest within the literature, much remains to be understood on the relation and alignment between the two frameworks.

Research questions and hypotheses

Coming back to the leitmotiv of heterogeneity highlighted at the beginning of the section, previous funding and areas worth of additional investigation point towards three broad domains across which the impact of EU economic governance on national budget structures may change, hidden behind average (limited to null) effects. Firstly, the nature and evolution of the supranational EU fiscal framework indicate that it may not be sufficient to assess the supranational economic governance architecture as a stable and unitary concept. In fact, the framework is composed of several instruments - among which chiefly the EDP - having undergone successive waves of reforms. Additionally, both fiscal policy and fiscal rules change across good and bad times. Much of the criticism of EU economic governance is linked to the Great Recession and Eurozone crisis. At the same time escape clauses may imply very little impact of the SGP in times of economic downturn. Finally, the domestic arena and the literature on fiscal rules point towards the EDP as a function of the political, institutional and economic context. For the supranational fiscal rule, the implication is the potential of heterogeneous effects in the interaction with national factors. From such a perspective, in addressing the EU-MS fiscal puzzle the thesis considers three main research questions:

1. *when and how the SGP affects the composition of national budgets.*
2. *if and how the SGP has affected the domestic composition of public expenditures during the Great Recession and Eurozone crisis.*
3. *if and how the impact of the SGP changes across different domestic political, institutional and economic conditions.*

The first research question concerns the heterogeneous force of the EU economic governance framework itself, across its preventive and corrective arms and over subsequent reforms, as well as its alignment with the CSRs. For what concerns the Great Recession and sovereign debt crisis, the analysis considers whether there is an impact on budget structures at all and how it differs across budget lines and their heterogeneous implications for investment, transfers and inequality mitigation. Finally, in relation to the domestic arena, the interplay with the supranational fiscal framework is assessed for political (ideological distance, alternation and ideology), institutional (decentralisation and national fiscal rules strength preferences) and economic (unemployment and ageing) determinants of the budget structure. As a result, for each of the three research questions above, three sub-hypotheses are put to test, capturing heterogeneities, allowing for the evaluation of adherence of the SGP to its policy objectives and deriving its broader distributional implications, as presented in Table 1. 1. That is two say that nine main hypotheses are tested throughout the analysis across the broad categories of heterogeneity within the SGP, across the economic cycle and domestic determinants.

Table 1. 1 - Research questions and sub-hypotheses

[RQ1] ***when and how the SGP affects the composition of national budgets.***
[HP1.A] *EDP surveillance leads to consolidation-driven higher structural changes in national budgets.*
[HP1.B] *the impact of EDP surveillance on the composition of national budgets substantially increases with the 2011 reform of the SGP.*
[HP1.C] *the impact of EDP surveillance on national budget structures is congruent with the CSRs.*
[RQ2] ***if and how the SGP has affected the domestic composition of public expenditures during the Great Recession and Eurozone crisis.***
[HP2.A] *the SGP contravenes its countercyclical policy objectives in enforcing consolidation in times of crisis.*
[HP2.B] *the SGP-at-crisis in pushing toward an investment rich response to the recession came at the expenses of transfers and inequality mitigating expenditures.*
[HP2.C] *the SGP-at-crisis furthered the social cost of the recession by negatively impacting social spending dynamics.*
[RQ.3] ***if and how the impact of the SGP changes across different domestic political, institutional and economic conditions.***
[HP3.A] *the effect of the Pact on the budget structure is larger for government coalition characteristics (e.g. low ideological distance, high alternation) more conducive to changes in the budget structure.*
[HP3.B] *the effect of the Pact on the budget structure is larger if domestic institutional configurations are more conducive to fiscal consolidation.*
[HP3.C] *the effect of the Pact on the budget structure is smaller when running against opposing domestic economic conditions.*

The assessment of the impact of EU economic governance on the composition of public expenditure in the Member States locates itself in the intersection between the domestic political economy and the functioning of the supranational regulatory framework. The hypotheses driving the dissertation outline a substantial contribution to both fields. Firstly, the budget structure remains an under-investigated area of research even for national determinants, compared to aggregate spending dynamics. Studies assessing synthetically the budget structure, its disaggregation into budget lines and macro-components of investment, transfer and inequality mitigation are quite rare, especially in considering recent years and covering the full EU28. From such perspective, it comes to little surprise that their linkage with EU economic governance has similarly received limited systematic attention, especially in view of the underwhelming evidence on the effectiveness of the SGP. The thesis furthers the understanding of such dynamics, covering the full lifespan of EU economic governance and yielding an innovative contribution to the analysis of the supranational fiscal rule in terms of how the causal mechanisms at play and their implication for how the supranational fiscal architecture should be conceptualised. In this regard, it highlights as crucial a better accounting of the framework, centred around EDP surveillance, and accounting for the main heterogeneity at play in the complex environment in which national budgets take form. The next section positions such contributions within the latest academic and policy debate.

1.2 The relevance, implications and contributions of the work

That fiscal policy and its distributive implications matter is an argument hard to dismiss. Over the years and especially in the wake of the Great Recession, the same conclusions are often reached for EU economic governance also in the debate of public opinion. EU economic governance has been a highly contested policy (Heipertz & Verdun, 2010), to the extent that it can be considered one of the central concerns in the political debate against European integration (Roth et al., 2016). Within this context, the narrative of negative (social) implications of the Eurozone, limiting the responsiveness of national states to economic and social shocks under budgetary constraint derived from the supranational level has become increasingly widespread. A narrative argued to have contributed to the erosion of trust in European and national political institutions and to the rise of Euroscepticism (Roth et al., 2016).

The relevance of furthering the understanding of the impact of EU economic governance on disaggregated public spending is closely connected to the broad economic, social and political implications of the fiscal policy mix. From an economic perspective, the composition of public expenditures has been well-established to impact growth prospects (e.g. Barro, 1990; Baum & Lin, 1993; Devarajan et al., 1996; Kneller et al., 1999; Romero-Avila & Strauch, 2008; Afonso & Fuceri,2010; Gemmell et al., 2011; Bottasso et al., 2013; Fournier, 2016; Gemmell et al., 2016; Jeong et al., 2019). At the same time, the budget structure carries implications for social and inequality concerns (e.g. Afonso et al., 2010; Fuest et al., 2010; Joumard et al., 2012; Anderson et al., 2017; Johansson, 2016; d'Agostino et al., 2020; Szczepaniak, 2020). At the political level, recently the debate has considered the consequences of austerity and distributional dynamics within domestic budgets (e.g. the social costs of fiscal consolidation) for the erosion of trust in national and supranational institutions and the rise of Euroscepticism (e.g. Kuhn & Stoeckel, 2014; Della Porta, 2015; Armingeon et al., 2016; Börzel, 2016; Kotroyannos et al., 2018; Banducci & Loedel, 2020; Crespy, 2020; Turnbull-Dugarte, 2020). Beyond their interest in their own right, such implications allow for a linkage between changes in the composition of national budgets and prospects for inclusive growth, a key policy objective of the SGP along with fiscal consolidation, which can be empirically assessed through this research. On the political side, similarly, the distributional effect of EU economic governance, in turn, can be associated with its implications for the support for European institutions and integration.

If the literature has devoted limited comprehensive quantitative assessment to how the supranational level contributes to spending composition, much of the criticism raised against EU economic governance goes beyond its impact on fiscal stances and deficits across the Member States. Even in its early stages, the reliance on a numerical expenditure rule within the SGP raised some concerns for its potential to crow-out investments (Blanchard & Giavazzi, 2001; Creel & Saraceno, 2010; Creel et al., 2013). Likewise, similar concerns have been put forward for welfare, especially in the aftermath of the crisis (e.g. Heins & De La Porte, 2015; Costamagna, 2018). Concerns have been raised also for specific categories of spending such as health, of chief interest in the context of the Covid-19 pandemic. Does the SGP crowd-out investment? Is falling under EDP surveillance bad news for social spending and inequality mitigation? Is EU economic governance to blame for negative trends in healthcare? The empirical analysis puts forward robust answers to such crucial questions not only for the assessment of the supranational fiscal rule but also for the everyday life of citizens and the sustainability of the EMU architecture.

On a similar account, much of the critics of the Pact have highlighted the weakness of the framework especially in times of crisis, due to its pro-cyclical impact on fiscal policy. That is to say that the fitness of the framework is questioned especially in times of severe downturns (e.g. Larch et al., 2010; Lane, 2012; Creel et al., 2013; De Grauwe, 2013; De Grauwe & Ji, 2013; Jones et al., 2016; Braun & Hübner, 2018; de Quadros & Sidjanski, 2017). Moreover, the (mis)management of the Great Recession is blamed for the furthering of the divergence between the core and periphery (e.g. Feathersone, 2011; Lin & Treichel, 2012; Anderson et al., 2014; Matthijs & McNamara, 2015; Matthijs , 2017; Hutter et al., 2018), persistent to these days as a key challenge for the post-pandemic reconstruction. The in-depth assessment of crisis dynamics and the distributional impact of EU economic governance in bad times sheds some light on such interrogatives, showing whether escape clauses protected spending from consolidation at the hands of the SGP during the Great Recession and addressing at the same times potential geographical heterogeneities.

Additionally, distinguishing across the components of the SGP and over the evolution of the EU fiscal surveillance framework is a substantial added value of the dissertation. Indeed, pinpointing the conditions under which the EU economic governance framework affects the budget structure puts to rest the claim of ineffectiveness of the SGP. Rather, it provides guidance for research on the EU economic governance far beyond the focus of the research questions at hand, in uncovering the centrality of EDP surveillance. Additionally, the value of considering the full timeframe of the life of the SGP while at the same time distinguishing across policy reform opens valuable insights on EU economic governance. Firstly, it allows for the assessment of its evolution. More importantly, it pinpoints the distributive impact of the SGP today, post the 2011 reform and the introduction of the Fiscal Compact. Additionally, the research contributes to the recent florid debate on the European Semester, in a dimension generally overlooked: the congruence between the demand of the supranational fiscal rule and the CSRs, shedding some light on whether indeed there is a primacy of fiscal discipline when contradicting, for example, with social objectives.

Finally, the contribution of the thesis takes an additional value at the time of writing. Indeed, the SGP has been long due for a revision, for which findings were presented in early 2020, right around the outbreak of the Covid-19 pandemic. The health crisis has raised unprecedented challenges for the EU and the EMU, discussed extensively against the finding of the research in the concluding chapter. In this context, the SGP has once again proven itself unfit for crisis management, (temporarily) set aside and complemented by novel (likewise temporary) measures such as SURE and Next Generation EU. If Covid-19 may have changed extensively the context, it has further evidenced the shortcomings of EU economic governance, re-entering the centre stage of the debate. Additionally, the delayed Conference on the Future of Europe is tasked with setting the path forward for integration, including in the two primary areas called into play by the pandemic: health policy and economic governance. Against this backdrop, it is especially timely to assess in-depth the SGP over its full life and across the various configurations which foster its impact on the national fiscal policy mix.

1.3 Data and methodology

The analysis is carried out on the panel of the EU28 from 1995 to 2018, bringing together a multitude of public datasets with the analysis of official documents. The complexity highlighted so far is partially reflected in the conceptualisation and operationalisation of the key variables and the methodological approach. In this respect, several challenges have to be overcome and/or mitigated. This section presents a synthetic overview of the variables and methodological choices considered in the analysis.

The structure of public expenditures has an inherently composite nature, which is not straightforward to summarise into a synthetic assessment of whether and how the fiscal policy mix has been impacted. One can easily assess the overall trend with regards to the size of national budgets. For the budget structure, however, the information of interest is multidimensional as it is connected with trends across all of its components. International classification – COFOG – disaggregates into budget components allowing for homogeneous cross-country comparison of public accounts over 10 broad divisions (e.g. social protection) and within them 69 groups (e.g. pension spending, unemployment, etc.). Previous empirical work (Tsebelis & Chang, 2004) has tackled the challenge of a synthetic indicator of changes to the fiscal policy mix, in considering the budget distance consisting of the Euclidean difference between allocations across the components of public expenditure over two consecutive years.

Likewise, multidimensionality surrounds also the key independent variable, the supranational fiscal surveillance and coordination framework. In its most basic conception, a fundamental distinction has to be made in terms of membership across the EU28. The time of accession to the European Union varies in some instances pre-dates the starting time of the analysis while in others takes place within the examined period. Similarly, also Eurozone membership, for all instances commencing within the sample, occurs across different waves for countries participating in the Euro Area. Additionally, the SGP holds a sharp internal distinction between compliant countries under the preventive arm and those found in violation of the supranational fiscal rule, under EDP surveillance for convergence back towards fiscal discipline. Considering regulatory evolution, the Pact was first reformed after its early failures in 2005, followed by a substantial overhaul in the 2011-2013 period in response to the Eurozone crisis, culminating with the introduction of the Fiscal Compact. In addition, especially during and in the aftermath of the crisis, several countries entered financial assistance program: those observations differ both in terms of the dependent variable - with specific budgetary challenges leading them into such grouping - and the independent one, as they do not, strictly speaking, fall under the purview of the SGP during such times. All these elements of multidimensionality are captured by dummies indicating the permanence of the observation under a given status (e.g. Eurozone, EDP and financial assistance).

Additionally, the domestic arena is accounted for in three key dimensions: the political, institutional and economic spheres. Politically, the controls capture three characteristics of the governing coalition: its ideological distance, the alternation against the previous cabinet and its (weighted) ideological stance. Institutionally, the analysis accounts for decentralisation, distinguishing across unitary and federal states, and national fiscal rule preferences. The latter requires non-trivial disentangling between how the effect of a fiscal rule can be attributed to the domestic and supranational level, solved with an innovative approach presented in detail in chapter four. In the economic arena, the two main determinants of shifts in the budget structure - changes in old-age dependency rate and unemployment rate - are considered, along with a dummy capturing the Great Recession and Eurozone crisis.

In summary, the key variables included are:

- dependent variables: (i) budget distance, (ii) the ten division level budget components, (iii) the 69 group level budget components and (iv) the five macro-aggregates of investment, transfers, inequality addressing spending and budget lines catering to youth and the elderly.
- independent variables: (i) membership to the Union and the Eurozone, (ii) EDP status, (iii) regulatory framework iteration over the two key SGP reforms, (iii) Fiscal Compact status and (iv) falling under financial assistance (FAP).
- domestic controls: (i) political factors of ideology, ideological distance and alternation, (ii) institutional factors of decentralisation and national fiscal rule strength preferences and (iii) economic factors of unemployment and old-age dependency rates, as well as the timing of the crisis.

In line with the research questions under consideration, several interactions are considered to uncover heterogeneous effects. Within the EU economic governance framework, that amount to considering changes of the effectiveness of EDP surveillance across Eurozone membership and policy reforms (e.g. the initial, post-2005 and post-2011 period, as well as the Fiscal Compact). In relation to the second research question, the analysis considers the interaction of the key independent variable - EDP surveillance - with the Great Recession. Finally, at the domestic level, interactions are considered for all the above-mentioned political, institutional and economic controls. As a result, the thesis pinpoints which configurations are more or less conducive to implementing the prescriptions of the supranational fiscal framework.

1.4 The main results

In answering the overarching question of whether national fiscal policy choices are affected by the supranational fiscal rule, the analysis provides a robust corroboration that *EU economic governance is far from neutral in affecting the budget structure of the Member States*. Specifically, the key takeaways across the three main research questions of the analysis are:

- the impact of the EU economic governance on the national fiscal policy mix is heterogeneous over time – increasing substantially with the latest wave of reform – and scope, limited predominantly to Eurozone countries under EDP surveillance and aligning quite poorly with prescriptions of the CSRs;
- budgetary dynamics do not escape the bind of the EDP in times of crisis, rather the framework is the most impactful in such circumstances, generating substantial spending restructuring – pro-cyclical and detrimental for inclusive growth and geographical convergence;
- heterogeneity in the effect of the Pact extends to domestic circumstances, with political characteristics of the government (e.g. small budget distances, high alternation) and a unitary institutional structure as a precondition for any impact to materialise, while in the economic domain the restraint of the SGP materialises especially in countering expansionary pressures such as those of the crisis, ageing and unemployment.

Heterogeneity within EU economic governance

Findings refute the widespread argument within the literature of a limited impact of the supranational fiscal governance framework given the poor track record of compliance with the deficit targets of the Stability and Growth Pact. Conversely, the work contributes a more sophisticated account of EU economic governance. It goes beyond simply accounting for membership to the EMU and the Eurozone considering close supranational budgetary surveillance under the Excessive Deficit Procedure. Additionally, it accounts for the heterogeneous effects of the Pact over its life and two substantial reforms. While an effect that runs against fiscal discipline is somewhat confirmed for EU and Eurozone membership, *EDP surveillance emerges as the key driver of a consolidation-driven restructuring effect on national budget structures*. Such dynamic, however, is far from homogeneous across time and place: being under the EDP leads to changes in the fiscal policy mix only within the Eurozone and after the

2011 reform when excluding the period of the crisis.

The analysis also investigates the *alignment between the effect on the national budget structure of the supranational fiscal rule and the policy coordination within the Semester comparing the distributive effect of the Pact with the Country Specific Recommendations (CSRs) in selected Member States*. Overall, the negative impact of the EDP on inequality mitigating measures and investment and specifically on health, education, and social protection, more often than not clashes with the CSRs in the considered Member States. Heterogeneities both in the impact of the EDP on the budget structure in the post-2011 period across the core and periphery and the CSRs imply, however, a more substantial disconnect between the two arms of the EMU for the Southern Member States, supporting the narrative of a particularly detrimental effect of the Pact on social spending and inequality.

The SGP-in-crisis

A further contribution is the granular analysis of dynamics in times of crisis, unveiling whether escape clauses shield domestic budget structures from any shock at the hands of the supranational fiscal rule or rather the national fiscal policy mix is affected. The analysis offers a rare detailed account of the cost of the SGP in times of crisis for specific budget components and their relative penalisation at the hands of austerity policies, allowing to pinpoint if investments have been preserved at the expenses of social policies and measures mitigating inequality, together with the intergenerational distribution of fiscal discipline.

The results contradict the hypothesis of national budgets escaping from the claws of the Pact during economic downturns. Rather, *more marked restructuring of the fiscal policy mixes emerges during the crisis, as EDP surveillance has a significant and sizeable impact on the budget structure and some of the key budget lines of interest even before the 2011 reform in these times*. The analysis reveals that not all spending is equally affected. While EDP surveillance acts to (nearly fully) contain the recessionary upward push on spending, for example, in the domains of education and social protection, it more than compensates for the crisis for another key budget line such as health. As a result, divergences emerge in the constraining effect of the Pact on transfers, investment, and inequality mitigation. A change in the impact of the EDP across the cycle is present for both of the three spending groups. Transfers are only negatively impacted by the EDP surveillance in times of crisis when the supranational fiscal rule contains most of the expansionary pressure of the downturn. For the other two categories, investment and inequality mitigation, the effect is far more comprehensive with the constraining influence of the Pact when under EDP present throughout the economic cycle. Nevertheless, while the push towards consolidation materialises also in good times it is further strengthened during the Great Recession. The EDP overcompensates the effect of the crisis, implying overall a negative trend for investment ad inequality. While investment is the worst impacted, that is not to say that transfers and inequality are not affected. A significant cyclical impact of EDP surveillance emerges for social protections and - heterogeneously - several budget lines within this division.

The already bleak picture for an inclusive and growth-enhancing investment rich recovery hides substantial divergences between core and periphery. Such distinctions are explored in details in the dissertation, in view of their overarching implications and predominant position within the debate. The SGP-in-crisis holds substantial geographical heterogeneities in its distributive impact on the budget structure of the Member States. Within this divide, southern countries carry the worst prospects in terms of full containment of transfers and slashing of investments. The additional in-crisis effect of the EDP on investment is nearly doubled in the periphery compared to the core. Likewise, for transfers, the expansionary effect of the crisis is more than matched by the additional constraining effect of the EDP during the crisis, which is not the case in countries within the core. In addition, the intergeneration distribution of in-crisis consolidation is also heterogeneous along geographical fault lines. In the South the cost of the recession is shouldered especially by youth, with social expenses for old-age mostly spared.

The interactions with the domestic arena

Finally, the work considers as well *the interplay between the supranational level and the national context*, identifying how the characteristics of the governing coalition (i.e., ideology, range within the government and alternation), the federal-unitary institutional nature, along with fiscal rule strength preferences in the Member State, and the demographic and employment conditions affect the transmission of the supranational commitments within the Stability and Growth Pact onto the domestic budget structure. In doing so, it uncovers as well which national configurations and conditions are conducive to a (restraining) impact of the SGP on national spending and the fiscal policy mix.

Findings show that *national political contexts facilitating changes to the budget structure (i.e. small coalition ranges and high alternations) are associated with a larger impact of the EDP surveillance on the fiscal policy mix, which loses significance under less favourable political conditions*. A similar pattern emerges for ideology, with somewhat moderate governments as a precondition for any impact of the EDP surveillance, which is more sizeable on the left side of the spectrum. In the institutional arena, unitary countries are more conducive to restructuring their budgets when falling under EDP surveillance. Conversely, national fiscal rule preferences show a complementarity between the extent to which countries prefer fiscal discipline on their own and the Pact, with EDP surveillance affecting more substantially the Member States with a laxer approach to spending. Finally, the demographic pressure and that of high unemployment stiffen the budget structure, increasing the barriers against a restructuring effect of the Pact. However, from the opposite perspective - alike for the crisis - the constraining power of EDP surveillance is quite remarkable, containing their budgetary implications. To that effect, the EDP enacts substantial convergence across various levels of unemployment and old-age dependency rate. As such, the thesis confirms that while the effects are heterogeneous and dependent on the national context, *the Pact for Eurozone countries under EDP surveillance is far from a minor nuisance but rather a powerful force capable of substantially restraining if not annihilating key pressures such as that of demography, unemployment, and even the crisis*.

The structure of the thesis

The thesis continues as follows. Chapter Two situates the analysis within the extant literature on the domestic determinants of the budget structure, fiscal rules, and the EU economic governance, which informs and ground the research questions and hypotheses presented in Chapter Three. From such premises, the methodological approach and research design are outlined in Chapter Four, touching on the key empirical challenges and mitigation strategies deployed in assessing such a complex ecosystem.

The core of the analysis is presented through four empirical chapters. Chapter Five uncovers heterogeneities in the effect of the EU economic governance over its different configurations (e.g. Eurozone, EDP surveillance) and subsequent regulatory framework (i.e. initial, post-2005, and post-2011), together with the (mis)-alignment across the effect of the Pact on domestic budget structures and the prescriptions of the Country-Specific-Recommendations. Chapter Six and Seven are dedicated to the assessment of the effect of the Pact during the Great Recession and Eurozone crisis, evaluating whether - against the expectations derived from the escape clauses - any impact on the budget structure emerges during the crisis, considering as well at a granular level where the bite of the EU economic governance at crisis lands across budget lines. Chapter Seven continues in the analysis of at-crisis dynamics considering the distributional effects on investments, transfers, and inequality mitigation during the Great Recession, taking a closer look at the social dimension and how the intergenerational balance of spending is altered at the hands of the Pact. Chapter Eight concludes the empirical analysis evaluating the interaction between the Pact and the national context uncovering which political, institutional, and economic domestic configurations are most conducive to the impact of the SGP.

Finally, Chapter Nine situates the key findings of the thesis in the context of the reform debate on the Pact and EU fiscal governance. Along the same line, it considers the insights and outlook for the future of political and economic integration in view of the unprecedented challenge of the Covid-19 crisis and (partial) policy evolution for the pandemic response. In concluding, the thesis puts forward a rich research agenda spanning from the key contributions of the dissertation in uncovering heterogeneities in the impact of EU economic governance and specifically the central role played by EDP surveillance, the dramatic pro-cycle and distributive consequences of the framework in bad times and the interplay with domestic factors.

2. The political economy of national budget structures under the EMU: the state of the art

In its twenty years of history the achievements and (more often) the failures of EU economic governance have been long debated. Much ink has been dedicated to the determinants of choices regarding the nature and regulatory framework governing the Economic and Monetary Union (EMU) and the winners and losers of the inter-institutional balance of powers. In considering the effect of the regulatory regime on national spending choices, the focus has chiefly been on fiscal discipline concerning deficits, debts and to a lesser extent spreads (e.g. Freitag & Sciarini, 2001; Hauptimiter et al., 2011; Creel et al., 2013; Iara & Wolff, 2014; Koehler & König, 2015; Ademmer & Dreher, 2016). Although the most recent reform in the aftermath of the Eurozone crisis may have created expectations of balanced budget rules yielding a future scenario of generalised low debts (Barns et al., 2012), the vast majority of the literature comes to different conclusions. The general theme is that of failure of the Stability and Growth Pact (SGP) in generating fiscal discipline and an extensive debate on how to regain credibility of fiscal sanity within the Eurozone (e.g. De Haan et al., 2004; Bearce, 2009; Blavokus & Pagoulatos, 2008; Begg, 2017; Creel et al., 2013; Herzog & Hengstermann, 2013; Koehler & König, 2015).

Against this backdrop, there is limited evidence on the impact of the supranational regulatory framework on national budgetary choices. At the same time, national fiscal rules stack more extensive evidence on their success in containing profligacy, often, however, failing to account for the role of the European economic governance framework or finding even a negative effect on fiscal discipline (e.g. Dahan & Strawczynski, 2013; Reuter, 2019; Tòth, 2019). That is especially problematic in the context of the post-crisis years as the Fiscal Compact transposition requirements of balanced budget rules at the national level create quite a fuzzy distinction between the extent to which the effect of domestic fiscal rules may be attributed to countries or rather the supranational regulatory framework.

Within this broad context the understanding of how national and supranational dynamics shape choices related to the composition of domestic spending are even more sparse. Conversely, the (negative) consequences of the Economic and Monetary Union are often attributed in the literature to the erosion of the welfare state and social spending, which has driven a substantial proportion of the criticism on the disruptive effect of the Pact especially in the periphery (e.g. Scharpf, 2009, 2015; Heins & De La Porte, 2015; Matthijs & MacNamara, 2015; Greer & Jarman, 2018; Hemerijck & Ronchi, 2020). The debate has gained increased salience with the introduction of the European Semester and, more recently, the adoption of the European Pillar of Social Rights sparking a mix of higher expectations and scepticism in the reconciliation of economic and social objectives within the EMU (e.g. Copeland & Daly, 2018; Maricut & Puetter, 2018; Verdun & Zeitlin, 2018; Zeitlin & Vanhercke, 2018; D'Erman et al., 2019; Grohs, 2019; Haas et al., 2020; Vesan et al., 2021). At the same time, in the context of the Semester the presence of social concerns and the promotion of social investment has been documented (e.g. Bekker, 2017), leaving open the question of how the pro-social rhetoric matches in practice against the widespread accusation of social butchery at the hands of the EU, especially in the Southern Member States. A similar reasoning applies to the policy objective of investment-rich and growth enhancing fiscal consolidation which likewise finds its place in Country-Specific-Recommendations and whose reality in budgetary dynamics remains unclear.

Under such premises, this chapter situates the work at the intersection of the literature on the determinants of fiscal policy and its composition, the role of fiscal rules and that of EU economic governance. In doing so it marks how - within the complexity and multifaceted nature of the EU-Member States fiscal puzzle - the fields highlight the need for a comprehensive and granular accounting of national and supranational dynamics to uncover when, where and how the bite of the Stability and Growth Pact hits at home. In parallel, the chapter delineates the limits of existing unsophisticated approaches in assessing how the supranational fiscal framework contributes to shaping national fiscal policy choices and the extent to which the analysis can support the furthering of a detailed understanding on the effectiveness of the EU economic governance, the alignment of its actual impact with policy objectives and whether some of the key accusations to the EMU can find empirical backing. The chapter continues considering first the drivers of the fiscal policy mix and how EU economic governance fits within the picture, followed by an account of existing approaches and shortcomings within the domain of the analyses of the impact of (supranational) fiscal rules before turning to a close look of how the work fits within and extends the literature on the budgetary impact of the SGP.

2.1 The national drivers of budget composition

Within the context of EU economic governance, evolutions such as the Semester have provided increased supranational tools for spending coordination. Nevertheless, budgetary choices are at the core of national sovereignties, albeit within the constraint of the Stability and Growth Pact and under the Fiscal Compact of balanced budget rules. Hence, fiscal policy decisions, especially with regards to the allocation of the public spending mix, remain predominantly in the hands of the Member States even within the framework of the Economic and Monetary Union and the Eurozone.

Against this background the purpose of this section is that of building on the understanding of national fiscal dynamics – especially relating to the composition of spending – in order to identify both what domestic factors shape the budget structure and how EU economic governance fits into the picture as a (supranational) fiscal rule. Considering how the "domestic scene" remains a crucial factor in the context of conflicting national and supranational commitments (Heipertz & Verdun, 2010, p. 198) sets the scene for a further evolution from the prevalent approach in considering either national dynamics alone or simply accounting for the presence of supranational constraint in suggesting the two levels may indeed interplay in determining the extent to which the EU economic governance affects domestic budget structures.

While much has been said on how the national context impact the size of fiscal policy or the path toward consolidation, evidence directly considering budget composition is far more limited. In this context, three key strains can be distinguished: (i) early analyses contemplating timeframes antecedent to the Eurozone, (ii) recent findings on specific areas of spending and/or factors and (iii) work concentrating on the convergence of budget structures over time. Leaving the latter last, work on spending components generally identify three key arenas at play at national level in shaping budgetary choices: political, institutional and economic determinants.

Before shifting the focus to each of the three arenas it should be noted that in most instances studies (i) either on single or limited countries and/or spending categories (e.g. Swank 1988; Hicks & Swank 1992; Bawn, 1999;Sanz & Velasquez, 2007; Sanz, 2011; Brenden & Drazen, 2013; Dahan & Strawczynski, 2013; Russo & Verzichelli, 2016; Bojar, 2019); (ii) consider broad areas of spending such as transfers and investment, generally with the aim of deriving implications for growth or convergence rather than explaining budgetary choices per se (e.g. Sanz & Velázquez, 2004; Ferreiro et al., 2009; Breunig & Busemeyer, 2012; Ferreiro et al., 2012; Ferreiro et al., 2013; Gemmel et al., 2011, 2015; Censolo & Colombo, 2016; Jeong et al., 2019); and (iii) fail to derive a (synthetic) account of the overall impact on the budget structure. A notable exception on all fronts - and especially the latter - is the work of Tseblis and Chang (2004) which considers a cross-country panel of 19 industrialised countries from 1973-95 in assessing synthetically budgetary dynamics and comprehensively the impact on all budget lines.

The national political determinants of the fiscal policy mix

Shifting the focus to the political dimension, a predominant portion of the literature on the political drivers of fiscal policy concentrates on the characteristics of the government coalitions. Within this context, fragmented governments can be expected to yield to increased spending due to collective action challenges which create a deficit-bias as decision-makers "do not fully internalise the costs of the public goods they acquire" and will push to increase spending to the benefit of their own constituencies (Foremny, 2014, p. 87). A competing explanation links heterogeneity within a coalition with more difficulties in adjusting spending patterns with a "war of attrition" yielding delayed stabilisation characteristic of coalitions rather than single-party governments given the more daunting challenge of reaching "a consensus to change an unsustainable status quo when there are too many parties in government" (Tsebelis, 2002, p. 275; Alesina & Drazen, 1991). While the channels differ, expectations under fiscal consolidation align: more politically fragmented coalitions yield to less scope for adjustment (Franzese, 2002), which find empirical backing especially in early years (e.g. Roubini & Sachs, 1989; Alt & Lowry, 1994; Poterba, 1994; Alesina & Perotti, 1995; Baldassarre & Giordano, 2001; Volkerink & de Haan, 2001; Perotti & Kontopoulos, 2002; Tsebelis & Chang, 2004; Wehner, 2010). Under such premises, expectations about deficits and political fragmentation translate somewhat to the budget structure. From a delayed stabilisation perspective, likewise fragmented governments yield to more limited scope for changes to the composition of public spending (Tsebelis & Chang, 2004). Expectations find empirical confirmation in the OECD during the 1973-95 timeframe as smaller ideological distance (the range of a coalition) and higher alternation (the midrange across two consecutive cabinets) are associated both with larger overall changes in the budget structure and in (some) spending components (Tsebelis & Chang, 2004).

Another key area of interest within the domain of government characteristics concerns ideology, with some empirical backing for higher spending associated to the left side of the political spectrum catering to lower income and employment status constituencies, while budgetary restraint can be more easily associated with the right (e.g. Hibbs, 1977; De Haan & Strum, 1994; Perotti & Kontopoulos, 2002). In more recent years, government toward the left have been associated both with higher duration of expansions as well as of consolidation, with no effect of ideology on the probability of each dynamic (Giesenow et al., 2020). Considering the components of public spending the picture is far more mixed, with some indication of changes over time which may have led to a decrease in partisan politics since the 90s (Potrafke, 2017) and over the cycle, with more redistribution from the right in good times and from the left in bad times (Herwartz & Theilen, 2017) and different categories favoured (e.g. defence over education for the right) in normal times and during consolidation (e.g. the right cuts more public consumption and less investment) across the ideological spectrum (Herwartz & Theilen, 2020). In the Italian setting - coming as recently as 2009 - ideology has been shown to play a role only for defence, further limited when considering fragmentation dynamics (Russo & Verzichelli, 2016). Similarly, in a cross-country context within the OECD a limited role emerges for ideology in shaping the budget composition, nonetheless finding increased spending in education in the 1990-2006 timeframe and public services in the 1970-97 period favoured by the left-side of the political spectrum (Potrafke, 2011). However, going beyond the focus on general spending to concentrate on the central government alone may confirm a more substantial role for ideology (Potrafke, 2020). Characteristics of the coalition hence play a role in determining the scope for change in the budget structure (small ideological ranges and high alternation), the appetite for fiscal discipline and the preference on where to cut (ideology). As such they may also interplay with the ability of the EU to affect the budget structure and to where the derived push towards consolidation hits at home.

The national institutional determinants of the fiscal policy mix

Moving on to the institutional domain, the latter is considered a "major determinant of the cross-country heterogeneity in fiscal positions" (Foremny, 2014, p. 86). Among the key elements in this arena is decentralisation, were - especially in federal systems - subnational entities carry out a substantial share of public expenditures, contributing in the European context to debt and cross-country heterogeneity (Rodden & Wibbels, 2010; Foremny, 2014). From a theoretical perspective, expectations are parallel with fragmentation with more spending (collective action approach) and/or slower adjustment (veto player approach) associated with more dispersed actors in the budgetary decision process across levels of government (e.g. Tsebelis, 2002; Von Hagen, 2005; Foremny, 2014). However, expectations becomes less straightforward when considering the role for the institutional framework in which sub-national elements operate, as whether the latter faces a soft or hard budget constraint affects whether or not it internalises the cost of overspending (Rodden et al., 2003), with ownership of own revenue generation in federal contexts and fiscal rules when the funding comes from the central government as key elements in spending discipline performance (von Hagen and Eichengreen, 1996; Foremny, 2014). Additionally, specific categories of spending may fall under the purview of sub-national entities especially but not exclusively in federal context and in relation to components of key interest such as in the health and social domain and more in general account for a substantial share of public investment and especially infrastructure (Grisorio & Prota, 2015; Rodden & Wibbels, 2010). The common pool argument has found some empirical backing (e.g. von Hagen & Harden, 1995; Hallerberg & von Hagen, 1999; Oates, 2006; Afonso & Hauptmeier, 2009; Baskaran & Field, 2013), alike the importance of sub-national spending autonomy (e.g. Rodden, 2002, 2006) and sub-national fiscal rules (Plekhanov & Singh, 2006). Evidence on the latter element is, however, non-univocal as decentralisation has been linked with divergent sub-national mechanisms improving fiscal performance, namely fiscal rules in the context of unitary countries and ownership in federal ones: "more stringent rules do not always result in more desirable outcomes and neither does a general restriction of tax autonomy" (Foremny, 2014, p. 104). Such element highlights the importance of the interaction between the institutional and political context in shaping outcomes of interest beyond the narrow decentralisation domain.

The constraint of local spending has obtained some attention especially in the framework of the SGP, as sub-national fiscal rule has been deployed to keep spending in check or to shift the cost of consolidation away from the central government, associated with pro-cyclical effects as constrained autonomy may combine with decrease in central transfers in a recession (Rodden & Wibbels, 2010). The latter dynamic, combined with different spending allocation along the central-regional divide carries implication for budget composition as empirical evidence has backed in the Italian context a negative effect of the Domestic Stability Pact on local spending and especially public services and substantial shifts in the composition of expenditures (Gregori, 2018). Remaining in the composition domain, evidence on the specific shift in the fiscal policy mix under decentralisation is mixed and more often than not focused on single country analyses or comparisons of few at best, finding, for example, a shift toward current expenditure with decentralisation, which may in aggregate terms hide a negative impact on human capital investment (as well as social protection) to the benefit of infrastructure spending (e.g. Rodríguez-Pose, et al., 2009; González Alegre, 2010; Grisorio & Prota, 2015). Larger cross-country analyses have uncovered an increase in government consumption under decentralisation (Fiva, 2006), an increase in investment (Kappeler et al., 2013) and within it the share for its infrastructural component compared to, for example, recreation (Kappeler & Välilä, 2008), as well as increase in the share of spending dedicated to health and education (Arze del Granado et al., 2005). If the specific impact on budget components may not be univocal, a clear take-away is indeed that decentralisation does not only carry implications for the size of spending but also for the budget structure.

Additionally, budgetary institutions likewise are of high relevance in determining fiscal outcomes (e.g. Alesina & Perrotti, 1995). The elements of the budget process discussed within the literature are variegated, with the focus evolving as well over time to the most recent trend of the role for independent fiscal councils (e.g. Debrun & Kinda, 2017; Horvath, 2018; Larch & Braendle, 2017; Beetsma et al., 2019; Tesche, 2019). Fiscal rules, however, remain a stable king in this domain as a key "commitment device for fiscal discipline" (Von Hagen & Harden, 1995, p. 775) to which copious attention has been dedicated over the years. Leaving the detailed account of when and how (national) fiscal rules affect the budget structure to the section to follow, it is needless to say that their mechanisms are of key interest for the research question at hand, not only in their domestic component but also in how they transplant to the supranational arena as well as in relation to the interplay between the two levels.

While the effectiveness of fiscal rules has not gone unquestioned, especially regarding the enforceability of balanced budget commitments (e.g. Alesina & Perrotti, 1995), a further element to consider in the realm of fiscal policy composition relates to how a spending ceiling may affect the budget structure, with the latter argued to derive from partisan preferences (Bojar, 2019) or conversely depend also on the budget content itself (e.g. Gregori, 2018). The above-mentioned empirical study on the impact of fiscal rule at the sub-national level already suggest "fiscal rules are able to affect budget composition significantly", at least for what concerns restrictions imposed by national governments (Gregori, 2018, p. 342). Their divergent effectiveness under heterogeneous political and institutional contexts (Grisorio & Prota, 2015) reinforces the approach of this work in assessing the interaction between the supranational and national arena. In selected Euro area countries between 2000 and 2013 a distributive effect on composition emerges for strong budgetary institution, especially for debt constrained countries, to the disfavour of public consumption and in support of investment (Hauptmeier et al., 2015). Along the same line, considering a cross-country comparison of 22 OECD countries from 1960 to 2010, Dahan and Strawczynski (2013) find an effect of national fiscal rules on composition of public expenditures to the detriment of social spending - confirming in part the social butchery argument against consolidation - which is however quite heterogeneous across countries. The authors highlight how there may be distributional cost and social and inequality implications from the "unintentional change in the composition of government expenditures" which should be factored in the assessment of the costs and benefits derived from a given regulatory framework (Dahan & Strawczynski, 2013, p. 485). Their results, are robust to accounting for welfare preferences and ideology of the government indicating indeed that some components of the budgets may end up as unintended collateral damage from fiscal rules. Such reasoning can be extended as well to the EU economic governance framework and the derived budget constraint imposed by the supranational level onto domestic fiscal choices per the (asymmetric) design of the EMU. Leaving further considerations on the rich literature on fiscal rules to the section to follow, the far less extensive analyses on the impact on composition already indicate that there is a potential for an (unintentional) restructuring on the budget both at national and supranational levels with under-investigated distributional consequences and implications for the costs, benefit and support for the regulatory framework.

The national economic determinants of the fiscal policy mix

Coming to the final arena, the economic factors affecting budget size and composition have received extensive attention. Beyond "conscious government choices" several economic factors and exogenous shocks affect budget components directly and the feasible policy options (Tsebelis, 2002, p. 272). Within this domain three core distinctions can be made relating to (i) the economic climate, which accounts for the more copious stream within the literature, (ii) specific factors such as demography and employment or the role of international linkages such as globalisation and trade. Starting from the latter, limited and no clear unidirectional evidence has emerged on the role of globalisation in shaping the fiscal policy mix (Heimberger, 2020), with limited indication on the promotion of investment (e.g. Benarroch & Pandey, 2017) and at times no evidence supporting welfare retrenchment (Dreher et al., 2008), while in other a compensation effect increasing social spending (Gemmel et al., 2008). However, within the economic arena, it has long been argued that the main drivers of demand for shifts in the allocation of public expenditures are associated with unemployment and the old age dependency ratio (Tabellini 1990, 1991). The two factors have direct implications for some categories of spending, namely unemployment and pensions spending respectively, while may also be linked with other components such as health for old-age or poverty reduction measures for the unemployment rate. Within this context, demography and ageing has been assessed for its broader budgetary composition implications. For example, Sanz and Velázquez (2007) in the 1970-1997 period in the OECD find that the share of the elder population is a key contributor to the increase in government spending, carrying however also distributional consequences for the budget structure: with the increase of social protection (not only in the short term but also in the long one) and health spending (in the long term), comes a short-term negative impact on education and an increased demand for security related services. While spending dynamics also in reaction to ageing may have well changed in the last twenty years findings confirm demography as a key determinant not only of the size of national budget but of its components both through direct impact on age-related categories and for changed demand for given services (e.g. public order and defence) or negative pressure on other components. Such a dynamic is bound to be even more pronounced as the share of spending dedicated to pension increased in more recent years and when hard budget constraint such those deriving from the Pact or balanced budget commitments imposed in the Fiscal Compact implied the need for compensating increased pressure on social protection elsewhere in the fiscal policy mix or in subcomponents of social spending (e.g. family policy). Some backing emerges in the assessment of post-crisis dynamics and implications of fiscal consolidation under extensive demographic pressure, with the projection that ageing may lead to a 18% decrease in the fiscal space available for spending other than pensions in 2030 compared to 2011 in the OECD (Marcel, 2014). Substantial cross-country differences emerge also within the EU spanning from just 1.6 in Denmark to the striking 34.2 per cent in Greece, with Portugal (28.2) and Spain (20.8) close behind indicating geographical (core-periphery) patterns may arise in this domain (Marcel, 2014). Similarly, negative dynamics have linked ageing and public investment from 1971 to 2007 in 19 OECD countries (Jäger & Schmidt, 2016). More recent analyses of spending preferences from survey data up to 2006 in the OECD confirm sharp age-related distinction across key budget components such as education, health and pensions, with negative implications of ageing for the former and positive for the last two, also highlighting, however, the scope for cross-country differences (Sørensen, 2013). Moreover, an analysis of the drivers of the growth in social spending from 1980 to 2015, affecting especially Southern European countries, confirms a crowding out effect on other expenditures (especially for public infrastructure) leading to social dominance linked with population ageing, making fiscal sustainability especially challenging (Schuknecht & Zemanek, 2020). Under sharp budget constraints, a parallel reasoning may to some extent apply to unemployment rates as their direct impact on social protection may need to be offset elsewhere. From this perspective, not only may those two key national variables need to be accounted for given their distributional impact on the budget structure, but the implications for the available fiscal space may lead also to heterogeneous scope for the transmission of supranational commitments onto national spending and affect as well where the mandate for consolidation hits at home.

Focusing once more on composition, going back to the economic climate, the impact of crises, fiscal adjustments and austerity for the budget structure has investigated, in assessing how budgetary dynamics may change during the crisis and how consolidation commitments affect the national fiscal policy mix. Recessions, especially through the kicking in of automatic stabilisers, have direct budgetary implications for some categories of spending, primarily unemployment. In this context, public spending - absent external constraints - is "negatively correlated with the business cycle" as countercyclical fiscal policies - especially in respect to social spending - have been the norm (e.g. Rodden & Wibbels, 2010, p. 41), with smoothing the cycle generally recognised among the purposes of fiscal policy (e.g. Tóth, 2019). If budget constraint were to hold, the increase would imply a need for restructuring the fiscal policy mix. Nonetheless, even if escape clauses allow for expansionary counter-cyclical policies - as in principle under the Pact - it remains to be established whether some level of constraint remain even in the absence of stringent impositions from the supranational level, for example, through peer pressure derived from the fiscal prudence bias among creditor countries especially in the context of the Eurozone crisis (Creel et al., 2012) or the anticipation of the future need for consolidation. With crisis dynamics in the EU and Eurozone receiving ample attention, negative patterns for fiscal sustainability have been confirmed empirically, with countries generally experiencing "significant structural weakening of their public finances in the wake of the financial crisis", at an unanticipated scale, in which the fiscal stimulus put forward to smooth the cycle played a central role (Bozio et al., 2015, p. 413). Additionally, the budgetary implications of the aftermath of the economic crisis – with the notable exception of Germany – led to corrective austerity measures to offset the heightened borrowing and spending in the downturn and address the pre-existing unsustainable fiscal imbalance (Bozio et al., 2015). On this account, the wide distance in the "damage done to public finances" across EU countries, 'championed' by Ireland and Spain translated into substantially different post-crisis adjustments in fiscal policy varying not only in terms of size but also in composition, reaching short of 20% of national income and majorly arising from spending cuts in Ireland, predominantly through tax increases in France and unnecessary in the case of Germany (Bozio et al., 2015).

Leaving a closer account of crisis dynamics to the section to follow, it should be noted that (i) the cycle may impact not only for the size of spending but also its composition, (ii) the impact of the supranational regulatory framework should also change across the cycle if its restraining restructuring effect is suspended through escape clauses and (iii) cross-countries (and geographical groupings) differences may be substantial in crisis carrying a legacy also for the subsequent period. Within this context, an account of spending dynamics between 1999 and 2013 in selected Eurozone countries considering composition of the fiscal policy mix, shows how the pre-crisis expansion was largely driven by public consumption, transfers, and subsidies, followed by substantial expansions during 2008 and 2009 in Belgium, Greece, the Netherlands, Portugal and Spain, turning as of 2010 into sizeable spending cuts concentrated on public consumption and most marked in Southern Europe (including Italy which maintained a more restrained spending during the Great Recession) and Ireland (Hauptmeier et al., 2015). Over the 2000-2013 period the analysis of determinants across the economic, institutional and political arena of deviation of expenditures and their components from rule-based targets finds little scope for the political and institutional arena, including EU surveillance (Hauptmeier et al., 2015). However, it should be noted that while controlling for the macroeconomic context there is no attempt to distinguish cross-cycle dynamics, which may be hidden by average effects highlighting the importance of indeed accounting for how the Great Recession may interact with the impact of EU governance on national budget structures. Another key takeaway regards the post crisis dynamics, which may merit as well a closer assessment rather than considering them jointly with the pre-2008 phase both in view of divergent spending dynamics and the different regulatory framework at play.

Before turning to an account of the broader implications of changed to the budget structure and how fiscal consolidation and EU economic governance fit into the picture, the overview of the key literature of national political, fiscal and economic determinants of domestic budget structures highlight how: (i) limited evidence covers the most recent years, the full period of the Euro and spatially all European Union Member States, (ii) the heterogeneous focus often prevents a balanced account across all three domains affecting the budget structure, (iii) the role for EU economic governance is nearly unanimously disregarded or non-significant and counter-fiscal disciplinary effect emerges from the simple membership of the Union and Eurozone (further discussed in the last section of the chapter) and (iv) a limited account is given of how average effects may hide divergent dynamics across the cycle and/or specific domestic configurations. The approach to the analysis of the research question at hand thus ought to address these four key areas in developing a nuanced assessment of how the various elements interact in determining when and how the EU economic governance affects the composition of public expenditures in the Member States.

Categories of expenditures and their broader implications

The need to account for how supranational dynamics affect national budget structures within the EU goes beyond the mere under-consideration of the extant literature on the topic. The composition of spending carries indeed a broad array of well-established social, economic and political implications which determine that the effects of EU economic governance on the budget structure may be evaluated not only against its policy objectives but also in view of what the consequences of the framework may be for growth, inequality and political support for integration.

While the specifics of how each budget component fits within the above-mentioned classification is left to chapter four in the context of detailing the research design, it should be noted that the relation between public expenditure and growth has long been investigated (e.g. Barro, 1990; Devarajan et al., 1996), in assessing which budget structure yields to positive developments. While the exact taxonomy of budget components is not uncontested, the general division is that across investments (e.g. research, infrastructure, health and education) and transfers (e.g. social protection and public consumption), with the former controversially but overwhelming associated with improving growth prospects which are conversely hindered by the latter (e.g. Baum & Lin, 1993; Kneller et al., 1999; Romero-Avila & Strauch, 2008; Afonso & Fuceri, 2010; Gemmell et al., 2011; Bottasso et al., 2013; Fournier, 2016; Gemmell et al., 2016; Jeong et al., 2020). In this context, it should be noted that the distinction often links investment with productive public spending, while the opposite is the case for transfers (e.g. Krogstrup & Wyplosz, 2009; Ferreiro et al., 2013; Gemmell et al., 2016; Jeong et al., 2020). The classification of productive and unproductive spending builds on a well-established literature on the efficiency of public spending and growth (e.g. Barro, 1990; Devarajan et al., 1996; Kneller et al., 1999). In the context of fiscal rules and the SGP has raised the concern that productive investment may become collateral damage of supranational fiscal surveillance (e.g. Blanchard & Giavazzi 2004; Beetsma & Debrun 2004, 2005; Creel & Saraceno, 2010; Creel et al., 2013). While approaches, long-term vs. short-term considerations and specific budget lines considered in the assessment and significant in their impact of growth do find mixed empirical backing, the rough generalisation of growth-enhancing spending being investment rich while containing transfers generally holds, as reflected by the own policy goals of the Stability and Growth Pact, recurring as well in later years in the Country-Specific-Recommendations issued to the Member States (European Commission, 2019; EGOV, 2020).

The sole distinction across productive and unproductive spending may be, however, problematic. Firstly, it may either explicitly or unintentionally suggest a normative assessment of budget components based solely in its contribution to growth. A consequent limit is failing to account for other key concerns such as those pertaining social implications and inequalities. Inequalities addressing policies are transversal to the two above mentioned categories as social policies play a key role, together with education and health investments (Fournier & Johansson, 2016). Welfare transfers are found to be the key contributors in reducing inequalities (e.g. Afonso et al., 2010; Fuest et al., 2010; Joumard et al., 2012; Anderson et al., 2017; Johansson, 2016; d'Agostino et al., 2020; Szczepaniak, 2020). A study of trends in public finances post-crisis highlights substantial differences within the OECD and the EU: clustering countries across their spending components and inequality performance shows clear distinctions from the bottom performing group of Greece, Hungary, Italy and Portugal (among which Southern Member States are over-represented) with high inequality, high social protection spending, low education and health investment (and low government effectiveness) compared to Nordic countries with better performances in terms of spending and inequality outcomes (Bloch et al., 2016). While the Southern spending mix and inequality outcomes warrants a word of caution in generalising from single budget line performance, the importance of dynamics relating to inequality addressing spending are twofold. On one side, they account for an overwhelming share of public spending within the OECD, where in 2011-2013 social protection amounted to 35 per cent of primary budgets on average, followed by the 18 per cent of health-related expenditures and the 15 percent dedicated to education (Bloch et al. 2016). On the other side, inequality dynamics carry themselves broader implications for political stability and in the EU context the extent of support for the EMU and integration at large.

The last concern regarding spending composition dynamics are political, as, especially in relation to the impact of EU economic governance on national budget structures, dynamics carry non trivial implication for public support, especially has the EMU and the Fiscal Compact with its associated austerity paradigm have been contested not only in view of their detrimental effect of lengthening the crisis (e.g. Creel et al., 2012; Lane, 2012; O'Rourke & Taylor, 2013; Pasimeni, 2014; Regan, 2017; Andor, 2019) but also in relation to distributional and social costs of the Great Recession and Euro crisis against economic priorities persistent also in its aftermath and with the introduction of the Semester (e.g. Cramme & Hobolt, 2014; Crespy & Menz, 2015; Dolvik & Martin, 2014; Vaughan-Whitehead, 2015; Crespy; 2016; Maricut & Puetter, 2018; Ronchi, 2018; Crespy, 2020) argued to have contributed to fuelling Euroscepticism and erosion of national democratic support especially in the periphery (e.g. Kuhn & Stoeckel, 2014; Della Porta, 2015; Armingeon et al., 2016; Börzel, 2016; Kotroyannos et al., 2018; Banducci & Loedel, 2020; Crespy, 2020 ; Turnbull-Dugarte, 2020), although support for the Euro has been shown to hold even in heavily affected countries during the crisis at least within the Eurozone (e.g. Hobolt & Leblond, 2014). Within these prospective, emerging divides are not limited to cross-country differences between the north and the south, further discussed later in the chapter but also within countries and groups. For example, the negative effect of austerity policies for gender related concerns have been associated with a parallel gap in support for the EMU (Banducci & Loedel, 2020) and the constraint of the Pact and the Fiscal Compact has been considered especially detrimental for welfare policies and health spending, associated as well in recent work with unpreparedness in the face of the pandemic (e.g. Crespy, 2016; Prante et al., 2020). Such dynamics render of particular value the understanding of distributive dynamics in times of crisis and in its aftermath in their connection with the Pact.

However, extant analyses fall substantially short of a comprehensive empirical assessment of the extent to which changes in spending components, especially in key areas such as social policies and health, can be attributed to the EU economic governance and the supranational fiscal rule. Against this backdrop, nonetheless the topic of what is cut first during consolidation and in crisis time has received attention, outside of its linkages with the EMU, with detrimental distributional consequence finding some empirical backing (e.g. Castro, 2017; Paulus et al., 2017; Woo et al., 2017). Castro (2017) – the first work considering the distributional effects disaggregated at functional component level – finds an impact on the budget structure form consolidation with particularly detrimental patterns for safety, health, education and social spending among 15 European countries in the 1990-2012 period, hitting the hardest on the prospect of vulnerable groups. These findings fit into a larger context considering the impact on macro-aggregates such as investment which has been found the primary target of consolidation especially in times of crisis and in countries with a particularly difficult context in terms of debt (e.g. Breunig & Busemeyer, 2012; Bamba et al., 2020), as investment is crowded out from the budget structure as the "path of least resistance" when enacting austerity driven policies (Jacques, 2020, p.2). These patterns have raised the question on how to devise fiscal rules to avoid such detrimental effect on investment thus preserving growth prospects (Ardanaz et al., 2021), of high relevance also in the context of the Pact and Fiscal Compact, which policy objective may fare quite problematically in practice. These dynamics partially contradict earlier analyses (Sanz, 2011), finding the most growth-enhancing investment such as education and health shielded in fiscal adjustments in the period preceding 2007, partially coherently with the recent veering toward a stringent austerity paradigm, which has likewise been associated with changing approaches in coping strategies in times of crisis in recent years in the domain of social protection to the detriment of welfare spending (Steinebach & Knill, 2018). The emerging picture is that of a potential for a detrimental effect of fiscal consolidation, especially in times of crisis, to a budget structure conducive to inclusive growth. The extent to which specific categories are impacted and how the EU economic governance framework interplays with national environment in affecting the fiscal policy mix remains however to be seen, especially in a context in which no restraint is in principle enforced under the Pact escape clauses in a period such as that of the Great Recession.

2.2 Fiscal rules between the national and supranational level

As anticipated in the previous section, one channel through which the budget structure is affected deserves specific attention as the key mechanism in relation to EU economic governance in its key component of the Stability and Growth Pact. From this perspective, it is of value to consider the lessons from the well-established literature on national fiscal rules in relation to when and how they affect spending and its composition. Additionally, in view of the research question, one must put forward a precise understanding of how EU economic governance fits into the picture as a supranational fiscal rule, highlighting at the same time the challenges in disentangling the effect of national and supranational dynamics within this arena, as well illustrated by the Fiscal Compact mandating implementation through domestic fiscal rules of balanced budget commitments. Two further elements - in part emerging already in the first section - deserve further discussion. On the first account, works on national fiscal rules have at times found no effect of the EMU or one running against fiscal discipline, which join the rank of analyses on the EU governance itself similarly disregarding the scope for an impact of the supranational fiscal surveillance framework in view of its dismal track record of violations. A critical assessment of the approach highlights instead how such an account may be oversimplified, questioning at the same time the little consideration given to fiscal rules in crisis times in the context of the problematic dynamics highlighted in the previous section.

When and how national fiscal rules affect spending and its composition

It is beyond the needs and ambition of this section to carry out a comprehensive review of the copious and variegated literature on fiscal rules. Rather, it aims to provide an overview of how, even at national level, fiscal rules are heterogeneous in its effects as a function of their characteristics and broader context in which they act. Such understanding serves two purposes. Dirstly, to draw parallels from the national arena to the mechanisms at play within the Stability and Growth Pact and how they may determine a heterogeneous impact across varying domestic configurations. On a second account setting the framework for disentangling the budgetary effect which may be attributed to the supranational and national arena, a key challenge of the research design. It should also be noted that short of few instances already presented in the previous section the large research body dedicated to fiscal rules is primarily focused on aggregate spending dynamics and on the impact on budget deficits (e.g. von Hagen & Harden 1995; Hallerberg & von Hagen 1999; Fabrizio et al., 2006; Hallerberg et al., 2009), a parallel which also emerges for the literature on the domestic impact of the SGP. Some work has considered as well the interaction between budgetary institutions and the political context in determining fiscal outcomes, remaining in the aggregate spending dynamics domain (e.g. Whener, 2010; de Haan et al., 2013; Martin & Vanberg, 2013; Bergman et al., 2016). Nevertheless, understanding the conditions for compliance and effectiveness are yet indicative of the strength of the budget constraint which then may indirectly have distributive effects for the budget structure.

From a theoretical standpoint, fiscal rules find their justification in mitigating the deficit bias of governments and hence overspending (e.g. Alesina & Drazen, 1991; von Hagen & Harden 1995; Persson & Tabellini, 2002; Wyplosz, 2012). The mainstream economic support of fiscal rules as a key institutional solution to the deficit bias translated into "a two-decade long period during which national budgetary rules conquered European countries" (Tóth, 2019, p. 4), arguably not without the contribution of the EU economic governance framework and paradigm (e.g. Debrun et al., 2008; Ayuso-i-Casals et al., 2009), as while fiscal rules where rare at the time of introduction of the SGP, every Member State displayed at minimum one as of 2014 (European Commission, 2017). However, while the general purpose of containing fiscal profligacy may unite fiscal rules, commonalities may not extend much further as rules are heterogeneous in their design and implementation, associated likewise to different constraining impact on budgetary choices and likelihood of compliance (e.g. Debrum & Kumar, 2007; Wyplosz, 2012; Reuter, 2015).

Remaining within the domain of numerical fiscal rule they can be distinguished according to coverage, type of targets, flexibility, legal bases, as well as enforcement and sanctioning, with different expected success in constraining public finances. For example, rules can target expenditure or debt, cover central government spending or sub-national levels carrying parallel difference expectation on the ease of escaping constraint in case of limited coverage or "shift the burden of compliance across government levels" (Reuter, 2019, p. 131). Other key distinctions can be drawn across cycle adjusted or nominal targets (Wyplosz, 2012) and the legal bases of the rules - with mixed expectations on compliance for stickier constitutional commitments or weaker ones which may be more closely linked to ownership by the government - as well as the strength of the enforcement mechanisms (Reuters, 2015). A further issue in this arena, is that of reverse causality as fiscal rules may be a signal of preference for fiscal discipline rather than the enforcer of budgetary restraint (e.g. Debrun & Kumar, 2007; Heinemann et al., 2018). At national level rules may be introduced to "demonstrate the government's commitment to sustainable public finance", acting at the same time, however, as "a means of limiting policy discretion" (Tóth, 2019, p. 4). However, that is hardly an issue at the supranational level in which there is little scope on the short term for a single government to redefine the regulatory framework or even in the domestic arena for constitutional ranking rules or after the mandated implementation of balanced budget commitments with the Fiscal Compact (de Haan et al., 2013). Conversely, such reasoning backs considering fiscal rules as a function of national fiscal discipline preferences (e.g. Poterba, 1994; Debrun et al., 2008; Heinemman et al., 2018), which is the perspective taken in view of the research question at hand and the quest for disentangling the national and supranational arena. Another element to consider in connection with the impact of fiscal rules on expenditures is connected to the economic climate as it is both not desirable in times of economic downturn to put forward a similarly constrained fiscal stance, nor necessarily pursued by fiscal rules - including at the supranational level - which may include escape clauses as a leeway to counter severe recessions (Tóth, 2019).

In practice, without disregarding the scope for heterogeneity already highlighted above, a constraining effect of fiscal rules on public expenditures has been widely identified empirically. Early studies already indicated that stringent fiscal rules provide for faster correction of unexpected deficits (e.g. Roubini & Sachs, 1989; Alt & Lowry, 1994; Poterba, 1994). Ever since, while mixed results do at time arise, fiscal rules have been widely associated with lower deficits and/or debt (e.g. Von Hagen & Harden, 1994; Hallerberg & von Hagen, 1999; Perotti & Kontopoulos, 2002; De Haan & Strum, 1997; Fabrizio & Mody, 2006; Hallerberg et al., 2007; Debrun et al., 2008; Ayuso-i-Casals et al., 2009; Dahan & Strawczynski, 2013; Reuter, 2015; Alesina & Passalacqua, 2016; Badinger & Reuter, 2017; Heinemann et al., 2018), increased fiscal space (e.g. Nerlich & Reuter, 2016), output stabilisation (Sacchi & Salotti, 2015). Their effectiveness has been argued however to vary across rule characteristics and the overarching framework in which they operate. The same is the case for compliance, with the best track record associated with expenditure rules with defined nominal targets (e.g. Cordes et al., 2015) and debt rules outperforming balanced budget rules (Reuters, 2019). Scope is as well a factor with more comprehensive rules rather than constraints to central government spending faring better (Reuters, 2019). Mixed findings, for example, in terms of the statutory vs constitutional comparison and coalition-based rules entailing political ownership possibly outperforming both (e.g. Cordes et al., 2015; Reuters, 2015, 2019). Monitoring and enforcing mechanisms have been argued as crucial in determining compliance, while the same is not the case for sanctioning (Reuters, 2019). Relevance pertains to the supranational fiscal rule per se, whose key stick especially in the early phase, limited indeed to the prospect of such punishment mechanism. Additionally, relevance extends to the interplay between the EU and domestic arena, as national fiscal rules may be conceived as an enforcement mechanism of the SGP, especially after their Fiscal Compact mandated implementation. An ulterior empirical finding that may be of interest for the research question, linked to the relation between compliance - or lack of thereof - to fiscal rules and the effect of the latter on public expenditures. Specifically, fiscal rules may change fiscal policy even when they are not complied with: “the actual non-compliance of many countries with their fiscal rules does not necessarily mean that they are not effective” (Reuter, 2015, p. 68). Such findings, which one can reasonably expect to hold true also for supranational fiscal rules, indicate that even in periods displaying an unsatisfactory track record in terms of compliance - or, translated into the EU economic governance framework, in which Member States fail to respect the deficit threshold and fall under the Excessive Deficit Procedure - the supranational governance framework may still hold a constraining impact on public expenditures. As a consequence, whether a country respects the three per cent threshold - or its fiscal targets more in general - may not be a pre-condition for a potential effect of EU economic governance.

At the same time, it has been largely confirmed empirically that the effectiveness of fiscal rules depends not only on the characteristics of the rules but also "on the institutional and political background of the respective country" (Foremny, 2014, p. 89). A crucial determinant of the impact of fiscal rules is hence the political context, mitigating especially those circumstances of heterogeneity within coalition governments associated with the worst prospects from a common pool and/or veto players perspective, with similar heterogeneity associated with decentralisation (e.g. Hallerberg et al., 2007; Debrun et al., 2008; Hallergber et al., 2009; Forenmy, 2014; Grembi et al., 2016; Reuters, 2019; Gootjes et al., 2020). For example, higher governments' fragmentation, election politics and decentralisation are associated respectively with 13%, 10% and 21% lower compliance probability (Reuter, 2019). That is to say that the effect of fiscal rules may vary across different economic - and especially - political circumstances, a result which can be even more so expected to translate into the impact of the EU economic governance framework on domestic budgets. At the same, in the EU27 in 1990-2012 effectiveness of fiscal rules in reducing deficit has emerged regardless of the political context finding however a substitution effect for government efficiency, while balanced budget rules are those leading to the most substantial impact indicating that the latest governance reform at the supranational level may improve fiscal discipline within the continent (Bergman et al., 2016). Under the substitution argument, translatable as well in the interplay between national and supranational rules, budgetary constraints are most crucial and impactful in those configurations that are less promising for fiscal discipline. Within this broad perspective, some have also argued for a further disaggregation of the analysis of the theoretical mechanisms linking budgetary institutions, political context and fiscal outcomes beyond the common pool problem perspective, considering how issues beyond delegation and multiple principals may be at play such as time inconsistencies explaining how fiscal rules may have an albeit weaker effect even beyond the context of heterogeneous coalitions (e.g. Nakanishi, 2019). Accounting for such dimension would further broaden the spectrum of possible interacting elements, which in the context of an overarching account of the national political, institutional and economic arena as well as the complexity of the heterogenous supranational context. As such, the research design in this analysis, detailed in chapter four takes a streamlined approach than in the context of the broad categorisation of Member States in the disentanglement of national preferences from supranational imposition can be reasonably argued not to affect the results.

A further theme, linked with heterogeneity of fiscal rules across economic determinants of the fiscal policy mix, is countercyclical fiscal policy and fiscal rules design has been found as a crucial element both in terms of avoiding pro-cyclicality and in mitigating the detrimental impact on investment especially in times of crisis, best achieved through regulatory framework explicitly protecting this component of the budget (Guerguil et al., 2017). Another element of relevance for the research question is that escape clauses do not seem sufficient to achieve such objective (Guerguil et al., 2017), raising the question hence of actual spending dynamics during the Great Recession and whether indeed the SGP unshackled national fiscal spending spending or regardless of its policy objective is guilty of imposing procyclical patterns as accused extensively within the literature. Such question runs against the approach of discarding crisis years due to diverging objectives when assessing fiscal rules (e.g. Tóth, 2019), as further discussed at the end of the sections, taking caution as well in going beyond simply controlling for the cycle but aiming instead to uncover explicitly the heterogeneous dynamics and impact on national budgetary choices during times of recession.

This brief and far from exhaustive overview prints a clear picture of complexity and heterogeneity within the arena of national fiscal rules and how they interplay with the domestic context in shaping fiscal policy outcomes. The previous section has shown as well that while evidence of the distributional effects is mixed, the composition of the budget structure is indeed impacted with negative expectations reasonable both for investment, social spending and inequality performance. How to account for fiscal rules and their heterogeneity is far from an uncontested issue with a variety of approaches put forwards in extant literature. Other than analyses comparing rule types or characteristic explicitly, cross-country panel assessment generally relies on indexes capturing the characteristics of fiscal rules in a way that they reflect their (relative) strength. Such is the process for one of the mainstream approaches (Hallerberg et al., 2009; Hallerberg & Yläoutinen, 2010), which may be furthered by accounting for the mutual reinforcement of more stringent measure by capturing the overall aggregate constraining impact of the budget process (Martin & Vanberg, 2013). Similarly, the European Commission (2017) has curated a dataset of National Fiscal Rules tracking their characteristics and changes over time, compiled as well in the Fiscal Rule Index capturing the strength of national budgetary institutions across five procedural criteria tailing the methodology of Deroose, Moulin and Wierts (2006), which have been employed empirically and associated with improving the budget balance as a function of the strength displayed by the index (e.g. Marneffe et al., 2010; Bergman et al., 2013; Nerlich & Reuter, 2013; Reuter, 2015, 2019) The domains considered by the Commission do not perfectly overlap, capturing the legal base, the binding nature of targets, the type of monitoring and enforcing bodies, correction mechanisms and media visibility, as the first approach considers the budgetary institutions and processes environment at large rather than taking a specific focus on fiscal rules (Manescu Bleu & Bova, 2020). From this perspective, the latter approach more closely reflects the preferences of Member States concerning fiscal rule stringency, at the core of the strategy employed in the analysis for separating the supranational fiscal rule and national dynamics illustrated in chapter four.

Where does EU economic governance fit in? The role for the SGP as a (supranational) fiscal rule

A key question with regards specifically to supranational fiscal rules remains to be addressed: can the same theoretical expectations that characterise fiscal rules domestically be also applied to supranational fiscal rules? The issue of substitution, complementarity and in general interaction between national and supranational rules is left to chapter four and the outlining of an ad-hoc methodological approach. However, it is of use to briefly address if it would be appropriate to consider EU economic governance as a fiscal rule alike those imposed by Member States directly, to which throughout its evolution one can associate varying, for example, of flexibility, legal bases, enforcement and sanctioning. In this domain, the central puzzle sits in the motivation that have led national state to agree to "limit their sovereignty over budgetary policies" (Heipertz & Verdun, 2010 p.4).

In terms of the rationale and justification for an international fiscal rule, the same considerations arising from deficit bias at national level transfer at supranational level in the context of a Monetary Union (Krogstrup & Wyplosz 2010). One of the driving arguments for the introduction of the SGP in the context of the EMU amounted to the deficit bias and risk of free riding such that "the inflationary fiscal policy of a single country would incur costs that would have to be shared by all member states" (Stark, 2001, p. 79). The implication is that EMU would require at least a rudimental element of fiscal coordination (Heipertz & Verdun, 2010), as in a monetary union fiscal rules are necessary in light of the risk for moral hazard and free riding connected to profligate fiscal policies, entailing amplified cross-border negative externalities for the other members (e.g. Dixit, 2001; Dixit & Lambertini, 2001; Thirion, 2017; Franchino, 2020). That is to say that "the budgetary policies of countries participating in a monetary union are interdependent" with the consequence of "negative fiscal spillovers", providing a strong rationale for the dissuasive arm of the SGP, especially as the supranational monetary policy reduces the "disciplinary effect of financial markets" against governments' fiscal profligacy, as shown by bond yields dynamics pre-crisis (Heipertz & Verdun, 2010, pp. 71-73). In this context, within the EMU in the absence of (strong and binding) supranational rules the incentive to free-ride may worsen the deficit bias of the Member States (Beetsma, 1999). In its initial form, the SGP introduction provided for a rudimentary mechanism for fiscal policy coordination, through which decentralised decision-making of the Member States would be coordinated into keeping their national budgets in order, in the absence of a supranational fiscal policy (Issing, 2002). In this context, the supranational SGP fiscal rule has been analysed through an extension of domestic models (Krogstrup & Wyplosz 2010), indicating that the parallel can be made between fiscal rules at national and international level. While the framework as further discussed later in the chapter has substantially evolved over time with a strengthening of the soft side of economic policy coordination initially entrusted to the Broad Economic Policy Guidelines (BEPG) into the European Semester, the core of the framework remains the Stability and Growth Pact, supported by hard enforcement mechanisms ultimately "backed by sanctions" (Heipertz & Verdun, 2010, p. 78).

Such an approach has not been free from criticisms, even in its early years, because of the inherent asymmetry between centralised monetary policy and decentralised but restrained fiscal policy left in the hands of the Member States reluctant to relinquish power over one of the core elements of national sovereignty (Fabbrini & Putter, 2016). Arguably, with budgetary coordination entrusted to fiscal rules (Thirion, 2017), the set up creates a vacuum of sovereignty over budgetary decision, capped at the national level without the shift to a supranational counterpart (e.g. Crum, 2018). In this context, arguments against the architectural framework of the Pact as the need of any constraint deemed necessary under the no bail-out clause under article 125 TFEU (e.g. Buiter et al., 1993; Eichengreen & Wyplosz, 1998; Buiter, 2006) and the numerical targets harshly criticised for their arbitrary nature linked to averages in the early '90s which lends itself to potentially pro-cyclical excessive restrictiveness in times of crisis and little bite at all in normal times (e.g. Buiter et al., 1993; Pasinetti, 1998; Gros & Hobza, 2001; Fatas et al., 2003; Begg & Scheckle, 2004; Larch et al., 2010; Creel et al., 2012). At the opposite side of the spectrum, the weak ability to coordinate national budgetary policies beyond adherence to fiscal discipline has come under fire as a structural flaw of the initial EMU design (e.g. Begg, 2002; Schure & Verdun, 2008; Alcidi & Gros, 2015; Crum & Merlo, 2020; Howarth & Verdun, 2020).

Times and crises have strengthened and proved right the pack of critics of the framework, which has moved well past elites and scholars especially after the contentious management of the Great Recession and following mayhem in the Eurozone, with a strengthening of the austerity paradigm enshrined in the latest wave of reform and the Fiscal Compact directing the fingers of discontent in the public debate toward the European Union. EU economic governance has been at the receiving hand of the accusation of lengthening and worsening the economic crisis and divergence across the core and periphery, which has regained centre stage in the debate on tackling the Covid-19 pandemic and reconstruction (e.g. Lane, 2012; Heise, 2012; De Grauwe, 2013; Jones et al., 2016; Wyplosz, 2017; De Grauwe & Ji, 2018; Howarth & Verdun, 2020). Against this backdrop both the issue of democratic legitimacy has been widely debated in the aftermath of the crisis and increased constraints to national fiscal policies with the 2011 reform and especially the Fiscal Compact, along with the broader shortcomings of EMU and the prospects for reform (e.g. Dyson, 2009, 2013; Feathersone, 2011, 2016; Hallerberger, 2011; Dawson & Witte, 2013; De Grwuwe, 2013; Hinarejos, 2013; Dawson, 2015; Da Costa Cabral, 2016; De Wilde et al., 2016; de Quadros & Sidjanski, 2017; Hughes Haller, 2017; Greer & Jarman, 2018; Crum & Merlo, 2020). Against this backdrop, while regulatory advances have come a long way since the birth of the EMU and common currency especially with the Fiscal Compact and European Semester, the (asymmetric) institutional framework at the core of EU economic governance has remained the supranational fiscal rule of the Pact, to which hence many of the reasonings put forward in the beginning of the section may be extended. Such an approach, although largely concentrating on aggregate spending dynamics as illustrated later on, has indeed been taken up in the analysis of the national budgetary consequences of the SGP and more in general when accounting for the supranational context in assessing fiscal choices, albeit with a generally simplistic approach which may fail to capture the complexity of EU economic governance and the heterogeneity of its effects explored in this work.

An oversimplified account of the SGP within the literature

In view of the lessons from the literature on the political economy of budgetary dynamics previous work focused on the SGP specifically or accounting for the supranational regulatory framework in broader context may have taken an oversimplified approach in relation to EU economic governance in three ways. On one hand the effect of fiscal rules is varies according to their characteristics, making the simplistic accounting of EMU derived dynamics as membership to the Union and Eurozone problematic as further evidenced in the last section of the chapter highlighting the multifaceted nature of EU economic governance and its evolution over time. A second element of heterogeneity regards the interplay with the national context specifically along the political, institutional and economic dimensions, including considering changes against the economic climate, which are well established in extant literature as core interacting elements in determining the effectiveness of fiscal rules. Finally, the aggregate focus on deficit and debt fails to consider the distributional impact of the supranational fiscal rule, in line with the evidence provided by studies on the heterogeneity with which different spending categories are affected, overall and during a recession and/or consolidation effort. A key contribution of the analysis is indeed addressing all three limitations, which are briefly explored below.

On the first account, the EU economic governance framework's effect on fiscal discipline and compliance with national fiscal rules has been tested empirically. In addition, studies covering EU Member States after the introduction of the EMU have at times attempted to account for the supranational fiscal framework albeit quite simplistically, while more often than not in assessing (national) fiscal rules the context of the common currency and the derived constraints on national fiscal choices are fully disregarded.

When that is not the case, the account of the framework can be quite rudimental, coming so far as to brutally comparing the pre and post Maastricht period (e.g. De Haan et al., 2013; Fortunate & Loftis, 2018). Such an approach, which does find an improvement of fiscal discipline is problematic also in light of the evidence of a pre-Maastricht effect under the threat of exclusion from the common currency, which "had become defunct" after the introduction of the EMU, leaving space to the return of fiscal delinquency (Heipertz & Verdun, 2010, p. 77). With Maastricht fatigue characterising the initial years of the Pact, early failures leading to the de-facto suspension of the SGP in 2003 and the reform rush to strengthen the framework and restore credibility in the midst of the Eurozone crisis resulting in the TSCG and the Fiscal Compact (e.g. Fatas & Mihov, 2003; Heipertz & Verdun, 2010; Larch et al., 2010; Tsebelis & Hahm, 2014; Schimmelfennig, 2015; Tóth, 2017; Franchino & Mariotto, 2020) , it is a quite unconvincing argument that over the 20 years life of the EMU the effect of the EU economic governance framework should be expected to be homogeneous. From this perspective, the timeframe of previous large-scale analyses generally stops at most short after the introduction of the latest reform. As the current framework may have to the most substantial budgetary implications, previous analyses provide little room for capturing such dynamics addressed in these work by considers the period up to 2018 and explicitly the post-2011 changes.

Coming farther than the pre-post Maastricht approach still generally relies on membership, at most distinguishing that of the Eurozone (e.g. Nerlich & Reuter, 2013; Bergman et al., 2016; Reuter, 2019; Jalles et al., 2020). As a result, a significant negative effect on compliance has been associated with EMU membership, indicating that fiscal discipline may be lower for Eurozone members free-riding on the benefits of the monetary union (Reuter, 2019) due to an implicit bail-out expectation (Jalles et al., 2020). On the same line supranational governance have been shown not to positively impact the effectiveness of national fiscal rules (Bergman et al., 2016). Such findings - against the overwhelming evidence of the austerity cost and implications in the Member States - questions the approach, calling instead both for a distinction over time and across policy reform and relevant regulatory framework. Along the same line, a central element of the supranational fiscal rule, the EDP procedure, has been grossly disregarded as evidence of failure of the system rather than a key - sanction backed - mechanism through which the EU economic governance framework operates. A rare exception in the quantitative assessment of the relation between supranational rules and national budgetary trends in the 2010-2016 period considers being under EDP surveillance and Eurozone membership along with macroeconomic factors in determining what explain austerity, finding a significant contribution of falling under the EDP which is not the case for Eurozone membership (Tamborini & Tomaselli, 2020). Of interest for this analysis, heterogeneous dynamics emerged when splitting the Eurozone dummy into fiscally sound core countries and those - generally in the periphery - coming under extreme pressure and requiring financial assistance, both significant but in the opposite direction with a decreased austerity associated with the former and increased with the latter (Tamborini & Tomaselli, 2020). While the analysis is quite a simple account of the EU economic governance itself as it does not consider the interplay across the EDP, Eurozone membership and other factors at play, it gives already a strong backing to the need for more precise accounting than in extant literature in assessing the research questions at hand, which may indeed be reasonably expected to have at it centre EDP surveillance and should as well account for heterogeneity across core and periphery even within the Eurozone.

A further problematic simplification to overcome regards disentangling the effect of national and supranational fiscal rules, especially but not exclusively after the Fiscal Compact. National budgetary institutions have indeed evolved under the influence of the EU economic governance framework and targets, as suggested by the acceleration towards fiscal rule adoption within the old continent over the years post the introduction of the SGP (European Commission, 2017). Indeed, especially crisis dynamics and the latest governance reform at the supranational level have been linked with a Europeanisation of domestic budgetary processes (Raudla et al., 2019). Hence national fiscal rules may themselves have been devised to internalise supranational constraints as "the reforms of the SGP also altered the design of national fiscal rules and their institutional framework" (Reuter, 2019, p. 134). Evidence has also been put forward of the EU playing an important role even as early as the pre-2005 period in leading to the introduction of fiscal rules (Debrun et al., 2008). As such the effect of national fiscal rules themselves may be at least partially attributed to the supranational framework and partially explain why significance is hardly achieved or reversed when accounting for EU or Eurozone Membership on top of the former (e.g. Reuter, 2019). The implications are that disentangling the effects and interactions between supranational and national fiscal rules - especially after the Fiscal Compact - pose a non-trivial methodological challenge which will be discussed in detail in chapter four. A final word returns to the interplay between the supranational fiscal rule and national determinants of the fiscal policy mix, along the line of established linkages in the domestic context. More often than not this aspect is also disregarded, with the partial exception of the interaction between the two levels of fiscal rules, which - partially with no surprise given the reasonings above - do not find an impact of the supranational regulatory framework on the effectiveness of national fiscal rule (Bergman et al., 2016). In a different context, a significant interplay between the EMU and national political institutions has emerged with heterogeneous effects of the former by the latter in increasing the size of the public sector and deficits (Mäkelä, 2018). Hence while the aspect is under-investigated, these example reinforce the importance of considering heterogeneity of the impact of the EU economic governance framework also in relation of national variables as the absence of a significant average effect may hide diverging dynamics.

Finally, a further gap to which this work contributes is the limited systematic accounts of dynamics beyond aggregate spending size and deficit and/or debt concerns, in light of the key implications highlighted in the previous section and the strong criticism stacked against the EMU on the basis on the subjugation of social concerns to the primacy of fiscal discipline. Such view is also an oversimplification of the potential dynamics between EU economic governance and the national budgets as fiscal rules even domestically have been demonstrated as far from neutral to the fiscal policy mix. Such worry has been put forward also in relation to the SGP, with the concern that the spending threshold could prove detrimental for investment, with the framework considered suboptimal with respect to a golden rule approach (Blanchard & Giavazzi, 2004; Creel & Saraceno, 2010; Creel et al., 2013). At a descriptive level, considering trends in components in terms of economic type and not functional components, a worrisome dynamic in investment was highlighted in the aftermath of the strengthening of the SGP (Creel & Molteni, 2017). Such a negative outlook has emerged also in the context the Covid-19 crisis, supporting the need for a large-scale public investment program in the Eurozone (Della Posta et al., 2020). In parallel, similar concerns have been put forward for welfare, arguing, for example, that social spaces have become an adjustment variable for fiscal discipline in the EMU (Costamagna, 2018). That is especially the case after the crisis, with the increasingly intrusive scope for the Pact in national budgetary dynamics and a strengthened focus on consolidation, with the potential for substantial negative consequences for social investment and retrenchment especially in the worst hit Member States (Heins & De La Porte, 2015). Hemerijck and Ronchi (2020) note that the current framework heightens cleavages between Member States and is inherently biased against social transfers against concerns of financial sustainability, a problematic asymmetry between social and economic priorities which remains even within the European Semester (Maricut & Puetter, 2018). Such dynamics reiterate the need clear comprehensive quantification of the contribution of EU economic governance, far from fulfilled by extant literature. A partial exception is Dahan and Strawczynski (2013) work which while problematically largely disregarding the political national context, attempts to account for the Maastricht Treaty, the EMU and SGP finding no empirical evidence on a negative effect on investments which conversely is the case for transfers. Nevertheless, the topic warrants a specific assessment which aims at overcoming the limitations in disregarding the effects of EMU or considering them as homogeneous, while also delving in-depth into the granular effects on budget components.

On the importance and specificity of the crisis

The final element to (briefly) consider concerns the specificity of the period of the Great Recession. The previous section has already explored changes in fiscal policy and dynamics as a function of the economic climate. Similarly, the element is relevant also in the context of national and supranational fiscal rules. Much has been said on the crisis and EMU, but little has emerged in terms of how the EU economic governance framework impacts the budget structure, let alone how such effect changes across the economic cycle. Even considering national fiscal rule, the majority of the literature considering compliance and effect together with the interplay with other factors disregards either potential differences as a function of the economic climate or exclude crisis times completely, considering only public expenditures in good times (e.g. Reuter 2015, 2019; Tóth, 2019). Against this backdrop the pro-cyclical effect of fiscal rules has been a common trope and concern even in the context of EMU, with some empirical support of (some) fiscal rules and their compliance mitigating such dynamics (Nerlich & Reuter, 2016; Combes et al., 2017; Guerguil et al., 2017; Larch et al., 2021). The judgement of the ability of the EU economic governance framework to deliver on stabilisation by way of countering the cycle is, however, quite bleak (e.g. Claeys et al., 2016; Aldama, 2017; Guerguil et al., 2017).

In this context, the overall structural shortcomings of the EMU, the mismanagement of the Euro crisis and the SGP reform, furthered in perspective with the introduction of the balanced budget rule with the Fiscal Compact, have been associated with a worsening and lengthening of the Euro crisis questioning the fitness of the framework in times of severe downturns (e.g. Larch et al., 2010; Lane, 2012; Creel et al., 20013; De Grauwe, 2013; De Grauwe & Ji, 2013; Jones et al., 2016; Braun & Hübner, 2018; de Quadros & Sidjanski, 2017). At the same time, the consequences have been far from homogeneous geographically, increasing the core-periphery divergence and straining the economies, societies and democracies in Southern Europe, a conflictual divide that if unmitigated may pose insurmountable differences for the future of integration (e.g. Feathersone, 2011; Lin & Treichel, 2012; Anderson et al., 2014; Matthijs & McNamara, 2015; Matthijs , 2017; Hutter et al., 2018).

Under such premises, the austerity paradigm of the EMU, fully embodied by the SGP and Fiscal Compact, has been called into question especially in the context of the crisis, specifically in the balance between the benefits and dangers of consolidation, partially repudiated even by the IMF itself as they may be far from sustainable even in purely economic terms (e.g. Asensio, 2013; Blyth, 2013; Ban, 2015; Hazakis, 2015; Mabbett & Schelkle, 2016; Zezza, 2020). At the same time the crisis and its (ill) management carries substantial distributive implications, not only geographically across the debtor-creditor fault lines but also within the policy mix. Especially in the absence of a golden rule, the implications are for investment to suffer with negative outlooks for growth (Creel & Saraceno, 2010; Creel et al., 2013; Fragetta & Tamborini, 2019). Detrimental prospects have also emerged for health (e.g. Correia et al., 2015; Forster & Kentikelenis, 2019; Crookes et al., 2020). Along the same lines work abounds on the negative trends in EMU during the Great Recession for social policies and welfare retrenchment (e.g. Raudla, 2013; Everson, 2015; Heins & De La Porte, 2016; Seikel, 2016; Greer & Jarman, 2018). Beyond these broad areas several other detrimental trends have been highlighted such as constraints to local government expenditures (Bolgherini, 2016) and the gender gap (Perugini et al., 2019). Trends even in relation to the composition of spending may, however, be quite heterogeneous across the Member States, especially in comparing the core and periphery worse affected both in terms of budget restructuring and crowding out of investment (Censolo & Colombo, 2016).

In this context, if the distributive impact of fiscal policy choices in times of crisis is hard to contest, the technocratisation of the approach to crisis management in the context of the Great Recession has raised some concerns for legitimacy post-crisis (Sánchez-Cuenca, 2017). In this context, the crisis and EU economic governance resulting reforms have been argued to worsen democratic legitimacy at the EU level (e.g. Bellamy & Weale, 2015; Genschel & Jachtenfucs, 2018; Crum & Merlo, 2020; Papadopulous, 2020), the support for European integration (e.g. Daniele & Greys, 2015; Armingeon et al., 2016; Cordero & Simón, 2016; Roth et al., 2016; Crespy, 2020; Matthijs & Merler, 2020) and come at a steep cost for national political systems (e.g. Grittersová et al., 2016; Matthijs, 2017; Giuliani, 2020; Kutter, 2020). From such perspective, the crisis appears far from a period to exclude or disregard. Conversely, how spending dynamics have been affected in crisis both in aggregate terms and in relation to key components such as investment, social spending and health is of primary interest in pinpointing the contribution of EU economic governance to the problematic trends emerging from previous work.

Taking stock on the rich knowledge around fiscal rules and how it may translate at the supranational level and in the interplay of the EU framework with national determinants, several elements should be considered. The effect of national fiscal rules is well established as heterogeneous both as a function of the fiscal rule itself - and at supranational level its change across reforms and rules applying to the specific circumstances at hand - and in its interaction with the political, institutional and economic context. From this perspective a more nuanced approach than the simple accounting for the supranational fiscal rule being at play or at most distinguishing across membership to the Eurozone is called for as average effects may well hide heterogeneous dynamics across configurations of national and supranational determinants. Likewise, finding on national fiscal rules suggest the problematic track record of compliance with the deficit threshold should not automatically suggest disregarding the SGP as failing in affecting the budget structure as its constraint may well be felt on the national fiscal policy mix even for violating Member States. The same reasoning applies to sanctioning not being a necessary or sufficient condition for compliance and/or effectiveness. Rather than a short-term stick guaranteeing adherence to commitments the key mechanism at play may be that of the pressure arising from the scrutiny and surveillance, for instance under the Excessive Deficit Procedure, bringing more nuanced expectations on the scope for an impact of EU fiscal governance during the Great Recession. Unveiling whether empirically the negative reputation of the SGP is indeed called for is at the same time of high interest in view of the considerations on the specificity of the crisis and the copious literature dedicated to failure of EU economic governance in the face of the challenge of the Great Recession.

2.3 Understanding EU economic governance

EU economic governance in its SGP component can be characterised as a fiscal rule, albeit oversimplified in its operationalisation in extant literature failing to account for heterogeneity both inherent to the fiscal surveillance framework and its interplay with other factors affecting the budget structure. It remains, however, to evaluate what implications can be derived for the multifaceted nature of its SGP in building expectation on when and how the supranational fiscal rule impacts national spending, together with its interplay with both the Semester and the domestic environment.

The State of the art on the SGP: the focus on debt and the deficit

With monetary policy delegated to the supranational level and fiscal policy remaining at national level, the rationale itself of the SGP is enshrined in the containment of debt and deficit for the sustainability of the Economic and Monetary Union by reigning in fiscal policies of the Member States (e.g. Issing, 2002; Beetsma & Debrun, 2007). In parallel, the Pact ability to constraint spending both on a theoretical level as a function of the regulatory framework and in practice has been the predominant focus of the field, considering also how the evolution of the framework is itself a function of the political context at the time (e.g. Heipertz & Verdun, 2010; Franchino & Mariotto, 2020). Focusing on the impact on the deficit and spending, the claim of failure of the SGP and ineffectiveness of the governance architecture is widespread, especially in the early days of the EMU (e.g. Bearce, 2009; Blume & Voigt, 2013; Dahan & Strawczynski, 2013; De Haan et al., 2004, 2013, Hallerberger et al., 2009; Hauptmeier et al., 2011; Andre et al., 2015; Koehler, & König, 2015; Afflatet, 2017; Begg, 2017).

However, such result is not unanimous as a positive impact on budget balances has emerged considering the SGP dummy even as early as in the pre-2003 period (De Haan et al., 2013) and recent work on institutions and budgets indicate a positive trend post-Maastricht (Fortunato & Loftis, 2018). Others recent studies have indicated under the protection of monetary policy the incentives for fiscal discipline remain weak (Losoncz & Tóth, 2020) and concluded and Eurozone membership does not lead to better fiscal outcomes even when post-crisis times are included (Franek & Postula, 2020) - which may be partially linked to the detrimental effect of the monetary union for fiscal discipline (Jalles et al., 2020) - harshly questioning the Fiscal Compact ability to improve structural balances (Belke, 2017; Raudla & Douglas, 2020).

As previously anticipated, in several instances empirical investigations on the impact of fiscal rules have indicated that once controlling from national fiscal rules variables capturing the participation to the SGP and EMU or the application of the Maastricht Treaty are not significant and may even have the opposite sign as expected, which has been interpreted as an indication of the negative international externality associated with the participation of the EMU (e.g. Dahan et al., 2013; Tòth, 2019). Within this context how to overcome such weaknesses and render the system credible has been a key topic in the academic and policy debate (e.g. Hauptmeier et al., 2011; Herzog & Hengstermann, 2013; Begg et al., 2015; Bilbow, 2016; Bongardt & Torres, 2016; Chang et al., 2016; Cottarelli, 2016; De Grauwe & Foresti, 2016; Herzog, 2018; Andor, 2019; Constâncio, 2020; Spadafora, 2020). The key takeaway can be summarised in Wyplosz (2016, 2017) assessment of the Eurozone as structurally flawed from the onset and heavily mismanaged, especially in the context of the crisis.

Heterogeneity within the multifaceted nature of the SGP

As discussed earlier in the chapter, when the SGP is accounted for it is usually considered either across the breaking point of Maastricht or as a simple function of membership to the Union or the Eurozone. However, the EMU itself is questionable as a meter to judge the applicable regulatory framework as it changes across Eurozone membership and over time with subsequent policy reforms. In this respect, it should be noted that the Excessive deficit procedure and its constraints to fiscal policy as of Maastricht are antecedent of the Stability and Growth Pact and considered the “cornerstone” of the EU economic governance framework, “unconditionally” mandating fiscal discipline, enforced through monitoring and by “penalising profligate behaviour” (Hallerberger et al., 2009, p. 171-172). From such perspective, although the Maastricht Treaty has been considered “insufficiently developed in the area of economic governance” and especially lacking for what concerns “the precautions against overly lax fiscal policy and arrangements for fiscal policy cooperation” (Heipertz & Verdun, 2010 pp. 106-107), further legislative developments with the SGP and its corrective arm in particular fully coming into play in 1999 retain the centrality of the EDP as a distinction between compliant and non-compliant Member States. While the preventive side of the framework has been reinforced over time (Franchino & Mariotto, 2020), the "hard" side of EU fiscal governance is embedded in the dissuasive arm of the SGP and specifically the EDP, under which Member States - within the Eurozone - failing from correcting excessive deficits would be sanctioned according the conditions set forth by the EDP regulation (Heipertz & Verdun, 2010, p. 78). A first heterogeneity in the impact of the EU economic governance on national budget structures can be hardly be discarded in the distinction between countries remaining in the "goodwill" based preventive arm of the SGP framework and those exposed to the surveillance - and potential sanctioning - of the EDP in the context of the corrective arm (Heipertz & Verdun, 2010, p. 78). While in recent times the excessive deficit procedure has staked some criticism with its ineffectiveness and lack of compliance pictured as the Achille's heel of the governance on which the Fiscal Compact relies (Belke, 2017), it nevertheless remains, along with the Fiscal Compact, the most coercive element of the Pact calling for the assessment of the extent to which it influences national budgetary policies and the fiscal policy mix. As such the analysis - while not considering the mainstream focus on deficit and aggregate spending, contributes to furthering the understanding on the bite of the SGP, testing the extent to which the limited evidence of consolidation may derive from its confined efficacy on those countries subject to EDP surveillance (within the Eurozone).

A further element of well-documented heterogeneity takes place over time, inherently connected to the political context at the time of reform. The divide between hawks and reticent (Southern) Member States with a poor track record of fiscal discipline led to high contestation in the nature and specifics of the rules even at the times of their introduction (Heipertz & Verdun, 2010; Franchino & Mariotto, 2020). However, aided by the pressure of the single currency, lack of flexibility and (quasi) automaticity in sanctioning was salvaged - largely in appearance - in the compromise, backed by a non-legally binding resolution indicating the "self-commitment to apply the EDP in a strict and timely manner" (Heipertz and Verdun, 2010, p. 6). Nevertheless, the EDP and its Council centricity far from relinquished political control from the Member States, an element which has been argued as a key weakness of the set-up, as evidenced by the early policy failure leading to the demise of the initial regulatory framework with the de-facto suspension of the SGP running into the wall of the Franco-German alliance (e.g. Heipert & Verdun, 2010; Genschel & Jachtenfuchs, 2018; Franchino & Mariotto, 2020). The constraining power of the early SGP can thus be easily be questioned, with widespread violations of the deficit threshold and outright defiance from the two biggest Member States, among the strongest advocate of discipline in the earlier phase.

That is the context against which the 2005 reform took place, rather than under the threat of derailing the introduction of the common currency against the status quo of a side-lined commitment to fiscal discipline (Heipertz & Verdun, 2010; Franchino & Mariotto, 2020). With the objective of improving both flexibility and compliance in avoiding further crisis mining the credibility of EMU, the results of the reform have been argued as a weakening of the framework, albeit with an increased focus of prevention, by way for instance of subjecting the EDP to greater discretionally and mitigating circumstances (Heipert & Verdun, 2010; Larch et al., 2010; Franchino & Mariotto, 2020). Hence expectations should be of a hinderance of the ability of EDP surveillance to impact national budget structure post-2005. Initial positive developments running against such expectation with Member States exiting the Excessive Deficit Procedure (Larch et al., 2010) should be weighed against the favourable economic circumstances suggesting that initially "it was not possible to assess the usefulness of the reformed SGP, given the good times and the absence of a bad-weather test", albeit the existence of early encouraging signals of cooperation with the uncontroversial initiation of an EDP notice against Germany (Heipertz & Verdun, 2010, p. 174). A test egregiously failed by EU economic governance in the context of the Great Recession and sovereign debt crisis, with the framework considered especially unfit both in preventing imbalances in good times and managing the difficulties of hard times (Larch et al., 2010; Creel & Saraceno, 2010; Creel et al., 2012; Alt et al., 2014; Wyplosz, 2017; Thirion, 2017).

Under such premises, the context of the subsequent reform of the SGP diverges substantially from the first. The fear of a "spreading sovereign debt crisis", mad a reform capable of restoring "fiscal confidence and stability" essential as urgent (Tsebelis & Hahm, 2014, p. 1396). The worsening of the sovereign debt crisis, the increasingly rising "risks of default and contagion effects" in 2011 and 20012 were the backdrop of the negotiation over the new EU economic governance framework (Creel et al., 2012, p. 538), with the EMU perceived as under "existential threat" in case of failure to find support for a deep reform of the framework (Schimmelfennig, 2015, p. 329). Fiscal rule and fiscal discipline hence returned to the centre stage (Cottarelli et al., 2014) as the fragility of the system was under everyone's eyes along with the pressure to reform with leaders shiftly committing to substantially improving enforcement to avoid similar risk in the future and put the crisis to rest by returning credibility to the SGP (Tsebelis & Hahm, 2014; Reuter, 2015; Tóth, 2019). In this context, the wave of reforms in 2011-2013 to strengthen the framework has been recognised as a major overhaul, while at the same time remaining within a similar (heavily criticises) asymmetrical set up based - with the exclusion of the Fiscal Compact - on the same mechanisms that have contributed to such a poor track record. Nevertheless, the changes to the framework were substantial, as the reform drove the EU Member States to “significantly strengthen their supranational and national fiscal frameworks” (Reuter, 2019, p. 125). The Six-pack strengthened both the preventive and the corrective arm of the framework, together with the introduction of the Macroeconomic Imbalance Procedure, going beyond the sole consideration of budgetary policies (Creel et al., 2012; Mabbett & Schelkle, 2014; Verdun & Zeitlin, 2018). In addition, requirements on national authorities for the monitoring and harmonisation were tightened resulting in the introduction of the two-pack regulation in 2013 (Mariotto, 2018; Reuter, 2018). A further breaking point can be identified with the introduction of the Treaty on Stability, Coordination, and Governance in the Economic and Monetary Union (TSCG) containing the Fiscal Compact to which all Member States with the exception of the EU are signatories, portrayed as the “climax of reform” (Creel et al., 2012, p. 538). Beyond the strengthening of existing rules (Tsebelis & Hahm, 2014), a crucial departure is the aim at “the incorporation of fiscal restraints into domestic law” (Mabbett & Schelkle, 2014, p. 9), severely limiting “the fiscal room for manoeuvre” of the Member States under the commitment to balanced budgets (Creel et al., 2012, 541) and the imposition of the introduction of appropriate numerical fiscal rules (Reuter, 2019). Specifically, Article III.3.2 TSCG prescribes that new fiscal rules are in place in national law “through provisions of binding force and permanent character, preferably constitutional”. From this perspective, the - albeit somewhat fuzzy over a three-year period - 2011-2013 reform wave undoubtedly increased the strength and restrictiveness of the EU economic governance framework, so that an improved ability to impact national fiscal policies can be expected, with a further potential distinction of those countries subject to Title III of the Fiscal Compact.

As a result, being under EDP surveillance may mean something arguably quite different across the three main iterations of the supranational fiscal rule, let alone after its debut into the domestic arena with the Fiscal Compact. Building on the expectation derived from such - mostly qualitative - analyses, the work provides additional evidence of the extent to which subsequent policy reforms have improved the constraining power of the SGP and its intrusiveness into fiscal (and social) policies. At the same time assessment of the change in the impact of the supranational fiscal rule on the national fiscal policy mix contributes to the copious debate on the 2011 reform, going beyond the sole focus on debt and deficit in considering how the supranational budget constraint translates into distributional changes within the domestic budgets, how it interplays with domestic factors and its alignment with the European Semester.

The interplay between the Pact and the Semester

Even in its early phase, EU economic governance was not exclusively a supranational fiscal rule, albeit if even the coercion power of the SGP have been deemed quite bleak little can be expected from soft coordination mechanisms. Beyond the deficit containment mechanisms provided by the Treaties and the SGP, several fiscal coordination instruments have over the years indicated benchmark for the convergence of national budget structures, spanning from the Broad Economic Policy Guidelines (BEPG), the Lisbon Strategy, and the reformed SGP in connection with "the view that fiscal policy can positively affect Member states' growth performance by managing the composition of public expenditures between productive and non-productive components", hence - at least on paper - devoting attention not only on the quantity but also on the quality of public expenditures (Censolo & Colombo, 2016, p. 705). Beyond the improved focus on quality, a substantial strengthening of the coordination of economic policies within the EU can be identified in the European semester. The Semester brings social, economic and fiscal coordination within a single process, building on existing frameworks subject to multiple legal bases with the objective of promoting structural reforms for increased growth, employment and investments, in line with the Europe 2020 strategy (Verdun & Zeitlin, 2018).

The Semester having become a key topic in the academic debate on EU economic governance. Findings on its nature, ability to affect national budgetary choices and its prioritisation of fiscal restraint compared to social objective are, however, mixed. On one side bringing social policies directly in connection with fiscal consolidation objectives - where failure in demonstrating sufficient improvement in economic targets may result in sanctioning - may be argued to put additional pressure on the Member States in complying with Country Specific Recommendations (CSR) also within the social domain in which the purview of the supranational influence is limited to coordination and guidance. Such view aligns with findings of prioritisation of economic rather than social objectives which has received substantial backing in the literature in line with the austerity paradigm often associated with the supranational fiscal rule and derived regulatory framework (e.g. Copeland & Daly 2015; Crespy & Menz 2015; de la Porte & Heins 2015). On the opposite side of the spectrum, it can likewise be considered that joint consideration of economic and social dynamics may better highlight the social consequence of fiscal choices in line with the finding that the European Semester may allow for the mainstreaming of social objectives (e.g. Bekker, 2017; Gómez Urquijo, 2017; Jessoula, 2015). Within this reasoning, an empirical case study uncovered a pro-social policies role of the Commission in relation to budgetary choices of Latvia while under financial assistance (Eihmanis, 2017).

Along these lines, evidence is mixed also in relation to the ability of the Semester to affect the budget structure of the Member States in the prescribed direction, argued both as highly limited (e.g. Hallerberg et al., 2011; Darvas & Leandro, 2015) and non-negligent (e.g. Deroose & Griesse 2014; Guardiancich & Guidi, 2020). Moreover, the CSRs themselves are also a product of political considerations in the context of the SGP , with extensive intervention of the Council towards consolidation especially for Member States in less rosy economic conditions and some (primarily among bigger and/or Eurosceptic countries) conversely successfully weakening recommendations (e.g. Baerg & Hallerberg, 2016; Mariotto, 2018), although in certain domains such as pension there is evidence supporting limited politicisation (Guidi & Guardiancich, 2018). In this context, it should also be noted that the budgetary consequences of structural reform may long-lasting but not immediate. An example in this regard is the case of pension, for which the EDP and CSRs have been shown to contribute to triggering reforms (Guardiancich & Guidi, 2020). As such, EU surveillance shapes spending in the most sizable domestic budget line. The implication of pension reforms, however, are hardly concentrate in the immediate aftermath of the implementation of the recommendation and/or the consolidation effort spurred by the deficit surveillance. Conversely, its effect on social spending may be delayed and protracted over time, leading to the potential underestimation of the impact of the supranational fiscal framework. The emerging picture indicates that while it may be of high value to further investigate the scope of the direct impact of the EU economic governance framework on national budgetary choices through the CSRs, expectations are far from straightforward both in general in relation to the ability to affect the fiscal policy mix, especially in relation to categories of primary interest such as social policies. Additionally, a further complication arises in the difficulty of disentangling the impact from the SGP from that of the EU economic governance 'beyond fiscal rules', not unlike for the case of supranational and national numerical targets.

However, that is not the case in considering - in line with the interests of the aim of the research - the alignment between the soft and hard side of EU economic governance, which remains largely unexplored. The 2011-2013 reform wave has been depicted as a "deficit reduction approach to the economic problems of the EU"(Tsebelis & Hahm, 2014, p. 1405), with the balance still tilting in favour of fiscal discipline over social issues in the Semester (Maricut & Puetter, 2018). At the same time, some elements of mainstreaming of social concerns within the system have been highlighted (Zeitlin & Vanhercke, 2017). Additionally, the introduction of the European Pillar of Social Rights may indeed represent a rebalancing away from purely economic and disciplinary concerns (e.g. Garben, 2019; Rasnača, & Theodoropoulou, 2020; Vesan et al., 2021). The two objectives are embedded in the CSRs – in part already defining the specific balance for each Member State along the economic-social dimensions – nevertheless with scope for conflict between discipline and social investment (Crespy & Vanheuverzwijn, 2019). The same considerations, however, do not apply to the numerical supranational fiscal rule side of EU economic governance which does not directly account for the CSRs, generating possible misalignments. The precise pinpointing of how the Pact shapes national budget structures in the context of this analysis offers the opportunity to contribute to this debate investigating if the two arms clash, namely in the supranational fiscal rule forcing national budget in a different direction than the CSRs would prescribe, offering some fresh insights on how conflicting economic and social objectives turn into budgetary choices.

The (sparse) findings on the interplay between domestic and supranational dynamics

Finally, shifting the focus to the last key question, limited attention has been systematically dedicated to the quantitative assessment of how the EU economic governance framework impact on budgetary policies - let alone their composition - is hindered or supported by the national context. The possible interaction between the national environment and the supranational fiscal framework is of particular relevance given the latter has been "caught up in politics, both domestic and international" (Heipertz and Verdun, 2010, p. 197). Some lessons on the interplay among the three key political, institutional and economic domains can be drawn from national fiscal rules as already explored earlier in the chapter. Moreover, the interaction need not to be stable over time given the evolution of the supranational regulatory framework, especially in connection with national fiscal rules. Budgetary processes in the Member States have also been impacted by the latest reform (e.g. centralisation), creating a potentially different national and fiscal governance environment to be attributed to the supranational fiscal rule (Raudla & Keel, 2020). Among few examples of EMU-specific accounting for interactions with national factors can be found, for instance, in Mäkelä (2018) finding the increase in the size of the public sector dependant on national political factors. On a similar note, national political dynamics have been associated to both to the enacted structural reforms in the social domain (Sacchi, 2018) and whether reforms are sticky post-conditionality or austerity driven changes are reversed (Branco et al., 2019). In the arena of pensions, EU economic governance has been shown to interact with domestically derived pressures of unsustainability of spending and deficit to trigger reforms (Guardiancich & Guidi, 2020). Domestic policy plays also in important role in creating the incentive structure which may push countries toward creative accounting to abide with the SGP (Alt et al., 2014). Such analyses, while not covering the topic of interest reinforce expectations of heterogeneity and the need to account not only for the direct effect of national determinants but also for their effect on the ability of the supranational fiscal rule to impact the budget structure.

However, it should be noted that there is a domain in the field for which heterogeneity has become a key focus especially with the sovereign debt crisis and its problematic aftermath: the divergency between the core and periphery. In this context, crisis-management and the EMU itself has been considered to blame for increased geographical divisions both in economic performances and politically, creating a perilous context for any compromise on how to overcome such dynamics (e.g. Issing, 2011; Lin & Treichel, 2012; Matsaganis & Levanti, 2014; Gambarotto & Solari, 2015; Matthijs & McNamara, 2015; Jones et al., 2016; Matthijs, 2017; Bull, 2018; Cesaroni et al. 2019; Howarth & Verdun, 2020; Matthijs & Merler, 2020; Notermans & Piattoni, 2020; Pagoulatos, 2020). The literature underlines the importance of considering the potential for heterogeneity in the impact of EMU on the budget structure across core and periphery. The work hence contributes to a more granular understanding of the geographical cleavage in spending dynamics and whether indeed the South is more heavily impacted by EU economic governance compared to the core. At the same time, the overrepresentation of countries requesting financial assistance during the crisis brings the attention to another element not always considered sufficiently in the assessment of the impact of the SGP, as the relevant commitments derived from the Memorandums and not the Pact under those circumstances and their inclusion may confound the true impact of the 'normal' EU economic governance. The last word of caution refers to divergent trends among Western Europe and Central and Eastern European Member States. Heterogeneities across the interplay between budgetary dynamics and political and institutional factors - including fiscal rules - are well documented to the extent that they are often excluded from systematic cross-country comparisons in the EU (e.g. Fabrizio & Moody, 2006; Berger et al., 2007; Staher, 2008; Pavlović, & Bešić, 2019; Vinturius, 2021). With the aim of retaining the maximum geographic coverage, the limitation at least in the interplay with the national level is hard to overcome and there may indeed be the need to limit the analysis at least in its final part to the Western block raising the issue of the extent to which finding may not be well representative of this other under-investigated geographical cleavage, which would deserve more comprehensive further addressing beyond the scope of this work.

Conclusions

The overall implication that can be derived from this chapter is that a complexity of often interacting factors is at play in determining the size and composition of public expenditures both domestically and in the interplay with EU economic governance. Such background may give rise to different configurations that may be more or less conducive to abiding to supranational commitments. The purpose of the literature review and the work is not, however to take on the unfeasible challenge of an exhaustive account of all political, institutional and economic domestic factors and their interplay with the EU economic governance framework. Rather, the objective is identifying key contributors in the three arenas and analysing the impact beyond aggregate spending dynamics and into their components to pinpoint the distributional consequences of the Pact and their heterogeneity across political, institutional and economic national configurations. Such account allows as well to contribute to a trope within the literature relating to the core-periphery fault line within the Union and Eurozone, its increase as a result of the EU crisis-management and economic governance framework and the dire implications it carries for the future of EU economic governance.

The chapter has grounded the work in identifying the key findings in relation to how domestic factors shape the budget structure. Additionally, it has pinpointed the limits within extant analyses in their coverage over time, geographical scope and disaggregation. Furthermore, limited attention has emerged to accounting at all or with sufficient sophistication for the impact of the EU regulatory framework. In section one, the analysis of the literature on broader political, social and economic implications of the composition of the budget structure reinforced the argument for a need of furthering the (granular) understanding of how supranational constraints translate into fiscal policy choices of the Member States. At the same time, it signalled the need to consider distinctions which may emerge not only geographically but also over the troubled history of the EMU.

Against this framework, the chapter in section two has explored the extensive literature of national fiscal rules of which EU economic governance in its main component of the SGP represent a special supranational case. At the national level, the section illustrates the sheer complexity of accounting for fiscal rules and heterogeneity of their effects across political and institutional contexts and - especially - the economic climate. Drawing a parallel to the supranational level, similar heterogeneous effects fairly unexplored in extant literature may likewise be expected. At the same time, the (unsophisticated) characterisation of the supranational fiscal rule as a simple monolith represented by membership to the Union and the Eurozone clashes with the nuances of fiscal rule effectiveness over their changing characteristics highlighted in section two, relevant as well for a Pact which has undergone two substantive reforms culminated with the balanced fiscal rules translation into national legislation under the Fiscal Compact. A parallel distinction which the works contributes to outline is hence of value in exploring how limited effects overall may hide quite heterogeneous patterns over time. A similar reasoning applies to crisis dynamics. As illustrated the period is often disregarded in assessing fiscal rules due to escape clauses. The criticism to the SGP in the failure to enact its policy objectives of counter-cyclical fiscal policies, however, begs the question of putting to the empirical test whether there has been at all an impact on the budget structures during the Great Recession and if detrimental effects on social policies and/or investment are indeed confirmed by the data.

Finally, in section three starting from the limitations in current findings of a cohesive assessment of the distributive impact of EU economic governance on national budget structures, the interplay and disentanglement of national and supranational determinants is discussed. The section positions the work within the extant literature on the SGP, focused chiefly on deficit, consolidation and aggregate spending dynamics. Additionally, it evaluates what the debate on the Semester suggests on the connections between the supranational fiscal rule and the CSRs, opening the path for the analysis of the alignment between the two. Furthermore, it indicates how the political economy of national budget compositions likewise calls for an account of the interplay between the national and supranational arena. Given the effect of the latter may be heterogeneous, it warrants investigating how it varies across constellations of domestic contexts. As such the chapter grounds the research objectives into the intersection of fields this work touches upon, outlining the contribution of the analysis. At the time it assesses the scope for further exploring how national and supranational determinants of the fiscal policy mix interact in contributing to the understanding of (i) the far from neutral distributional implications of EU economic governance and (ii) how the latter fares in terms of its own policy objectives of fostering a inclusive growth enhancing spending in the Member States.

3. The puzzle of the domestic impact EU economic governance

The overview of the relevant literature at the intersection of the political economy of national budget composition, fiscal rules and the SGP – pinpointing the gaps the analysis aims to contribute to further understanding – provides a guiding framework for the assessment of the puzzle of the interplay between the EU regulatory framework and the budgetary choices of the Member States. The complexity at play is extensive and multifaceted. Consequently, the research approach needs to carefully account for the multiple contributing factors. Additionally, several key elements concerning the EU impact on national budget structures have not been the object of extensive analysis, especially regarding the specifics of the mechanism at play that may fail to capture the richness of the derived dynamics.

This chapter proceeds in (i) refining the research objectives and outlining the research questions before (ii) considering the causal mechanisms linking the EU economic governance framework and the budgetary outcomes in the Member States and (iii) defining on such basis expectations and the specific hypothesis to be tested throughout the analysis. Limited evidence is available on some of the dimensions to be assessed, especially regarding the interplay among the national and supranational level. As a result, clear-cut expectations are not always straightforward. In addition, in some instances, more than one competing forces – with opposite implications for budgetary outcomes – may concur in determining the overall dynamics, requiring a parallel deliberately composite account in the research questions and hypotheses.

3.1 Framing the puzzle: the research questions

Fiscal policy dynamics are highly diverse across the Member States both within the European Union and the Eurozone. Variation is substantial in the overall size of the public sector as well as in the sectorial distribution of public expenditures. It is of interest to disentangle the role played by national and supranational determinants in shaping national fiscal policies. Extensive attention has been dedicated to the overall fiscal performance of the Member States, especially concerning budget deficits and debt outcomes. In this context, the analysis contributes to an in-depth assessment of disaggregated fiscal choices by considering the composition of public expenditures. Sectorial allocations can allow for the assessment of the effectiveness of the SGP in carrying out its policy objectives, that is to say, constraining expenditures while directing them toward optimal growth-enhancing investments. Additionally, uncovering the impact on the budget composition and especially on specific expenditures such as in the social domain, contributes to the academic and policy debate on the criticism and socially detrimental impact of the SGP. Starting from the big picture of the puzzle at hand and a detailed assessment of the nature of both domestic fiscal dynamics and the common supranational regulatory framework, this section frames the analysis in defining and justifying the main research questions together with the specific sub-questions of interest.

An overview the EU-MS fiscal puzzle

Looking at fiscal behaviour across the Member States, the emerging picture is composite and variegated, with the total level of expenditures spanning from a mere 25 per cent to over 65 per cent of GDP. Divergencies emerge in both space and time, with common trends over the year as well as country 'types' in the preferred size of the public sector. In terms of the latter, Figure 3. 1 below shows country averages across the 1995-2018 timeframe, with seven Member States well below 40% and six scoring above 50%, spanning from the mere 36% of Romania to the 55% of France.

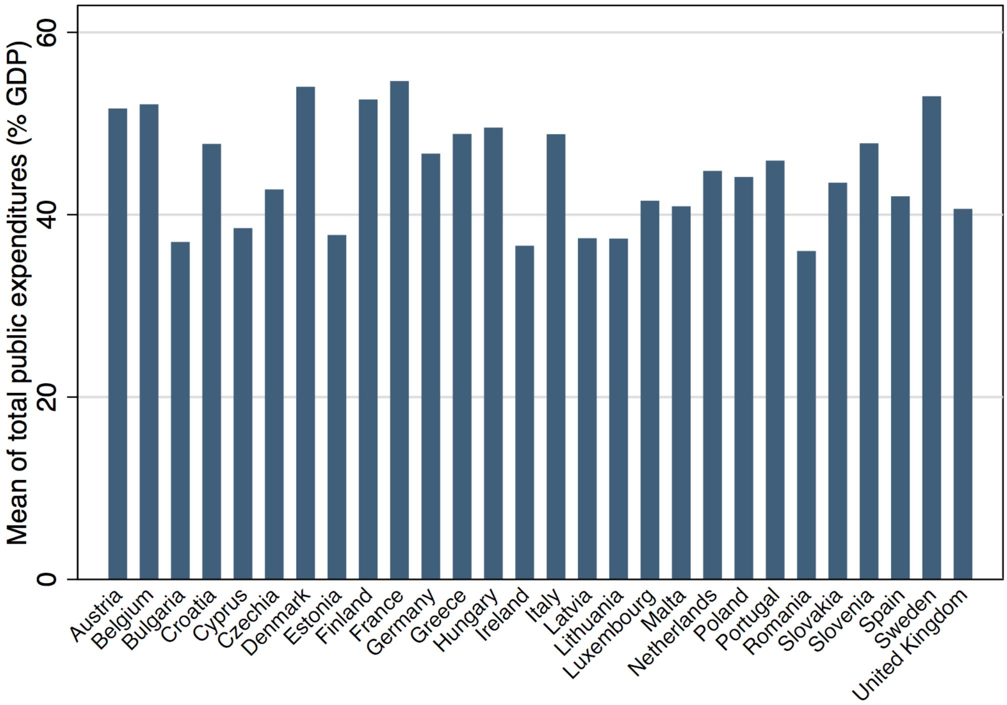


Figure 3. 1 - Country averages in total public expenditures as percentage of GDP (1995-2018)

Similarly, trends arise not only across countries but also over time, with substantial differences in yearly averages in total expenditures, shown in Figure 3. 2 below. The overall decline in the initial period – with the brief intermission of the post-2001 shock – brought total expenditure to reach a minimum ahead of the Great Recession in 2007. However, budget sizes skyrocketed following the global financial turmoil in 2009-2010. Amid the negative cycle, the Eurozone crisis set off a sharp declining trajectory, which persisted in the subsequent period. The cycle appears, as expected, to play a primary role in shaping national fiscal policies, although counterintuitively consolidation does seem to occur also in the negative phase of the cycle. At the same time, in line with the cross-country differences shown above some substantial divergences in the timing and sharpness of adjustments need not to be excluded.

Figure 3. 2 - Yearly averages in total public expenditures as percentage of GDP across EU28

In terms of overall expenditure level, the puzzle of a highly variegated national fiscal behaviour in the context of a monetary union with common budgetary rules is evident. Furthermore, substantial distinctions also emerge in the area of key interest for the research question at hand: the composition of public expenditures. Figure 3. 3 below shows the average country fiscal policy mix in the time frame considered, displaying the share dedicated to each of the main components of public expenditures. For example, considering a key category, social protection, substantial divergencies occur in the absolute amounts in comparison to national GDP dedicated to this component across countries. Specifically, country averages as a percentage of GDP span from below 11 in Cyprus to over 23 in Sweden. Accounting for the overall budget size choices, differences remain. The below comparison in Figure 3. 3 shows sizeable variations also in the share of the public budget dedicated to each component, including social protection. Such patterns are also confirmed to be persistent regardless of changes over time in actual allocation preferences, with limited convergence not only across the EU but also within the Eurozone, especially in the aftermath of the crisis (Ferreiro et al., 2013).

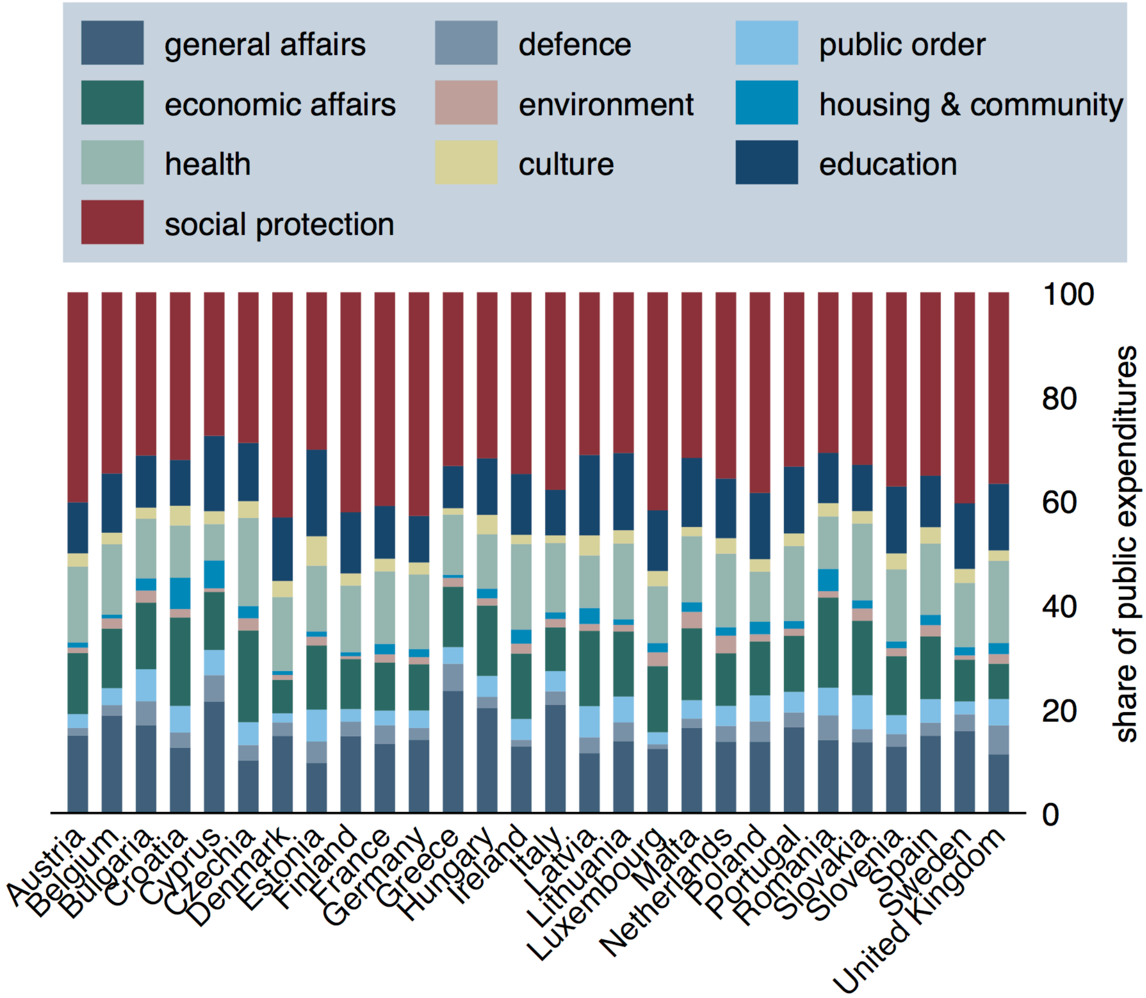


Figure 3. 3 - Average composition public expenditures across EU28 countries (1995-2018)

The heterogeneity of budgetary trajectories across the EU and especially the Eurozone, together with partially aligned trends beg the question of the extent to which the common regulatory framework translates into common - or rather heterogeneous - fiscal choices at the national level. The EMU-disregarding literature on budget composition has risen a distinction across clusters of fiscal allocation behaviour (Sanz and Velázquez, 2004). The extent to which such divergences in the fiscal policy mix (e.g. in the space reserved for transfers or investment) derive fully from national preferences or to at least some extent from their interplay with the EU economic governance framework remains an open question.

However, building on the extant literature on budget composition, fiscal rules and the SGP, some general considerations on potential contributing factors can assist in defining how to account for the uncovered heterogeneity and the role of the SGP. Firstly, national dynamics have been shown to play an important role - hence cannot be disregarded. At the EU level, it is important to understand the mechanisms through which the supranational fiscal rule may affect the budget structure so to appropriately test under what conditions the fiscal policy mix is affected. Along this line, the complexity of the EU economic governance framework is uncontested both in relations to its underlying mechanisms and provisions and the evolution over time (e.g. Halleberg et al., 2009; Heipertz & Verdun, 2010; Franchino & Mariotto, 2020). Moreover, the literature on fiscal rules offers both a cautionary tale and a further motivation for taking into careful consideration an additional dimension: the economic climate. Specifically, it is of relevance for the analysis that the nature of fiscal rules – including the supranational one – changes during the negative cycle through escape clauses and policy expectations that may for good reasons deviate from consolidation (e.g. Creel et al., 2012; Reuter 2015, 2019; Tóth, 2019). However, such premises rather than justifying the exclusion of crisis years from the analysis – as per the usual approach in the literature – rather raise a question of high relevance in investigating empirically what takes place in reality during a deep recession. Finally, beyond the direct impact of the national determinants on the budget composition, the national and supranational arena may interplay so that the effect of the EU economic governance framework may only or to a different extent materialise under specific configurations both at European and domestic level. Such an overview of the multidimensionality of the problem at hand allows for the definition of research questions that are both of high relevance and well-grounded in the literature and its gaps.

A variegated impact? The multifaceted dimension of EU economic governance

The first element to consider in assessing the impact of the EMU on the budget structure relates to the capturing of the complexity of the mechanisms at play within the EU governance framework that may be ill represented by a simple membership indicator. Refuting an oversimplified characterisation of the SGP as it may fail to well reflect the dynamics at play, allows to contextualise the findings of the literature on fiscal rules in trying to disentangle the interplay between national and supranational spending targets (e.g. Bergman, 2016; Reuter, 2019). In this context the SGP - accounted for simply as Eurozone membership - either fails to show any significant effect or a reversed effect on fiscal discipline. For example, in uncovering the determinants of national fiscal rules compliance, Reuter (2019) finds a negative effect for membership to the Euro area, argued as a consequence of the potential for free-riding off of the monetary union. In this context, the reasoning links to findings of the weaknesses of the EMU framework of fixed exchange rates in terms of fiscal discipline and the connected high importance of political mitigating factors and (national) fiscal rules (Jalles et al., 2020). At the same time, the author also recognises the problematic choice of allocating the full effect of national fiscal rules to domestic choices in the aftermath of the latest EU fiscal governance overhaul with the introduction of the Fiscal Compact (Reuter, 2019). Within the same approach of an oversimplified account for the supranational fiscal rule, the SGP was found not to contribute to the effectiveness of fiscal rules in other empirical studies (Bergman et al., 2016) or a significant disciplining effect of the EMU was identified only prior to joining the Eurozone and not after membership had been secured (Nerlich & Reuter, 2013).

These findings raise two issues relevant to the research design and the framing of the research questions. The first calls into question the appropriateness of reducing the governance framework to the sole membership to the Eurozone, especially in assessing its impact on the budget structure. The second dimension relates to disentangling the national and supranational role of fiscal rules in impacting the fiscal policy mix, especially after the introduction of the Fiscal Compact through which the domestic regulatory framework becomes at least partially EU mandated. The complex and multifaceted nature of the EU economic governance framework may indeed be ill-suited for an oversimplified characterisation of its impact of national fiscal policies. In this context, the absence of an overall impact may derive from the different extent to which various mechanisms within the supranational fiscal rule architecture or subsequent iterations of the SGP regulatory framework are equipped to alter national budgetary choices. In this scenario, the first research question is dedicated to disentangling the multifaceted nature and intrinsic divergent impact of the EU economic governance in assessing:

[RQ1] *when and how the SGP affects the composition of national budgets.*

In addressing the first research question three key subcomponents can be identified and investigated within (i) the mechanisms of the SGP; (ii) the three main iterations of the regulatory framework and (iii) the direct and indirect effect of the SGP on the composition of public spending.

Starting from the first element, the SGP can hardly be considered as a monolithic element, as its regulatory provision and surveillance process vary not only across Eurozone membership but also according to the fiscal performance of the Member States. The supranational fiscal rule makes a clear procedural distinction between complainant countries and Member States displaying an excessive deficit. While the formers remain within the preventive arm of the framework, the latter are subject to corrective measures that may in case of non-compliance result in sanctioning. Under such premises, it is of value to distinguish between the impact of the Stability and Growth Pact per se and that of the Excessive Deficit Procedure, namely in assessing the impact on the domestic fiscal policy mix of a Council decision on the existence of an excessive deficit in a Member State. Consequently, a specific sub-question is warranted in assessing:

> [RQ1.A] *the extent to which the EDP has an impact on the composition of national budgets.*

In looking at the second dimension, in the "tumultuous" history of the first twenty years of the EMU (Howarth & Verdun, 2020, p. 287), the supranational regulatory framework has gone through several reforms. Specifically, the two major breaking points of 2005 and 2011 allow for the distinction of three iterations of the framework, with a substantive difference in terms of the associated strictness. Such distinctions have been widely debated in the literature (e.g. Heipertz & Verdun 2010, Franchino & Mariotto, 2020) suggesting that failing to account for the evolution of the policy may be problematic. Instead, it is of value to consider the extent to which the three iterations of the SGP are capable of producing changes in the budget structure. In this context, it is of interest to uncover the respective bite of the three reformed SGPs, especially in considering the extent to which the early weaknesses have been addressed by the latest reforms in the aftermath of the Eurozone crisis. In view to its potentially game-changing mandated national implementation of supranational commitments, a further distinction should also be made for the Fiscal Compact. Consequently, a specific sub-question is warranted in assessing:

> [RQ1.B] *the extent to which the impact of the EDP on the composition of national budgets changes over SGP policy reforms.*

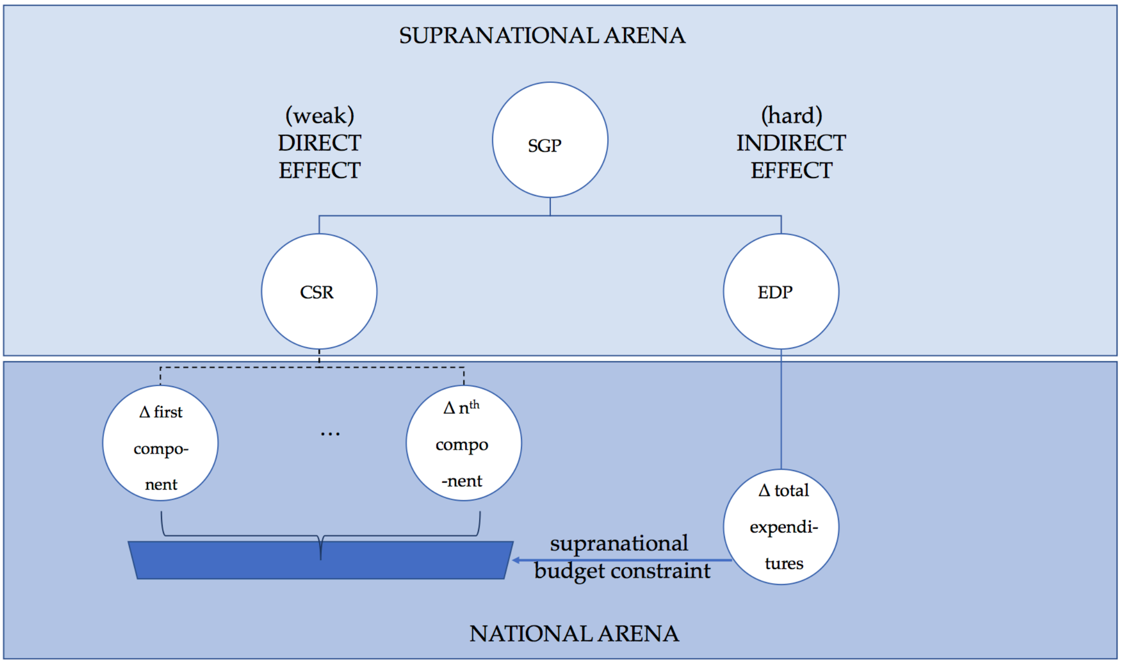


Figure 3. 4 - The direct and indirect impact of the SGP on the budget structure

The third element of complexity within the EU fiscal coordination infrastructure relates to the coexistence of the traditional and central elements of a pure supranational fiscal rule, with the soft coordination of specific fiscal policies objectives strengthened in the latest iteration of the SGP with the introduction of the European Semester (e.g. Verdun & Zeitlin, 2018). In this scenario, one may distinguish across a direct and indirect impact on the national budget structure. On one side, the EU fiscal rule considered so far in assessing RQ1.A and RQ1.B takes the form of a budget constraint imposed by the supranational level. As such, the EDP – through its pressure towards consolidation – directly affects the size of the pie of public spending. In turn, the constraint on overall spending has an indirect effect on the composition of the national budgets – how public finances are allocated across budget lines (e.g. health, education, social spending). Conversely, the process of the European Semester and the resulting country-specific recommendations (CSRs) offers a direct orientation to the fiscal policy mix of the Member States, in indicating reforms associated to specific arena such as health, education or social policies. At the same time, the two mechanisms are associated with substantial regulatory differences, as the enforcement mechanism of the CSRs are considerably softer than the hard sanctioning foreseen in the EDP procedure. As further explored in section two, sanctioning may not be the sole mechanism through which the EDP is able to force the hand of national governance towards convergence. Indeed, the political and procedural cost and pressure of the Excessive Deficit Procedure can hardly be disregarded. Similarly, at the level of aggregate deficit dynamics under scrutiny within the EDP, the awareness of the spillovers effects and risk of profligacy within the EMU may support governments behaviours in protecting the credibility of the SGP. That same dynamics may apply with a similar strength to the CSRs – or homogeneously within them – is far less convincing. That is because the architecture of the EMU indeed was built around strong conditionality on deficit ceilings, relegating economic coordination to voluntary benchmarking and cooperation under the OMC, of which the CSRs are a descendant. In this context, while ample debate has been dedicated to the novelty and impact of the European Semester (e.g. Hallerberg et al., 2011; Deroose & Griesse 2014; Darvas & Leandro, 2015; Baerg & Hallerberg, 2016; Mariotto, 2018), the disentanglement of the two concurrent components of the EMU infrastructure are far from straightforward, especially concerning the congruence between the direction toward which the two dimensions pull the budget structure. This question may be of particular relevance if indeed the CSRs have managed to mainstream social concerns into the EU economic governance, which may, however, run counter to EDP prescriptions. Consequently, a specific sub-question is warranted in assessing:

> [RQ1.C] *if the impact on the budget structure of the SGP aligns with the prescriptions of the CSRs.*

Changes across the cycle: the specificity of in-crisis SGP

The crisis period has attracted substantial attention in the literature, for example, for what concerns the subsequent reform process of the SGP, the derived strengthened political and economic divide between the core and the periphery and the crisis mismanagement with the associated negative consequences for the support for the EU project and the rise of Euroscepticism (e.g. Armingeon et al., 2016; Baerg & Hallerberg, 2016; Daniele & Greys, 2015; Greer & Jarman, 2018; Jones et al., 2016; Hobolt & Wratil, 2015). In this context, the crisis appears as a key timeframe for the assessment of the EU economic governance framework. Crisis dynamics indeed spurred sharp criticism for the performance of the supranational fiscal coordination infrastructure in times of severe downturn. Such accusations come with (e.g. socially) problematic implications both at the Member State and supranational level. On one side, at the domestic level, it is of value to better understand if the SGP has indeed a pejorative impact on the crisis trajectories and associated budgetary choices. On the other, findings would shed some insights on the real performance of the EU economic governance in comparison to its policy objectives.

At the same time, while the crisis period may be undoubtedly worth of close analysis, not only has little attention been devoted to assessing the dynamics of budget allocation in this timeframe but also the literature on fiscal rules more in general excludes times of negative cycle (e.g. Reuter 2015, 2019; Tóth, 2019). Such exclusion is not unjustified, as it is undeniably problematic to include crisis years in a larger cross-cycle panel assessing the impact of fiscal rules. Two problems of different order arise in this regard. On the practical level, escape clauses may kick-in during a recession, de-facto suspending or considerably weakening a fiscal rule and hence changing to some extent its nature in-crisis. On a normative level, diverging fiscal policy objectives ground fiscal choices across the positive and negative side of the cycle, as further considered in the previous chapter. As a consequence, the assessment of the performance of a fiscal rule should be vis-a-vis different benchmarks in good and bad times.

The illustrated dynamics justify the need for a sharp distinction across the phases of the cycle. However, translating such a requirement into the disregard for budgetary dynamics at crisis does not find a similarly strong grounding. At the same time, one should not be quick to exclude any impact of a fiscal rule even in the presence of an escape clause given that an effect was even found when fiscal rules are violated (Reuter, 2015). In this scenario, it is of interest to dedicate the second research question to crisis times in assessing:

> [RQ2] *if and how the SGP has affected the domestic composition of public expenditures during the Great Recession and Eurozone crisis.*

In doing so three key sub-focuses can be identified: (i) the aggregate impact on budget composition, (ii) the extent to which different expenditures are affected at the disaggregated level and within this domain (iii) the dynamics taking place in relation to social spending. In this context, the starting point is a synthetic assessment of the impact of the framework in the negative cycle, which allows a straightforward comparison between good and bad times. In doing so, the analysis also uncovers the extent to which the SGP facilitates or hinders countercyclical fiscal policy in the context of the recession and in turn if the criticism of its pro-cyclical nature (e.g. Larch et al., 2010; Lane, 2012; Creel et al., 2013; De Grauwe, 2013; De Grauwe & Ji, 2013; Jones et al., 2016; Braun & Hübner, 2018; de Quadros & Sidjanski, 2017) is indeed warranted. Consequently, the first sub-question addresses:

> [RQ2.A] *the extent to which the SGP impacts the overall budget structure in times of crisis.*

Beyond the aggregate level, the analysis of the impact on the specific budget lines allows for the uncovering of the potentially divergent budgetary implication of the SGP-at-crisis. [RQ2.A] addresses the linkage between escape clauses and the reality of crisis expenditures. It provides, however, only a partial picture of the indirect impact of the supranational budget constraint on the fiscal policy mix. In assessing instead whether the SGP does or does not behave in adherence with its nominal policy objectives, only an in-depth analysis of the impact on specific sub-categories of spending can benchmark against the goal of promoting a growth-enhancing stimulus in the recovery (European Commission, 2019a). Against such objective, the analysis should consider the sub-components of the fiscal policy mix pertaining to investment and transfers (e.g. Ferreira et al., 2013; Fournier & Johansson, 2016; Jeong et al, 2019). Consequently, the second sub-question addresses:

> [RQ2.B] *the extent to which the SGP impacts investment, transfers and inequality mitigation during the crisis.*

Finally, within the in-depth analysis of the impact of the supranational fiscal rule on disaggregated spending, some areas of national fiscal policy carry additional implications given their connection with the main criticisms to the SGP: its negative impact on national social expenditures. Within this context, one further distinction may be warranted in addressing intergenerational concerns, namely in relation to the age-distributive divergences of the indirect impact of the supranational fiscal rule. Consequently, the final dimension on at-crisis dynamics addresses:

> [RQ2.C] *the extent to which the SGP impacts social spending and its subcomponents in the negative phase of the cycle.*

In considering the above-illustrated dynamics [RQ.2] sheds light on two further elements of interest. Firstly, the analysis can offer insights on the claim within the literature that the EU in general - and more specifically the EU economic governance infrastructure - is not equipped for crisis management (e.g. Larch et al., 2010; Lane, 2012; Creel et al., 20013; De Grauwe, 2013; De Grauwe & Ji, 2013; Jones et al., 2016). Additionally, findings on the first crash-test for the SGP architecture (Heipertz & Verdun, 2010) can inform the debate on the second and unprecedented challenge for the EU economic governance framework following its latest revamp, in the context of the pandemic response and recovery effort together with the current Eurozone reform debate in connection with the Conference on the Future of Europe.

The home (dis)advantage? The interplay between the domestic and supranational arena

Finally, it should be considered that the SGP does not function in a vacuum but in concomitance with the domestic factors at play in shaping national budgetary choices. In this context, there may be certain domestic configurations that are more or less conducive to the SGP impacting the budget structure. Different political, institutional or economic circumstances may affect the room of manoeuvre for translating supranational commitments into the appropriate fiscal behaviour at the aggregate level. That is to say that the impact of the SGP may be stronger or weaker as a function of domestic factors. At the same time, besides the scope of the impact, the latter may change also in its distributional consequences with specific domestic scenarios, for example, shielding or constraining certain budget items while leaving other as the prime candidates for consolidation. Under these premises, it is of interest to consider:

> [RQ.3] *if and how the impact of the SGP changes across different domestic political, institutional and economic conditions.*

Within this context, three domains can be distinguished at the national level: (i) the political arena, (ii) the institutional arena and (iii) the economic arena. The literature on the national determinants of the budget structure offers some guidance in identifying the key factors at play. Political determinants of fiscal performance have been widely debated, with more circumscribed efforts dedicated to the budget structure. Within the latter, the contribution of Tsebelis and Chang (2004) considers the impact of (current and previous) government characteristics on fiscal policy choices, with the former emerging as key determinants of the scope for changes in the budget structure. Within this line, in affecting the room for changes in expenditure, political factors may favour or hinder the impact of the SGP. Consequently, the first sub-question addresses:

> [RQ3.A] *the extent to which the impact of the SGP varies across different domestic political configurations.*

In addition, parallel reasonings concern institutional characteristics of the Member States. Within the institutional arena, two elements arise with the potential for generating substantially different environments at the national level: (i) decentralisation and (ii) national fiscal rules. The first dimension is fairly straightforward, as directly affecting the extent to which the national government has more or less extensive control over the full domain of public expenditures. Consequently, it may as likely in turn affect the extent to which SGP commitments are translated into budgetary choices within the Member States. National fiscal rules present a more complex scenario. On one side, it may be just as straightforward to expect their potential interaction with the supranational fiscal framework while on the other the interplay between the two levels is hard to disentangle. Nevertheless, the relationship between the two domestic institutional characteristics and fiscal policy choices indicate the need for the second sub-question addressing:

> [RQ3.B] *the extent to which the impact of the SGP varies across different domestic institutional configurations.*

Finally, the domestic economic environment may also affect ability of the SGP to transmit constraints into national spending allocations. In continuity with [RQ.2] differences may occur across the cycle, especially for countries under extensive economic duress. In parallel, changes in key economic drivers of national expenditures may affect where the supranational constraint hits at home. At the same time, given the substantial share of the budget dedicated to unemployment and old-age expenditures (Tabellini 1990, 1991), changes in the latter may render the national budget more or less flexible and responsive to the supranational fiscal framework. Consequently, the third sub-question addresses:

> [RQ3.C] *the extent to which the impact of the SGP varies across different domestic economic conditions.*

3.2 The links: identifying the causal mechanisms

As already indicated, the SGP does not act in a vacuum but instead carries on its function in conjunction to the domestic determinants of budget composition. Under such premises, three levels contribute to shaping the national budgets: (i) the domestic level within the Member States, (ii) the supranational regulatory framework and (iii) the interplay between the two. In addition, the causal mechanisms at play at national level offer some insight on the channels through which the supranational framework may affect the domestic fiscal policy mix.

Before delving into the factors at play at the national level it is of value to characterise the effects according to a standard typology to be employed consistently in uncovering the causal linkages among the variables under consideration. In this context, two levels of distinction can be identified. On the broader level, there can be a direct and indirect impact on the budget composition, a distinction already introduced in comparing the action of the supranational fiscal rule and the country-specific recommendations in the context of the European Semester. Specifically, a factor has an indirect effect when it defines the budget constraint within which the budget allocations are derived. As such, it contributes directly to determining the overall size of national fiscal policy. At the same time, through its push toward consolidation, it is linked – indirectly – to changes to the allocation for specific budget lines (e.g. health, social spending). Conversely, a factor has a direct effect in impacting the size of a specific slice of public spending, that is to say in shaping the direction and size of the change of the components of the budget, either in affecting a single or multiple budget lines (e.g. social spending or transfers more in general). Along the same line of reasoning, a second distinction can be made across a general or component-specific impact. On the first account, it is indeed possible to have a general but nonetheless direct effect on the budget components. For example, an expenditure rule capping all budget lines to their historical amounts has a direct effect on the size of a budget item rather than an indirect one through the overall size of the budget constraint, while affecting every (or most) budget lines. Such distinctions is valuable in indicating when the casual links between the factor and the shape of fiscal policy have intended or unintended distributional consequences.

Understanding the determinants of budget composition: the domestic factors

Within the national arena, three key domains contribute to determining the budget structure through (i) political, (ii) institutional and (iii) economic factors. Starting from the former, the theoretical framework of veto player theory, applied by Tsebelis and Chang (2004) to the composition of the fiscal policy mix, links the relative position of the former and the status quo to budgetary outcomes with a direct connection between the political environment and the scope for budgetary changes both at aggregate and disaggregate level.

For what concerns the institutional arena, the story is not necessarily the same for the two key factors at play. For decentralisation, in its simplest conception, federalism is linked to budgetary outcomes in determining the extent to which the central government has full control over the budget. Specifically, the share of the budget under the purview of the national government changes from the entirety to a subpart in comparing unitary and decentralised countries. As such, an indirect effect on the budget structure can be associated to decentralisation in determining the overall responsiveness across different components of the budget. In addition, decentralisation may have a direct impact on changes to a given budget line. Specifically, in a federal country sub-nationally delegated budget lines may be shielded from a quest for consolidation at the national level (Forenmy, 2014). On the contrary, in a unitary country, a central government may have an incentive to use its control over the budget to shift the political cost of consolidation toward expenditures at the sub-national level (e.g. Grisorio & Prota, 2015).

Linkages are similarly potentially multiple for fiscal rules. The nature of the causal link between fiscal rules and the budget structure depends on the type of rules at play, often in concomitance. For example, debt and deficit rules may have an indirect effect through a budget constraint, in determining the overall resources to be allocated across the components of the budget. However, that need not to be the case if, for example, certain categories of expenditures such as investments are excluded from the accounting of the deficit, thus shielding some budget items from the indirect constraint of the fiscal rule. On a similar account, expenditure rules may be general - as in the above historical-cap example - or specific to certain budget lines.

In the last domain within the national arena, several - and to some extent interconnected - factors are at play. The key ones to account for in the context of this analysis are the cycle and the two major contributors to budgetary changes, namely the unemployment rate and the old-age dependency rate. The latter two have specific targets within the budgets that they directly affect, namely unemployment expenditures and pensions. However, their impact may also cross-contaminate other budget lines such as in the case of health expenditure for the demographic component or those related to poverty in the case of unemployment. In addition, if the dimension of the fiscal blanket is fixed, pulling it toward those two categories may indirectly leave out in the cold other expenditures. On more general terms, the cycle has an even broader but equally composite impact on the budget structure, alike unemployment with given budget items directly affected through automatic stabilisers and others called into play by the countercyclical stimulus policies enacted by the government. In the economic arena it should be noted that several factors linked to market and fiscal pressure (e.g. deficit and debt to GDP ratios), are generally considered in accounting for national budgetary dynamics. However, under the premises which guide the mechanisms through which EU economic governance affects national spending, such elements are direct factors in the technical and political decisions regarding the EDP. Additionally, the assessment of the domestic economic environment through the EDP may influence substantially the perception of the sustainability of national public finances. That is to say that the pressure to consolidate within the EMU may be greater when EU partners deem a country’s public finances unsustainable by initiating an excessive deficit procedure, than in view of the given deficit-debt circumstances. Conversely, countries may benefit from the EU stamp of approval of their fiscal dynamics even when – for example – holding high stocks of public dept. The exact interplays between political dynamics and actual economic conditions within the Member States – beyond the scope of the analysis – would warrant precise investigation, for example, considering if and why countries in similar position are subjected to EDP or spared from its pressure and enhanced surveillance. However, within the framework considered which hinges on the centrality of the EDP – as further explored in chapter four – the two above-mentioned dimensions are partially accounted in exploring the sensitivity of the analysis to the specific period of highest market duress (e.g. the Eurozone crisis) and geographical dynamics (e.g. differences between the core and periphery).

The emerging picture is that of the concomitance of a broad array of factors both shaping specific budget lines and affecting the composition of the budget indirectly by determining the overall size of public spending. The direct and specific budgetary impact is of key interest especially in relation to those research questions looking at the dynamics across the disaggregate components of the budget rather than its aggregate change. However, even when the impact is indirect it is likely if not even of more value to uncover the less straightforward linkage between the input and budgetary outcome, in considering how a given constraint - or upward push in one budget line - hits at home either due to different elasticities of the budget components or political choice and cost associated to cutting a specific expenditure.

Understanding the determinants of budget composition: the role for the supranational arena

The latter dimension is of particular value in the supranational context given that the core of the SGP is indeed a debt\deficit fiscal rule that determines the national budget constraint. Its impact on the budget structure to that extent can be considered primarily indirect in affecting directly the level of expenditures while translating at national level into the actual allocation decision across the different components.

However, even for the supranational fiscal rule element of the mechanisms at play entail an additional complexity. Firstly, a question arises on whether there is always a similar impact of the supranational budget constraint. In this context, an evident distinction pertains to Eurozone memberships as different provisions within the EU regulatory framework apply to countries within and outside of the Euro area as "participating Member States" and "non-participating ones" (Regulation (EU) No 1175/2011). An additional difference occurs as a function of national budgets. The framework itself distinguishes across compliant and non-compliant countries (Regulation (EU) No 1175/2011;

Council Regulation (EU) No 1177/2011). The formers display a fiscal stance within the parameters of the supranational fiscal rule, thus only subject to preventive surveillance. The latter instead are characterised by an excessive deficit with corrective measured deployed at the supranational level within the EDP procedure to return the country's fiscal position towards a sustainable path. The conceptualisation of the indirect effect of the (supranational) fiscal rule as an EU-derived budget constraint highlights a distinction among the Member States in the two fiscal circumstances. The regulatory framework can hardly be considered to bind countries at all times, but rather it is only for those countries forced to correct their fiscal position that the mechanism of the SGP - or more specifically the EDP - budget constraint is at play.

Along the same line, the strictness of the regulatory framework and its enforcement mechanisms are bound to play a role in affecting in parallel the forces of the supranational-national linkages. The starkest example in the latest wave of reforms is the Fiscal Compact. The enforcement mechanisms change extensively in imposing the translation of supranational commitments into national legislation and specifically preferably constitutional grade balanced budget rules (TSCG, 2012). The impact on the budget structure remains indirect through the determination of the overall size of the pie to be allocated. However, rather than relying on the more indirect blame-and shame mechanisms - in principle with the potential to result in sanctioning - with the implementation of the Fiscal Compact automatic corrective measures within the national legislative framework may even be activated by the risk of non-compliance (TSCG, 2012).

Nevertheless, regardless of the non-trivial nuances emerged, the SGP - and more specifically the EDP - can be considered to impact the budget structure indirectly, by promoting consolidation and hence changes to the budget and its composition. The question remains of whether the SGP – in principle and practice – is blind to the specific components of the budget or rather at least a partial direct effect can be foreseen. The philosophy at the basis of the EMU fiscal policy constraints and coordination offer some insight. The SGP aims to promote sustainable growth-enhancing fiscal behaviour (Regulation (EU) No 1175/2011). In doing so, it makes its own the paradigms within the economic literature associating deficits and debt with a negative growth trajectory (e.g. COM/2015/012 final; European Commission, 2019). Within this context, however, not all public expenditures are thought as equals. Specifically, investment-type spending is linked with a positive contribution to growth and consequently considered productive (European Commission, 2019). On the opposite side of the spectrum, transfers are judged as a hindrance to growth. If the SGP adopts such prospective, those distinctions are translated into policy objectives sensitive to the quality and not just the quantity of public expenditures and assessed accordingly. However, concerning the causal links at play such distinction needs to be accounted for as a direct impact on budget composition only if it is translated into provisions that discriminate across budgetary components. That was not - or very weakly - the case in early iterations of the policy, while reinforced not only in principle but also in law in the latest reform (Heipertz & Verdun, 2010), with Regulation (EU) No 1175/2011 acknowledging explicitly the need to account and leave room for public investment. As such even the SGP itself mixes its main indirect impact with a strengthening over time direct impact on composition in freeing – in principle – investments while keeping the leash tight on transfers.

To further complicate the picture, the soft-law element of fiscal policy coordination, present also in the early stages through the Broad economic policy guidelines (BEPG) was further reinforced with the introduction of the European Semester and its direct - even if weak - coordination of budgetary policy with the submission of draft budgets and reform plans by the Member States and the adoption of Country-Specific recommendations (CSRs) at the supranational level (Regulation (EU) No 1175/2011). Giving direct indications on fiscal policy choices, their impact on the composition of the budget is rather direct. However, conversely to the hard(er) enforcement mechanisms within the EDP procedure, with the stick of sanctioning foreshadowed for non-compliant countries, the guidance of the CSRs is rather soft (e.g. Efstathiou & Wolff, 2018; Savage & Howarth, 2018). In parallel, the political pressure implied by the EDP may be reasonable expected to be more substantial than that derived by failing to comply with the CSRs, especially if it does not translate in a violation of the SGP.

In summary, the nature of the linkages at play between the EU economic governance and the national fiscal policy mix, one may conceive the – weak – guidance of the CSRs as the intended budget structure consequences of the supranational framework, while the fiscal role component acting primarily indirectly through the budget constraint as unintended distributional shifts. With the two effects being extensively entangled, one element of the fiscal governance framework - strictly speaking outside of the purview of the SGP, can shed some light on EU intentionality regarding Member States consolidation efforts: the memorandums concerted between the supranational institutions and countries accessing Financial Assistance Programmes (FAP). As such it may be of use to consider budgetary dynamics of Member States finding themselves in those unfortunate circumstances in highlighting the extent to which emerging indirect patterns are truly unintended or rather confirmed in dealing with countries under considerable economic duress.

Interactions: the potential interplay between the supranational and national dynamics

Supranational dynamics are, however, concomitant in affecting the fiscal policy mix with national factors. The two arenas may interplay reciprocally supporting a given budgetary trajectory or conversely counteracting one another. That is to say that there may be certain domestic configurations more or less conducive to the impact of the SGP. Specifically, national circumstances can be thought of as defining the budgetary space available to the supranational fiscal rule. The opposite reasoning also applies: the bind of the SGP can be a powerful force in limiting the extent to which national pressures are allowed to change domestic fiscal policy accordingly.

For example, if domestic politics determines the extent to which there is scope for changes in the budget structure, under given national political circumstances an SGP-induced consolidation effort may find a favourable ground or conversely crash against the impossibility of enacting substantial changes to the status quo in the Member State. The same reasoning can apply to institutional dynamics, as it was already argued that - for example - a centralised or a federal organisation offer varied room for action of the national government and thus a diverse ability to translate supranational commitments into the appropriate domestic budgetary behaviours. Similarly, within the economic arena demographic or unemployment dynamics may leave little fiscal room for respecting the supranational budget constraint either in general or within specific budget lines. Finally, the SGP is not insensitive to the economic climate. The crisis not only may extensively strain national budgets rendering any consolidation push unfeasible but may likewise change the nature of the supranational constraint itself, as already illustrated. In this context, it may be of particular importance to account for the interplay between the national economic circumstances and EU economic governance.

The emerging picture indicates that it may not be enough to control for national factors in identifying the impact of the SGP. If there is an interplay between the domestic and supranational arena, the impact of the SGP on the budget structure may well change across given circumstances. That is to say that the effect of the supranational fiscal rule may not be homogeneous across the full sample. Conversely, it may vary across sub-samples so that - for example - finding no effect on average may hide a strong effect under some national conditions and none in the remaining cases or even a likely strong but opposite impact. The implications for the research design and the hypothesis to be put forward in the upcoming section are that (i) one must test whether there is indeed an interaction between national factors and the SGP in impacting the budget structure and (ii) the mechanisms illustrated in this section should guide the identification of the configurations - e.g. the sub-samples - for which one may expect a binding effect of the supranational fiscal rule.

3.3 The argument: the research hypotheses

In spelling out the hypotheses in relation to each research question and sub-question, the overarching argument is that the SGP cannot be considered as a monolith in assessing its impact on the Member States through an oversimplified conceptualisation. Rather, its complex nature requires careful analysis in identifying the different mechanisms at play and how they may translate into configurations carrying different implications for the frameworks ability to affect national budget structures. Its complexity is multidimensional, as reflected in the research questions, taking place within the framework itself and its interplay with the domestic environment. Such diversity extends, in the case of the economic climate, to changing the rules of the game of the supranational fiscal surveillance (e.g. through escape clauses).

The research hypotheses aim to guide the analysis through the jungle of the SGP and its domestic interplay. In doing so the hypotheses incorporate - and clearly specify - two levels of expectations: (i) theoretically driven on one side and (ii) policy-driven on the other. While the latter is taken under consideration throughout, they come especially to the rescue when multiple elements - resulting in non-unambiguous overall expectations - concur from a theoretical perspective. That is to say that when several factors and mechanism may render synthetic hypotheses unfeasible, the minimal last resort in guiding the empirical analysis can be the testing of the policy outcomes adherence to its nominal goals. Nonetheless, the minimal take on the hypotheses is the exception rather than the rule, with the complexity addressed, accounted for and tamed whenever feasible.

The multifaceted nature and impact of EU economic governance

In general terms, because of the multifaceted nature of EU economic governance, the first hypothesis expects that its impact changes within the regulatory framework. In this context, an oversimplified conceptualisation of the supranational fiscal coordination framework, based - for example - on the sole membership of the Eurozone, is rejected. Conversely, [RQ1] aims to uncover the specific elements within the EU framework associated with varied strengths of the linkages between the fiscal rule and national budgetary behaviour. The overall hypothesis for the first research question can thus be stated as follows:

> [HP1] *the effect of the SGP on the budget structure varies across components and reforms of the supranational regulatory framework.*

Turning to the specific sub-questions allows to derive narrower expectations in relations to the changes across the elements at play, on the basis of the literature on EU economic governance, read through the lenses of that on budget composition and fiscal rules. For the fiscal rule components of the SGP, a distinction within the legal provisions exist between the preventive and corrective arm of the framework. The first houses by default all Member States, with the second reserved to those found as non-compliant to the prescriptions of the supranational fiscal rule (Art. 126 TFEU). A Council Decision on the existence of an excessive deficit hence triggers the EDP procedure (Council Regulation (EU) No 1177/2011). The implication is a prescribed pathway back toward sustainable fiscal behaviour, hence consolidation (Council Regulation (EU) No 1177/2011). At what consequences for the budget structure? Unless an unlikely perfectly linear cut to spending across all budget lines takes place, pushing domestic fiscal policy down toward the budget constraint imposed by the supranational level will likely result in changes in allocations. Furthermore, if the aims of the SGP are successfully achieved, one would expect some budgetary components (e.g. transfers) to be the primary recipients of the supranational induced spending diet. The takeaways are twofold. On the first account, the supranational budget constraint is not always actively at play in shaping national spending. Specifically, the full bind of the SGP is only felt by those countries trespassing towards unsustainable spending in the eyes of the EU fiscal governance framework. In those instances, a modification of spending behaviour is required by their partners in guiding the country back within the fence of the SGP thresholds. As such the SGP can be expected to impact the budget structure primarily for countries under the EDP. On the second account, when it does have an impact on national budgets in negatively affecting total spending one can expect a positive effect on changes to the budget structure. The related hypothesis for the first sub-question can be formulated as follows:

> [HP1.A] *EDP surveillance leads to consolidation-driven higher structural changes in national budgets.*

Moving on to the second element, a parallel reasoning should be extended to the iteration of the SGP regulatory framework as the history of the EU economic governance infrastructure – however short – has already proved troubled. Two breaking points are unambiguously identified in the literature within the timeframe under consideration, with both crises translating into policy reform. While the core of the EMU asymmetric architecture has received substantial criticisms since its onset, to this day never extensively addressed, the specifics of the fiscal coordination infrastructure have been reformed twice in attempting to compensate for the emerged shortcomings. However, the regulatory evolution has not been unidirectional. In the aftermath of the first existential crisis of the SGP proving unenforceable through its de-facto suspension when attempting to come for the big and powerful Member States (Heipertz & Verdun, 2010), the 2005 reform further weakened and rendered more flexible and already mild regulatory framework. Within the purposes of the second sub-question, the extent to which the SGP impacts the national fiscal policy mix can be expected to be reduced from the first to the second iteration of the EU economic governance framework. The opposite is the case in response to the second existential crisis of the SGP with the Great Recession and Eurozone crisis, under the pressure of regaining credibility of the failed framework (e.g. Creel et al., 2012; Tsebelis & Hahm, 2014; Schimmelfennig, 2015). On one side the credibility defence required to prove the infrastructure could work through a crisis through its built-in flexibility, with the commitment to never again resort to a tout-court suspension. On the other, the offence required a strengthening of the surveillance and enforcement mechanisms to credibly exclude future unsanctioned perpetrations of violations of the spirit and the code of the SGP. The ensued reform, while leaving unaddressed many of the shortcomings of the architecture, was far from marginal. Not only was the supranational fiscal rule regulatory framework reinforced through the two-pack and six-pack but a game-changing reform was introduced for national enforcement through the Fiscal compact (Franchino & Mariotto, 2020). The result is an infrastructure that more than reverses the weakening in its second phase strengthened also in comparison to its introductory form. In parallel, the effect of the SGP on the national fiscal policy mix can be expected to be more substantial in its third version in comparison to the former two. At the same time, the hardship of the Eurozone crisis which drove the strengthening of the SGP framework, can likewise be expected to increase along with the procedural invasiveness the political pressure associated with the EDP, the key mechanisms through which supranational surveillance may impact domestic spending and its composition. Consequently, if at all present, the impact of the EDP is expected to be the weakest in phase two, followed by phase one with phase three on the top step of the podium. The related hypothesis for the second sub-question can be formulated as follows:

> [HP1.B] *the impact of EDP surveillance on the composition of national budgets substantially increases with the 2011 reform of the SGP*

The third element within [RQ1] is less suitable for straightforward expectations on the impact of the soft-side of the EU economic governance framework of the national fiscal policy mix. However, some guiding questions can aid in formulating some general expectation in this regard, especially in considering the relation with the fiscal rule side of the framework. The most basic element is if an effect should at all be expected, with some positive confirmations (e.g. Deroose & Griesse, 2014; Guardiancich & Guidi, 2020). In this context, CSRs have been shown to play an important role in translate problematic national circumstances into reforms in the context of pensions Guardiancich & Guidi, 2020). The second point concerns the scope for the impact of the European

Semester. In line with the overall approach, what can be expected for the interplay between the Semester and the supranational fiscal rule? Specifically, the question arises of whether an impact is to be expected under the full domain of the SGP, or rather only for countries subject to the EDP. On nominal terms, the policy goals aim for a comprehensive effect on the budgetary choices of the Member States, unconditioned to their overall fiscal position (European Commission, 2019). However, in the absence of hard enforcement mechanisms within the Semester, its guidance can be argued to have more bite in countries under the scrutiny and potential for sanctioning of the EDP. To further complicate the picture, in the latter circumstances - for countries found in excessive deficit - the hard and soft sides of the SGP work in concomitance. With difficulties in disentangling the two, those may be conceived as having intended direct (the Semester) and unintended indirect (the EDP) domestic budgetary consequences. In this context, for the policy to fulfil its purpose, while tangled together the two faces of the EU economic governance framework should be aligned, so that consolidation efforts should follow the CSRs for the Member State under consideration. Indeed it is of value to assess if the impact on spending composition enacted by the EDP is compatible with CSRs reform prescriptions. Empirically, there is limited scope for reference as – partially in view the EDP generally regarded as ineffective – the interplay between different element of the EMU architecture is hardly considered in investigating CSRs and their implications. From a theoretical perspective, the difference in force of the two components of the policy backs the EDP, so that any conflict between the two can be hardly expected to be resolved in favour of the CSRs. At the same time, for the two policies pull budgetary dynamics toward contrasting direction would amount to a policy failure. The derived hypothesis reflect the policy aims in testing how they fare in reality, formulated as follows:

> [HP1.C] *the impact of EDP surveillance on national budget structures is congruent with the CSRs.*

A cycle-appropriate supranational budget constraint?

Shifting to the second research question moves expectations back to a more straightforward dimension. In fact, in looking at fiscal dynamics in times of crisis the contribution of the supranational budget constraint should not be of binding nature. On one hand, this is the case because of the built-in escape clauses in the SGP and EDP procedure that account for the negative cycle (Council Regulation (EU) No 1177/2011). Not only is the judgment of countries fiscal position more generous in the presence of a deep economic downturn but also the punishment for infringement is fundamentally less severe, in excluding sanctioning under such circumstances (Council Regulation (EU) No 1177/2011). On the other hand, also the prescribed policy objective varies in a recession in expecting counter-cyclical fiscal policies at domestic level (e.g.

Creel & Saraceno, 2010; Tomann, 2017; Tóth, 2019) coherently with the stabilisation goal of the SGP (European Commission, 2019). Accordingly, the general hypothesis for [RQ.2] can be formulated as follows:

> [HP2] *the SGP does not change the budget structure and induce consolidation during the Great Recession and Eurozone crisis.*

At the aggregate level, the translation into the hypothesis for the first sub-question is rather direct, in largely aligning with the overall [RQ2] hypothesis. However, the implications are not unremarkable as a hefty proportion of the political and policy criticism to the EU economic governance framework is indeed linked to its pro-cyclical nature (e.g. Ayuso-i-Casals et al., 2009; Creel & Saraceno, 2010; Heins & De La Porte, 2016; Kuusi, 2017; Larch et al., 2010; Tomann, 2017; Wyplosz, 2016). The SGP shortcoming most closely associated with the rise of Euroscepticism has to some extent found empirical backing in the literature (e.g. Armingeon et al., 2016; Baerg & Hallerberg, 2016; Daniele & Geys, 2015; Wyplosz, 2017). In this context, the analysis allows for a fine-grained assessment of the extent to which a contradiction between policy objective and reality application emerges. Additionally, if the hypothesis holds, the importance of procedural and political pressures rather than the sole risk of sanctioning – not in play during the severe downturns – is indeed reinforced. Starting from the aggregate level, the related hypothesis for the first sub-question can be formulated as follows:

> [HP2.A] *the SGP contravenes its countercyclical policy objectives in enforcing consolidation in times of crisis.*

Going beyond the aggregate level, once again policy objectives and emerged criticism can offer guidance in deriving the hypotheses to put to test. Policy-wise, the context of the crisis offers some indication of the allocation shifts deemed optimal in a recession. In principle, the SGP explicitly adheres to the economic philosophy of promoting growth-enhancing investment and limiting growth-hindering transfers (European Commission, 2019). The importance of the former is considered to be key in an economic downturn and recovery (Jeong et al., 2019). Hence, the expectation for the SGP not to interfere with the functioning of stabilisers is paired with a positive impact on an investment-rich fiscal stimulus. From this perspective, expectations at the general subcomponent level of investment and transfer can cascade onto the underlying individual budget lines within each. Conversely, focusing on the criticism, a non-negligible and inconsequential claim links the SGP to social butchery especially during the Great Recession and the Eurozone crisis. Within this line of reasoning, social expenditures and more in general welfare and inequality addressing policies were the primary casualties of the supranational fiscal rule during this social and economic critical juncture (Heins & De la Porte, 2015). In capturing and testing both dimensions at the disaggregate level, while leaving social spending for [RQ2.C], the overarching hypothesis for the second sub-question can be formulated as follows:

> [HP2.B] *the SGP-at-crisis in pushing toward an investment rich response to the recession came at the expenses of transfers and inequality mitigating expenditures.*

Under such premises, especially because of its broader social and political implications, the third sub-question assumes a key value. Expectations on the specific dimension of social spending are contradictory on a theoretical and empirical account. As already briefly illustrated above, in theory, the SGP makes no explicit - and likely politically unsustainable - claim of targeting social spending in the negative phase of the cycle. Rather, coherently with its stabilisation objectives, exceptional circumstances should allow for an ample room of manoeuvre for national governments in facing a deep recession (European Commission, 2019). However, the theory appears at face value well falsified by practice, taking the extreme but somehow telling example of the Greek crisis (Featherstone, 2011), which can with some rescaling be generalised to countries steering clear of emergency mechanisms (e.g. Ayuso-i-Casals et al., 2009; Creel & Saraceno, 2010; Heins & De La Porte, 2015; Kuusi, 2017; Larch et al., 2010; Tomann, 2017; Wyplosz, 2016). Condensing the two elements, the related hypothesis for the third sub-question can be formulated as follows:

> [HP2.C] *the SGP-at-crisis furthered the social cost of the recession by negatively impacting social spending dynamics.*

SGP-conducive domestic environments

Building on the mechanisms guiding national determinants of the budget structure and expectations at the supranational level, the third hypothesis concerns the interplay between the two arenas. In general terms, if factors at Member State level affect the scope for change in the budget structure, it is not a substantial leap to argue that the extent to which the supranational fiscal room can shape the fiscal policy mix may be affected. The same reasoning applies in the opposite direction. A binding supranational budget constraint determines the room of manoeuvre at the national level in shaping the budget composition from the given overall fiscal pie. Consequently, broadly, one can formulate the third hypothesis as follows:

> [HP.3] *the impact of EDP surveillance is greater for national political, institutional and economic configurations favourable for fiscal consolidation.*

That is two say that the interaction effect yields both a diversified strength of the supranational fiscal rule across national budget determinants and conversely the SGP changes the extent to which domestic factors are free to shape the national budget.

The argument seems especially robust for the political arena. In this context, Tsebelis and Chang (2004) key political determinants of budgetary choices can be seen as defining the extent to which there is scope for changes in the spending allocation in a Member State. When substantial change is politically feasible it may be easier to enact the SGP prescribed (consolidation) adjustment than when the characteristic of the government coalition and respective positions render any change hardly impossible. Conversely, coalitions that would not be predicted to produce any change at all to the budget may be 'forced' into seemingly unexpected budget shifts in the face of an EDP procedure and threat of sanctioning. Focusing primarily on changes in the impact of the SGP, the hypothesis for the first sub-question can be formulated as follows:

> [HP3.A] *the effect of the Pact on the budget structure is larger for government coalition characteristics (e.g. low ideological distance, high alternation) more conducive to changes in the budget structure.*

The parallel argument, adapted to the specific context, easily applies across all national factors considered in the analysis. In the institutional arena, similarly, there may be configurations heterogeneously conducive to budgetary changes. This is the case, for example, considering decentralisation. In highly centralised countries, control over the vast majority of the budget allocation, at least at a broad level, remains firmly in the hands and control of the central government (Rodden & Wibbels, 2010). Conversely, federal countries devote substantial budgetary powers – especially in certain components of the budget – to the subnational level weakening the grip of the government on budget composition. The interplay with the EU economic governance framework then is twofold, on one side decentralisation determining the overall ease of transmission of the supranational fiscal rule commitments and on the other also yielding differences in the categories most likely to be cut or shielded at the indirect hands of the SGP. Similar but not perfectly overlapping reasoning applies to another key institutional element – that of national fiscal rules. This domain poses the most considerable challenges in terms of research design to disentangle the contribution of the two levels of fiscal rules. Leaving the solution to the methodological approach, however, expectations in regard to the national-supranational interplay are not univocal. On one side, strong national fiscal rules may facilitate the transmission of the SGP acting as a sort of enforcement mechanism for the supranational budget constraint. On the other, strong national fiscal rules may facilitate the containment of national fiscal policy so much that they render the SGP fully unnecessary and irrelevant to their budget structure.

With this caveat of the double-sided argument concerning fiscal rules, one can derive a general hypothesis capturing overall the national institutional arena, formulated as follows:

> [HP3.B] *the effect of the Pact on the budget structure is larger if domestic institutional configurations are more conducive to fiscal consolidation.*

A necessary disclaimer applies to this hypothesis of relevance also for the economic arena. It is indeed of use to devise a general formulation that may capture the entire domain at the national level in giving a synthetic assessment of the domestic and supranational interplay. However, the general formulation of [HP3.B] requires careful ulterior specification into the features of each factor under consideration in the context of the empirical analysis to then, in turn, come back to an overall assessment of the hypothesis above.

Multidimensionality is even more relevant in the last arena capturing the main economic factors at play at the national level. Even the most extreme restraint in selecting the key variables to be accounted for requires three diverse and partially interlinked factors. Specifically, they are the two main contributors to changes in the budget structure – old-age dependency rate and unemployment. Additionally, linked to the latter, there is the element of the economic climate. Considering the recession and not the specific fiscal or debt circumstances of the Member States, as anticipated earlier, maintains the focus on changes to the working of the supranational fiscal framework. Nevertheless, their heterogeneity across severity of the crisis with parallels with fiscal and debt circumstances are considered when distinguishing across geographical fault lines between the core and periphery. Under such premises, similar reasoning applies in the interplay of economic determinants with the supranational arena. National factors exert pressure on the domestic budget, oftern directed on specific categories, eitherer lead to sharp restructuring to maintain the same expenditure level or an overall expansion of spending. That pressure runs against an opposite consolidation push for the containment of fiscal policy from the supranational level. Such claim also applies to the economic climate, coherently with an escape clause sparing consolidation in the negative phase of the cycle. If the Pact is indeed aligned with its policy objective of promoting a growth-enhancing recovery, its pressure on the budget structure favouring investments rather than transfers runs counter to the national one in times of crisis. The implication for the Pact is opposite domestic forces may hinder the scope for the impact of the EU economic governance framework on the budget structure. With the caveat put forward for institutional factors in mind, the hypothesis for the third sub-question can in general terms be formulated as follows:

> [HP3.C] *the effect of the Pact on the budget structure is smaller when running against opposing domestic economic conditions.*

Conclusions

The primary outcomes of this chapter are theoretically and empirically grounded research hypotheses that do not fail the complexity of the domain under investigation but rather fully embrace it identifying and accounting for the multifaceted and concomitant mechanisms at play.

The starting point for the chapter is the framing of the specific research questions derived from previous findings and gaps in the relevant literature. The result is a threefold focus of the research on the (i) complexity and multidimensionality within the EU economic governance architecture itself, (ii) the specificities of the dynamics during times of crisis and (iii) the interplay across the national and supranational determinants of the budget structure. The consequent framing and scoping of the analysis is well suited to overcome the problematic oversimplification that may fail to capture the impact of the SGP in depicting average effects hiding divergent trends across overlooked factors and sub-samples. At the same time, the research objectives as spelt out in the specific questions and sub-questions allow on one hand to contribute to outstanding puzzles while on the other shedding some light on dimensions that are either pertaining to the main criticisms to the SGP and EMU architecture more in general or carry weighty broader societal implications. An example is the attention given to crisis years and within this timeframe both to the effectiveness of the policy against its nominal objectives together with the resulting social outcomes.

The ensued in-depth assessment highlights the different causal mechanisms that link the supranational and national arena in determining the domestic fiscal policy mix. Such mapping is essential to the formulation of appropriate hypotheses but is also of high importance for uncovering some of the potential methodological challenges to be addressed by the research design. Three key levels of distinctions can arise concerning the mechanisms at play. Firstly, the main divergence in the effect of the SGP on the composition of public expenditures pertains to whether the impact is indirect or direct and in the latter case across factors with broad or specific budgetary implications. A consequent consideration in respect to the previous distinction relates to deriving whether the EU-MS linkages can be classified as intended or unintended consequences of the supranational governance framework. Such element is of value in concomitance with the assessment of the extent to which – across various dimensions – the EU economic governance framework fulfils its nominal policy goals. Specifically, whenever feasible, one can then distinguish across whether the failure toward nominal goals is deliberate or the accidental result of flawed regulatory design and institutional arrangements.

The selected hypotheses bring the analysis into three distinct directions of prominent academic and policy interest. At the same time, the three areas of investigation are complementary in contributing their specific perspective in understanding the EU-MS fiscal puzzle. Together they feed into an overall coherent and comprehensive assessment of the framework, its weaknesses and the implications for future reform. The three areas, in parallel with the research questions, allow for the unveiling of the configurations that are more conducive to a substantial effect of the SGP on national budget composition across the domain of (i) variations within the EU economic governance architecture, (ii) distinctions in the SGP-in-crisis and (iii) interaction with factors within the domestic arena. Specifically, starting from the first domain, the analysis tests variation in the impact as a function of the regulatory framework uncovering when the SGP actually binds national governments and how the direct and indirect effect on national budgets shifts across mechanisms and over time, through the general hypothesis and three specific sub-hypotheses depicted in Table 3. 1 - Synthetic overview of the hypotheses below. On the second account, considering the specificity of crisis dynamics overall and in key budgetary components of interest allows for testing whether the counter-cyclical policy objective of the SGP is fulfilled. Finally, the last domain brings the analysis towards the interplay between the national and supranational arena testing the cross-contamination of the two levels in jointly contributing to determining the fiscal policy mix, with the aim of identifying when the country level reality clashes against the supranational fiscal rule or conversely aids it.

Table 3. 1 - Synthetic overview of the hypotheses

[HP1] *the effect of the SGP on the budget structure varies across components and reforms of the supranational regulatory framework.*
[HP1.A] *EDP surveillance leads to consolidation-driven higher structural changes in national budgets.*
[HP1.B] *the impact of EDP surveillance on the composition of national budgets substantially increases with the 2011 reform of the SGP.*
[HP1.C] *the impact of EDP surveillance on national budget structures is congruent with the CSRs.*
[HP2] *the SGP does not change the budget structure and induce consolidation during the Great Recession and Eurozone crisis.*
[HP2.A] *the SGP contravenes its countercyclical policy objectives in enforcing consolidation in times of crisis.*
[HP2.B] *the SGP-at-crisis in pushing toward an investment-rich response to the recession came at the expenses of transfers and inequality associated expenditures.*
[HP2.C] *the SGP-at-crisis furthered the social cost of the recession by negatively impacting social spending dynamics.*
[HP.3] *the impact of EDP surveillance is greater for national political, institutional and economic configurations favourable for fiscal consolidation.*
[HP3.A] *the effect of the Pact on the budget structure is larger for government coalition characteristics (e.g. low ideological distance, high alternation) more conducive to changes in*
[HP3.B] *the effect of the Pact on the budget structure is larger if domestic institutional configurations are more conducive to fiscal consolidation.*
[RP3.C] *the effect of the Pact on the budget structure is smaller when running against opposing domestic economic conditions.*

4. Methodological approach and research design

This chapter sets the foundation for the empirical analyses by devising an approach on par with the complexities and challenges outlined in chapter two and three. In doing so it accounts for the dependent and independent variables along with the intricate ecosystem in which national and supranational factors coexist and interact in determining the fiscal policy mix. The methodological approach addresses: (i) how supranational commitments translate the budget constraint into changes in the composition of national public expenditures; and (ii) how different configurations of EU economic governance and domestic factors are more or less conducive to impacting the fiscal policy mix.

Starting from a brief overview of the research design and methodological challenges the chapter proceeds to present a conceptualisation and operationalisation of the dependent and independent variables, across all the configurations necessary in addressing the research questions, as well as the domestic factors within the political, institutional and economic arena. The section highlight how available information on the budget structure of the Member States allows for disaggregation of the dependent variable at the level of broad components and detailed budget lines. In addition, it considers how to conceptualise meaningful macros-subcomponents of public spending conducive to assessing specific policy objectives (e.g. concerning favouring investment-rich public spending) or broader societal implications in the economic, political and social arena. The derived operationalisation of the dependent variable is presented at the synthetic, disaggregated and macro-subcomponent level.

Shifting the focus toward the independent variable(s), the second section builds on the intricate nature of EU economic governance presented in chapter two. The derived conceptualisation of the variable(s) matches the multidimensionality of the supranational framework. Additionally, it allows for the multifaceted analysis under RQ[1] dedicated to uncovering when and how the Pacts affects national budget structures. In line with the two pathways through which the supranational governance affects the national budget structure, directly and indirectly, a first distinction is made across EU economic governance as fiscal rules - the core focus of the analysis - and beyond the supranational budget constraint in the context of the policy-orienting European Semester. Within the first arena, the independent variables further account for components and iteration of the Stability and Growth Pact. Additionally, the section navigates the interconnection between the Pact and the European Semester's Country Specific Recommendations (CSRs). On such basis, the independent variable(s) are operationalised in their fiscal rule dimension -

relevant throughout the analysis - while the methodological approach specific to RQ[1.C] (on the congruencies between the Pact and the CSRs) is briefly presented in illustrating the interplay between the Pact and the Semester.

Section four proceeds with the conceptualisation and operationalisation of the key domestic factors impacting the most on the budget structure and potentially on the transmission of supranational constraints on national fiscal choices. The section distinguishes across the three political, institutional and economic arenas addressing the factors highlighted in the literature and already introduced in the research framework in the context of chapter three. Specifically, on the political front, the coalition government is accounted for across its ideological positioning, the coalition range and the alternation across consecutive cabinets. Institutionally, both decentralisation and fiscal rules are considered, the latter representing one of the key methodological challenges in disentangling the domestic and supranational component. Finally, in the economic arena, the economic climate is considered together with the two variables accounting for a large majority of budgetary dynamics: demography and unemployment.

Finally, section five presents methodological choices for the data analysis, both overall and concerning three specific dimensions: the multifaceted nature EU economic governance, the crisis, and the interplay between the national and supranational arena, broadly reflecting the focus of the three research questions at hand. On the first account, a comprehensive overview of the components of EU economic governance is presented, together with the assessment of which mechanisms within the framework – namely Financial Assistance – could confound the analysis. Concerning the crisis, section five presents how the dynamics of the dependent and independent variables across the cycle reinforce and justify devoting a specific and separate analysis to the period of the Great Recession and Eurozone crisis. Finally, a brief account of the methodological approach towards considering the interplay between the national and supranational arena is presented before drawing some conclusions and setting the scene for the analytical chapters to follow.

4.1 Research design

The methodological approach builds on the research hypotheses situated in the broader context of the intersection between the fields of (national) fiscal policy and fiscal rules at both the domestic and EU level. The EU economic governance infrastructure is inherently complex in its evolution over time and interplay with the domestic arena. In parallel, the research design accounts for a multitude of challenges in coverage across space, time and scope, along with the conceptualisation and operationalisation of the variables of interest. From such premises, this section presents the rationale for the overall approach before delving into a detailed account of the variable choices and the models.

The space, time and scope of the analysis

Starting from coverage, the previous chapters have highlighted several elements of relevance for the analysis of EU economic governance. Firstly, the regulatory framework varies over time and across membership status to the Union, the Eurozone and the Fiscal Compact. Additional heterogeneity may characterise subsets of Member States, both along the East-West divide and especially across the core and periphery. Such distinction may be particularly crucial in the context of the Great Recession and Eurozone crisis (e.g. Lin & Treichel, 2012; Censolo & Colombo, 2016; Matthijs, 2017; Howarth & Verdun, 2020) and carried forward in its aftermath with long-lasting consequences for national public budgets. From this perspective, an additional element of complexity relates to countries – such as Greece – experiencing extreme economic duress especially in the period of the Great Recession. Because of such heterogeneity, coverage of different circumstances is essential for a fully-fledged assessment of the national impact of EU economic governance. That is to say coverage of the countries of the EU28 throughout their process of joining the Union and the Eurozone. At the same time, the analysis needs to account for – or segment across – membership status and access to programmes addressing economic duress and/or when appropriate distinguish across regional groups.

Moving from space to time, two key elements have been highlighted so far: (i) the evolution of the governance architecture over time (ii) the specificity of the crisis years. Alike for the first dimension, time dynamics suggest on one side the broadest coverage – in this context amounting to the 1995-2018 period – while on the other likewise reiterate the importance of accounting for differences across years subject to subsequent iterations of the governance framework or special circumstances such as the crisis. Within this arena, the specificity of the period of the Great Recession and Eurozone crisis has emerged markedly in the literature (e.g. Creel et al., 2013; Bellamy & Weale, 2015; Armingeon & Cranmer, 2016; Aldama, 2017; de Quadros & Sidjanski, 2017; Crum & Merlo, 2020) as reflected by the research hypothesis. Hence, it may not be sufficient to control for the crisis but rather preferable to conduct a separate accounting of crisis dynamics.

The dimension of scope well captures the multitude of factors at play in shaping domestic spending, together with the interdependence that may occur among different arenas and in the context of the research questions at hand in particular across the national and supranational level. Within such complexity, the approach and analytical framework need to account for three dimensions:

(i) the intricacy in the EU economic governance infrastructure itself, (ii) the (many) variegated political, institutional and economic factors shaping the composition of public spending domestically and (iii) the interplay between the two levels and specifically how national determinants alter – facilitating or hindering – the impact of the supranational fiscal framework on the budget structure.

The research design and its limitations

Given such objectives and prescriptions, the design adopts a quantitative comparative approach in explaining the causal connections between EU economic governance - in particular for its most binding dimension - and national budgetary outcomes in terms of public expenditures composition. The analysis is carried out on a (balanced) panel capturing the 28 countries over 24 years, for a total of 672 observations. Leaving the details of the variables to the specific sections to follow, the datasets consist of secondary data and its elaboration across seven databases. National political variables require the matching of data across two sources extensively reworked to convert information on cabinets and their composition into the yearly characterisation of countries' governing coalitions. Furthermore, disentangling the interplay between the domestic and supranational attribution of institutional factors for fiscal rules requires an ad-hoc conceptualisation and operationalisation building from secondary data. In addition, the dataset is further completed by membership and status variables derived from the analysis of EU official documents, which include the account of the supranational fiscal rule beyond the regulatory framework the country is subjected to considering the specificity of being under the scrutiny of the excessive deficit procedure, at the core of the analysis representing an innovation for the approach within the field.

Such an approach is consistently employed throughout all four empirical chapters and in the analysis of all research questions. It should, however, be noted that the comprehensive quantitative analysis is complemented by a case study approach in the context of [HP.1.C] looking at the congruence between the fiscal rule dimension of EU economic governance and the fiscal coordination within the European Semester embodied by Country-Specific recommendations. The approach, while keeping with a quantitative assessment of the distributional impact of fiscal rules on spending, allows for a richer (qualitative) capturing of the intended direction for spending composition indicated by the Council. Specifically, while remaining within the appropriate ambition within the broader context of the research at hand, the approach allows for accounting, for example, for the nuances of recommendations without the over-simplification of an unsophisticated keyword analysis covering the full sample.

Overall, as further detailed in the methodological choices specific to the variables and model, the approach allows for the accounting of confounding factors both within the national and supranational arena, as well as their interaction. At the same time, the most problematic element in this domain - the crisis years - is both accounted for within the analysis and devoted specific attention in an ad-hoc setting, at the same time considering the impact of the supranational fiscal rule also strictly outside of such period. Such approach along with the nuanced analysis across the multifaceted dimensions of EU governance and its interplay with domestic factors, including the assessment of potential divergences within the Union not only across Eurozone membership but also – for example – across geographic areas, bodes well for the validity of results. General findings are at the same time robust to the specificities of the many focuses carried out in addressing the three key research questions and sub-questions while allowing to uncover the configurations for which there is an impact of the EU economic governance framework on national fiscal policy choices.

On the other hand, limitations do arise across several dimensions. Firstly, the focus of the analysis is that of EU economic governance as a fiscal rule, with limited scope for exploring the role of the Semester beyond its alignment with the effect of the Pact in the context of [HP.1.C], which is itself limited to the case study of CSRs across some Member States. Additionally, the richness of complexity within the national and supranational arena poses some challenges in the extent to which specific dynamics can be assessed. As highlighted in the context of the assessment of specific research questions, panel splits are not always possible given the characteristics of the data. In fact, out of the 672 observations very few may remain, for example, if singling out the latest phase of economic governance during the crisis, which would only amount to 2012 data. In addition, while the panel itself is balanced, the same is not necessarily the case for indicator variables, as, for example, permanence within the excessive deficit procedure is limited in the early years of the Pact.

Challenges also arise in the domestic arena. Firstly, a conservative approach - in line with previous analyses (e.g. Tsebelis & Chang, 2004) is taken in accounting for domestic factors focusing on (i) the main determinants of national spending across the three arenas and (ii) variables that correlate and interplay with the EU fiscal rule whose exclusion would run the high risk of biasing results. Such an approach does not amount to capturing the full richness of dynamics at play at the national level, which are also problematic to control away in the context of variables stable within countries over time. At the same time, some national variables are problematic per se (e.g. in the political domain), especially in comparisons across the full sample of Western and Central and Eastern European Member States. The young democracies in Central and Eastern Europe may indeed be characterised by distinct interplays between political and budgetary dynamics, which per se yield to different budgetary effects, for example, of government ideologies or range, escaping the more clear-cut theoretical expectations which may apply to their Western counterparts.

Furthermore, two elements not directly considered in the analysis may warrant further justification. As anticipated in chapter three, the framing of EU economic governance – through EDP surveillance – as a political and procedural cost for Member States, pressuring delinquent countries to redress their national spending (which is tested throughout the analysis), implies a primacy of the assessment by partners within the EMU over the actual fiscal circumstances at play. From such a perspective, being subjected to EDP surveillance may be conceived as a powerful signal of the assessment of fiscal unsustainability by European partners. Conversely, if – even under similar fiscal circumstances – mitigating factors are accepted under the EMU supranational surveillance, the resulting message is one of sustainability of public finances. Under such premises, variable as the size of the deficit and the debt stock – which do factor into the assessment of the EDP – can be easily expected to have limited influence per se, compared to the strong political signal of the EDP. Nevertheless, these factors are to some extent considered indirectly in the analysis through geographical heterogeneities across the core and periphery, which largely overlap with countries running the highest deficits and holding the most sizable debt stock in relation to GDP. A similar reasoning may apply to other forces at play, such as, for example, market pressure. Without discounting the troublesome period of the Eurozone crisis, the EMU and common currency especially within the Euro area reduces the "disciplinary effect of financial markets" against governments' fiscal profligacy (Heipertz and Verdun, 2010, p. 73). Such dynamics are the primary justification for the SGP (Beetsma, 1999), entrusted to take over in providing the necessary incentives for discipline for market forces which – especially in the early years of the EMU ahead of the financial crisis – did hardly account for national dynamics within the Eurozone (Heipertz and Verdun, 2010). Against such backdrop, the EDP, especially in the earlier period, can be reasonably argued as the most relevant force at play. While such view may be more controversial in later years, especially given the concentration of the impact of the SGP in times of crisis, several elements support that results are not driven by such exclusion. Firstly, the in-crisis effect itself is robust to sensitivity analysis distinguishing between the early phase (Great Recession) and later years (concomitant with the sovereign debt crisis and the highest pressure from market forces). Indeed results emerge in the early years of the crisis as well. Finally, the SGP plays an important role also in the post-crisis phase, reinforced by the Fiscal Compact, which reflects a strengthened commitment to fiscal discipline and a stronger political and procedural cost from delinquency.

4.2 The dependent variable

The section outlines how to account for and operationalise the dependent variable at the different levels of aggregation called for by the research questions, starting from the available international data sources and standards. In doing so it offers an overview of available information and how to translate it into a (i) synthetic aggregate indicator of change to the budget structure, (ii) component level information at different levels of disaggregation and (iii) a typology of public expenditures capturing groupings of spending associated with both the Pact policy objectives and broader societal implications. On such basis, the operationalisation of the dependent variables is provided, together with some preliminary descriptive statistics in areas of interest for the research approach.

Conceptualising the budget structure: the components of public expenditures

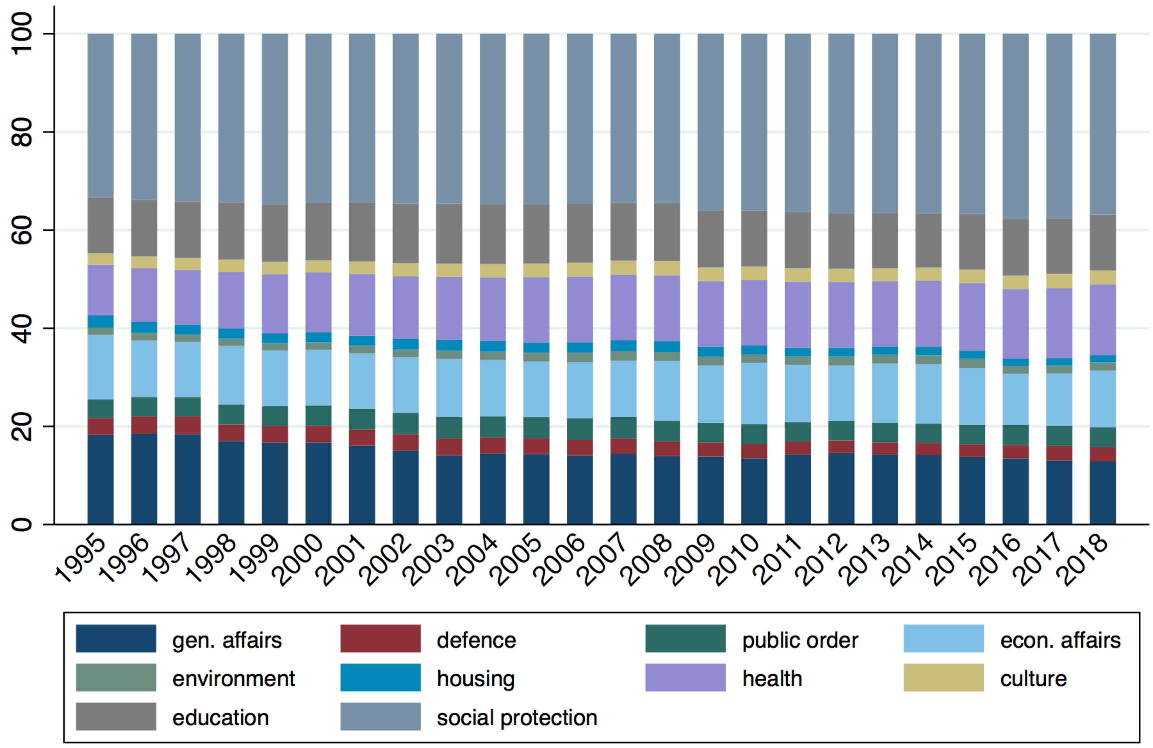
The composition of public expenditures follows the international standard of the Classification of the functions of government (COFOG) developed in its current version in 1999 (Eurostat, 2019a). The data is available in nominal terms (in the national currency) or as the percentage of GDP, allowing for more straightforward cross-country comparison. Additionally, information is available on the all-inclusive 'general government expenditures' category as well as distinguishing across expenditures of the central government and sub-national levels, nominally state and local governments, as well as social security funds. Level-disaggregated data is linked to the extent to which spending is delegated to subnational entities. Hence patterns may vary substantially, while the general variable reflecting overall dynamics – selected for the analysis – provides enhanced consistency. Allocations and their evolution vary substantially across the Member States both for overall size and composition. The classification distinguishes across two different levels [1] 10 divisions, referring to the breakdown according to broad objectives and [2] 69 groups, referring to the breakdown according to means by which objectives are achieved, shown in Table 4. 1 below (Eurostat, 2019a).

Table 4. 1 - COFOG divisions and groups

Government broad objective (division)	Sub-items (groups)
General public services (GF01)	Executive and legislative organs, financial and fiscal affairs, external affairs; foreign economic aid; general services; basic research; R&D related to general public services; general public services n.e.c.; public debt transactions, transfers of a general character between different levels of government.
Defence (GF02)	Military defence; civil defence; foreign military aid, R&D related to defence; defence n.e.c.
Public order and safety (GF03)	Police services; fire-protection services; law courts; prisons; R&D related to public order and safety; public order and safety n.e.c.
Economic affairs (GF04)	General economic, commercial and labour affairs; agriculture, forestry; fishing and hunting; fuel and energy; mining, manufacturing and construction; transport; communication; other industries, R&D related to economic affairs; economic affairs n.e.c.
Environmental protection (GF05)	Waste management; water waste management; pollution abatement; protection of biodiversity and landscape; R&D related to environmental protection.
Housing and community amenities (GF06)	Housing development; community development; water supply; street lighting; R&D related to housing and community amenities; housing and community amenities n.e.c.
Health (GF07)	Medical products, appliances and equipment; outpatient services; hospital services; public health services; R&D related to health; health n.e.c.
Recreation, culture and religion (GF08)	Recreational and sporting services; cultural services; broadcasting and publishing services; religious and other community services, R&D related to recreation, culture and religion; recreation; culture and religion n.e.c.
Education (GF09)	Pre-primary, primary, secondary and tertiary education, post-secondary non-tertiary education, education non-definable by level, subsidiary services to education, R&D; n.e.c.
Social protection (GF10)	Sickness and disability; old age; survivors; family and children; unemployment; housing; R&D; social protection and social exclusion n.e.c.

The breakdown into level 2 is not homogeneously available over the full sample as for 13 countries group level coverage only starts from 2001 (for two in 2000). Only for Croatia data is unavailable in the earlier series (pre-2001) also at the group level. Data availability limits the analysis to division level disaggregation – which is the primary choice in earlier accounts of the political drivers of the budget structure (Tsebelis & Chang, 2004) – when covering the full life of the Economic and Monetary Union, while further detail may be deployed when focuses on more recent years (including those of the crisis).

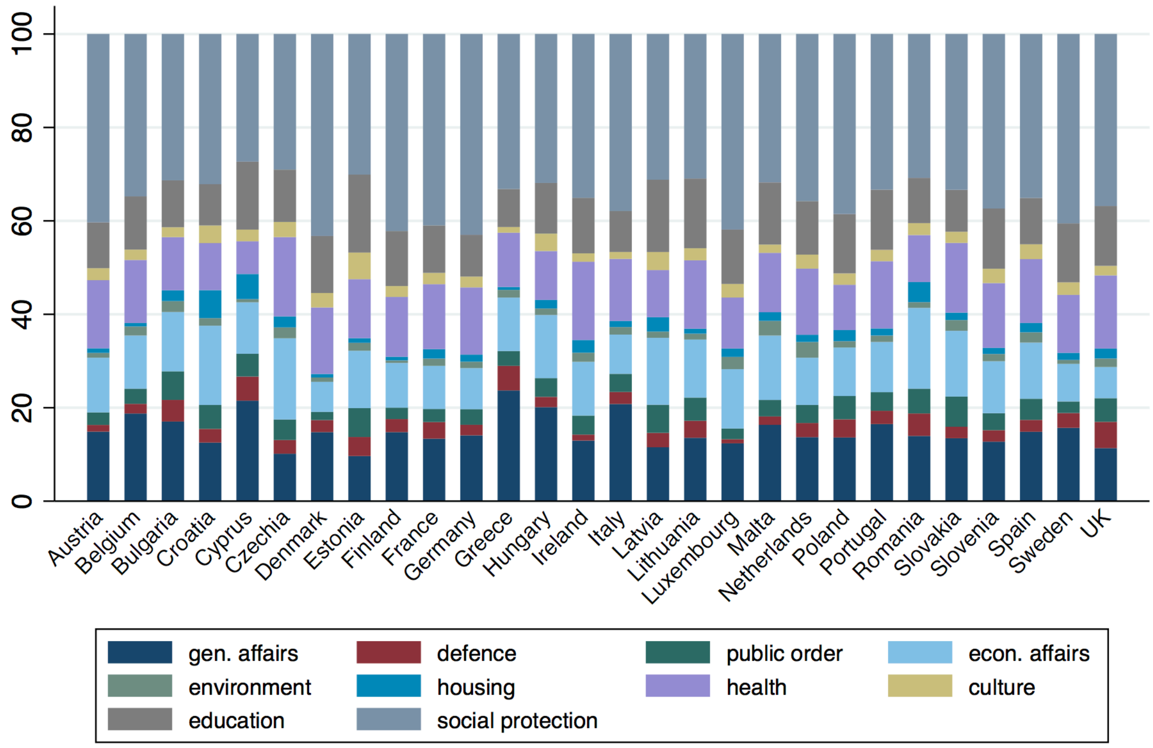
Figure 4. 1 below shows the evolution of the budget structure over time. Specifically, the extent to which each division contributes to public spending is depicted below, showing overall a sizeable and growing allocation to social spending and a similar increasing trend for what concerns health expenditures, while on the opposite side of a spectrum spending for general affairs shrinks over the years. Nevertheless, the average trends over time hide extensive heterogeneity in terms of composition and evolution at the Member State level.



Source: Eurostat

Figure 4. 1 - Share across budget components by year

Beyond the yearly trends emerging above, a cross country average of the full period considered highlights substantial differences across countries and divisions. For example, while the preponderance of social protection remains a stable fixture of all public budgets, the share fluctuates from just 30 per cent in Estonia to over 42 per cent in Denmark. Similarly, general affairs span from below 10 per cent in Estonia to nearly 24 per cent in Greece. While differences emerge across all division, focusing on key variables of interests reveal that shares in the health domain span from just 7 per cent in Cyprus to nearly 17 per cent of the budget in the Czech Republic. Education similarly displays a marked range falling well short of 9 per cent of the budget in Italy while surpassing 16 per cent in Estonia. Preferences and relative strengths of given sectors within the budget is thus substantial and as shown by individual country data over time available in Appendix 1 (see Figure A. 1) also evolve across the period considered.



Source: Eurostat

Figure 4. 2 - Share across budget components by country

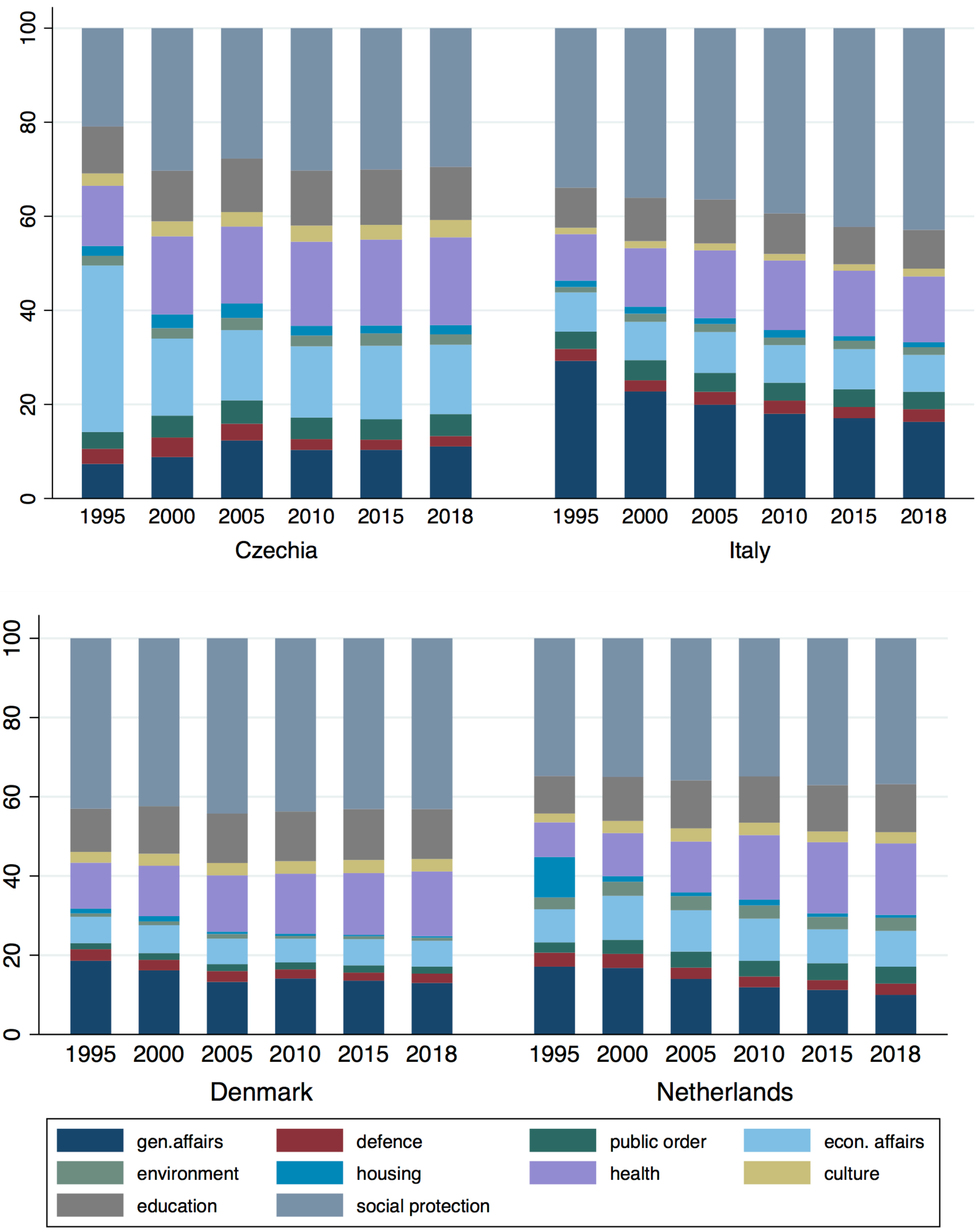
Before shifting the focus to the categorisation of budget components, the heterogeneity within the sample can be read through the perspective of a cross-country classification by spending patterns. Previous analyses have characterised fiscal policy mixes across OECD countries according to clusters reflecting their preference for budget allocations more or less tilted toward social expenditures. Specifically, three typologies of budget structure can be identified. On one side there is a "community" cluster with higher social expenditure, followed by a middling "representative" cluster reflecting the OECD average and a "mixed" cluster containing countries devoting lower allocations to welfare policies, later consolidating into just the first two models in the '80s to remain stable in the '90s (Sanz & Velázquez, 2003). Without the construction of specific clusters, Table 4. 2 below shows the evolution in the timeframe of referencing of the analysis, illustrated by a heatmap of the share of social expenditures across the 28 countries and over time. While the picture does evolve, in some countries, especially for those starting at the lower end of the spectrum, three broad groups can be identified of countries remaining (at least for parts of the period) below 30, those displaying some values above 40 per cent and a remaining middling group.

Table 4. 2 - Heath-map of social expenditures across the EU 28

	1995	2000	2005	2010	2015	2018
Austria	39%	41%	40%	40%	41%	41%
Belgium	34%	33%	33%	35%	36%	37%
Bulgaria	27%	31%	29%	36%	33%	33%
Croatia			30%	32%	34%	32%
Cyprus	23%	24%	28%	29%	33%	29%
Czechia	21%	30%	28%	30%	30%	29%
Denmark	43%	42%	44%	44%	43%	43%
Estonia	28%	29%	29%	35%	32%	33%
Finland	41%	41%	41%	42%	45%	45%
France	39%	39%	40%	42%	43%	43%
Germany	38%	42%	44%	42%	43%	43%
Greece	26%	29%	33%	36%	38%	40%
Hungary	32%	31%	34%	35%	29%	29%
Ireland	34%	32%	36%	27%	36%	36%
Italy	34%	36%	36%	39%	42%	43%
Latvia	34%	35%	27%	31%	31%	30%
Lithuania	28%	31%	29%	34%	32%	35%
Luxembourg	42%	41%	41%	42%	44%	43%
Malta	32%	31%	31%	33%	30%	30%
Netherlands	35%	35%	36%	35%	37%	37%
Poland	40%	42%	39%	36%	38%	39%
Portugal	28%	29%	32%	34%	38%	39%
Romania	29%	27%	30%	35%	32%	33%
Slovakia	31%	27%	36%	36%	32%	34%
Slovenia	33%	38%	38%	38%	38%	38%
Spain	32%	32%	33%	36%	39%	40%
Sweden	40%	41%	42%	40%	41%	39%
United Kingdom	38%	38%	35%	36%	38%	36%

Source: Eurostat

On such basis, countries' budget shares over time for four representative Member States capture the three groups as well as other key differences highlighted in the literature along the north-south and east-west divide. Considering the Czech Republic, Denmark, Italy and the Netherlands, Figure 4. 3 shows trends in shares across components over time. Dynamics appear heterogeneous on many fronts beyond the social dimension. Within the latter, divergence is not limited to the share but also in its evolution over time remaining fairly stable in Denmark and the Netherlands while changing substantially in the Czech Republic and Italy. Differences do not stop here, however, as - for example - education increases in Denmark and the Netherlands while the opposite trend emerges in Italy. Also in the case of general affairs, the aggregate trend of strong reduction over time has an exception in the Czech Republic for which the trend is somewhat increasing. From a methodological perspective, the key takeaway is that both cross-country composition and its evolution over time varies substantially. That is to say that while an aggregate account of changes in the budget structure is essential in developing a synthetic understanding of trends and the overall impact on the fiscal policy mix, such dynamics may hide quite diverse distributional patterns in the (re)allocation of spending both in line with national determinants and the extent to which it is attributable to supranational constraints.



Source: Eurostat

Figure 4. 3 - Share across budget components over time in selected countries

From such a perspective and in addressing the research questions at hands three levels of analysis are necessary: (i) an aggregate synthetic indicator capturing changes in the fiscal policy mix, (ii) disaggregated components at either division or group level depending on the timeframe and purpose and (iii) macro-aggregates of the components allowing, for example, to single out spending dedicated to investment. Leaving the third dimension to the section to follow, on the first account changes to the fiscal policy mix can be captured constructing the budget distance across two consecutive years, namely, the Euclidean distance in terms of spending components, illustrated in detail in the operationalisation of the variable following the approach of Tsebelis and Chang (2004). On the second account, the level of disaggregation is indisputably bound by data availability, with group-level analysis constrained to the post-2001 sample. Conversely, full coverage across the lifespan of the EMU and the three iterations of the Stability and Growth path requires division level data. On the other hand, divisions are broad categories, especially for sensitive and variegated dimensions such as social protection, so that disaggregation may yield a better understanding of dynamics and - for instance - their intergenerational implications (e.g. pensions vs. family policies). In this context, a trade-off emerges between depth and coverage, which throughout the analysis is matched to the priorities of each research (sub)hypothesis.

A typology of public expenditures

The third level of analysis requires the identifications of how divisions and groups feed into macro areas of interest for the adherence of the Pact with its pro-growth policy objective and the divergent broader political, social and economic implications. In this context, the classification of public expenditures across its macro-components allows for addressing the effectiveness of the supranational fiscal surveillance infrastructure in pursuing its objective of promoting sustainable growth-enhancing fiscal policies at the national level, aimed at the Member States recalibrating their budget structure toward investment such as - for example – infrastructure and research (Ferreiro et al., 2013). Within this arena, substantial attention has been dedicated to which kind of expenses enhance growth or go to its detriment. The relation between public expenditure and growth has long been investigated (e.g. Barro, 1990; Devarajan et al., 1996), in assessing which budget structures yield to positive developments. Investments, spanning the categories of capital, education, telco and transport, is generally identified at the heart of growth-enhancing productive expenditures while unproductive current expenditures are generally found to hinder growth (Kneller et al., 1999). As considered in the literature review, the classification into productive investment and unproductive transfer – while pervasive in the economic literature – is problematic as it may be misinterpreted as a normative message – from which EU economic governance is, however, not immune – of the primacy of growth and fiscal discipline over social objective. Hence, while in presenting the literature the classification based on the productive and unproductive distinction is reported reflecting the categorisation of the authors, the typology used in the analysis is limited to the neutral distinction between transfers and investment. Nevertheless, there reasoning on the basis of the distinction considers that while investment contributes positively to growth at least in the short term (Gemmell et al., 2011), for example through infrastructure and educational investments, the opposite may be the case for transfers, such as those associated to social protection (Gemmell et al., 2016). The categories, while debated and with mixed empirical backing, are at times further expanded to include a broader series of expenditures covering active labour market policies, health, defence, public order and general administrative costs, transport, and communication (Afonso et al. 2005). An additional challenge rests in the difficulty in disentangling productive and unproductive categories within the broad functional classification, especially at the division level, as "the theoretical classification of public outlays into 'productive' or 'unproductive' is not available at macroeconomic level" (Ferreira et al., 2013, p. 804).

Distinguishing across investment and transfers is thus not straightforward within the context of the COFOG classification. Nevertheless, previous analyses offer some guidance. For instance, in addressing what categories of government spending contribute to sustainable economic growth, a positive effect was found for education and specific categories of R&D - namely GF0907 and GF1008 in Table 4 below - relating respectively to education and culture (Jeong et al.,2019). Within this context, a significant negative effect was found for division level environmental protection - both in the short and long run - and housing in the short-run (Jeong et al., 2019). In other instances, the classification across productive investment and unproductive transfers expenditures has taken a broader approach, considering within the former COFOG divisions and groups spanning across "defence, public order and safety, economic affairs (including sectorial R&D and transport and communication), environmental protection, housing and community amenities, health, and education" (Ferreiro et al., 2013, p. 807).

Additionally, the game of fiscal policy has been argued to be driven by two contrasting forces, on one side the pressure for growth-enhancing alignment (Barro,1990) and on the other the increased demand for social protection deriving from globalisation (Rodrik, 1998), which at the same time increases the competitive pressure toward a productive budget structure (Tanzi & Schuknecht, 2000). These partially contradictory objectives indicate that it is difficult to consider fiscal policy in terms of the monolithic single-purpose of growth, with other objectives being also essential, including ″income redistribution or social cohesion″ (Ferreiro et al., 2013, p. 814). Such view refutes the concept of "a single optimal composition of public spending defined in terms of its contribution to the economic growth″, suggesting on the other hand "a trade-off between the different purposes of public expenditures that can affect the size and composition of public spending." (Ferreiro et al., 2013, p. 815). Accordingly, in analysing the impact of EU economic governance on the budget structure, it is likewise essential to track both dimensions: on one side (i) those related to efficiency and growth and on the other (ii) those that are also central in the critical narrative against the Stability and Growth Pact, namely distributional concerns connected with social policies and inequality.

Starting from (i), a corresponding classification of COFOG divisions and group in line with the approaches of the literature can distinguish across the investment and transfer components of fiscal policy. Although the appropriate distinction is not unanimous, in line with Ferreiro's (2013) approach, one can consider sectoral R&D, defence, public order, economic affairs, environmental protection, housing, health and education as investments, with the remaining categories - that is to say general affairs, recreation and social protection - identified as transfers. Such distinction is depicted in Table 4. 3 below. Alternative specifications (e.g. Jeong et al., 2019) may restrict investment to sectorial R&D, health and education, or disregards sub-divisional specifications (especially in early analyses), focusing instead on division level aggregates. Given the non-univocal classification of what is 'productive' and should be considered within the category of investment in line with COFOG divisions and group two specifications are constructed and employed in the analysis, as shown in Table 4. 3. In line with differences within the literature the restrictive approach (in dark green in the table) considers only sectorial R&D, basic research and the health and education division, while a wider approach (also including groups in light green) expands to the inclusion of defence, public order, economic affairs, environmental affairs and housing. Concerning (ii), one may identify those categories of spending (e.g. health, education and social protection) most closely related to inequality reduction, as well as take an intergenerational distribution view in looking at changes in allocations benefiting the elderly and youth, as depicted in Table 4. 3 In this regard, previous research has linked the above-mentioned categories within the fiscal policy mix - especially for what concerns family benefits and subsidies, as well as social protection together with education - with the reduction of inequalities (Fournier & Johansson, 2016).

Table 4. 3 - A typology of public expenditure: divisions and group level classification across investments, transfers, inequality and intergenerational spending

Division		Group		Investment	Transfers	Elderly	Youth	Inequality
GF01	General public services	GF0101	Executive and legislative organs, financial and fiscal affairs, external affairs					
		GF0102	Foreign economic aid					
		GF0103	General services					
		GF0104	Basic research					
		GF0105	R&D General public services					
		GF0106	General public services n.e.c.					
		GF0107	Public debt transactions					
		GF0108	Transfers of a general character between different levels of government					
GF02	Defence	GF0201	Military defence					
		GF0202	Civil defence					
		GF0203	Foreign military aid					
		GF0204	R&D Defence					
		GF0205	Defence n.e.c.					
GF03	Public order and safety	GF0301	Police services					
		GF0302	Fire-protection services					
		GF0303	Law courts					
		GF0304	Prisons					
		GF0305	R&D Public order and safety					
		GF0306	Public order and safety n.e.c.					
GF04	Economic affairs	GF0401	General economic, commercial and labour affairs					
		GF0402	Agriculture, forestry, fishing and hunting					
		GF0403	Fuel and energy					
		GF0404	Mining, manufacturing and construction					
		GF0405	Transport					
		GF0406	Communication					
		GF0407	Other industries					
		GF0408	R&D Economic affairs					
		GF0409	Economic affairs n.e.c.					
GF05	Environmental protection	GF0501	Waste management					
		GF0502	Waste water management					
		GF0503	Pollution abatement					
		GF0504	Protection of biodiversity and landscape					
		GF0505	R&D Environmental protection					
		GF0506	Environmental protection n.e.c.					
GF06	Housing and community amenities	GF0601	Housing development					
		GF0602	Community development					
		GF0603	Water supply					
		GF0604	Street lighting					
		GF0605	R&D Housing and community amenities					
		GF0606	Housing and community amenities n.e.c.					
GF07	Health	GF0701	Medical products, appliances and equipment					
		GF0702	Outpatient services					
		GF0703	Hospital services					
		GF0704	Public health services					
		GF0705	R&D Health					
		GF0706	Health n.e.c.					
GF08	Recreation, culture and religion	GF0801	Recreational and sporting services					
		GF0802	Cultural services					
		GF0803	Broadcasting and publishing services					
		GF0804	Religious and other community services					
		GF0805	R&D Recreation, culture and religion					
		GF0806	Recreation, culture and religion n.e.c.					
GF09	Education	GF0901	Pre-primary and primary education					
		GF0902	Secondary education					
		GF0903	Post-secondary non-tertiary education					
		GF0904	Tertiary education					
		GF0905	Education not definable by level					
		GF0906	Subsidiary services to education					
		GF0907	R&D Education					
		GF0908	Education n.e.c.					
GF10	Social protection	GF1001	Sickness and disability					
		GF1002	Old age					
		GF1003	Survivors					
		GF1004	Family and children					
		GF1005	Unemployment					
		GF1006	Housing					
		GF1007	Social exclusion n.e.c.					
		GF1008	R&D Social protection					
		GF1009	Social protection n.e.c.					

Note: Restrictive specification of investment in dark green, wider expands to include light green

While the impact of the budget structure on growth and inequality may appear as contrasting in terms of the entailing allocations, it should be noted that there is a partial divergence and overlap: within inequality addressing policies both investment in education and health is encompassed as well as social transfers. Likewise, investments include inequality addressed policies so that among the latter both growth-enhancing and hindering categories coexist. Within the literature, when both domains have been jointly considered, budget structures conducive at the same time with the enhancement of growth prospects and the reduction of inequalities have emerged, especially in relation with well-designed reforms in the fields in education, while more, in general, the two objectives of benefiting the lower section of the income distribution at the same time as promoting beneficial investments has been deemed achievable through a multitude of interventions (Fournier & Johansson, 2016).

Operationalising the dependent variable(s)

At the aggregate level, the synthetic indicator of budget distance allows for the non-trivial effort of reducing the composition of public expenditure to a single variable capable of carrying its structure. Tsebelis and Chang (2004) provide a framework base of the identification of the budget distance across two following years in a similar - albeit solely national - context.

The approach can serve as a basis of the analysis for the 'aggregate' assessment of the impact on the composition of fiscal policies. However - as also carried out by Tsebelis and Chang (2004) - individual divisions (or groups) should be considered when assessing the impact on categories of interest, such as social expenditures. The Budget Distance (BD), as anticipated above, is a synthetic indicator for changes in the budget structure which is constructed as the Euclidean distance between the budget division level allocations across time t and time t-1:

$$BD_{it}= \sqrt{[(GF01_{it}-GF01_{it-1})^2 +(GF02_{it}-GF02_{it-1})^2+(GF03_{it}-GF03_{it-1})^2+\ldots+ (GF10_{it}-GF10_{it-1})^2]}$$

Specifically, the implied unit of analysis at observation level is the Budget Distance for country i at time t, covering all observation for which the budget allocations are available except for the first year, spanning from 1996 to 2018 with the sole exception of Croatia. While accomplishing the complex task of reducing changes to the budget composition to one number the indicator is, however, insensitive to the direction of the changes, treating contractions and expansion likewise as increased alterations to the fiscal policy mix.

The same is not the case for the disaggregated division or group level variables, capturing - for each category - the difference compared to the previous year. The result is indicators of change for each budget line across the 10 divisions (ΔGF1…ΔGF10) and 69 groups (ΔGF101…ΔGF1009). Unlike at the aggregate level, such variables (e.g. $\Delta health_{it}$) indeed sensitive to the direction of the change allowing at the specific budget line level to identify contractions and expansions while more, in general, facilitating the (directional) interpretation of the synthetic indicator.

Finally, according to the typology and categorisation outlined in the previous section, macro-components can be operationalised across the classification in Table 4. 3 as respective sub-aggregates for investment (in its two alternative specifications) and transfers, as well as inequality and intergenerational associated expenditures. The variable captures the global size and direction of the change for what concerns the part of the budget considered as the yearly difference of the sum of all specific budget lines (e.g. associated with investment) for the macro-component under consideration.

4.3 The independent variable

To conceptualise and operationalise EU fiscal governance one must consider what instruments are available at EU level to affect public expenditures in the Member States and how they have evolved, considering that several major reforms have taken place in the last 25 years tightening controls over fiscal policy at the national and supranational level. At the initial stage, as seen in chapter two the embryo of EU fiscal policy coordination consisted – for the most part – of a set of supranational fiscal rules setting targets for public debt and the deficit. Over time the evolution of the EU framework has changed not only the strictness of the rules but also the nature of the monitoring and enforcement mechanisms, which the literature identifies as a crucial determinant of the impact of fiscal rules. At the same time, the political commitment to discipline and cost for delinquency, in line with enhanced procedural intrusiveness, can be argued to have strengthened over reforms. As a consequence, the conceptualisation and operationalisation need to account for the full-set of heterogeneous tools of EU economic governance and their evolution over time.

In addition, the evolution of supranational fiscal coordination with the crisis and the 2011-2013 major policy overhaul, has arguably expanded the scope of EU economic governance beyond mere expenditure or deficit rules. The latest reforms have not only imposed the transcription of supranational constraints into national fiscal rules but also a fully-fledged coordination process within the European Semester. As such, the aim of EU economic governance in its current form departs from the initial rationale of ensuring sustainability by imposing fiscal prudence leaving to the national government to devise how to achieve such a goal. Conversely, albeit with limited enforcement, guidance and benchmarking to adopt to obtain not only fiscal but also economic sustainability are now set forth by the supranational level. From this perspective, the approach to the independent variable needs to account for the additional challenge in the research design for investigating the role of supranational 'fiscal steering' mechanisms that go beyond fiscal rules - such as country-specific recommendations - and specifically how the direct indications on allocation match the indirect impact of the supranational fiscal rule on the composition of public expenditures in the Member states.

Conceptualising EU economic governance as fiscal rules

Given the variegated mechanisms at play within the EU economic governance framework, the starting point is defining a typology of the fiscal rule dimension of the Pact across the three phases of its evolution. The first basic identification of the independent variables of interest in terms of EU economic governance and source of variability within the dataset is represented by the extent to which for each observation – that is to say for a specific country at a given time – is bound by the supranational fiscal rule infrastructure. The relevant regulatory framework is dependent on the accession date to the European Union and the Eurozone at the starting time of the analysis and throughout the following years, shown in Table 4. 4 below. Given the timeline for which the data is available the table shows the year of accession to the European Union (EU), with no date indicated for those already members in 1995, and in case of Eurozone membership (EZ) the year in which the Euro was adopted.

Table 4. 4 - EU and Eurozone membership

Member State	EU	EZ	Member State	EU	EZ
Austria	1995	1999	Italy		1999
Belgium		1999	Latvia	2004	2014
Bulgaria	2007		Lithuania	2004	2015
Croatia	2013		Luxembourg		1999
Cyprus	2004	2008	Malta	2004	2008
Czechia	2004		Netherlands		1999
Denmark			Poland	2004	
Estonia	2004	2011	Portugal		1999
Finland	1995	1999	Romania	2007	
France		1999	Slovakia	2004	2009
Germany		1999	Slovenia	2004	2007
Greece		2001	Spain		1999
Hungary	2004		Sweden	1995	
Ireland		1999	United Kingdom		

The relevance of distinguishing across Eurozone membership comes from the differences in the EU fiscal surveillance infrastructure – highlighted in chapter two – and specifically in how, while some rules may apply also to all Members States, in many instances prescriptions and mechanisms of enforcement are limited to Euro area Members, which is always the case with the sanctioning hard side of the policy. Along with procedural differences, at the same time, the negative externalities of profligacy and spillovers associated with the monetary union are limited primarily to Euro area countries, along with the parallel heightened concern for the credibility of Pact and political pressure to comply.

Additionally, given the evolution of EU economic governance over time, the distinction across regulatory frameworks needs to be accounted for. To this purpose, three elements that have guided the analysis in chapter two are central: the nominal strictness of the framework, the inherent flexibility and the strength of the enforcement mechanism. The latter is itself a characteristic tying together multiple dimensions, such as the extent of political discretion, the inter-institutional balance of power – as, for example, an increased role for supranational institutions favours compliance (Franchino & Mariotto, 2020) – and 'invasiveness' into the Member States' national framework. To operationalise EU economic governance and it changes in assessing the research question(s) a defined timeline of SGP reforms is imperative. The EU economic governance framework, born with the Maastricht Treaty in 1992 and the Stability and Growth Pact in 1997, entered into force in 1998 for what concerns the preventive arm and in 1999 for the corrective arm. Its first reform in 2005 was assessed in chapter two as weakening the fiscal surveillance infrastructure. However, it should also be considered that the framework had been de facto suspended as of 2003. Finally, moving on to the third phase of the ramped-up EU economic governance framework, a clean cut-off is not straightforward. Specifically, the European Semester system was implemented as of 2010, with 2011 seeing the introduction of the Macroeconomic Imbalances Procedure and the reformed SGP with the adoption of the six-pack. Only in 2013 did the two-pack and fiscal compact enter into force, with the latter binding only for Eurozone members, Bulgaria, Denmark and Romania, where the implementation of the prescription into national legislation was bound to occur before the beginning of 2014. As a consequence, there is no sharp breaking point between the middling phase two economic governance framework and the latest phase, with a progressive strengthening of fiscal coordination rules starting from 2010 and culminating as of January 1 2014. In addition, a further complication in the third phase of the SGP is the intertwining with the Great Recession and the Eurozone crisis with escape clauses coming into play and the accession of some Member States to emergency measures confounding the impact of the supranational fiscal rule if not accounted for. Deriving a general classification, as depicted in Table 4. 5 below, one may consider phase 1 to commence with the entry into force of the Corrective SGP and the birth of the Eurozone, stopping when the SGP was suspended in 2003. Phase 2 is set off by the clear timeframe of the SGP reform, while Phase 3 can be reasonably considered to commence in 2011. However, given that no sharp breaking points are present in some instances (e.g. Phase 3 reform and suspension in Phase 1), sensitivity analysis is carried out for alternative more inclusive (or limited) timeframes. Additionally, specific assessment is given separately for the Great Recession period.

Table 4. 5 - EU economic governance timeline

1992	1998	1999	2003	2005	2009	2010	2011	2013	2014
Mastricht Treaty	Preventative SGP into force	Eurozone Corrective SGP into force	SGP Suspension	SGP Reform		European Semester	SGP Reform Six Pack MIP	Fiscal Compact Two Pack	National Implementation Deadline (Jan 1)
		Phase 1		Phase 2			Phase 3		
					Great Recession & EZ sovreign debt crisis				

Furthermore, as highlighted in chapter two and indicated by the above timeline, at a given moment and 'phase' the SGP is not a monolithic framework but is a composite regulatory framework with a divergent 'bite' on the Member States so that a parallel different impact on national budgets could be expected. Consequently, the research design needs to also provide for the distinction between the relevant regulatory framework. On one side it gives specific attention to times of crisis in which escape clauses may change 'the rules of the game'. On the other it accounts for whether each observation takes place under the preventive or corrective arm of the Pact. The latter – and the connected inherent threat of sanctioning for Eurozone countries – is in fact at the core of the analysis due to its 'harder' bite on the fiscal policy mix and the intrusive spotlight and pressure the Excessive Deficit Procedure (EDP) imposes on the Member States.

If the distinction across the preventive and corrective arm is crucial, the latest policy innovation may also account for a breaking point for the intrusion of the EU fiscal surveillance framework into domestic budgetary choices. The coming into force of the Fiscal Compact, and specifically the deadline associated with the national implementation of fiscal rules should be also taken into account, in considering how it may change the impact of the EDP and its variation across Eurozone membership. Specifically, the Fiscal compact has multiple components, implying varied constraint and 'relevant audiences' across them, with some elements applying to all signatories (Title V), some only to Eurozone members (Title III and IV) which may, however, be on - a voluntary basis - extended to signatories outside the Eurozone through a declaration committing the Member State to be bound by those provisions, the balanced budget provisions under Title III for the purpose of the analysis. In this regard, it should be also kept in mind that in phase three of EU economic governance, and especially in connection with the entry into force of the Fiscal Compact, the Eurozone membership may become a poor indicator of the strictness of the applicable regulatory framework, if the national implementation of fiscal rules is per se sufficient in enacting fiscal prudence.

Finally, if crisis times alter the functioning of the dependent variable, special circumstances of specific countries and their interaction with the EU economic governance framework should be likewise considered. Morover, in concomitance with the Great Recession several Member States accessed Economic Adjustment Programmes, Financial Adjustment Programmes and Balance of Payment Programmes (Franchino & Mariotto, 2020). Countries adhering to Financial Assistance programmes fall outside of the scope of the SGP being bound instead to the terms of their MoU. As such, for the relevant years, one cannot consider those Member States falling either under the preventive or corrective arm of the EU economic governance. To further complicate the picture, the mix of instrument put forward, some preceding and other introduced in the midst of the crisis – such as the European Financial Stability Facility (EFSF) – also go beyond the scope of EU law (European Court of Auditors, 2015). While, it may also be of interest to investigate the impact of those specific circumstances on the dynamics of national budget structure – as considered in chapter seven – observations falling under FAP should be generally excluded by the analysis for the purpose of the research questions at hand.

Table 4. 6 below shows a timeline of measures for each country while omitting the second and third BoP programme for Romania due to its precautionary nature in the absence of disbursements (European Court of Auditors, 2015; European Commission, 2021).

Table 4. 6 - Financial assistance in the Euro crisis

	EAP		**ESM**	**BoP**	**FAP**
Cyprus	2013-2016				
Greece	2010-2013	2012-2015	2015-2018		
Hungary				2008- 2010	
Ireland	2010-2013				
Latvia				2009-2012	
Portugal	2011-2014				
Romania				2009-2011	
Spain					2012-2014

Source: European Commission

On the interplay between the Pact and the Semester

The birth of the EU economic governance framework has been shown in chapter two as closely connected with the introduction of the common currency as a fundamental tool for controlling externalities and moral hazard within the Economic and Monetary Union (Heipertz & Verdun, 2010). In this context, with monetary policy delegated to the supranational level while fiscal policy remaining at the national level, the early SGP can be seen as a tool to reign in fiscal policies of the Member States to render them compatible with the EMU (Issing, 2002). Beyond the deficit containment mechanisms provided for by the Treaties and the SGP, several fiscal coordination instruments have over the years indicated benchmarks for the convergence of national budget structures, spanning from the Broad Economic Policy Guidelines (BEPG), the Lisbon Strategy, and the reformed SGP. A mainstreaming of concerns over budget structures ensued from an improved focus not only on the quantity but also on the quality of spending under "the view that fiscal policy can positively affect Member states' growth performance by managing the composition of public expenditures between productive and non-productive components (Censolo & Colombo, 2016, p. 705).

Even in early stages, while the toolbox remained equipped nearly exclusively for the containment of national spending, the stated purpose of the EU economic governance framework went beyond the sole deployment of expenses limiting numerical rules. Specifically, one can identify a stated objective of providing guidance even in the lack of binding instruments to the

Member States for national fiscal policies allowing not only for macroeconomic stability but also, for example, for the promotion of investment in infrastructure and human capital. Such orientation is further confirmed by the Broad Economic Policy Guidelines (BEPG) already in 2005, which calls directly for the promotion of a "growth-and employment-oriented and efficient allocation of resources" through national fiscal policies, calling on the Member States to "re-direct the composition of public expenditure towards growth-enhancing categories" identified as spanning across the fields of research - including towards greener technologies - as well as physical and human capital (European Commission, 2005, p. 41). At the same time, choices in the fiscal policy mix are intrinsically political and reflect national preferences and priorities (Barrios & Schaechter 2008), to the extent that "significant differences in the role, functions, and size of national public sectors" can be expected to remain highly relevant in limiting also supranational coordination going far beyond "current rules related to fiscal imbalances" (Ferreiro et al., 2013, p. 815).

Beyond the improved focus on quality, a substantial jump in the coordination of economic policies within the EU can be identified in the European semester, which as illustrated in chapter two, brings social, economic and fiscal coordination under a single hat and process, building on existing frameworks subject to varied legal basis (Verdun & Zeitlin, 2018). While the Semester had become a popular topic in the academic debate on EU economic governance, findings on its nature, ability to affect national budgetary choices and its prioritisation of fiscal restraint compared to social objectives are mixed. Starting from the social dimension, on one side bringing social policies directly in connection with fiscal consolidation objectives – where failure in demonstrating sufficient improvement in economic targets may result in sanctioning – may be argued to put additional pressure on the Member States in complying with Country Specific Recommendations (CSR) also within the social domain in which the purview of the supranational influence is limited to coordination and guidance. Such view aligns with findings of prioritisation of economic rather than social objectives which has received substantial backing in the literature in line with the austerity paradigm often associated with the supranational fiscal rule and derived regulatory framework (e.g. Copeland & Daly 2015; Crespy & Menz 2015; Heins & de la Porte, 2015). On the opposite side of the spectrum, it can likewise be expected that joint consideration of economic and social dynamics may better highlight the social consequence of fiscal choices, in line with the finding that the European Semester may allow for the mainstreaming of social objectives (e.g. Bekker, 2017; Gómez Urquijo, 2017; Jessoula, 2015), notably with empirical case studies uncovering a pro-social policies role of the Commission for budgetary choices of Latvia while under financial assistance (Eihmanis, 2018).

Along these lines, the evidence is mixed also concerning the ability of the Semester to affect the budget structure of the Member States in the prescribed direction, argued both as highly limited (e.g. Hallerberg et al., 2011; Darvas & Leandro, 2015) and non-negligible (e.g. Deroose & Griesse 2014). The emerging picture indicates that while it may be of high value to further investigate the scope of the direct impact of the EU economic governance framework on national budgetary choices through the CSRs, expectations are far from straightforward concerning the ability to affect the fiscal policy mix and specifically concerning categories of primary interest in the context of the research question at hand such as social policies. Additionally, a further complication arises in the difficulty of disentangling the impact from the SGP from that of the EU economic governance 'beyond fiscal rules', not unlike for the case of supranational and national numerical targets.

Within the framework of the analysis at hand, the interplay between the two dimensions offers an angle of high relevance in evaluating the outcomes of the impact of the national fiscal rule on the composition of public expenditures. Indeed, the mechanisms through which the Pact and the Semester operate differ substantially: the first operates chiefly indirectly through a budget constraint imposed by the supranational level, while the second offers direct orientation on budgetary choices. One may thus interpret the guidance of the CSRs as intentional while the indirect distributive effect on the budget structure may be less purposeful. From this perspective, the alignment of the two policies offers precious insight in putting findings on the political, social and economic impact of the SGP and the EDP in the broader context of the EU economic governance aims and the extent to which they are deliberate. Given the specificity to HP[1.C] dedicated to Semester, detailed methodological considerations and the operationalisation of CSRs are left to its empirical chapter, with the remainder of the section devoted to the independent variables of relevance throughout the analysis.

Operationalising the independent variable(s)

The operationalisation of the independent variables in its varieties illustrated in this section comes predominantly through a definition of a set of dummies capturing membership, EDP status and the relevant regulatory framework (including the exclusion criteria of falling under FAP).

On the first account, membership is captured via dummy variables taking the value one for observations of a country at the time member of the Union and Eurozone, as indicated in Table 4. 4. Such variables are not only of use per se – reflecting falling under the purview of the Pact – but also in altering the regulatory framework of the primary independent variable, the EDP. Nevertheless, it should be kept into account that in principle that may not always be the case as for Title III balanced budget provisions of the Fiscal Compact which is extended to signatories.

In terms of regulatory framework three elements are at play (i) the three iterations of the SGP, (ii) the Fiscal Compact and (iii) falling under Financial assistance. On the first account, two indicators are developed. The first simply reflects the three phases as depicted taking values going from 0 (before the Euro) to 3 in Table 4. 5, while the second alternative specification accounts for the SGP de-facto suspension by taking the value zero instead of 2 in the relevant timeframe. It should be noted that sensitivity analysis is also carried out about the early stage, namely considering the years leading to Eurozone accession. Coming to the Fiscal Compact, the variable is operationalised as a dummy taking a value one for Title III signatories after the elapsing of the implementation deadline (as of 2014). Finally, a dummy variable captures falling under FAP in line with Table 4. 6.

Coming to the main independent variable, falling under the corrective arm is operationalised via a dummy variable taking the value one for countries subject to the Excessive Deficit Procedure. As indicated in chapter two, the corrective arm and the EDP consist of a sequence of steps, initially in the hands of the Commission to be further escalated under the political control of the Council. Given the history of the SGP highlighting how the sanctioning mechanisms may be largely under political control, Council Decision is employed as the threshold both for what concerns the existence and abrogation of an excessive deficit. The periods under which countries fall under the EDP, originating from Council decisions in the Official Journal are displayed in Appendix 2 (see Table A. 1). In the construction of the EDP dummy, the starting or endpoint is approximated by delaying to the following year for Council decisions on the existence of an excessive deficit issued in the last two months of the year and to the previous year abrogation in the first two months. As a result, 203 of the 643 observation for which division level COFOG data is available fall under the EDP, with the remaining 440 observations subject only to the preventive arm of the Pact.

4.4 Domestic controls

Chapter two pinpointed the key drivers of public expenditure composition within the national political, economic and institutional arena to inform the research design of (i) factors to control for in the assessment of the research question and (ii) potential interactions with the former leading to heterogeneous effects of the EU economic governance framework on Member States' budget structures. While (ii) is considered in the section to follow, this section is dedicated to delineating and operationalising the domestic controls.

Political factors

Within the political arena, chapter two identified several factors that have been argued in the literature to affect budget size and composition. Taking the approach of Tsebelis and Chang (2004) as the starting point, within the context of veto player theory, two characteristics of national governments are identified as key determinants for the scope for changes in the budget structure: ideological distance and alternation. The first element is operationalised by authors as the absolute value of the difference between the ideological score - according to Warwick (1994), Castles and Mair (1984) and Laver and Hunt's (1992) indexes - of the two most extreme cabinet parties (Tsebelis & Chang, 2004). Formally, the government's ideological distance indicator (ID) of country i at time t can be constructed as follows:

$$ID_{it} = | MAXGOV_{it} - MINGOV_{it} |$$

where MAXGOV represent the party within the cabinet with the maximum score of the considered index and MINGOV the one with the minimum score. The second element, alternation, is operationalised by Tsebelis and Chang (2004) as the difference between the midrange of the current and previous government. Formally, the government alternation indicator (AL) of country i at time t can be constructed as follows:

$$AL_{it} = | (MAXGOV_{it} + MINGOV_{it})/2 - (MAXGOVP_{it} + MINGOVP_{it})/2 |$$

where MAXGOVP represents the party within the previous cabinet with the maximum score of the considered index and MINGOVP the one with the minimum score.

Within this context, the Tsebelis dataset does not match the need for the analysis both in terms of time (1973-1995) and scope, covering 19 OECD countries which leave out several Member States, especially from central and Eastern Europe. However, information on government composition is contained in several datasets such as the Comparative Political Dataset (Armingeon et al., 2020), the ParlGov database (Döring & Manow 2019), the ECPR Political Data Yearbook (Clark et al., 2020), the Party Government Data Set (Woldendorp & Keman, 2011) and the Manifesto Project Database (Volkens et al., 2020). Given the coverage (especially for what concerns the timeframe) and the scope of information concerning the key variables of interest - specifically the need for (i) identification of all parties in government (ii) information on each respective ideological position – only the ParlGov database alone allows for the construction of the above-mentioned variables. In this regard, several indices – with different coverage – are available (namely Castles/Mair 1983, Huber/Inglehart 1995, Benoit/Laver 2006, CHES 2010, Ray 1999) and summarised into four variables: *left/right, liberty/authority, EU anti/pro* all assessed on a one to ten scale. Of them, the first variable – *left/right* – is the one with the most 'universal' coverage across all observations with party affiliation. Nevertheless, the variable presents a crucial limitation: it does not account with capillarity and continuity for changes in party positions over time, rather it assigns ideological values to parties periodically and not in the context of each election. Employing the variable as the source for party positions in the analysis is problematic also in practice: running the model with the sole domestic determinants and the Western Member States reveals results that are either never significant or run against theoretical expectations. As such the ParlGov variable may be a poor measure of ideological positioning in this context.

An alternative is to complement ParlGov information on cabinet composition with political positioning data from the Manifesto Project, overwhelmingly used in the literature as it captures party positions at the time of the elections. Political data originating from analysis of the party manifestos allows for the coding of a broad array of positions on external relations, freedom and democracy, the political system, the economy, welfare and the quality of life, the fabric of society and social groups, summarised into five programmatic dimensions. Of the five variables – *rile, planeco, markeco, welfare* and *intpeace* – the first reflects the right-left position in line with Laver/Budge methodology and is used to substitute for the ParlGov *left/right* variable. It should, however, be noted the use of Manifesto data is not unproblematic itself in light of the construction of the two main indicators. Specifically, when a coalition manifesto is available, the coding of the composing parties reflects such joint manifesto and is thus the same in some – albeit limited – instances for parties running together in the elections. Such an approach does not thus always align with the need to account for the range within the cabinet coalition. Nevertheless, while both ideology variables are somewhat problematic in a way that should be considered when interpreting the results – or lack of thereof – the Manifesto derived variables hold up better to the empirical test achieving significance in the expected direction in the model considering only domestic factors, albeit under specific conditions such as the exclusion of Eastern Member States.

In constructing the above-mentioned indicators of need, cabinets data is attributed to the respective years, with a weighted average used for years with multiple cabinets. Additionally, in avoiding dropping period with caretaker governments, ideological distance and alternation are inputted in such case, so not to exclude periods where the specific national dynamics may have significant fiscal policy implications and be far from unrelated to the budgetary conditions of the country under consideration. Additionally, a caretaker indicator is generated, taking the value one for years in which a country was led by a caretaker government for more than 6 months, however only 4 observations fall within such predicaments. Finally, an ulterior variable is generated from the data – *ideology* – to account for political preferences in spending allocation within the budget. The variable is the seat weighted average of the positions of parties represented within the cabinet, time-weighted within the year as for the other two national political variables.

Institutional factors

The domestic institutional arena is similarly far from unproblematic. Two elements were discussed in the context of chapter two as central in this domain for the research questions at hand: (a) decentralisation and (b) fiscal rules. Given the dataset under consideration, the stability in both dimensions may suggest that - alike other stable differences within the Member States with budgetary impact - they may be controlled away with country fixed effects. However, two elements partially already discussed in chapter three indicate such approach may be problematic: (i) while relatively stable over time there may be significant changes over the whole dataset, especially if one considers fiscal rules and changes consequent to the introduction of the fiscal compact; (ii) relying on countries fixed effects to capture the impact of institutional factors does not allow for addressing their potential interaction with the impact of EU economic governance on the budget structure.

Excluding such route, the problem remains especially for fiscal rules not much on how to account for their strength but especially in how to disentangle the extent to which such strength is to be attributed to national preferences or supranational imposition. In light of the supranational fiscal framework, especially in its third iteration with the Fiscal Compact, a central dilemma in the assessment of the research question is the disentanglement of the impact of national and supranational fiscal rules. Even prior to the latest reform to the EU fiscal governance framework, the two levels of fiscal constraints can hardly be considered independent as the ongoing supranational constraint even when not explicitly imposing the introduction of explicit limitation to public expenditures into national law can be expected to have had an impact in the design of fiscal rules at the time of their introduction. In this context, a further concern can be identified in phase 3 of the supranational surveillance infrastructure given that consequently to the introduction of the Fiscal Compact SGP commitments have been translated into national legislation, preferably under a constitutional-level legal basis.

As such, in several instances, empirical investigations on the impact of fiscal rules have indicated that once controlling from national fiscal rules, variables capturing the participation to the SGP or the application of the Maastricht

Treaty are not significant and may even have the opposite sign as expected, which has been interpreted as an indication of the negative international externality associated with the participation of the EMU (e.g. Dahan, 2013; Tòth, 2019). At the same time, disregarding national fiscal rules is similarly problematic as even after the Fiscal Compact they are not equivalent across all Member States, so that national fiscal rules can be expected to impact the dependent variable and are highly correlated with EU fiscal governance performance and EDP status. Specifically, they may be expected from a theoretical standpoint to reinforce the supranational framework so that an interaction between the two levels of fiscal constraint may be at play. Within this scenario, especially in phase three of EU economic governance and under the obligation of national translation of the supranational surveillance framework, one may conceptualise differences in the strengths of national fiscal rules as diverging strengths of national enforcement of the EU level fiscal rule. Conversely, it may also be the case that the two are complementary so that national preferences for fiscal profligacy lead to a large supranational effect on the budget structure, while EU fiscal constraints are quite irrelevant when the Member States prefer restraining spending on their own.

However, given that fiscal rules are reasonably stable over time and the timeframe for adherence to the reformed framework mandated at EU level with a level of homogeneity thus implied across the Member States, it could be argued that such differences would be captured by country fixed effects, especially when considering the coming into force of the former prescription as a breaking point and looking separately at the two eras pre and post the Fiscal Compact. Specifically, one may distinguish across two components of national fiscal rules (*NFR*) for each country:

$$NFR_i \begin{cases} OFR, stable\ over\ time\ and\ captured\ by\ country\ fixed\ effects \\ EFR, changes\ by\ phases\ EUEG\ captured\ by\ specif.of\ indep\ var \end{cases}$$

For each Member State, the first element (*OFR*) indicates the component related to 'own fiscal rule preferences', which has been argued in the literature to be fairly stable over time within countries and would be captured by country fixed effects. The second element (*EFR*) captures the 'EU surveillance' component of national fiscal rules, either reflecting the need to comply with the supranational framework or in the most recent iteration of the EU economic governance infrastructure the prescription of explicitly translating commitments into national rules. The latter component can be captured by the independent variable across its difference specifications (e.g. reflecting the phases of EU economic governance or the Fiscal Compact).

Parallel reasoning can apply to variables measuring national fiscal rules and specifically their strictness as captured by the Fiscal Rule Index. Within this framework from a theoretical perspective, one can distinguish among Fiscal Rule Index (*FRI*) components associated with country preferences (*OFRI*) and European level prescriptions (*EFRI*), as illustrated below:

$$FRI_{it} \begin{cases} OFRI_i - stable\ country\ preferences \\ EFRI_t - changing\ EUEG\ prescriptions \end{cases}$$

In capturing the former, several approaches may be followed, either looking for changes over time – associated to changes in the EU economic governance framework – within each country or where each country sits at a specific time in comparison with the other countries falling within the same regulatory framework. Following the latter approach, one may devise a domestic fiscal rule strength indicator differentiating across below the median and above the median of the Member States or those countries, for example, falling within the domain of applicability of the provisions of the Fiscal Compact. Such an approach also allows for additional analysis, especially in investigating the interaction between the supranational and domestic arena. The derived indicator may not only be controlled for but also interacted with EU economic governance framework to capture the varied impact of the latter in the Member States with high and low strengths preferences\enforcement mechanisms, as indicated by the strictness of the national fiscal framework.

In this context, the Fiscal rules database of the European Commission (2019b) contains a 'Standardised fiscal rule index' (FRI) covering the 1990 - 2017 period, which being stable within countries across the last three years may be reasonably extended to 2018, allowing for the above-described classification in respective terms and the constructions of a national fiscal rule strength indicator (NFR). The indicator can be constructed by calculating yearly averages of the Fiscal Rule Index, reflecting a stable regulatory framework, and coding each country at time t with a high (low) fiscal rule strength preference if their index is above (below) the average at the given time, associated with a value of one (zero) for the NFR:

$$Fiscal\ rule\ strenght\ preference\ (NFR)_{it} \begin{cases} 0\ if < average\ FRI_t \\ 1\ if > average\ FRI_t \end{cases}$$

This results in a quite balanced indicator across the panel with 311 observation within countries favouring a higher fiscal low strength and 361 instead belonging to the Member States preferring weaker restraint to domestic spending.

The second institutional variable is far more straightforward to operationalise. Decentralisation measures are available in the context of the Comparative political dataset (Armingeon et al., 2019), which includes information on whether the country has a federal institutional framework (*fed*) as well on Lijphart's second federal-unitary dimension (*Isec*). The first, based on Huber methodologies distinguished among countries with no, weak and strong federalism - assuming respectively values zero, one and two - covers both the scope and timeframe of the entire dataset (Armingeon et al., 2019). The second, being inputted in 1960 for the initial period irrelevant for the analysis and in 1981 for the period 1981-2010, consists consequently of a single stable country value across the whole timeline, with the exclusion of Cyprus for which no information is available (Armingeon et al., 2019). While the indicated timeframe may suggest *Isec* cannot cover the necessary timeframe, it should be noted that, except for Belgium between 1992 and 1993, no changes within countries are captured between 1990 and 2017 indicating that for both indicators, their coverage can be reasonably extended to the full period considered in the analysis (1995-2018), opting for the first variable which covers fully the 28 countries.

Economic factors

Within the economic arena, the first key dimension relates to the economic climate. Given the significant changes for both the dependent and the independent variables, it was already highlighted how the period of the Great Recession deserves a dedicated analysis in the context of chapter six and seven. Nevertheless, panel restrictions and interaction require an operationalisation of the crisis variable, through a dummy capturing the timeframe of the Great Recession and Eurozone crisis in the years spanning from 2009 to 2011. In addition to the simplest consideration of a single period, the analysis can also be expanded to distinguish across the early (2009-2010) and late (2011-2012) stage, in assessing whether within crisis dynamics differ – along with the robustness of results to the absence of the severe market pressure characterising the second phase.

Moving on to the key controls concerning the economic arena to be deployed throughout the analysis, as already discussed extensively in chapter two, Tsebelis and Chang (2004) argue for the use of (a) unemployment and (b) the old-age dependency rate, in line with empirical findings of the key economic drivers of changes in budget size and composition. In this context, before moving on to the operationalisation of the variables, it should also be noted that Tsebelis and Chang confirmed their variable choice through sensitivity analysis including growth and inflation, which were left out of the analysis as a result. While the dataset covered by Tsebelis and Chang (2004), considers a different time and geographical scope, it should be noted that the primacy of social – and especially pension and unemployment – spending remains a feature of budgets within the EU28. Similarly, the exclusion of variables linked to the monetary context is unproblematic especially within the Eurozone. The same cannot be directly extended to those relating to aggregate spending and the derived potential pressure for consolidation. However, it was highlighted in the previous chapter and in the limitations of the scope of this analysis that within the EMU fiscal surveillance – e.g. the EDP and its powerful signalling on the sustainability of public finance assessment – can be reasonably argued to be the primary channel for budgetary discipline. Indeed, the SGP and its corrective component of the EDP were devised exactly to compensate for the weakening of market pressures as a result of the common currency – which in turn also lessens an autonomous concerns for sustainability as a result of imbalances (e.g. high deficit and debt). On such premises, and given the problematic disentanglement of attribution of effects independent from the supranational pressure alike for fiscal rules, no further controls for domestic economic circumstances are directly included in the analysis. At the same time, some elements of heterogeneity of circumstances are considered when distinguishing dynamics across the core and periphery.

For what concerns the operationalisation of economic control variables, in line with the overall research design yearly changes in the two rates indicated above are considered. Specifically, starting from (a) annual unemployment – capturing "the number of unemployed persons as a percentage of the labour force" according to ILO definitions – rate data is available as of 1995 up to 2019 through Eurostat (2019a). On this basis the indicator of changes in the unemployment rate (*ΔUR*) is constructed as follows:

$$\Delta UR_{it} = UR_{it} - UR_{it-1}$$

It should be noted that coverage is not universal, especially in the early years, with up to six observation missing as of 1997, three in 1999 and France remaining the sole excluded from 2000 to 2002. Such dimension should be kept in mind in terms of which observation are dropped for early years when controlling for changes in the unemployment rate. The OECD dataset allows to partially complete the coverage over the sample, resulting in 38 missing data, of which only 6 relating to the 1999-2020 period and none relating to a Member State at the time within the Eurozone.

Moving on to (b), the old-age dependency ratio – capturing the proportion between the (normally) inactive elderly population and that of working age – is available through Eurostat (2019b) starting from 1995 to 2019. Specifically, the old-age dependency ratio (*EDR*) captures the share per 100 persons of working age (15-64) of persons aged 65 and over. Both of the latter information is available through Eurostat (2019c) population database so that the early values can be imputed accordingly so that the old-age dependency ratio (*EDR*) is constructed as follows:

$$EDR_{it} = POPED_{it} / POPWA_{it} * 100$$

Where *POPED* represents the population 65 and over, while *POPWA* represents the population aged between 15 and 64. Having expanded coverage to the full dataset, the indicator of change in the old-age dependency rate (*ΔEDR*) is constructed as follows:

$$\Delta EDR_{it} = EDR_{it} - EDR_{it-1}$$

4.5 Data analysis

On the basis of the multitude of secondary data sources and own elaborations outlined in the previous sections, two datasets are constructed: (i) on cabinet information and political positioning (merging data from ParlGov and the Manifesto Project) and (ii) the full dataset for the analysis containing information on a panel of 24 years and 28 countries across the dependent, independent and domestic control variables. In summary, the variables included are:

- *dependent variables*: (i) budget distance, (ii) the ten division level budget components, (iii) the 69 group level budget components and (iv) the five macro-aggregates of investment, transfers, inequality mitigation and budget lines catering to youth and the elderly.
- *independent variables*: (i) membership to the Union and the Eurozone, (ii) EDP status, (iii) regulatory framework iteration through phase 1 to 3 (including the alternative specification accounting for the SGP suspension), (iii) Fiscal Compact status and (iv) falling under financial assistance (FAP).
- *domestic controls*: (i) political factors of ideology, ideological distance and alternation, (ii) institutional factors of decentralisation and national fiscal rule strength preferences and (iii) economic factors of unemployment and old-age dependency rates, as well as the timing of the crisis.

Additional variables are generated to distinguish across geographical areas such as the EU15 in excluding eastern countries and dummies for the core and periphery introduced in detail in the context of their use in the analysis.

While missing values and their country-time distribution have already been highlighted throughout the outlining of the variables for the analysis, only 34 variables are missing for the aggregate budget distance indicator, due to the design of the yearly difference excluding the initial data point and the early gap of Croatia. Nevertheless, sample sizes and potential problems and limitations relating both to missing data and the distribution of the independent variable(s) are discussed in the context of each hypothesis tested due to the variegated set of subsamples required for the assessment of the research questions at hand, of which a high-level rationale is presented in the remainder of the section. On such premises, the analysis cross-sectional time-series – complemented by case studies solely for [HP1.C] on the EDP-CSRs congruence – is carried out as a linear regression with panel corrected standard errors, employing the xtpcse command in Stata. Before turning to the empirical analysis, the section provides a brief overview of the matching of the variables across the three main research questions, providing preliminary information and rationale for the interactions and panel splits throughout the analysis.

The multifaceted nature of EU economic governance

The first empirical chapter is devoted to going beyond EU economic governance as a monolith and distinguishing across its components and evolution in addressing:

> [HP1] *the effect of the SGP on the budget structure varies across components and reforms of the supranational regulatory framework.*

In alignment with the main question and sub-questions, the impact on the synthetic indicator of the budget distance of the independent variables of (i) membership, (ii) EDP status and the interaction of the first two across the three phases of EU economic governance and the Fiscal compact are considered, excluding in all instances countries under financial assistance. In addition, the interpretation of overall dynamics is supported by considering, along with budget distance, dynamics at the component level which are informative not only on the size but also on the direction of the change. On the account of membership and EDP status – considering the fracture line of the Eurozone – the sample is quite balanced both in terms of observations within and outside of the Euro area (slightly in favour of the former) and EDP status across the two, affecting about 40 and 37 per cent of observations respectively. The same is not the case across governance phases, with only 15 per cent of observations under the EDP in the first iteration of the Pact, raising substantially to 46 per cent in phase two and remaining in phase 3 at nearly 42 per cent. From such a perspective, while both interactions among the variables and panel splits are fairly unproblematic in the assessment of dynamics across Eurozone Membership and EDP status, the limited number of observations under the EDP in the early years of the Pact should be considered in interpreting the interplay between the corrective arm and the iterations of the regulatory framework and results across the subsamples. That is not the case for the Fiscal Compact as while only 109 observations fall under its regulatory purview concerning balanced budget rules, a fair amount of observations (30 per cent) are subjected the EDP.

Coming to the last element of [HP1], without delving into excessive methodological details, it should be noted that the analysis needs to expand beyond the focus on the aggregate dependent variable to consider the effect of the EDP – for the subsample of Eurozone countries in the timeframe following the introduction of the Semester – on (i) division level disaggregated budget components and (ii) macro-aggregates across investment transfers and inequality. As such, the analysis of the first research question focuses on aggregate dynamics, while delving into disaggregated details as an exception for the specific needs either to support interpretation or to assess specific budget line changes in the context of [HP1.C] on the EDP-CSRs congruence.

Accounting for the specificity of crisis

Moving on to the second research question, chapter six and seven are dedicated to addressing the impact of EU economic governance and specifically the EDP on budgetary dynamics in times of crisis in assessing:

> [HP2] *the SGP does not change the budget structure and induce consolidation during the Great Recession and Eurozone crisis.*

It is of use to reiterate the need for a separate account of the period of the Great Recession and Eurozone crisis, backed not only by the literature but also by the data in relations to spending dynamics across the cycle. As indicated in the crisis-specific research questions and hypothesis, it should be recalled that the Pact changes in the negative cycle, with its flexibility under the 2005 reform of the SGP implying that the exceptional circumstances clause provided for the halting of any sanctioning mechanism (Heipertz and Verdun, 2010). That amounts to de facto altering the nature of the supranational fiscal rule in the absence of any instrument of enforcement and compliance, indicating as well the potential for increased political leniency toward spending. Such reality is reflected in deficit performances across the Member States and years shown in the heat-map in Figure 4. 4 below, depicting how mildly (exceeding the three per cent threshold, in yellow) and strongly (doubling the allowed limit, in red) negative values are concentrated predominantly in the crisis years and shortly after.

Turning the focus on the budget structure, likewise, the national driven dynamics are not unaffected by the cycle. As already pointed out in justifying a separate account of the period, a negative downturn poses strains on the public budgets through several channels both in terms of decreased revenues and increased expenses. Focusing on the latter, it was already indicated that stimulus efforts as well as bailouts can greatly affect fiscal policy and in turn the budget structure. Together with the functioning of the supranational fiscal rule, prescriptions related to fiscal policy also change in times of crisis, both in terms of aggregate objectives and composition.

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	201
EU27 (2007-2013)	-1,6	-0,9	-2,5	-6,6	-6,4	-4,6	-4,3	-3,3	-2,9	-2,4	-1,7	-1,1	-0,7	
EA17 (2011-2013)	-1,5	-0,6	-2,1	-6,2	-6,3	-4,2	-3,7	-3,0	-2,5	-2,0	-1,5	-1,0	-0,5	
Belgium	0,2	0,1	-1,1	-5,4	-4,1	-4,3	-4,3	-3,1	-3,1	-2,4	-2,4	-0,7	-0,8	
Bulgaria	1,8	1,1	1,6	-4,0	-3,1	-2,0	-0,3	-0,4	-5,4	-1,7	0,1	1,1	2,0	
Czechia	-2,2	-0,7	-2,0	-5,5	-4,2	-2,7	-3,9	-1,2	-2,1	-0,6	0,7	1,5	0,9	
Denmark	5,0	5,0	3,2	-2,8	-2,7	-2,1	-3,5	-1,2	1,1	-1,2	0,1	1,8	0,7	
Germany	-1,7	0,3	-0,1	-3,2	-4,4	-0,9	0,0	0,0	0,6	0,9	1,2	1,2	1,9	
Estonia	2,9	2,7	-2,6	-2,2	0,2	1,1	-0,3	0,2	0,7	0,1	-0,5	-0,8	-0,6	
Ireland	2,8	0,3	-7,0	-13,8	-32,1	-12,8	-8,1	-6,2	-3,6	-2,0	-0,7	-0,3	0,1	
Greece	-5,9	-6,7	-10,2	-15,1	-11,2	-10,3	-8,9	-13,2	-3,6	-5,6	0,5	0,7	1,0	
Spain	2,1	1,9	-4,6	-11,3	-9,5	-9,7	-10,7	-7,0	-5,9	-5,2	-4,3	-3,0	-2,5	
France	-2,4	-2,6	-3,3	-7,2	-6,9	-5,2	-5,0	-4,1	-3,9	-3,6	-3,6	-2,9	-2,3	
Croatia	-3,1	-2,2	-2,8	-6,0	-6,5	-7,9	-5,4	-5,3	-5,3	-3,3	-1,0	0,8	0,2	
Italy	-3,6	-1,3	-2,6	-5,1	-4,2	-3,6	-2,9	-2,9	-3,0	-2,6	-2,4	-2,4	-2,2	
Cyprus	-1,0	3,2	0,9	-5,4	-4,7	-5,7	-5,6	-5,8	-8,7	-1,0	0,3	2,0	-3,7	
Latvia	-0,5	-0,6	-4,3	-9,6	-8,7	-4,3	-1,4	-1,2	-1,6	-1,4	0,2	-0,8	-0,8	
Lithuania	-0,3	-0,8	-3,1	-9,1	-6,9	-9,0	-3,1	-2,6	-0,6	-0,3	0,2	0,5	0,6	
Luxembourg	1,9	4,4	3,5	-0,2	-0,4	0,6	0,5	0,8	1,3	1,3	1,8	1,3	3,1	
Hungary	-9,3	-5,1	-3,8	-4,8	-4,5	-5,2	-2,3	-2,6	-2,8	-2,0	-1,8	-2,5	-2,1	
Malta	-2,5	-2,1	-4,2	-3,2	-2,4	-2,4	-3,5	-2,4	-1,7	-1,0	1,0	3,3	1,9	
Netherlands	0,1	-0,1	0,2	-5,1	-5,2	-4,4	-3,9	-2,9	-2,2	-2,0	0,0	1,3	1,4	
Austria	-2,5	-1,4	-1,5	-5,3	-4,4	-2,6	-2,2	-2,0	-2,7	-1,0	-1,5	-0,8	0,2	
Poland	-3,6	-1,9	-3,6	-7,3	-7,4	-4,9	-3,7	-4,2	-3,6	-2,6	-2,4	-1,5	-0,2	
Portugal	-4,2	-2,9	-3,7	-9,9	-11,4	-7,7	-6,2	-5,1	-7,4	-4,4	-1,9	-3,0	-0,4	
Romania	-2,1	-2,7	-5,4	-9,1	-6,9	-5,4	-3,7	-2,1	-1,2	-0,6	-2,6	-2,6	-2,9	
Slovenia	-1,2	0,0	-1,4	-5,8	-5,6	-6,6	-4,0	-14,6	-5,5	-2,8	-1,9	0,0	0,7	
Slovakia	-3,6	-2,1	-2,5	-8,1	-7,5	-4,5	-4,4	-2,9	-3,1	-2,7	-2,5	-1,0	-1,0	
Finland	4,0	5,1	4,2	-2,5	-2,5	-1,0	-2,2	-2,5	-3,0	-2,4	-1,7	-0,7	-0,9	
Sweden	2,2	3,4	1,9	-0,7	0,0	-0,2	-1,0	-1,4	-1,5	0,0	1,0	1,4	0,8	
United Kingdom	-2,8	-2,7	-5,1	-10,1	-9,3	-7,5	-8,2	-5,5	-5,6	-4,6	-3,3	-2,5	-2,2	
	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	

Source: Eurostat, Government deficit/surplus, debt and associated data

Figure 4. 4 - Heat map of deficit across the Member States and over time

Firstly, in aggregate terms, fiscal policy goals differ in bad times to smooth the cycle (Tóth, 2017), so that overall expenditures and especially those related to social policies are expected to act counter-cyclically (Rodden & Wibbels, 2010). Additionally, the appropriate fiscal policy mix in bad times also varies, with some arguing that especially in the midst of an economic crisis it is of the essence to concentrate spending within those domains that yield a positive long-term growth contribution (Jeong et al., 2019). Theoretical expectations on countercyclical dynamics deteriorating countries fiscal position found extensive confirmation in the Great Recession, with countries generally experiencing "significant structural weakening of their public finances in the wake of the financial crisis", with increased expenditures through fiscal stimulus packages being a key driver (Bozio et al., 2015, p. 413). At the aggregate level, Figure 4. 4 above, looking at the evolution of EU Member States public finances before, during and after the crisis, confirms this picture, with generalised and in some case dramatic deterioration of national accounts. Figure 4. 5 shows how such dynamics reflect onto the budget structure: with some exceptions the sharpest division level (positive) changes take place during the crisis and within the domain of social spending. Conversely, non-crisis years are characterised by a generalised albeit non-universal contraction across most budget lines, however with marked differences in overall size and composition. Such picture confirms the interest of devoting special attention at crisis times in the context of [HP2] and in particular to the key category of social spending both in aggregate and group level terms.

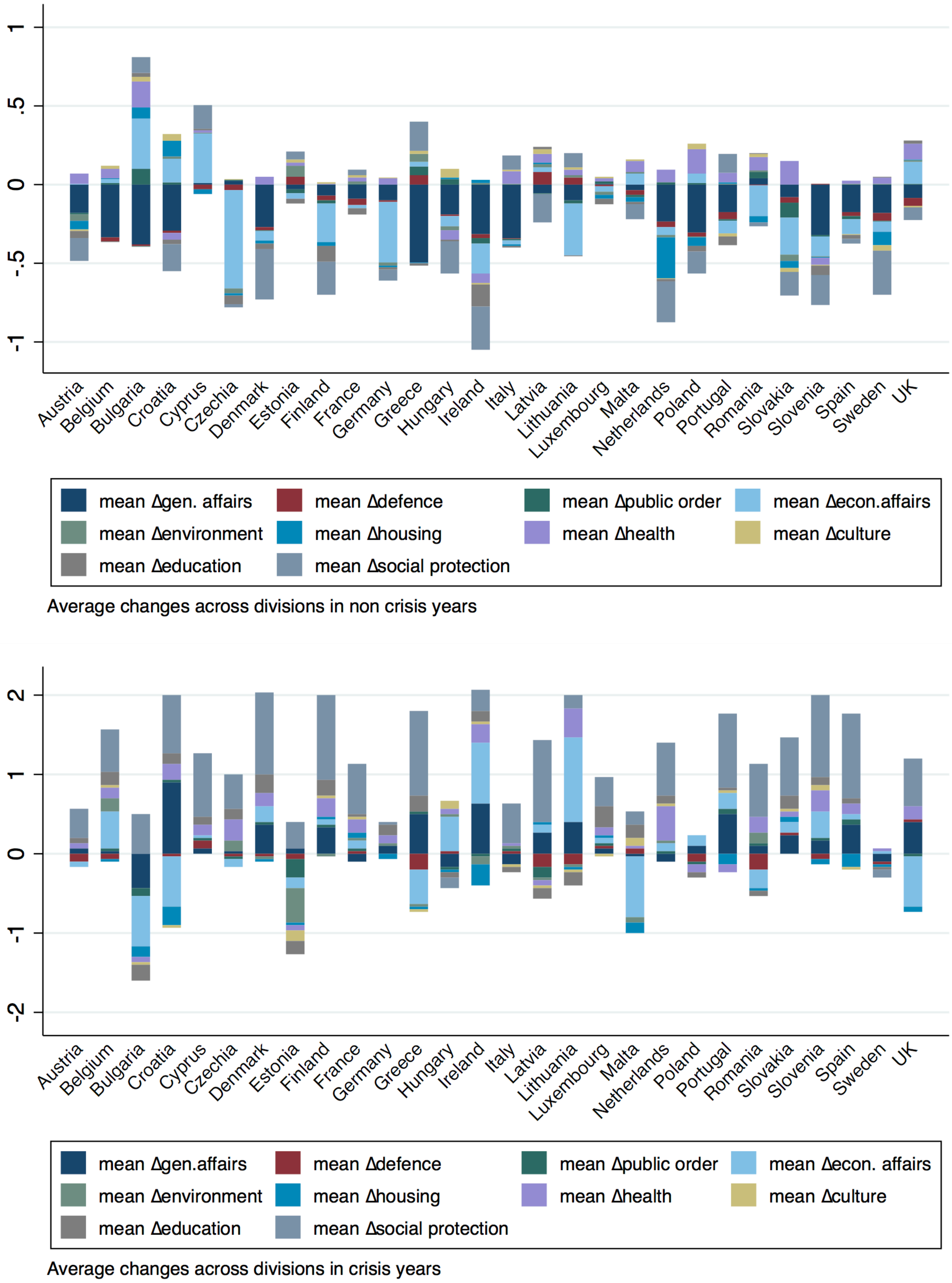


Figure 4. 5 - Average changes in allocations across the Member States and divisions in crisis and non-crisis years

A further element concerning divergences of the impact of the crisis on public expenditures which is not equal across the Member States in crisis times relates to common patterns within geographical clusters. Specifically, "core" and "periphery" countries, with the latter referring to Greece, Spain, Portugal and Ireland, (as well as Italy in some instances), differing substantially in terms of the debt track records in the years preceding the crisis, experienced a divergent trajectory also in terms of public expenditures (Censolo & Colombo, 2016, p. 705). Such differences are reflected in the crisis-related increased deficit turning into divergent trajectories for debt and fiscal standing across the core and periphery (Bertarelli et al., 2014). As depicted by Figure 4. 5, divergence in the impact of the crisis can also be identified in terms of the budget structure (Censolo & Colombo, 2016). Specifically, it has been noted that while core countries experienced contained disturbances to the allocations of public expenditures, the fiscal policy mix of periphery countries was substantially impacted by the crisis, to the detriment of the balance between investment and transfers with the former crowded out by crisis-related budgetary needs (Censolo & Colombo, 2016). Within this context, public investment came to a blunt halt in the periphery, with its share halving from the 2007-2008 average to the 2001-2012 average – while remaining essentially stable in the core – with a corresponding sharp rise in social benefits and debt interest (Censolo & Colombo, 2016). The composition of public expenditure also varied, with convergence mostly limited to social protection, namely due to periphery's share increasing toward the higher levels of core countries. Conversely, periphery countries changed their fiscal policy mix to the detriment of education – whose share in terms of the total public budget remained stable in the core – and health expenditures, confirming the image that the budget structure in the periphery tilted away from investment during the crisis (Censolo & Colombo, 2016). The core-periphery and diverging trend picture leave open the question of the role of EU economic governance in shaping such patterns or rather the extent to which they are driven predominantly if not exclusively by domestic factors and preferences. Additionally, given the divergent trajectories and lack of convergence in budget structures not only among the EU Member States but also within the Eurozone, expectations may be warranted that the impact of the EU economic governance framework varies across different domestic configurations, so that it may be of key importance to understand its interaction with domestic political, economic and institutional factors.

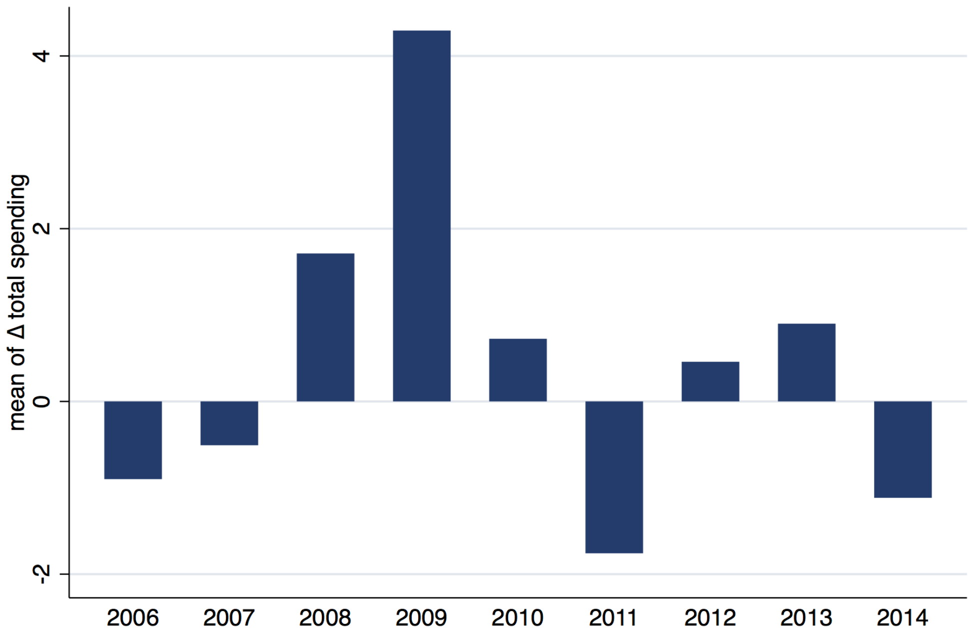


Figure 4. 6 - Eurozone average changes in total spending in the years surrounding the crisis

An additional consideration regards the dynamic of public expenditures throughout the crisis. While expectations generally indicate a gradual reining in of budgetary positions during and in the aftermath of the crisis, this was largely not the case in the Great Recession, as negative dynamics of deficit and debt put into question the sustainability of the positions of many countries, especially within the Eurozone (Marcel, 2014). In this context, Figure 4. 6 above already depicts this dynamic, corresponding to a substantial decrease in total government expenditures as a percentage of GDP starting for some countries as early as 2010. This trajectory may be of particular interest for the research question, in understanding the extent to which the EU economic governance framework and its pressure to enact austerity measures to converge towards SGP targets contributed to such evolution, and how in turn the budget structure was affected.

Having considered crisis dynamics for the dependent variable already indicating the value of assessing patterns across all level of (dis)aggregation, a few characteristics of the sample should be considered in delineating the most appropriate methodological approach. Firstly, a limitation to consider is that crisis years restrictions come with limited sample sizes, with 84 observations overall and only 49 within the Eurozone. In addition, EDP prevalence changes dramatically across the two periods, within the Euro area amounting to just 34 per cent of observations in good times while over 70 per cent in bad times. Additionally, while in-crisis dynamics are per se of interest in the context of the research question, considering the cross-cycle change of the impact of the EDP is of high value in determining whether there is a weakening or a strengthening of the bite of the framework across the economic climate. Caution should be nevertheless exercised in the interpretation of results coming from limited sub-samples, which is especially the case in distinguishing across early and late phase of the crisis or within the Great Recession changes across the post-2005 and post-2011 iterations of the regulatory framework.

Domestic and supranational factors: interactions

Coming to the last empirical chapter and research question, the final part of the analysis is dedicated to the interplay of the supranational and national level in shaping the budget structure assessing:

> [HP.3] *the impact of EDP surveillance is greater for national political, institutional and economic configurations favourable for fiscal consolidation.*

That is to say that the interactions are considered across the EDP and domestic factors in the political, institutional and economic domain which are those controlled for throughout the analysis as outlined by the previous section. In this context, the primary dependent variable returns to the synthetic aggregate level of budget distance expanded as need be to the macro-categories of spending and in limited instances individual budget lines. On the side of the independent variable, the EDP remains the primary focus, while Eurozone membership and not falling under financial assistance determine the sample restriction in the near entirety of chapter eight, except for the assessment devoted to dynamics under FAP. In addition, a further distinction across national dynamics in the core and the periphery is deployed for most of the analyses of EU-domestic interactions. Beyond those general considerations, uniformity stops across the multitude of domains and variables requiring at times different approaches to better align with the needs of the research question and data structures.

For the political arena, the focus is that of identifying which domestic configurations lead to a more substantial restructuring of national budgets at the hands of the supranational fiscal rule. For ideological distance and alternation that amounts to test whether the impact of the EDP increases for ranges of coalition characteristics more conducive to changes in the budget structure. Such an indication can be obtained by splitting the sample across low and high values of the two variables. The same reasoning applied also to government's ideological positions, in comparing across which ranges the transmission of supranational prescriptions is facilitated or hindered.

The dynamics change in the institutional arena, as - for what concerns decentralisation - the variable captures (few) federal countries, one middling and the vast majority of unitary countries. Any consideration about middling countries is unfeasible while also federal-unitary comparisons remain problematic at best even within the full sample. The same is not the case for national fiscal rule preferences, as the challenge in this domain refers primarily in a conceptualisation and operationalisation disentangling the two levels rather than the data structure itself. Not only is indeed the panel balanced across low and high fiscal rule preferences, but also the prevalence of the EDP is not dramatically misaligned, ranging from 27 to 36 per cent of observations. In this context, both the interaction among the EU fiscal rule and national preferences are considered, as well as within the core-periphery subsample.

Coming to the economic domain, the analysis provides an overview of the interaction between the economic climate and the EDP, while also considering the (intended) distributional impact on the fiscal policy mix for countries under FAP. In addition, the interplay between the supranational fiscal rule and the two domestic key determinants of the budget composition is considered in terms of how they change the restraining force of the EDP together with the extent to which being under the corrective arm limits the budgetary reaction to changes in these two central domestic factors.

Conclusions

The chapter has delineated the research design and methodological choices of the analysis addressing the key challenges linked with the complexity of the dimension affecting the impact of the EU economic governance on the budget structure both at the supranational and national level, together with their interplay.

Specifically, the chapter has justified the selection of the variables and indicators included in the analysis in line with the research questions and preliminary descriptive statistics of the data. For the dependent variable, the operationalisation allows assessing dynamics at the (i) aggregate synthetic level, (ii) disaggregated level and (iii) for meaningful macro components such as investment and transfers. For the independent variable, section two – building on the literature – carefully identified all elements within the EU economic governance framework contributing to determining a diverse impact of the supranational fiscal rule. In addition, the innovative approach goes beyond a simplistic characterisation and operationalisation of the Pact testing conversely the impact of the 'stick' which is represented by the excessive deficit procedure. At the same time, considering key factors changing the effect of the framework and accounting form them in the analysis, uncovering the precise identification of those configurations of the supranational fiscal framework leading to an impact on national budget structures. The same reasoning applies to the interplay with the domestic arena, pinpointing the national preconditions for the supranational fiscal rule to lead to adjustments to the fiscal policy mix.

As such, the analysis, on one hand, identifies how national dynamics facilitate or hinder the constraining effect of the supranational framework while at the same time further evidencing the power of the EDP – even in the absence of any actual sanctioning over its life and a problematic compliance track-record – in restraining key national drivers of the composition of the fiscal policy mix such as demography and employment.

The chapter additionally highlights the limitation of the data in general terms and for specific research questions. In doing so alternative data sources and specifications were discussed while considering as well how given detailed distinctions within the data set – such as across the early and late crisis years or different levels of decentralisation – may be problematic given the number of observations falling within a particular subsample. In this context alternatives and mitigations were presented together with caution concerning the interpretation of specific results or the exclusion of in-depth distinctions unfeasible given the structure of the data. Nevertheless, those limited instances should be considered against the broader background of the analysis, especially as limitations run against the emergence of any significant effect, thus further reinforcing the results. However, given the possible specific unbalances and problems emerged in this chapter, the discussion of model specifications and descriptive statistics for each sub-research questions are mindful to this dimension reiterating how it may determine choice in the analysis relating to interaction and sub-samples.

5. The impact on national budget composition across the multifaceted dimensions of EU economic governance

Having developed in chapter four the analytical framework for the assessment of the research questions at hand, this chapter is devoted to the first set of research questions within:

[RQ1] *when and how the SGP affects the composition of national budgets.*

Firstly, in building the baseline model for the analysis in section one, the most basic account for the SGP overall as membership to the Union and the Eurozone is considered in looking at the effect of the EMU on national budget structures before turning the focus to the detailed mechanisms of the EU economic governance framework to which specific sub-questions are dedicated. This preliminary assessment also provides some insight on the potential for an impact on the budget structure regardless of the hard coercion mechanisms of sanctioning. Findings are of relevance both for the soft dimension of the SGP with the Semester and the analysis of the sanctioning-escaping crisis years in the subsequent chapter.

Shifting the focus on the hardest element of the supranational fiscal rule, the first sub-question is dedicated to the Excessive Deficit Procedure, which from a theoretical standpoint is the king in the EU governance framework in impacting Member State budgetary choices and spending allocations. Specifically, the hypothesis of a consolidation driven increase of the budget distance in association with the EDP is tested, considering as well the configurations for which being recognised as having an excessive deficit should lead to the starkest impact, namely within the Euro area. In doing so the section assesses whether:

[HP1.A] *falling under EDP surveillance leads to consolidation-driven higher structural changes in national budgets.*

Given the substantial changes over time to the regulatory framework, culminated with the introduction of the Fiscal Compact containing the most intrusive provisions in relation to Member States budgetary policies, it is likewise unrealistic to expect the impact of the EDP to remain constant over time. Rather, its impact is likely to change across policy reforms, in parallel with the resulting strictness of EU economic governance within each framework.

Such differences may affect both the preventive and corrective arm of the framework while being on prime importance for the latter as the effectiveness of the stick of sanctioning – and the political and procedural pressure – may very well vary across weaker and stronger enforcement mechanisms and especially in the latest iteration in which the commitment to national budget is translated directly into national legislation. In this context, section three assesses whether:

> [HP1.B] *the impact of EDP surveillance on the composition of national budgets substantially increases with the 2011 reform of the SGP*

Finally, the last section moves toward the opposite end of the spectrum, considering the 'softest' dimension of the EU economic governance framework, which is at the same time the only element aiming in principle at directly affecting expenditure composition at the national level, rather than a mostly indirect effect through the budget constraint imposed by the supranational level. Specifically, the congruence with the impact of the fiscal rule side of the framework and the economic policies coordination within the Semester is considered testing whether the impact of the EDP on the fiscal policy mix is aligned with Country-Specific recommendations. Section four hence assesses whether:

> [HP1.C] *the impact of EDP surveillance on national budget structures is congruent with the CSRs.*

Such overview provides a general understanding of the varied impact of the EU economic governance framework across its components and iterations, on one side allowing to already derive preliminary implications with regards to the SGP and EDP and on the other setting the stage to the later assessment in the subsequent chapters of the specificity of crisis years and the interaction between the supranational and national arena.

5.1 Supranational 'membership' impact on the budget structure

The overarching theme for this chapter revolves around the first research question, namely the varied impact on the national budget structure within the multifaceted EU economic governance in considering:

> [RQ1] *when and how the SGP affects the composition of national budgets.*

The analysis of chapter five assesses the first hypothesis of a varied impact of the SGP across its components and iterations. The starting point is the identification of the extent to which there is an overall effect of the SGP, that is to say of membership to the EMU. At the same time, in terms of membership, accession to the Euro Area is a key distinction within the supranational fiscal governance framework. In addition, these membership-driven conceptualisations of the supranational fiscal rule are often the independent variables of choice within the literature on EU economic governance (and its interplay with national budgetary institutions). In this context, this section considers the impact of the SGP on the budget structure, creating a baseline for more sophisticated distinctions across components of the supranational fiscal framework. At the same time, the baseline allows for the comparison of the relation between the supranational fiscal rule and national budget structure within the broader context of previous studies on fiscal rules and national budgetary outcomes.

Two preliminary steps in the research take place in this section: (i) developing the baseline model that will guide the empirical analysis throughout and (ii) the assessment of the selected national controls and whether their relationship with the budget structure is aligned with expectations. The section proceeds with putting forward the model specifications, followed by descriptive analysis before presenting results and finally discussing their implications.

Model specification(s)

Chapter four has presented the conceptualisation of the dependent variable(s), the independent variables and key national controls for the analysis which result in the variable matrix presented in Table 5. 1 below. Starting from this baseline, the model is then adapted throughout the analysis in line with each specific research question and hypothesis. The main dependent variable is the synthetic indicator of the budget structure captured by the budget distance, with the analysis repeated for the ten division components of the fiscal policy mix to aid the interpretation of results for the aggregate indicator. In assessing the impact of membership, the independent variables are the dummies capturing participation to the Union (EU) and the Eurozone (EZ).

The data covers the 28 Member States over the period 1996-2018, as both the dependent variable and some control variables represent the change against the previous year, resulting in 644 country-year observations.

Table 5. 1 - Baseline variable matrix

Dependent variable		Independent variables	Controls			
		x1	z1	z2	z3	z4
		EU	ideology	ideological distance	alternation	Δ unemployment rate
		x2	z5	z6	z7	z8
y	Budget distance	EZ	Δ old age dependecy rate	decentralisation	national fiscal rule preference	Great Recession

Given the nature of some of the independent variables and controls – often fully or largely stable within countries (e.g. EU and Eurozone membership, decentralisation) – fixed effects are excluded. Some controls would not be considered as perfectly country-invariant indicators and variables with limited within-country variation over time would be similarly problematic. Additionally, in deploying fixed effects in the model, only within-country variation can be explained, with information regarding cross-country variation fully captured by the country dummy variables. The model considers a panel with the potential for cross-sectional dependencies, accordingly estimated with panel-corrected standard errors.

As mentioned above, before delving into the analysis of the research question at hand a preliminary evaluation of control variable is carried out in considering a 'national' model, which only encompassed the key dependent variables and the national determinants of the composition of public expenditures, allowing for more straightforward comparison with expectations in the absence of the account for the supranational arena.

Shifting back the focus to the EU-MS puzzle, as anticipated in chapter four accounting for Eurozone membership is less straightforward than may appear at face value. The first consideration relates to the period of the facto suspension of the pact leading to its first reform in 2005 (Heipertz & Verdun, 2010) which may call for an alternative specification accounting for the parallel absence in 2004 of the potential for sanctioning specific of Eurozone countries under the SGP. Pre-accession years constitute an additional problematic element. Specifically, the peak impact of the supranational commitments translating into well behaved national fiscal performances has been associated to the period preceding the EMU given the threat of exclusion, argued to be later substituted by Maastricht fatigue concerning the respect of the EU imposed deficit thresholds (Fatas & Mihov, 2003). If this is the case, the impact of the restraining effect of the Eurozone predates 1999 so that an alternative specification accounting for the pre-accession period may be called for and is considered in the analysis.

Descriptive analysis

Having already considered extensively COFOG division level descriptive statistics in the context of chapter four, the dynamics of the budget distance indicator (*BD*) from 1995 to 2018 across the (would-be) 28 Member States are presented in Figure 5. 1 below. Substantial country-level differences emerge at the national level, with spikes in changes in the fiscal policy mix often taking place around the years of the Great Recession and for countries in financial difficulty, which in many instances where at the given time under a Financial Assistance Programme (FAP).

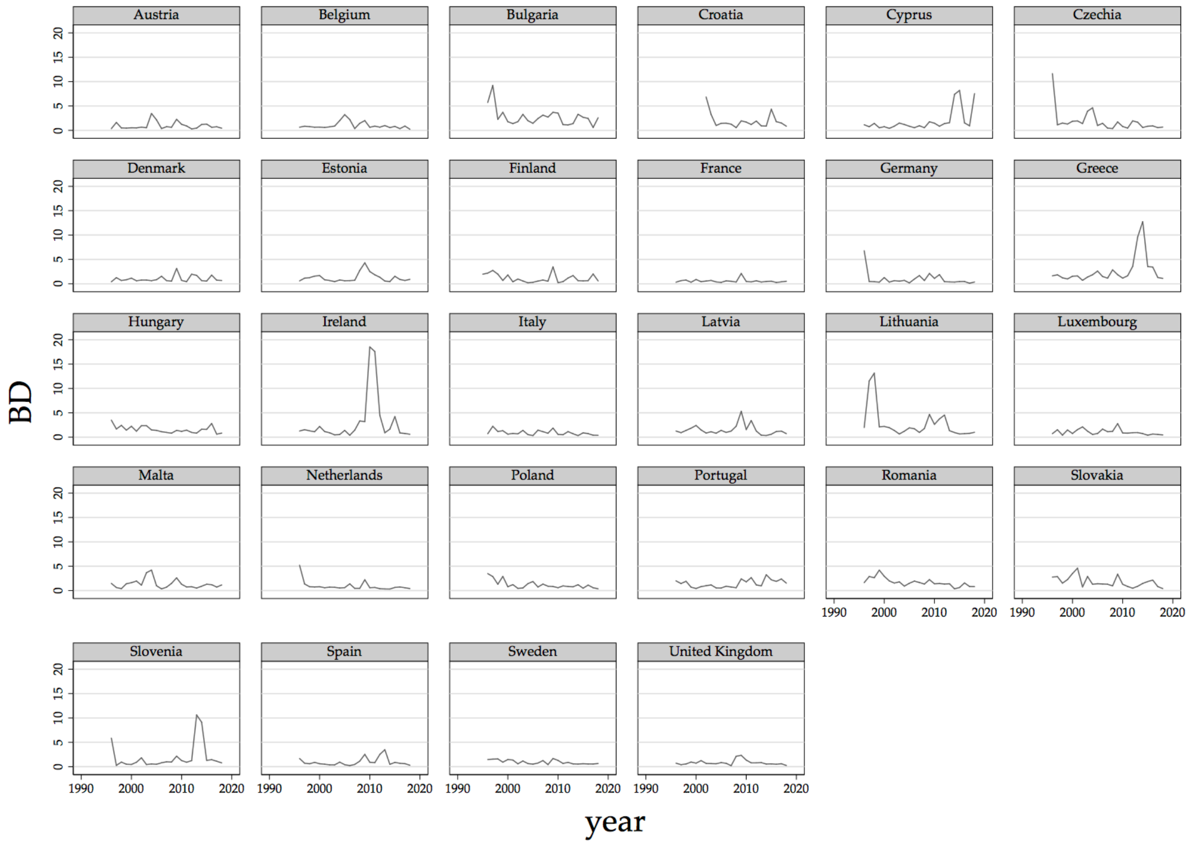


Figure 5. 1 - National budget distances (BD) 1995-2018

Over the full dataset, the dependent variable is defined for 639 observations, with missing data for Croatia until 2001 and the first year available across the sample in considering the difference between two consecutive years. The variable – which reflects synthetically changes in the national budget structure across subsequent years and is denominated as percentage points of GDP - spans from a minimum of 0.1 to a maximum of 18.52. For what concerns the distribution of the variable, *BD* displays a mean change in the fiscal policy mix corresponding to 1.49 percentage points of GDP, with a standard deviation of 1.78. While Figure 5. 1 indicates that extreme values may be concentrated in countries under Financial Assistance, excluding those Member States only partially limits the range of *BD* whose maximum scales down to 13.13, accompanied by a lower mean and standard deviation respectively of 1.36 and 1.38.

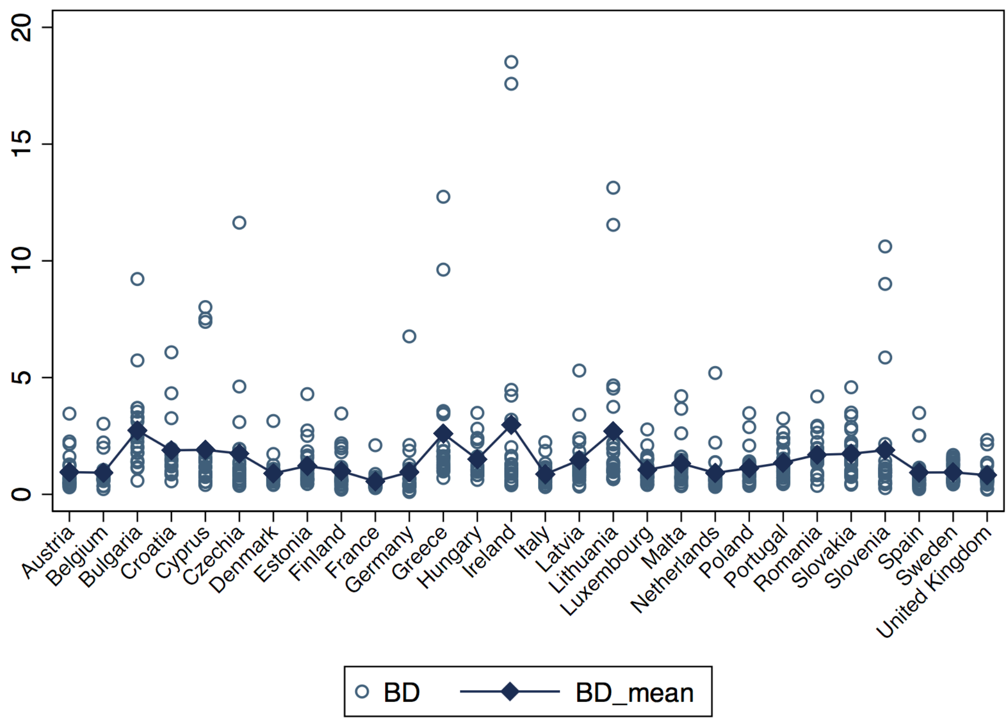


Figure 5. 2 - Budget distances (BD) across country and country averages (BD_mean) in 1995-2018

In understanding the dynamics of the key dependent variable Figure 5. 2 and Figure 5. 3 respectively display the scatter of budget distances within the panel across the 28 (would-be) Member States and the years under consideration, together with the country and yearly means. The emerging trends confirm substantial differences both across-country and for what concerns the trend over the years, specifically with a generalised increase in budget distance – that is to say in changes in the national budget structures – in concomitance with the crisis and especially 2009. Extreme budget distances within the 1995-2018 timeframe are concentrated mainly in two periods: in the years starting with the Euro crisis and following through in its aftermath and pre-1999. The trends may indicate that sharp restructuring of expenditures for some Member States took place pre-accession and in the aftermath of the Great Recession and subsequent sovereign debt crisis.

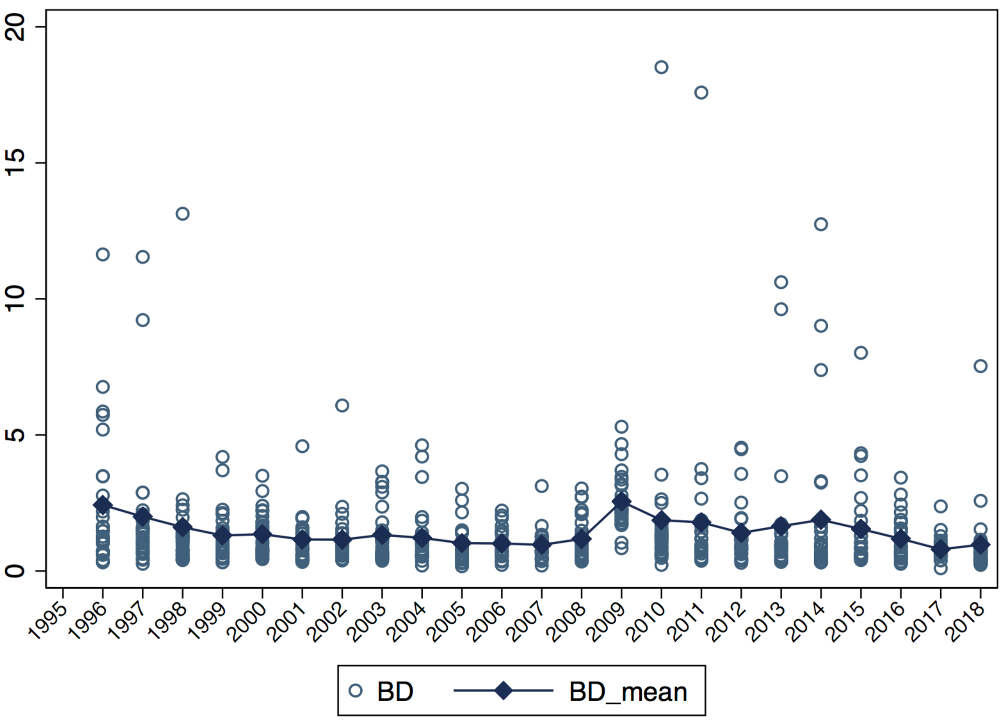


Figure 5. 3 - Budget distances (BD) over the years and yearly averages (BD_mean) in the 28 countries

Moving on to the independent variable(s), considering the full dataset containing 672 observations from 1995 to 2018, 540 observations consist of countries at the time members of the EU, while 299 observations belong to Member States within the Eurozone. For what concerns control variables, missing values are below ten for all variables except changes in the unemployment rate – with the latter exception – available for the full 639 observations for which the dependent variable is defined.

Table 5. 2 - Descriptive statistics across EU membership

	EU 0					EU 1				
	N	mean	sd	min	max	N	mean	sd	min	max
BD	113	2.089	2.126	0.265	13.13	525	1.309	1.662	0.100	18.52
Δ general affairs	113	-0.169	2.224	-13	11.50	525	-0.115	0.530	-3.300	2.800
Δ defence	113	-0.00177	0.343	-1.700	1	525	-0.0168	0.175	-0.900	0.800
Δ public order	113	0.0195	0.298	-0.900	1.100	525	-0.00400	0.111	-0.400	0.600
Δ economic affairs	113	-0.114	1.540	-11.60	3.600	525	-0.0387	1.792	-17.50	18.50
Δ	113	0.00531	0.167	-0.500	0.500	525	-0.000571	0.155	-1.100	1.100
Δ housing & community	113	0.0106	0.382	-1.300	3	525	-0.0293	0.281	-5.100	0.700
Δ health	113	0.0743	0.575	-2.700	2.500	525	0.0480	0.299	-1.500	1.800
Δ culture	113	0.0195	0.171	-0.800	1	525	0.00457	0.128	-0.700	1.200
Δ education	113	0.0195	0.392	-1.600	1	525	-0.0219	0.296	-1.300	2.800
Δ social protection	113	0.0221	0.815	-2.700	3.100	525	0.00857	0.793	-3.400	4.900
Number of countries	28	28	28	28	28	28	28	28	28	28

Descriptive statistics for the key dependent variable across the independent variables of interest are presented, depicting the behaviour of the budget distance synthetic indicator and facilitating preliminary considerations on its interpretation. Table 5. 2 and Table 5. 3 provides descriptive statistics across EU and Eurozone membership respectively, both for the budget distance (BD) and all the disaggregated yearly changes in division level budget items.

Table 5. 3 - Descriptive statistics across Eurozone (EZ) membership

	EZ 0					EZ 1				
	N	mean	sd	min	max	N	mean	sd	min	max
BD	339	1.544	1.523	0.200	13.13	299	1.338	2.022	0.100	18.52
Δ general affairs	339	-0.141	1.379	-13	11.50	299	-0.106	0.444	-1.900	1.500
Δ defence	339	-0.0218	0.254	-1.700	1	299	-0.00535	0.157	-0.700	0.700
Δ public order	339	0.00118	0.199	-0.900	1.100	299	-0.00100	0.102	-0.400	0.400
Δ economic affairs	339	-0.0994	1.192	-11.60	3.600	299	0.00167	2.218	-17.50	18.50
Δ	339	-0.00236	0.176	-1.100	0.700	299	0.00368	0.133	-0.900	1.100
Δ housing & community	339	-0.0274	0.396	-5.100	3	299	-0.0164	0.125	-0.600	0.500
Δ health	339	0.0611	0.421	-2.700	2.500	299	0.0431	0.283	-1.500	1.300
Δ culture	339	0.00914	0.159	-0.800	1.200	299	0.00502	0.106	-0.500	0.500
Δ education	339	-0.0103	0.377	-1.600	2.800	299	-0.0194	0.225	-1	0.800
Δ social protection	339	-0.0416	0.846	-2.700	4.900	299	0.0706	0.734	-3.400	3.200
Number of countries	28	28	28	28	28	28	28	28	28	28

Changes in the structure of the budget are higher on average in non-EU with respects to EU countries. Across the latter, the average budget distance is further lower for Eurozone countries. Additionally, the interpretation of the budget distance indicator is not straightforward. Specifically, values are not connected directly to the size of public expenditures but with the stability of the percentages of GDP devoted to budget items. In this context, lower values of BD indicate more stable budget structures. They are both compatible with slower reductions as well as containment of expenditures increases or even changes across budget items neutral in terms of the overall size of the budget. Accordingly, while the indicator provides a way to synthetically assess through regression analysis if there is an impact on the budget structure (e.g. does EU membership or EZ membership affect the fiscal policy mix), further interpretations require considering more in-depth the expenditure dynamics. In doing so, it is of use to consider the dynamics of specific budget items, as for instances the particularly indicative one of social expenditures. On this account, Table 5. 2 and Table 5. 3 show that positive changes in social expenditures are on average higher for EU with respects to non-EU countries. Member States outside of the Eurozone show on average a negative change in social expenditures, which is instead positive for the adopters of the common currency.

Results

Starting from the evaluation of control variables within the purely national context, all controls except ideological distance and alternation are significant over the full panel (model 1), as shown in Table 5. 4. Specifically, ideology has a significant positive impact on the budget distance, implying that coalitions on the right side of the spectrum tend to change the budget structure more than those on the left. However, the size of the effect is quite risible if one considers even a shift from zero toward the extremes in both sides (-40 and +20 respectively) would lead to a shift in the budget distance between -0.2 and 0.09 compared to a standard deviation grazing 1.78 in the unrestricted sample. A positive impact on changes in the fiscal policy mix also emerges for changes in the unemployment and old-age dependency rate, with the latter leading to a more than doubled shift in the budget structure compared to the former, confirming the king role of unemployment and demography in shaping national expenditures. For old-age dependency rates, that amount to about one third of a standard deviation change in the budget distance when considering the unrestricted sample. Within the institutional arena, both controls have a negative impact on changes in the budget structure, implying the fiscal policy mix is more stable in federal countries and for those preferring stronger national fiscal rules, with effect sizes falling in between those of the two economic controls. For what concerns the key variables determining the national feasibility of changes in budget allocation, significance is achieved in restricting the analysis to Western countries by only considering the EU15 subsample and focusing of a less ambitious timeframe more likely to yield homogeneous conditions (model 2). Specifically, the more extensive the range of a governing coalition the less scope for change in the budget structure, while the opposite is the case for alternation capturing the distance of the status quo from the preferences of the current government. Nevertheless, while the effect for once standard deviation change for alternation exceeds one third of a standard deviation change in the budget distance, in line with other national controls, the size of the effect is very limited for ideological distance alike that of ideology. Nevertheless, the implication is that emerging dynamics at the national level do not contravene theoretical expectations about the control variables selected for the analysis.

Table 5. 4 - Budget distance baseline estimates

	(1)	(2)	(3)	(4)
	BD	BD (EU15 after 2011)	BD	BD (excluding FAP countries)
EU			-0.340*	-0.393***
			(0.181)	(0.148)
EZ			0.117	-0.150**
			(0.157)	(0.0721)
ideology	0.00435**	0.0273**	0.00393*	0.00101
	(0.00214)	(0.0116)	(0.00216)	(0.00232)
ideological distance	-0.000168	-0.00189*	-0.000329	-6.57e-06
	(0.000931)	(0.00106)	(0.000943)	(0.00113)
alternation	-1.46e-05	0.0437***	-4.70e-06	-3.48e-05
	(0.00165)	(0.0130)	(0.00166)	(0.000673)
Δ unemployment rate	0.206***	0.198	0.201***	0.121***
	(0.0641)	(0.220)	(0.0653)	(0.0264)
Δ old-age dependency rate	0.485**	0.876**	0.519**	0.0642
	(0.199)	(0.360)	(0.211)	(0.104)
decentralisation	-0.198***	-0.0879	-0.200***	-0.116**
	(0.0458)	(0.101)	(0.0645)	(0.0550)
national fiscal rule preferences	-0.283*	-0.802**	-0.251	-0.104*
	(0.160)	(0.386)	(0.161)	(0.0618)
Constant	1.420***	1.053***	1.628***	1.718***
	(0.141)	(0.305)	(0.170)	(0.126)
Observations	605	120	605	575
R-squared	0.061	0.140	0.065	0.065
Number of countries	28	15	28	28
Linear regression, correlated panels corrected standard errors (PCSEs) Standard errors in parentheses				
*** p<0.01, ** p<0.05, * p<0.1				

Moving on to the supranational arena over the full panel (model 3) among the two membership variables only the first independent variable (EU) has a significant impact on the fiscal policy mix. Specifically, membership to the EU is associated with a decrease in the budget distance (-0.340 GDP percentage points), that is to say, countries within the Union display smaller shifts in the fiscal policy mix. Excluding countries under Financial Assistance (whose fiscal position is assessed and bound by the specific Memorandum agreements and not by the SGP), the effect strengthens in size and significance for EU membership and a negative and significant impact emerges for the Euro Area. While budgetary dynamics may be different in periods characterised by more limited EU and Euro Area membership that does not drive the significance of the results: restricting to a pre-2011 reform period increases the Eurozone effect to -0.32 per cent of GDP and a restriction to the pre-2005 reform period results in coefficients nearing -0.45 per cent of GDP. As more stability in the budget structure is compatible with lower consolidation effort time-dynamics connected with the SGP governance reforms are further explored in the context of section three of the chapter.

However, such a clear-cut interpretation of budget distance dynamics is not straightforward in terms of the overall budgetary trends, as a negative impact on the change in the budget structure may imply slower progress both in consolidation and expansion of public spending, or even a size neutral shift within allocations. Overall budgetary trends are not univocal over the full sample and emerge with greater clarity in consideration of key subsamples (e.g. distinguishing crisis and non-crisis years). However, division level dynamics may provide for some preliminary insights on the interpretation of the results. Employing the same model specification as model 4 in Figure 5. 4 but with the yearly changes across all division levels as dependent variables only in two cases is significance achieved and only for membership to the Euro Area and not for that to the EU. Specifically, Eurozone membership has a positive and significant impact on defence and social protection, albeit modest corresponding respectively to about one fifth and one eight of a standard deviation.[1]

The sensitivity analysis of the Eurozone membership variable to alternative specifications is assessed across three cases: (i) accounting for the 2004 suspension, (ii) accounting also for pre-accession years and (iii) considering the effect of the Eurozone to include the two preceding years for early joiners. While Appendix 3 (see Table A. 3) presents full results, the variable is indeed sensitive to its specification. On one hand, it ceases to be significant in excluding any impact from Eurozone membership over the 2004 de facto suspension of the SGP, which may however not be the best approach in accounting for the exclusion of sanctioning in that period as further explored in section three of this chapter. At the same time, running model 4 with the further inclusion of a dummy for the two years pre-accession for those countries entering the

[1] Regression tables available in Appendix 3 (see Table A. 2)

Eurozone in 1999 does not change (or if anything strengthens) results for both EU and EZ impact on national budget structures. The third specification runs model four with the Eurozone dummy taking the value one also for the early pre-accession years. The negative impact of both EU and EZ membership on the budget distance increases respectively to -0.5 and -1.2, with the latter amounting to nearly one standard deviation and the mean value for the BD variable, further strengthened in excluding crisis years. At the division-level a positive and significant impact of this specification of EZ emerges for economic affairs and housing, respectively amounting to nearly one and over one standard deviation. The impact of the pre-99 including EZ specification remains within the subsample of EU Member States and parallel positive and significant effects remain for the two above mentioned divisions. That is to say that a negative impact of the EU and Eurozone membership on budget distance (and a positive one for certain categories of expenditures) is not driven by an opposite dynamic taking place in pre-EMU years. Conversely, the same when not reinforced trend is common to that timeframe.

Implications

The two most important implications arising from the results concerning the baseline model relate to two distinct elements associated with (i) the dependent variables and (ii) the independent variables.

The considerations put forward throughout this section stress the importance of acknowledging the nature of the synthetic indicator of budget distance in interpreting aggregate results. Specifically, the key information provided by the variable is whether or not a significant difference in the fiscal policy mix is associated with the variable under consideration. Further reflections on budgetary dynamics require an additional assessment at a disaggregated level, or at the very least in relation to total expenditures. While this section has not dedicated extensive attention to the discussion of disaggregated variables, the first impression from the analysis at the division level already suggests that the overall impact on the budget structure may translate into diverging dynamics across the budget items that require specific assessment.

An ancillary consequence is that the potential necessity to distinguish across crisis and non-crisis years is further confirmed as changes in the budget structure form a normative point of view may be diametrically opposite under different economic circumstances. In such case, the aggregate analysis over the entire period may indeed 'hide' diverging dynamics that may take place in good at bad times, thus failing in addressing one of the research questions at hand associated with substantial political and social implications.

Coming back to the specific research question at hand, the results from this section show that considering the average impact over the full timeframe without distinction across crisis years and specific elements of the EU supranational governance architecture the supranational fiscal framework (i) has a significant but negative impact on the change in the fiscal policy mix (e.g. more stable budgets) at the national level (ii) only displays a significant impact for a minority of budget lines and (iii) in such instances is associated with an increase in spending in those categories. Such results are not compatible with a push toward consolidation of the SGP overall or even for the subsample of Eurozone countries potentially submitted to the harsher enforcement mechanism of sanctioning. Conversely, it is compatible with the findings in the literature associating a negative impact of Eurozone membership on fiscal discipline due to the scope for free-riding in the EMU (Reuters, 2019).

In light of these preliminary findings, RQ1, looking for the specific configurations within the supranational fiscal framework impacting budget composition and how diverging patterns may emerge under different circumstances aims to provide a richer account of the EU-MS fiscal puzzle. The 'basic' rudimental conceptualisation of the EU economic governance architecture failure to show a significant impact on most domestic budget lines is indicative of the complexity of the supranational governance mechanisms. Similarly, the overall average impact of the SGP may not well reflect all dynamics at play within the framework itself. In this context, the sharpest distinction concerns those cases in which countries recognised as having an excessive deficit enter the corrective arm of the SGP with the opening of an Excessive Deficit Procedure (EDP), considered in the section to follow.

5.2 The impact of the EDP on national budget structures

In developing the baseline model for the analysis considering the general impact of the SGP on the national budget structures both across the Union and within the Eurozone, the EU fiscal governance framework emerges as associated with lower structural changes in the fiscal policy mix. Focusing on the first sub-question and hypothesis, this section shifts the focus on the 'hard' component of the SGP - namely the EDP - testing whether being recognised as having an excessive deficit leads to consolidation and restructuring of the composition of domestic public expenditures. In doing so, it tests whether:

> [HP1.A] *falling under EDP surveillance leads to consolidation-driven higher structural changes in national budgets.*

The analysis expands on the baseline model and the derived insights on the dynamics across the variables under consideration. The modified independent variable, capturing falling under the excessive deficit procedure addresses the different nuances of the instruments within the toolbox of supranational fiscal surveillance. Substantial differences take place across instances within the corrective arm of the SGP (under the Excessive Deficit Procedure) and those remaining in the preventive arm.

As for the remainder of the analysis, the elements highlighted for model specifications and descriptive statistics only cover the novelties and specificities derived from the alignment of the baseline model with the research sub-question at hand (e.g. in the independent variable employed or the panel subsamples considered).

Model specification(s)

Starting from the variable matrix, no changes are envisaged for the dependent variable or controls, while the independent variable is the EDP dummy taking the value one in the years following a Council decision on the existence of an excessive deficit until its abrogation (e.g. a Council decision finding the country's deficit excessive is into force, having been published in the official journal and not yet revoked).

For what concerns sub-samples, the analysis distinguishes across the impact of the EDP for Eurozone and non-Eurozone countries, as well as assessing the interaction of the two variables over the full panel and considering the robustness of the results in excluding the years of the Great Recession and Eurozone crisis and countries under financial assistance.

A problematic element in this context is associated with the fact that the independent variable under consideration may indeed be particularly sensitive to the crisis as the supranational fiscal rule is susceptible to escape clauses that may render it ineffective in case of a substantial recession. While the crisis period is analysed in chapter six, the matter should be noted in the assessment of the overall impact of the corrective arm.

Descriptive analysis

The independent variable consisting in the EDP indicator captures observation for which the country-year falls within the corrective arm of the SGP, amounting to 203 instances within the panel. As a result, 32 per cent of observations pertain to Member States whose deficits at the time had been found excessive by a Council decision. Figure 5. 4 below displays the countries and years for which the indicator takes the value one. In line with the previous discussion on the linkages between countries' deficit performances and the economic climate, as well as the nature of the independent variable in time of crises, it should be noted that the EDP variable is heavily represented within the timeframe associated with the Great Recession. Specifically, 26 per cent of observations fall under the EDP outside this timeframe, while during the crisis the proportion of Member States with excessive deficits skyrockets to 70 per cent. Such dynamics translate into 59 of the 84 crisis years observations subject to the EDP.

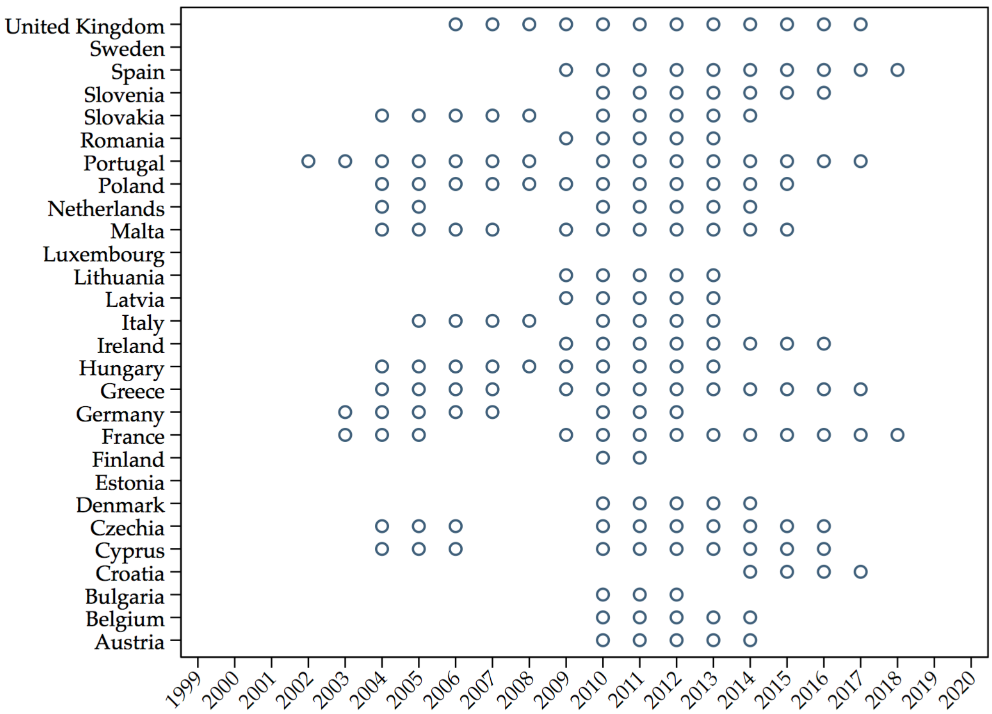


Figure 5. 4 - Countries and years of falling under the excessive deficit procedure

An additional parallel consideration applies to the distribution of breaching countries across the three phases of EU economic governance, with a higher proportion of observations falling under the corrective arm of the SGP under phase 3 of EU economic governance compared to phase two and especially phase one. While this predicament is not of high importance for the analysis of RQ[1.A], it affects the assessment of the supranational fiscal framework across the three phases of EU economic governance.

Shifting the focus to the descriptive analysis of the dependent variable, Table 5. 5 below shows the full descriptive statistics both for the budget distance (BD) and for all the disaggregated division level budget items across observations in the preventive and corrective arm of the SGP. On average, changes in the budget structure are higher under the corrective arm at the aggregate level. At the division level, dynamics vary across budget item, with higher positive changes in social expenditures associated on average to observations outside the corrective arm, as well as higher average negative changes in housing allocations. Conversely, general public expenditures show the opposite dynamics. While the trend is not perfectly univocal, in general, either a smaller positive changes or larger negative changes at the division level emerges within the corrective arm. Patterns suggest that more marked shifts in budget structure in this instance may indicate more sizeable negative fiscal adjustments.

Table 5. 5 - Descriptive statistics for countries under and outside of *EDP* surveillance

	EDP 0					EDP 1				
	N	mean	sd	min	max	N	mean	sd	min	max
BD	435	1.337	1.389	0.100	13.13	203	1.684	2.392	0.173	18.52
Δ general affairs	435	-0.156	1.203	-13	11.50	203	-0.0571	0.598	-3.300	1.900
Δ defence	435	0.000690	0.228	-1.700	1	203	-0.0458	0.179	-0.700	0.600
Δ public order	435	0.0122	0.178	-0.900	1.100	203	-0.0256	0.112	-0.400	0.400
Δ economic affairs	435	-0.0218	1.086	-11.60	7.500	203	-0.117	2.666	-17.50	18.50
Δ environment	435	0.00276	0.160	-1.100	1.100	203	-0.00443	0.151	-0.600	0.600
Δ housing & community	435	-0.00943	0.337	-5.100	3	203	-0.0498	0.201	-1.900	0.600
Δ health	435	0.0777	0.376	-2.700	2.500	203	-0.000985	0.328	-1.500	1.800
Δ culture	435	0.0205	0.148	-0.800	1.200	203	-0.0212	0.100	-0.500	0.400
Δ education	435	0.0170	0.294	-1.600	1	203	-0.0823	0.348	-1.300	2.800
Δ social protection	435	0.0126	0.769	-2.700	3.900	203	0.00739	0.854	-3.400	4.900
Number of countries	28	28	28	28	28	28	28	28	28	28

Two other differences should be highlighted concerning the dependent variable across the independent variable: (i) at aggregate level more variation in the budget distance synthetic indicator is associated with the corrective arm (ii) as well as more extreme values, especially at the higher end of the spectrum. The same pattern for the latter dimension is confirmed in most instances at disaggregate level, both in terms of maximum positive changes and also in some of the most extremes negative changes, with the notable exception of general public services.

Results

Over the full panel, the *EDP* has a positive and significant impact on the national budget structure (see Table A. 4 in Appendix 4), which is further reinforced when restricting the analysis to the Eurozone subsample, while the opposite is the case for countries outside the Euro area for which significance is not retained. Table 5. 6 below shows the resulting regression estimates across the dependent variables both at the aggregate level of the budget distance (BD) in the Eurozone (model 1) and for non-Eurozone observations (model 2).

Within the Eurozone having an excessive deficit is associated with an 0.44 increase in the budget distance. That is to say, the EDP increases changes to the composition of public expenditures by nearly half a percentage point of GDP, amounting to one fourth of a standard deviation. In model 1 all controls are significant except for alternation and can also offer some comparison in terms of the impact of the EDP, namely slightly below that of a change of one percentage point in the old-age dependency ratio and nearly twice that of one percentage point in unemployment.

One can already conclude that the EDP for Eurozone countries (which drive the significance obtained also in the full panel) does indeed lead to higher structural changes in national budgets. However, further interpretation of what the result for the aggregate variable means for budgetary dynamics (e.g. if the higher change in the budget distance is linked with consolidation) calls for investigating the directional impact of the EDP within the disaggregated components of the budget. A significant and negative impact emerges for the EDP on all division level components of national budgets except for general affairs, economic affairs and environmental protection[2], indicating that the increased change to the budget structure for countries under the EDP reflects a contraction across several budget lines. As a result, it is confirmed that the supranational fiscal framework – when its corrective arm is activated through an excessive deficit procedure – yields a consolidation effort affecting the composition of public expenditures.

Further confirming the distinction across Eurozone membership, model 3 and 4 evaluate its interaction with the EDP, indicating how the effect of the latter on national budget structures changes as a function of the former. Results for the full panel (model 3) indicate that the EDP is not significant across the overall sample. Conversely, the interaction of Eurozone membership with the EDP yields a significant and substantial increase in the impact of the corrective arm amounting to about 0.7 per cent of GDP and nearing half of a standard deviation. The interaction remains significant once crisis years and countries under Financial Assistance Programmes are excluded in model 4. The significant negative impact of the Eurozone on changes in the budget structure (-0.36 per cent of GDP) is more than fully compensated by the increased impact of the EDP for the Member States in the Euro area, which amount to 0.44 per cent of GDP and exceeds one third of a standard deviation.

[2] Regression results available in Appendix 4 (see Table A. 4 e Table A. 5)

Table 5. 6 - The impact of the EDP on the structure of national budgets

	(1)	(2)	(3)	(4)
	BD (Eurozone)	BD (non-Eurozone)	BD	BD (excluding FAP countries & crisis years)
EDP	0.435***	0.00649	-0.0549	-0.122
	(0.159)	(0.141)	(0.157)	(0.166)
EZ			-0.226	-0.364***
			(0.162)	(0.0688)
EDP#EZ			0.692**	0.437**
			(0.280)	(0.196)
ideology	0.0301***	0.00113	0.00419**	0.00164
	(0.00784)	(0.00394)	(0.00210)	(0.00253)
ideological distance	-0.00113*	0.0155***	0.000348	0.000418
	(0.000604)	(0.00457)	(0.00107)	(0.00127)
alternation	0.000809	-0.000457	-0.000189	-0.000176
	(0.000674)	(0.000774)	(0.00164)	(0.000696)
Δ unemployment rate	0.210***	0.169***	0.176***	-0.0156
	(0.0748)	(0.0411)	(0.0620)	(0.0326)
Δ old-age dependency rate	0.557***	-0.0615	0.307	-0.101
	(0.175)	(0.223)	(0.202)	(0.105)
decentralisation	-0.181***	-0.0566	-0.213***	-0.136*
	(0.0410)	(0.231)	(0.0713)	(0.0703)
national fiscal rule preferences	-0.582***	-0.0471	-0.233	-0.181***
	(0.149)	(0.0920)	(0.151)	(0.0675)
Constant	1.536***	1.248***	1.447***	1.454***
	(0.165)	(0.122)	(0.135)	(0.0914)
Observations	299	306	605	503
R-squared	0.121	0.078	0.077	0.046
Number of countries	19	28	28	28

Linear regression, correlated panels corrected standard errors (PCSEs)
Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Looking at the margins in model 4, for Eurozone and non-Eurozone countries under and outside of the EDP provides further insights which can aid the interpretation of results. Figure 5. 5 below shows how the budget distance changes across the EDP for Eurozone and non-Eurozone countries. Firstly, outside of the EDP shifts in the budget structure are distinguishably higher for countries outside of the Eurozone, while the latter is not the case under the EDP. Having an excessive deficit increases changes in Eurozone Members budget structures, while the opposite trend – albeit results showed the change is not significant – emerges for countries outside the Euro area. Additionally, while being under or outside of the EDP leads to clearly distinguishable budget distances for Eurozone countries the same is not the case for countries outside of the Euro area.[3]

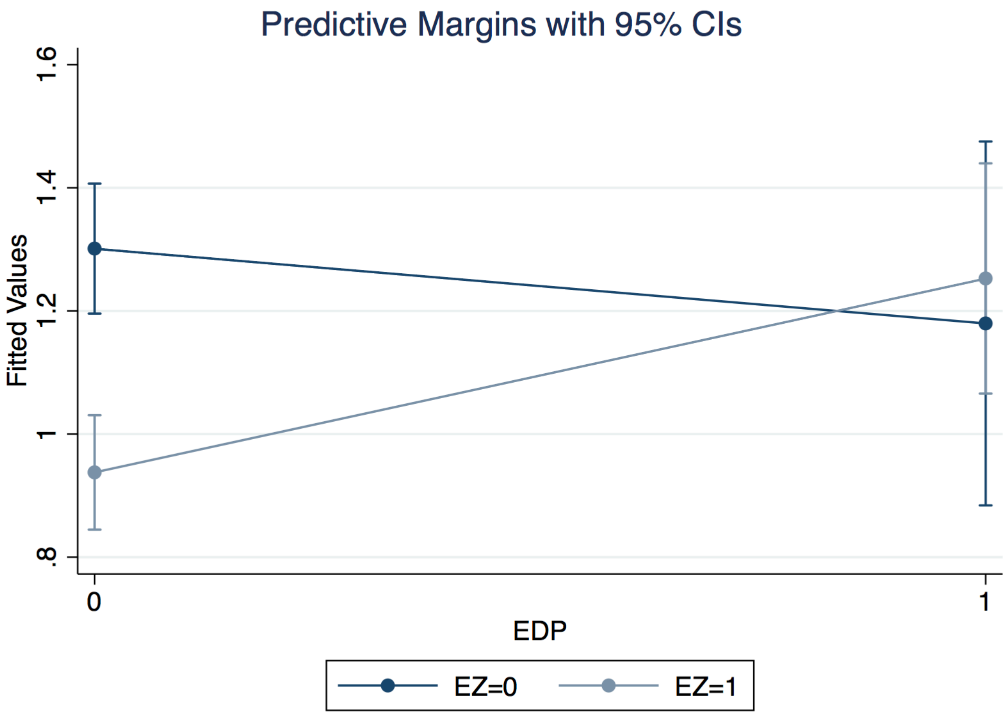


Figure 5. 5 - The impact of the EDP for Eurozone and non-Eurozone countries falling under the excessive deficit procedure

Implications

In looking back at the overview of the multifaceted nature of EU economic governance in chapter two, two key distinctions in the mechanisms of the supranational fiscal rule are confirmed in leading to a divergent ability to impact national budgets and their structure confirming that [HP1.A] is verified - albeit only for Eurozone countries - with the EDP leading to higher structural changes in national budgets by pushing domestic fiscal policy choices toward consolidation.

Remaining within the 'hard' domain of EU economic governance two crucial distinctions concern the 'bite' of the policy instruments and their consequent impact on the fiscal policy of the Member States: (i) the surveillance dimension based on Article 99 TEC within the preventive arm of the SGP in comparison to the dissuasion measures based on Article 104 TEC and the EDP protocol within the corrective arm of the SGP and (ii) in the context of the latter the toolset in

[3] Margin plots available in Appendix 4 (see Figure A. 2)

the hand of the supranational institutions in terms of the potential threat of sanctions and derived increased procedural and political pressure, which is restricted for the supranational fiscal rule to the countries adhering to the Eurozone.

Such elements find empirical backing in a significant impact on the budget distance – and hence the budget structure – being associated with the corrective arm of the SGP. Additionally, underneath the overall effect for the full panel, a sharp distinction is hidden for what concerns Eurozone and non-Eurozone countries, with a significant effect only recorded within the Euro area, suggesting that the potential threat of sanctioning and increased political peer pressure is crucial for determining compliance at the national level.

Such findings give empirical backing to one of the weaknesses hypothesised in the literature on the SGP, with the instruments – especially before its latest iteration – argued to fail in constraining non-Eurozone countries. Among those, instances of defiant excessive deficits emerged in the early years, for example, in Hungary, which in 2006 was running a deficit well over twice the prescribed limit (Heipertz & Verdun, 2010). Hungary is not alone in detaining a negative track record in this regard, falling under the EDP 43 per cent of the time, as several countries that never entered the Eurozone show long and often protracted period in the corrective arm of the SGP (e.g. within the EDP 43 per cent of the times for the Czech Republic, while 52 per cent for Poland and the United Kingdom). Additionally, while instances of failing to respect the three per cent threshold for consecutive years do indeed emerge also in Eurozone countries, the negative pattern outside of the Euro area does not necessarily overlap with the crisis. The violations highlighted above commenced well before the Great Recession, respectively in 2003 in Hungary and Poland and 2006 in the United Kingdom, to continue for ten to twelve years.

So far, in looking at the SGP in general and the EDP in particular, additionally to the failure in even the most constraining dimension of the EU economic governance framework in impacting national budgetary choices for countries outside of the Euro area, the preventive arm of the SGP also seem to similarly prove a quite weak constraint for the Member States. However, when the tough side of the framework of the corrective arm kicks in, the additional positive impact of the EDP on the budget distance within the Euro Area more than fully compensate the negative impact emerged for the Eurozone in section one, as shown by model 4.

Two additional elements arose in this section that should be kept under advisement in addressing the relevant research questions and sub-questions concerning (i) the crisis and (ii) the different phases of EU economic governance. The EDP variable is unbalanced with respect to both elements, over-representing as to be expected the years of the Great Recession and Eurozone crisis as well as later stages of EU economic governance, in parts due to the concomitance of the negative cycle but also potentially in light of the restrictive changes of the supranational fiscal framework over time. Leaving (i) to be addressed in the context of RQ[2] in chapter six, the following section will look specifically at changes across the three iterations of the EU economic governance framework.

Before moving on to the second sub-hypothesis, it should be noted that RQ[1.A] on EDP surveillance affecting national budget structures is confirmed. The excessive deficit procedure, even in the absence of actual sanctioning, represents the real bite of the SGP. As such, EDP surveillance promotes consolidation and in turn changes to the composition of the national budget structures. Such pattern only emerges for countries under the corrective arm within the Eurozone, a result that inform the models for the remainder of the analysis, in which the EDP is employed as the key independent variable and interacted with the other relevant factors under consideration.

5.3 The change in the impact of the EDP across SGP reforms

The evolution of the supranational regulatory framework has been substantial over its young life. Firstly, the SGP faced an early crisis with the 2004 suspension leading to the 2005 reform. Subsequently, the Eurozone crisis constituted an existential stress test calling for emergency mechanisms followed by an extensive strengthening of the framework culminated with the introduction of the Fiscal Compact. In this context, in parallel, the impact of the supranational fiscal rule on the national budget structure may have similarly changed over time, so that average results may not fully represent the different dynamics across policy reforms. On such premises this section investigates changes across the three iterations of the EU economic governance coordination infrastructure, testing whether:

> [HP1.B] *the impact of EDP surveillance on the composition of national budgets substantially increases with the 2011 reform of the SGP.*

Accounting for changes to the SGP over time in particular with the toughening of the regulatory framework with the latest policy reform indicates whether reforms have increased the ability of the supranational institutions in affecting fiscal choices of the Member States and consequently their budget structures. Building on previous results, the central element under consideration pertains to the effect of the EDP on national fiscal policy choices. However, the broader view of the SGP considered in section one is revisited to assess for potential divergent patterns across policy reform also outside of the corrective arm of the framework. Furthermore, given the introduction of extensive changes in terms of the enforcement mechanisms with the Fiscal Compact and specifically with the mandated implementation at the national level of fiscal rules reflecting the supranational prescriptions, the assessment is expanded to account for the entry into force of Title III in addition to the three key policy reforms.

Model specification(s)

Starting from the variable matrix, no changes are envisaged concerning the dependent variable or controls. On the other hand, the independent variable(s) are extended in alignment with RQ[1.B] to capture which EU economic governance framework is in place at the time in which the observation is recorded. In its simple form, the relevant independent variable is a factor variable, distinguishing across 'phase0' pre-1999, followed by 'phase1' up to the 2005 reform launching 'phase2', finally turning into 'phase3' as of 2011. An alternative specification accounts for the 2004 suspension during which the SGP is considered as not in place. Reflecting the Fiscal Compact as a game-changer warrant a further distinction in defining a 'phase4' after the entry into force of the relevant provisions of the Fiscal Compact for the signatories. Whichever the employed specification, the factor variable capturing the three or four phases needs to further account for EU membership at the time. The resulting indicator is an EU economic governance factor variable considering the respective phase at play only for countries within the Union, with the remaining observation associated with not falling under the SGP at the time ('phase 0').

The same words of caution about the economic climate put forward in the previous section apply. Not only is there an overlap between 'phase2' (and to some extent 'phase 3') of the EU economic governance and the crisis years but also there is a causal connection between the latter and the reform leading to a substantial policy overhaul in the latest iteration. As such, while the specifics of the crisis dynamics are deferred to chapter six, whether dynamics change in excluding crisis years should be considered through sample restriction in the context of sensitivity analysis. Another caveat is the exclusion throughout the analysis – unless otherwise specified – of countries under Financial Assistance, which are both in principle temporarily not subject to the SGP and EDP but rather the specific terms of their memorandums and under extreme economic duress.

In line with HP[1.B], the central question regards the changes in the impact of the element of the framework emerging as altering the national budget structure through consolidation – the EDP – for the sub-sample of the Eurozone Members for which its effect is significant. The impact of the EDP is compared across the three subsamples corresponding to the three 'phases' of EU economic governance. Additionally, the interaction between the two variables is considered across the full panel. A similar approach is pursued in relation to the Fiscal Compact, whose dummy accounts for countries bound to the balanced budget provisions under Title III.

Descriptive analysis

The new dimension of variation within the supranational fiscal framework distinguishes across the three regulatory frameworks resulting from the two main reforms of the SGP. Considering both alternative specifications accounting or not for the 2004 suspension, the three periods contain respectively 168 observations during 'phase 1' - reduced to 140 if the suspension year is excluded - 168 observations in 'phase 2'and 224 observations in 'phase three'. Restricting for the observations falling under the SGP at the time (e.g. considering membership), 100 observations fall under the 'phase 1' EU economic governance framework (75 excluding suspension), while 158 fall under 'phase 2' and 222 'phase 3'.

Looking at Eurozone membership across the three phases of EU economic governance (in the unrestricted specification), in 'phase 1' the sample is nearly balanced with 70 countries within and 98 outside of the Euro area. Similarly, in 'phase 2' 84 observations fall within and outside of the Eurozone. However, in phase 3 Eurozone membership grew to include 145 observations compared to 79 across non-members. When looking at the EDP across the three phases, the corrective arm - even in the lax specification failing to exclude suspension - is underrepresented in 'phase 1' accounting for only 15 observation (dropping to just 4 considering suspension), growing to 73 in phase two and 115 in phase three. As such, there are hardly any cases under the corrective arm of the EDP in phase one, with only 9 of them corresponding to Eurozone countries. Figure 5. 7 shows countries having observations that fall within the corrective arm for each of the three phases distinguishing across the Eurozone membership.

Shifting the focus to the Fiscal Compact (FC) 109 observations within the sample are bound to the Title III prescription balanced budgets. Of them, the overwhelming majority belong to Eurozone countries (94 compared to 15) and about one-third fall under the corrective arm (34 compared to 75), across 13 Member State as shown in Figure 5. 6 below.

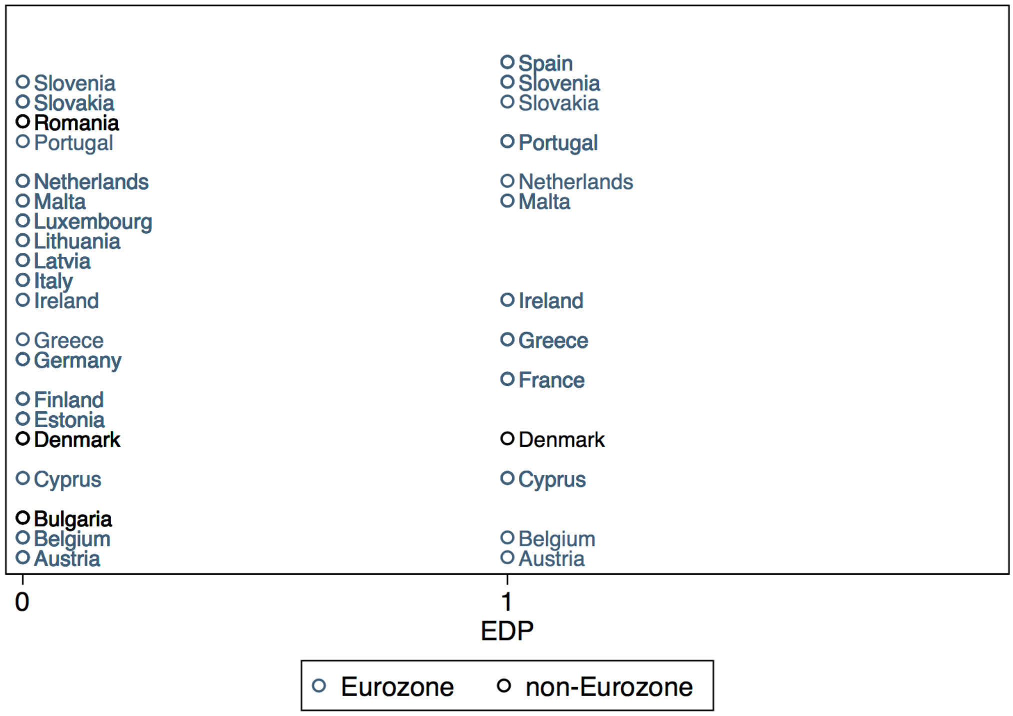


Figure 5. 6 - Countries' EDP surveillance status under the Fiscal Compact (Title III)

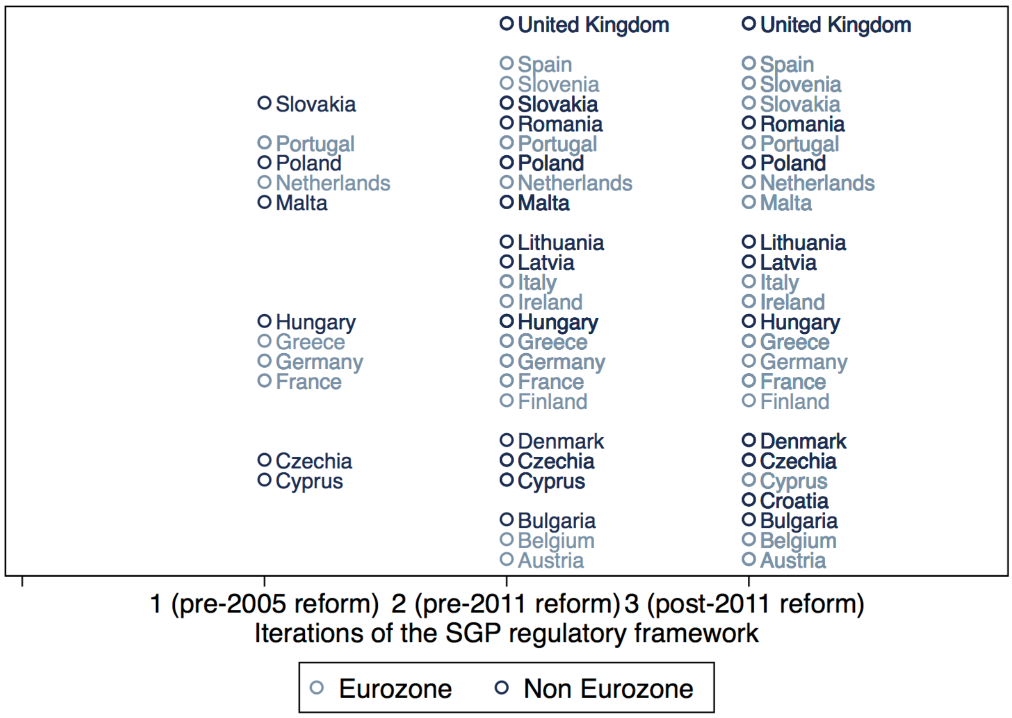


Figure 5. 7 - Countries under *EDP* surveillance across the three iterations of EU economic governance by Eurozone membership

Moving on to the dependent variable, Figure 5. 6 below shows descriptive statistics for the budget distance indicator in the timeframe of the three phases of EU economic governance, with phase zero capturing the years before the full roll-out of the SGP regulations, together with those of suspension in the restrictive specification. The first two columns are dedicated to the two alternative specifications of the three iterations, while the third displays descriptive statistics for the Fiscal Compact indicator. No substantial differences emerge across the two variables across the three phases of EU economic governance, with an increase in the average budget distance from the first to the second phase to slightly decrease in the third phase. For what concerns the Fiscal Compact, countries bound by Title III show on average a lower budget distance.

Table 5. 7 - Budget distance descriptive statistics across the phases of EUEG

'Inclusive' specification			'Restrictive' specification (suspension as phase 0)			Fiscal Compact		
phase 0	N	81	phase 0	N	109	FC=0	N	529
	mean	2.010		mean	1.806		mean	1.466
	sd	2.499		sd	2.248		sd	1.754
	min	0.265		min	0.200		min	0.173
	max	13.13		max	13.13		max	18.52
phase 1	N	165	phase 1	N	137	FC=1	N	109
	mean	1.251		mean	1.258		mean	1.358
	sd	0.964		sd	0.937		sd	1.885
	min	0.200		min	0.316		min	0.100
	max	6.083		max	6.083		max	12.74
phase 2	N	168	phase 2	N	168			
	mean	1.433		mean	1.433			
	sd	1.610		sd	1.610			
	min	0.173		min	0.173			
	max	18.52		max	18.52			
phase 3	N	224	phase 3	N	224			
	mean	1.400		mean	1.400			
	sd	2.000		sd	2.000			
	min	0.100		min	0.100			
	max	17.58		max	17.58			

Additionally, dynamics should be considered not only across the three phases of EU economic governance but also for the variables identified in section two as key in driving the impact of EU economic governance on national budgets: Eurozone membership and EDP. Table 5. 8 below shows diverging patterns across observations belonging to Eurozone countries and the Member States outside of the Euro area. While there is a decrease in the average budget distance across the three phases for the Member States outside the Euro area, the opposite occurs in the Eurozone which displays the lowest average in the budget distance indicator in 'phase 1' which grows substantially in 'phase 2' to further increase in 'phase 3'. Diverging patterns emerge likewise within the preventive and corrective arm. For observation of countries that have not been recognised as having an excessive deficit the mean of the budget distance decreases across EU economic governance policy reforms with the opposite trend emerging for countries falling under the EDP.

Table 5. 8 - Budget distance across EUEG phases, EZ Membership and EDP

	EZ					EDP		
Phases	0	1	Total		Phases	0	1	Total
0	2.01	.	2.01		0	2.01	.	2.01
	81	0	81			81	0	81
1	1.55	0.84	1.25		1	1.23	1.41	1.25
	95	70	165			150	15	165
2	1.42	1.45	1.43		2	1.37	1.51	1.43
	84	84	168			95	73	168
3	1.19	1.52	1.40		3	0.94	1.83	1.40
	79	145	224			109	115	224
Total	1.54	1.34	1.45		Total	1.34	1.68	1.45
	339	299	638			435	203	638

The overall means across the full panels are thus quite poor representations of the underlying patterns. For example, the full-sample mean in phase three is lower than that of phase two, hiding the two extremes across countries in the preventive arm which are at the overall minimum and those in the corrective arm that are at the maximum across the three phases. As such the impact of EU economic governance in the three phases may vary across Eurozone membership and EDP status, so that average results may indeed hide important divergences in the underlying dynamics requiring careful consideration of the potential for interaction effects and differences in the sub-samples. It should be noted that ‘phase 0’ - capturing the period before EMU and later observations of countries outside of the Union at the time and hence not subject to the SGP - displays the overall maximum. This element should be considered in the assessment of the research question which is not interested per se in the introduction of the SGP but rather in what changes in the frameworks’ ability to affect the national budget structures across the regulatory frameworks.

Results

Considering first the impact of the SGP on national budget structures across the three phases, the model includes as an independent (factor) variable the indicator capturing whether the observation is associated with ’phase 0’ (e.g. before 1999 or non-Members) or phase 1 through 3 EU economic governance. Taking ‘phase 0’ as a reference category, the results compare the impact on the budget structure of the SGP in each phase to its absence. Across the full panel, ‘phase 1’ and ‘phase 3’ associated with a decrease in budget distance, achieve significance. Dynamics change if the sample is restricted according to Eurozone membership. Outside of the Euro area, the impact of the SGP on national budget distance is only significant and negative in phase 3. Within the Eurozone, comparing the impact of later iterations to the early SGP, the pattern is reversed. The impact of the SGP on the budget distance increases in ‘phase 2’ and ‘phase 3’, with, however only the former achieves significance. Results are confirmed for both alternative specifications that do and do not account for the 2004 suspension.

Table 5. 9 - Direction of significant SGP impacts on budget distance (BD) and budget components across the three phases of EU economic governance within and outside of the Eurozone

		BD	Δ general affairs	Δ public order	Δ economic affairs	Δ health	Δ culture	Δ education	Δ social protection
Non Eurozone (reference: phase 0)	phase 1	-	-	+	+	+		+	+
	phase 2		+			+			+
	phase 3	-	+						
Eurozone (reference: phase 1)	phase 2	+	+						
	phase 3		+	-		-	-	-	

Looking at the impact on budget lines provides further insight into budgetary dynamics across SGP phases and Eurozone membership. Starting from countries outside of the Euro Area, at disaggregate level, with the sole exception of general affairs in ‘phase 3’, any significant result across the three phases is linked to higher expenditures. Within the Eurozone the higher changes in the structure of the budgets associated with ‘phase 2’ and ‘phase 3 ‘display divergent directional trends in the budget components for which the SGP has a significant impact. While in ‘phase 2’ the SGP is associated with significantly higher expenditures for general affairs, in 'phase 3' several budget components (public order, health, culture and education) display a negative trend in relation with the SGP. Table 5. 9 shows the direction of significant impacts at the aggregate budget distance level and for budget components within and outside of the Euro Area.

Looking back at the results for the effect of the SGP in the baseline, the negative impact on the budget distance is only confirmed for non-Eurozone countries, which also at disaggregate level display shifts in the budget components compatible with a potential free-riding effect of membership to the Union. However, although comparing EU to non-EU observations within each period yields to a negative and significant sizeable (more than half of a standard deviation) impact on the budget distance in 'phase 1', significance does not hold once Eurozone countries are excluded, as shown in Table 5. 10. Shifting to the Eurozone, in comparing the early SGP with later stages, a dissimilar trend emerges, especially in light of disaggregate dynamics in phase three, with a significant decrease in several budgetary components associated with the EU economic governance framework. Looking at the sub-samples across the three phases, while a negative and significant impact of Eurozone Membership of over one standard deviation remains in 'phase 1' and - albeit less than halved in size - in 'phase 2', in 'phase 3' the impact on the budget distance is quite modest but positive and significant.

Shifting the focus on the impact of the EDP across the three phases, running the interaction between the SGP-stages factor variable and being under EDP, the EDP is positive and significant across the full sample, while its impact on the budget distance compared to 'phase 1' decreases significantly in 'phase 2'. Conversely, further restricting the sample to the Eurozone, the EDP is not significant across the full three stages, but rather its impact on budget distance does change as a function of the regulatory framework in place. In comparison to 'phase 1', the interaction coefficient is positive and significant in 'phase 3'. As shown in Figure 5. 8, the budget distance increases over the three phases for countries under the EDP, reaching its maximum in the latest iteration of the EU economic governance framework. However, the same is not the case for countries that do no display an excessive deficit.

Table 5. 10 - Impacts of the SGP on budget distance (BD) in the EU and Eurozone across the three phases of EU economic governance

	(1)	(2)	(3)	(4)
	BD (Phase 1)	BD (Phase 1)	BD (Phase 2)	BD (Phase 3)
EU	-0.662***			
	(0.226)			
EZ		-0.655***	-0.256*	0.152*
		(0.101)	(0.132)	(0.0903)
ideology	-0.00226	-0.00192	-0.00755	0.0134***
	(0.00382)	(0.00354)	(0.00529)	(0.00320)
ideological distance	0.00233	0.00721*	0.0103***	-0.000698**
	(0.00505)	(0.00411)	(0.00389)	(0.000309)
alternation	-0.00227	-0.00191	0.000416	0.00102*
	(0.00170)	(0.00128)	(0.000318)	(0.000527)
unemployment rate	0.0369	0.0584	0.294***	-0.142**
	(0.0575)	(0.0495)	(0.0278)	(0.0674)
Δ old-age dependency rate	-0.393*	-0.309	0.0801	-0.0541
	(0.211)	(0.211)	(0.158)	(0.183)
decentralisation	-0.0835	0.0291	-0.0867	-0.293***
	(0.0977)	(0.0875)	(0.0987)	(0.0544)
national fiscal rule preferences	-0.288***	-0.451***	0.0309	-0.242**
	(0.0877)	(0.0997)	(0.0669)	(0.101)
Constant	1.884***	1.718***	1.213***	1.216***
	(0.252)	(0.146)	(0.0835)	(0.199)
Observations	160	160	159	203
R-squared	0.193	0.194	0.355	0.074
Number of countries	28	28	28	27
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

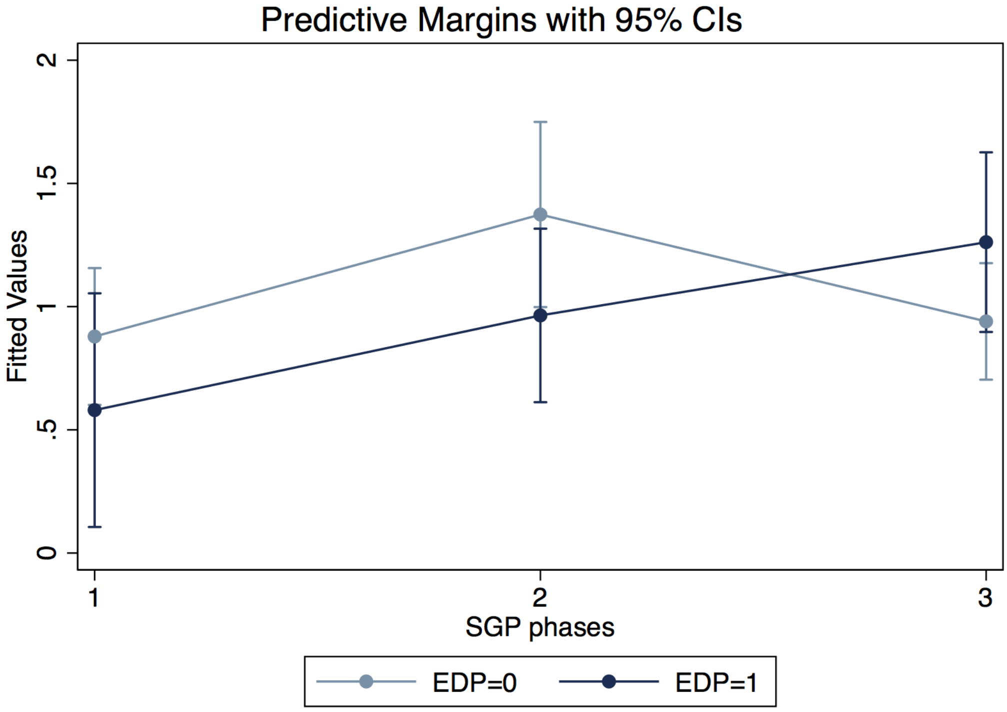


Figure 5. 8 - Budget distance within the Eurozone for countries under the EDP and not across the three phases of EU economic governance

Dynamics within the subsample in each phase provide a more straightforward portrayal of the overall impact of the EDP across the three regulatory frameworks. As shown in Table 5. 11 the EDP does not have a significant impact on budget distance in ‘phase 1’, while a significant but negative impact of -0.56 (about half of a standard deviation) emerges in ‘phase 2’. The lack of significance in ‘phase 1’ should, however, be considered in concomitance with the fact that few observations fall under the corrective arm at that stage. Conversely, in ‘phase 3’ the EDP increases the budget distance by 0.52 percentage points of GDP, corresponding to slightly above one-third of a standard deviation. At a disaggregated level, this corresponds to a negative impact of the EDP on all budget components for which it is significant, namely defence, public order, culture and social protection. Given the overlap of the two latest iterations of the SGP with the Great Recession, it should be noted that while results in ‘phase 3’ retain significance, with the impact of the EDP increasing to 0.74 (half of a standard deviation) once crisis years are excluded, the same is not the case for ‘phase 2’ for which the EDP coefficient is no longer significant.

Table 5. 11 - Impact on budget distance of the EDP within the Eurozone for each phase of EU economic governance

	(1)	(2)	(3)	(4)
	BD (Eurozone Phase 1)	BD (Eurozone Phase 2)	BD (Eurozone Phase 3)	BD (Eurozone Phase 3 excluding crisis)
EDP	-0.0674	-0.562**	0.516***	0.736***
	(0.163)	(0.244)	(0.0701)	(0.0651)
ideology	-0.00279	-0.00400	0.0329***	0.0418***
	(0.00670)	(0.00866)	(0.00922)	(0.0117)
ideological distance	-0.00225	0.000699	-0.000737	-0.000699
	(0.00333)	(0.00600)	(0.000718)	(0.000900)
alternation	-0.00771	-0.000153	0.00143***	0.00165***
	(0.00867)	(0.00919)	(0.000543)	(0.000554)
Δ unemployment rate	0.0399	0.345***	-0.212**	-0.266**
	(0.0799)	(0.0706)	(0.0985)	(0.118)
Δ old-age dependency rate	-0.179	0.417	-0.232	-0.673*
	(0.225)	(0.293)	(0.250)	(0.352)
decentralisation	-0.0890	0.0170	-0.331***	-0.496***
	(0.0868)	(0.137)	(0.0619)	(0.0792)
national fiscal rule preferences	-0.0167	-0.408**	-0.669***	-0.818***
	(0.0985)	(0.196)	(0.165)	(0.209)
Constant	1.080***	1.404***	1.579***	1.980***
	(0.156)	(0.224)	(0.267)	(0.361)
Observations	70	82	127	112
R-squared	0.066	0.386	0.176	0.225
Number of countries	12	16	18	18
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Finally, considering the Fiscal Compact in its interaction with the EDP, the Fiscal Compact substantially increases the impact of being recognised as having an excessive deficit on the budget distance. However, results vary according to Eurozone Membership, as the pattern is confirmed only within the Euro area, while conversely, no significant impact emerges for non-members. As shown in Table 5. 12, the impact of the EDP on budget distance increases by 0.95 under the Fiscal Compact (nearly one standard deviation), paired with the key independent variable not achieving significance over the full sample. Looking at the sub-samples, the divergent impact corresponds to the EDP yielding to a 0.50 increase in the budget distance under the Fiscal Compact (a bit less than half of a standard deviation), although no significant impact arises for countries not subject to Title III. While the impact further increases to 0.73 when restricting the sample to the Eurozone (a bit over half of a standard deviation), a further insight emerges concerning the interplay between the Fiscal Compact and Eurozone membership. In considering the impact of Eurozone membership before and after the Fiscal compact, while - even within the subsample of the Union - Eurozone membership is negative and significant outside of the Fiscal Compact, the same is no longer the case within the subsample of observations falling under Title III.

Table 5. 12 - Impact on budget distance of the EDP and SGP under the Fiscal Compact

	(1)	(2)	(3)	(4)
	BD	BD (Fiscal Compact)	BD (Fiscal Compact & Eurozone)	BD (Fiscal Compact)
EDP	-0.214	0.503**	0.726***	
	(0.165)	(0.250)	(0.174)	
FC	-0.143			
	(0.185)			
EDP#FC	0.966**			
	(0.385)			
EZ				-0.0234
				(0.106)
ideology	0.0135**	0.0187***	0.0413***	0.0150
	(0.00553)	(0.00653)	(0.0127)	(0.00917)
ideological distance	-0.000726	-0.000429	-0.000781	-0.000512
	(0.000867)	(0.000578)	(0.000899)	(0.000930)
alternation	-0.000105	0.00117	0.00172**	0.00169***
	(0.000895)	(0.000816)	(0.000744)	(0.000628)
Δ unemployment rate	0.158**	-0.562***	-0.379**	-0.615***
	(0.0660)	(0.176)	(0.178)	(0.168)
Δ old-age dependency rate	0.0379	-0.223	-0.706**	-0.0104
	(0.187)	(0.244)	(0.320)	(0.539)
decentralisation	-0.120**	-0.374***	-0.446***	-0.309***
	(0.0503)	(0.0862)	(0.0697)	(0.103)
national fiscal rule preferences	-0.346**	-0.444**	-0.511*	-0.657***
	(0.137)	(0.172)	(0.287)	(0.220)
Constant	1.449***	1.107***	1.783***	1.073***
	(0.163)	(0.236)	(0.343)	(0.230)
Observations	279	100	85	100
R-squared	0.096	0.240	0.300	0.214
Number of countries	19	21	18	21
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Implications

Even for what concerns the SGP, the analysis has shown changing dynamics across the three phases of EU economic governance, paired with the usual Eurozone distinction. Specifically, the impact of the latter diverges across the three regulatory stages turning from negative early on to positive and significant in the latest iteration of the policy, indicating that rather than free-riding there is an – albeit very modest – push toward consolidation associated with the Eurozone in ‘phase 3’. Such aggregates findings are further backed by expenditures dynamics at the disaggregated level, with a significant decrease of several budget lines within the Eurozone in ‘phase 3’. At the same time, a broader implication of the results is that it indicates also that divergent impact of EU economic governance may not just occur across the policy mechanisms and over time but also for specific budget lines.

Shifting the focus to the king of the analysis in addressing RQ[1.B], the EDP, its impact on the budget distance is not constant over time but rather it changes across the three phases of the supranational fiscal rule, reaching its maximum (positive) effect in the latest iteration while turning negative (and significant) in the more flexible and crisis concomitant ‘phase 2’. The latter dimension - the economic climate - may indeed play a role as the impact of the EDP in ‘phase 3’ is further reinforced once crisis years are excluded, indicating that fundamental differences between good and bad times may be at play, further explored in chapter six. While ‘phase 1’ is problematic to investigate due to the limited instances under the EDP, the patterns in the two subsequent governance frameworks do indicate an increased impact of having an excessive deficit in ‘phase 3’, verifying HP[1.B].

Such effect, in pair with the Euro-crisis-driven 2011 reform, may also be connected with the introduction of the Fiscal Compact, which does interact with the EDP in strengthening its impact. How the national implementation of supranational commitments may be a game-changer is also evidenced by Eurozone membership no longer displaying significant differences compatible with a free-riding effect after the entry into force of Title III and the deadline for national implementation of the balanced budget commitment.

Several implications should be derived beyond RQ[1.B]:

(i) The significance of the impact of the EU economic governance on the Member States budget structure – and especially its consolidation-leaning effect – is confirmed only for some sub-samples.

(ii) There is a variation of the framework’s ability to affect the budget structure over time, which may be of interest in looking at crisis year in which two phases with very divergent ‘strength’ overlap.

(iii) The enforcement mechanisms and thus the ‘hard’ nature of the policy instruments appears to be key in impacting the fiscal policy mix, as further confirmed by the analysis of the Fiscal Compact associated dynamics.

(iv) Considering appropriate panel splits and is fundamental for capturing diverging patterns and configurations in which EU economic governance has an impact otherwise hidden behind average effects ill-representing complexity and failing to achieve significance.

These elements are of importance not only in looking at the crisis years in chapter six but also in considering the interaction with the domestic arena in chapter seven.

Having considered the two main dimensions of variation of the supranational fiscal rule in the first three sections of this chapter, the last section focuses on the EU economic governance framework beyond fiscal rules. Through its component associated with soft coordination of budgetary policies - the Semester - EU economic governance provides a direct orientation to the budget structure albeit with limited if any mechanism at disposal for enforcing such guidelines. It should be considered that the two elements of the fiscal rule on one side and expenditure guidelines on the other are concomitantly at play in normal times. Hence, it is difficult to disentangle the impact associated with the budget constraint indirect or direct policy recommendations, especially when considering aggregate indicators such as the main dependent variable throughout this chapter so far.

5.4 The EU economic governance framework beyond fiscal rules

The last section of the chapter expands beyond the supranational fiscal rule considering the soft fiscal policy coordination dimension within the EMU under the European Semester. Against the premises of the near-impossibility of a straightforward disentanglement of the two concomitant and parallel impacts of soft and hard influences on the national fiscal policy mix, the alignment between the two prescriptions can offer an insight on the (inter)workings of the two components of the EU economic governance framework. If the connection between the supranational fiscal rule and budget composition remains fairly unexplored, its interplay with the direct coordination of the Member States fiscal policies and the resulting impact on the structure of domestic public spending poses a broad array of open questions. Do the two sides of the EU economic governance framework support or rather run against each other? Can the EDP act as a strong harm of the weak enforcement mechanisms under the Semester toward convergence? Or are the broader objectives under the Semester sacrificed on the altar of the prevailing consolidation-driven leash of the EDP?

A comprehensive analysis in this regard is beyond the scope of the current investigation of the relationship between the Pact and the national fiscal policy mix. However, the CSRs can be considered as nominal objectives of the trajectories of Member States spending allocations. As such they may provide some input on the intended impact of the supranational fiscal rule on the domestic fiscal policy mix. At the same time, the comparison of the two channels tests their alignment and consequently that of the direct (intended) and indirect (potentially unintended) consequences of the EMU for the national budget composition. In this context, the two parallel channels of influence on the composition of domestic public expenditures can be compared in its direct prescriptions through the Country-Specific Recommendations (CSRs) and the indirect impact of the EDP. In doing so, the section provides a preliminary analysis of whether:

> [HP1.C] *the impact of EDP surveillance on national budget structures is congruent with the CSRs.*

In building on the larger framework of the three research questions under consideration the analysis (i) determines the directional impact of the EDP on the macro and micro components of national budgets after the introduction of the European Semester (ii) identifies the reform prescriptions under the CSRs and (iii) puts forward a comparative analysis of the (real) impact of the EDP and (prescribed) impact of the Semester, following the methodological approach illustrated in the sub-section to follow.

Methodology

<u>Step 1: EDP</u> The baseline model enriched through the analysis of the impact of the EDP and its cross-reform evolution poses the basis for the identification of the impact of the EDP on the budget components for the relevant sample in terms of time and space. On the time account, the sub-sample is restricted to align with the introduction of the European Semester. Geographically, the scope of the analysis is restricted to Eurozone countries not under Financial Assistance for which an impact of the supranational fiscal rule has emerged so far. The dependent variable(s) are broadly the division level components and the three investments, transfers and inequality macro-aggregates. The output is a chart of the directional impact of the EDP on spending across the various components. This amount to depicting the consolidation-driven (indirect) distributive budgetary consequences of the SGP, to be then compared against what reforms (and the implied direction of spending allocations) are prescribed to Member States within the CSRs.

Step 2: CSRs All expenses-relevant recommendations for selected Eurozone Member States under EDP are considered to derive a qualitative assessment of the directional change prescribed for each division and group called into question by one or more CSRs. For each relevant recommendation the coding considers whether there is an clear implication on the direction of the change in the category (e.g. increasing poverty mitigation measures implying increase in social spending) or conversely if the result either of a single prescription or of several running in opposite directions is unclear. Having coded all division level budget lines, the derived overall implications of CSRs for the directional change in investment, transfers and inequality are presented.

The selection of the case studies should reflect two dimensions: time and geographical coverage. As shown in Figure 5. 4 earlier in the chapter, countries display a more or less prolonged permanence under the corrective arm, while geographically, a distinction should be made across the core and the periphery. Such selection reflects the potential impact on misalignment on the length of permanence under the EDP itself, which may shift the focus of CSRs, while conversely, the impact of the EDP on the budget structure may vary across geographical areas, implying a different benchmark of the effect of the supranational rule to compare the indications within the Semester to. The selection of Austria, Belgium, France, Italy, Portugal and Spain embodies the heterogeneity to cover both core and periphery, short and long permanence under the EDP and contains as well the case of countries exiting financial assistance. Specifically, Austria, Belgium and Italy remain under EDP for half of the timeframe or less starting from 2011, while the opposite is the case for France, Portugal and Spain.

Step 3: Alignment The comparative analysis highlights the alignment or divergence of the indirect and direct impact of the EU economic governance framework on key areas of public spending such as health, education and social spending which incorporate both elements of all three macro-categories of national fiscal policy, with disaggregation to the group level when warranted by the specificity of the CSRs.

The impact of the EDP on divisions and macro areas

To benchmark the distributional impact of the EDP the analysis needs to be restricted to the relevant timeframe (from 2011) and scope (Eurozone), while further distinction should be made excluding the (initial) year of crisis and distinguishing across core and periphery. The expectations in light of the previous section are indeed of an impact of the EDP given the timeframe of the latest iteration of the reformed EU economic governance. However, results of section four suggest a further distinction is in order in the subsample falling under the Fiscal Compact, which given the initial Eurozone restriction amounts to considering the timeframe starting after 2013 when the mandatory national implementation of balanced budget rules came into force.

The resulting picture as shown in Table 5. 13 - depicting the GDP size of the change across significant budget lines colour-coded by the corresponding standard deviation range - does indicate substantial variation across all fronts. With some divisions - namely culture and social protection - associated with a more generalised restraining impact of the EDP, nevertheless the strength of the effect changes across the Eurozone subsample. For example, for social protection, while a reduction of less than half of a standard deviation is associated with the Eurozone in the whole timeframe of the Semester, it reaches sixty per cent of a standard deviation for the periphery, seventy for the Fiscal Compact and nearly 1.6 standard deviations in the periphery after the balanced budget rule implementation. Striking divergences emerge along the core-periphery divide and the Fiscal Compact, with the most stringent restrictions (easily surpassing one standard deviation to reach 1.5) associated with countries with an excessive deficit in the periphery after the coming into force of the Fiscal Compact. In addition, significant effects do not only emerge on the negative side as for environmental protection and economic affairs whenever significant being under EDP surveillance is associate with an increase in spending in the given budget line for the periphery and core respectively. At the division level, different directional impacts also emerge for defence, negative and significant in the Eurozone, while the opposite is the case post-2011 in the core.

Table 5. 13 - Size of the impact of the EDP on division and macro categories (in percentage of GDP) from 2011 in the Eurozone, core and periphery, excluding the crisis and restricting by Fiscal Compact

	EZ	Eurozone (no crisis)	periphery	periphery (no crisis)	core	core (no crisis)	Fiscal Compact	Fiscal Compact (periphery)	Fiscal Compact (core)		Color legend
defence	-0.07	-0.04				0.04			0.04		sd<-1
public order	-0.03		-0.06								-1<sd<-.7
economic affairs						0.19			0.44		-.7<sd<-.5
environment			0.16	0.24				0.41			-.5<sd<-.3
housing			-0.06								-.3<sd<-.1
health							-0.11				+.5<sd<+.3
culture	-0.05	-0.05			-0.04	-0.05	-0.06				+.7<sd<+.5
education							-0.13				+1<sd<+.7
social protection	-0.21	-0.25		-0.31			-0.37	-0.56			sd>+1
inequality	-0.34	-0.38					-0.60	-0.71			
tranfers				-0.54				-0.65			
investment						0.34	-0.46		0.54		
investment (r)							-0.23				

Note: colour corresponds to the size of the impact in terms of standard deviations

Similarly, while a negative effect on investment is associated with falling under EDP surveillance in the Eurozone with the Fiscal compact, there is contrarily and increase in investment post-2011 in the core, substantial in size in both instances but with an increase well exceeding one standard deviation under the Fiscal Compact. Considering the other macro-categories, both inequality and transfers are always negative whenever significant, with the size of the effect increasing under the Fiscal Compact and in the periphery. Inequality mitigating spending decreases by less than a standard deviation for those under EDP in the Eurozone after the introduction of the Semester, but well over seventy per cent of a standard deviation under the Fiscal Compact and by over 1.6 standard deviations - corresponding to over 0.7 percentage points of GDP - in the periphery after the implementation of the balanced budget rule. Conversely, investment only decreases (moderately) under the Fiscal Compact for the whole Eurozone, while the opposite pattern emerges for the periphery with a significant increase after the Fiscal Compact exceeding one standard deviation and corresponding to half a percentage point of GDP.

Taking a subsample perspective, the most striking divergence occurs under the Fiscal Compact across core and periphery: while in the Eurozone the impact whenever significant is negative and somewhat moderate except for social protection and inequality, a clear distinction emerges across the periphery with the EDP associated with over one standard deviation decreases of spending (except for environmental protection) and the core where increases emerge nearing or surpassing one standard deviation. The emerging picture is undoubtedly rosier for the core than the periphery. It remains, however, to be assessed the extent to which the impact of the supranational fiscal rule on the budget structure does or does not align with EU fiscal policy prescriptions under the Semester.

The case studies

For each of the six countries, the Country-Specific Recommendations up to 2018 are considered (EGOV, 2020), to evince whether the policy recommendations prescribe a cut or expansion across divisions and how such guidelines aggregate into indication for spending on investments, transfers and inequality addressing measures. A brief summary of relevant recommendations by country and year is presented in Appendix 5, while a summary table of the direction of prescriptions is presented here for each country, alongside overall Fiscal Compact EDP budgetary impact together with that of the specific geographical subsample. When contradictory prescription, for example on sub-categories of social spending, are present, both are listed and explicated in a note.

Austria represents a core country falling under EDP for the first half of the sample up to 2014 included. Table 5. 14 shows whenever relevant CSRs are present for a given budget line. The picture is that of fairly stable prescriptions of consolidation of pension spending and healthcare, along with investment in care services and education. While there are some contrasting indications within social spending, clear-cut trajectories are indicated for consolidation of healthcare spending and investment in education. The overall macro-implications would suggest - in line with expectations - increased investments and spending on inequality addressing measures while conversely reducing transfers. Such dynamics diverge to some extent from the EDP impact under the Fiscal Compact in the Eurozone, while within the core subsample they are consistent with investment trajectories while no significant effect contradicts directly the CSRs.

Table 5. 14 - CSR prescriptions on changes across divisions and macro category by year for Austria along (right) with the impact of the EDP under the Fiscal Compact

Austria	2011	2012	2013	2014	2015	2016	2017	2018	Fiscal Compact	Fiscal Compact (core)
defence										+
public order										
economic affairs										+
environment										
housing										
health	-	-	-	-		-	-	-	-	
culture									-	
education	+	-/+($)	+	+	+	+	+	+	-	
social protection	-/+(*)	-/+(*)	-/+(*)	-/+(*)	-/+(*)	-/+(*)	-/+(*)	-/+(*)	-	
inequality	+	+	+	+	+	+	+	+	-	
tranfers	-	-	-	-	-	-	-	-		
investment	+	+	+	+	+	+	+	+	-	+
overall	-	-	-	-	-					

(*) -pension&invalidity +family policy

($) - increase efficiency +improve educational outcomes for disadvantaged

Belgium represents a core country falling under EDP for half of the post-2011 sample, up to 2014.

Table 5. 15 shows relevant CSRs prescriptions across each budget line from 2011 to 2018. While overall consolidation towards public finance sustainability is advocated over the full period, there is an initial phase in which a strong focus is posed on putting an end to early retirement and improving the sustainability of pensions, together with other areas such as health and in particular long term care, while in the post-2014 (non-EDP) period the focus of recommendation

somewhat shifts toward the promotion of investments – especially towards green policies – and inclusions, for example through training of vulnerable groups and youth. The implications for the macro-components are thus not homogeneous along the considered period, negative for transfers and to some extent for inequality and investment early on while positive for the latter two in later years. However, for the period under the EDP there is a negative trend prescription for health and social protection with negative implications for transfers, inequality and considering the relative budgetary share of healthcare and environmental protection likewise for investment. It should also be noted, that while the pattern of prescriptions does change after the end of being under EDP surveillance, one of the key supranational indication for the restructuring before then was the enactment and enforcement of pension sustainability reform that once implemented has similar implications for budgetary trends post-2014. Given that CSRs for the EDP period precede the Fiscal Compact, the meaningful comparison is with the left-side columns of Table 5. 13 where CSRs prescriptions do find some alignment with the Eurozone impact of the EDP on social protection and inequality but differ from the impact emerging in the core subsample which is only significant for spending on culture.

Table 5. 15 - CSR prescriptions on changes across divisions and macro category by year for Belgium along (right) with the impact of the EDP under the Fiscal Compact

Belgium	2011	2012	2013	2014	2015	2016	2017	2018	Fiscal Compact	Fiscal Compact (core)
defence										+
public order										
economic affairs					+	+	+	+		+
environment		+	+	+						
housing										
health		-	-	-					-	
culture									-	
education				+	+	+	+	+	-	
social protection	-	-	-	-					-	
inequality	-	-	-	-/+($)	+	+	+	+	-	
tranfers	-	-	-	-						
investment		-/+(£)	-/+(£)	-/+(*)	+	+	+	+	-	+
overall	-	-	-	-	-	-	-	-		

($) - social and health spending + education

(£) - health spending + environment

(*) - health spending + eduation & environment

France represents a core Member State falling under EDP over the full timeframe of the analysis. Table 5. 16 shows relevant CSRs prescriptions across each budget line from 2011 to 2018. Coherently, financial consolidation is advocated by the CSRs without interruptions from 2011 to 2018, with a fairly stable focus on pension and unemployment sustainability, paired with concerns and advocated support for youth employment. Improvement in education and training is also quite consistently supported throughout the series, while in the 2012-2014 timeframe infrastructural investment makes an entrance in the CSRs, joined in the latter two years by health consolidation. With the overall direction in the social protection category in the early years, as of 2013 prescriptions are clearly in the negative direction. Under such premises, implications are generally positive for investments, with the partial exception of years of health spending consolidation indications, while the opposite is true for transfers and in the overwhelming majority of the cases inequality addressing spending. Considering alignment between the CSRs and the EDP, taking a post-Fiscal Compact perspective, the EDP in the full sample of the balanced-budget bound Member Sates runs against the Semester in two instances: education and investment. However, the same does not hold if the impact of the EDP under the Fiscal Compact is considered solely for the core sub-sample.

Table 5. 16 - CSR prescriptions on changes across divisions and macro category by year for France along (right) with the impact of the EDP under the Fiscal Compact

<u>**France**</u>	2011	2012	2013	2014	2015	2016	2017	2018	Fiscal Compact	Fiscal Compact (core)
defence										+
public order										
economic affairs		+	+	-/+(")						+
environment										
housing										
health			-	-					-	
culture									-	
education	+	+		+		+	+	+	-	
social protection	-/+(*)	-/+(*)	-	-	-	-		-	-	
inequality	-/+($)	-/+($)	-	-	-	-	+	-	-	
tranfers	-/+(*)	-/+(*)	-	-	-	-		-		
investment	+	+	-/+(£)	-		+	+	+	-	+
overall	-	-	-	-	-	-	-	-		

(*) - sustainability of pensions + active labour market policies
($) + education and (*)
(£) - health + economic affairs
(") - environmentally harmful subsidies + energy interconnectivity

With Italy, the analysis shifts toward the periphery, with the Member State falling under the EDP only over 37.5 per cent of the timeframe, up to 2013. Table 5.17 shows relevant CSRs prescriptions across each budget line from 2011 to 2018. Regardless of EDP status, overall Semester prescriptions remain within the consolidation domain, albeit with a partial weakening of the language in some of the later years. Recommendations are less stable in their focus over time while concentrating primarily – beyond infrastructural investment – on social protection and education. The latter are united by the overall rationale of tilting spending in support of family policies to foster women participation in the labour market with a likewise effort to be pursued in support of young people through the youth guarantee and improvement of education and training, under the broader umbrella of strengthening active labour market policies. At the same time, rationalisation – and in an instance reducing the share of spending dedicated to pensions – is mentioned for over half of the timeframe considered. Overall, the CSRs amount to a positive trend for infrastructure investment and education paired with more mixed indications regarding social spending. On a broader account, that translate to mixed to positive guidelines (half of the times) for inequality addressing expenditures, mixed implications for transfers and a positive one for investments. The alignment of the EDP impact is partial at best. In several instances, the impact of the Fiscal Compact overall and within the periphery runs against the CSRs prescriptions. Considering, however, that the permanence under EDP ceases after 2013, alignment is better assessed through comparison of the early period with the overall Eurozone and periphery impact of the EDP starting from 2011. While the negative impact of education arising from the EDP under the Fiscal Compact no longer emerges, the negative impact on social protection, inequality and (within the periphery) transfers does remain, indicating in such categories there may be indeed a contradiction between what a country is prescribed under the CSRs and the impact of the EDP on the composition of budget expenditures.

Table 5. 17 - CSR prescriptions on changes across divisions and macro category by year for Italy along (right) with the impact of the EDP under the Fiscal Compact

Italy	2011	2012	2013	2014	2015	2016	2017	2018	Fiscal Compact	Fiscal Compact (periphery)
defence										
public order										
economic affairs		+	+	+						
environment										+
housing										
health									-	
culture									-	
education		+	+	+	+			+	-	
social protection	-/+ (*)	-/+ (*)		+		-/+(£)	-/+(£)	-/+ (^)	-	-
inequality	-/+ (*)	-/+ ($)	+	+	+	-/+(£)	-/+(£)	+	-	-
tranfers	-/+ (*)	-/+ (*)		+		-/+(£)	-/+(£)	-/+ (^)		-
investment		+	+	+	+			+	-	
overall	-	-	-	-	-	-	-	-		

(*) - unemployment benefit review + care services

($) + education and (*)

(£) - rationalise social spending + implement ALMP / antipoverty strategy

(^) - pension spending + ALMP and care services

With Portugal, while remaining within the periphery the analysis moves toward countries having fallen under financial assistance. As such, the CSR prescriptions are displayed in Table 25 as of exiting financial assistance in 2014. The country further remained under EDP until 2017, amounting to 75 per cent of the considered sample, paired with overall budgetary prescription of consolidation, albeit with a focus on preserving growth-enhancing spending. In the Portuguese context, the most stable prescription over time is that of health rationalisation. In two periods the need to strengthen education and training emerges in the CSRs while the picture goes from mixed to negative over time for social protection, with the sustainability of pensions remaining a key concern for the overwhelming majority of the timeframe. Under such premises, implications for macro-aggregates – except for 2016 and 2017 for which a negative trend emerges across the board – are often mixed to negative overall. The same holds if the focus is put on the sole period under EDP which excludes only 2018. Shifting the focus to the alignment of the EDP impact with CSRs, the final columns of Table 5. 18 already display the relevant comparison given where left side observations fall temporally. Considering the full sample, the Fiscal Compact openly runs against prescriptions for education, while the strongly negative effects on social protection and inequality (to a lesser extent also on investment) are far more stringent than the mixed picture for those categories of spending prescribed by the CSRs. The same remains for social protection and inequality and transfers considering the EDP impact under the Fiscal Compact in the periphery alone: the negative effect of the EDP always exceed one standard deviation, reflecting a more substantial negative trend that the CSRs mixed prescriptions would suggest.

Table 5. 18 - CSR prescriptions on changes across divisions and macro category by year for Portugal along (right) with the impact of the EDP under the Fiscal Compact

Portugal	2011	2012	2013	2014	2015	2016	2017	2018	Fiscal Compact	Fiscal Compact (periphery)
defence										
public order										
economic affairs				-/+ (*)						
environment										+
housing										
health				-		-	-	-	-	
culture									-	
education				+				+	-	
social protection				-/+ ($)	-/+(£)	-	-		-	-
inequality				-/+ (^)	-/+(£)	-	-	-/+ (§)	-	-
tranfers				-/+ ($)	-/+(£)	-	-			-
investment				-/+ (")		-	-	-/+ (§)	-	
overall				-	-	-	-			

(*) - finanial sustainability of public transport + energy interconnectiviy

($) - sustainability of pensions + adequate social assistance coverage

(£) - pension sustainability + adequate coverage of minimum income

(^) - health + education and ($)

(") - helth + education and (+)

(§) - health + education

Note: in grey years under Financial Assistance

Spain, shown in Table 5. 19 aligns with Portugal in representing a periphery country exiting Financial Assistance in 2014, as such restricting the period for which the comparison is made across CSRs and EDP. In this context, Spain remains under the EDP up until 2016, for about 60 per cent of the considered years. Overall budgetary prescriptions remain those of consolidation under the full period considered, albeit looking at specific measure the more stable recommendations are those of investment in education and training and improvement of family policies and measures addressing youth unemployment. Other than the two categories, health consolidation emerges but only in 2014 and 2015. Likewise, pension sustainability is only a concern highlighted in the initial year. As a result, implications for macro-categories are far more straightforward than for Portugal, while some mixed patterns remain especially in the initial part of the period. Under such premises, inequality mitigation measures are impacted by initially mixed later turning positive prescriptions, while the sign is positive for transfers and investment for the overwhelming majority of the years considered. As for the alignment with the EDP, Spain seems to pinpoint the more substantial gaps. Comparing the EDP under the Fiscal Compact for signatories the negative impact for education, the strongly negative one for social protection and in parallel with investment and inequality all run blatantly against the spending adjustment indicated by the supranational level under the CSRs. Alignment does not improve when considering the periphery subsample: here the EDP under the Fiscal Compact yields negative shifts exceeding one standard deviation in social protection, inequality and transfers to be contrasted with the prescription of improving education and social inclusion policies and in turn both of the macro-category the EDP substantially slashes.

Table 5. 19 - CSR prescriptions on changes across divisions and macro category by year for Spain along (right) with the impact of the EDP under the Fiscal Compact

Spain	2011	2012	2013	2014	2015	2016	2017	2018	Fiscal Compact	Fiscal Compact (periphery)
defence										
public order										
economic affairs										
environment										+
housing										
health				-	-				-	
culture									-	
education	+			+		+	+	+	-	
social protection	-			+	+	+	+	+	-	-
inequality	-/+ (*)			-/+ ($)	-/+ (^)	+	+	+	-	-
tranfers	-			+	+	+	+	+		-
investment	+			-/+ (£)	-	+	+	+	-	
overall	-			-	-	-	-	-		

(*) - pension sustainability + education and training
($) - health + education and social and familiy policies
(£) - health + education
(^) - health + youth employment support

Note: in grey years under Financial Assistance

Do CSRs and the EDP align?

Table 5. 20 aggregates finding into a comparative table displaying general trends for the CSR across the six countries considered together with the EDP impact under the Fiscal Compact as well as its core-periphery divide. While – as one would expect – cross-country differences are substantial in the CSRs, some trend emerges along the core-periphery fracture line, yielding differences in the alignment with the EDP overall and especially in its geographically distinguishing components. However, two CSRs trends are fairly consistent across all countries: health spending consolidation and investment in education. As such on this account comparison to the full-sample impact of the EDP seems appropriate, which concurs on the first dimension of health spending cuts, while blatantly contravenes the second as being under excessive deficit surveillance is associated with negative trends in education spending. Commonalities across core and periphery end there. An important distinction in CSRs emerges in the key area of social protection, somewhat distinct from what one may expect in line with the debate and findings in the literature on EU economic governance implications in the Southern Member States. In fact, while short of a mixed picture in Austria prescriptions are generally of consolidation in the core, the same is not the case in the periphery, with either clear cut indication of extending policies for social inclusion as for Spain, or more composite recommendations. However, this pattern contrast with the opposite cleavage in the EDP impact: negative overall and especially so for periphery countries (hence running against the CSRs) while non-significant in the core subsample for which consolidation would be coherent with the Semester.

Table 5. 20 - CSR prescriptions on changes across divisions and macro category by country and the impact of the EDP under the Fiscal Compact

	CSRs						Fiscal	Compact	Compact
	Austria	Belgium	France	Italy	Portugal	Spain	Compact	(core)	(periphery)
defence								+	
public order									
economic affairs		+	+	+				+	
environment		+							+
housing									
health	-	-	-		-		-		
culture							-		
education	+	+	+	+	+	+	-		
social protection	-/+	-	-	-/+	-/+	+	-		-
inequality	+	-/+	-	-/+	-/+	+	-		-
tranfers	-	-	-	-/+	-/+	+			-
investment	+	+	+	+	-/+	+	-	+	

Such a divide translates into macro-categories of spending. Overall the picture is mixed for half of the countries, positive for two and clear-cut negative only for France. That already somewhat implies that the overall negative impact of the EDP clashes to some extent with the CSRs. Geographical distinction worsens the prognosis for the periphery: while no significant impact of the EDP emerges for the core, with a more mixed CSRs scenario, one of over minus one standard deviation emerges for the periphery, where the prescriptions of the CSRs are never clear-cut negative. A similar dynamic emerges for transfers, which on the CSRs side are negative in the core and mixed to positive in the periphery. Against such a divide, the opposite appears for the impact of the EDP: a negative impact exceeding one standard deviation in the South, blatantly contravening CSRs, while significance is not achieved in core countries. The core-periphery divide remains also for investments, where overall the prescriptions of the CSRs have positive implications, short of the mixed picture in Portugal. That runs against the negative impact of the EDP overall, which once looking at the disaggregated level turns however positive in the core, coherently with the CSRs.

While the complexity and not always clear-cut nature of the CSRs require some caution in drawing conclusions, case studies do suggest the fiscal rule and the Semester may at time clash, directing the Member States spending toward investment – and to some extent social objectives especially in the periphery – while leading to the opposite dynamics for countries under EDP surveillance. The case studies further highlighted how the misalignment may be specially marked for the Southern Member States, for which the indirect effect of the supranational budget constraint under excessive deficit surveillance is stronger and yields more negative social and inequality implications, moreover running openly against what the EU economic governance would require from these countries in the context of the Semester. While the focus of the analysis returns to the supranational fiscal rule, in turning to crisis dynamics in the upcoming chapters, this section already cast some shadows on the EU economic governance framework and in particular on: (i) the impact of the EDP under the Fiscal Compact on spending such as in health and education and overall consequences for inequality and investments – contravening the objectives of EU economic governance – (ii) the core-periphery divide both in the EDP and CSRs and (iii) the lack of congruence between the Semester and the Pact for countries under excessive deficit surveillance.

Conclusions

The chapter sheds some light on the constellation within the EU economic governance regulatory framework yielding to a significant impact on national budget structures. Section one, specifying the model has confirmed previous findings (e.g. Reuter, 2019) of EU economic governance – considered as membership in the Union and Eurozone – as associated with less fiscal discipline. Indeed, at the aggregate level after accession to the Union and for Euro area members budgets compositions are more stable (there is a negative impact on budget distance) and beyond the aggregate level the few budget lines for which significant effect emerge show higher rather than lower spending. Confirming the limited push toward consolidation of the Stability and Growth Pact, the finding while aligned with much of the literature on ineffective fiscal discipline within the EU and Eurozone pave the way to the first substantive contribution of the research, confirming the limits of accounting for the supranational fiscal rule as a single element affecting, in the same manner, all Member States regardless of their fiscal standing and the economic climate.

Section two shifts the focus onto the key independent variable: the EDP. In doing so it confirms that rather than considering the EU economic governance framework as a failure because of breaches to the fiscal rule thresholds, the effect of the Pact may materialise especially for the Member States under the predicament of excessive deficit surveillance. Indeed, the EDP is associated with increased budget distance, implying a restructuring of the composition of public spending, which under the trend of decreasing total spending translates into a push towards consolidation, confirmed at the budget line level. Results, while innovative in the EU context should not come as too much of a surprise has it has been documented at the national level that fiscal rule may have a positive effect on fiscal discipline even when they are violated (Reuter, 2015).

Two further takeaways of high relevance for the subsequent research questions emerge in section two. Firstly, repeating the analysis in the Eurozone and non-Euro area subsamples highlights how the EDP effect on budgetary composition at the national level is confirmed only within the Eurozone. Even in the absence of sanctioning in the history of the EDP the prospect itself may be of high impact in the influence of supranational excessive deficit surveillance in the Member States spending restructuring to regain compliance within the Pact's fiscal rule. The interaction between EDP and Eurozone Membership confirms section one findings when looking jointly at the two elements: Euro area countries are associated with a significant decrease of budget distance, which is, however, more than fully compensated by the additional positive and significant effect of EDP surveillance. That is to say that Eurozone membership may give rise to free-riding effects on fiscal discipline which however disappear and are reversed once Euro area countries are under EDP. The latter dynamics in the interaction model, however, arise only once crisis years are excluded already confirming the Pact may have divergent trends and consequences in good and bad times.

Shifting to section three, the findings confirm a changing impact over time and regulatory iteration of both the Pact at large and specifically the EDP. On the account of the Pact, it should be noted, that while Eurozone membership is associated with smaller changes in budget structure in phase one (pre-2005 reform) and phase two (pre-2011 reform) of the Stability and Growth Pact, the opposite sign albeit with a modestly sized effect emerges for the post-2011 governance framework which may thus have improved its track record in terms of budgetary dynamics even for countries not under the scrutiny of the EDP. The impact of the EDP changes even more substantially across iteration of the Stability and Growth Pact. From a subsample perspective, if in the early phase no significant difference emerges across budget distances for observations under the preventive or corrective arm, the same is not the case as of the 2005 reform. However, dynamics are the opposite in phase two and three. Pre-2011, countries under the EDP display lower budget distances (less restructuring) than those remaining within the fiscal prudence prescriptions of the Pact. The opposite is the case for the latest governance framework, where excessive deficits surveillance is associated with a higher restructuring of public spending, which increases with the exclusion of crisis years and quite substantially with the coming into force of the Fiscal Compact. With the caution of considering that the crisis period weights more heavily on the second phase, the membership and EDP results confirm that the effectiveness of the governance framework on impacting national budget structures is not homogeneous over time, substantially improving in the latest years.

Coming to the final section, limited and preliminary exploration of the EU economic governance beyond fiscal rules yields to fewer positive conclusions regarding the supranational surveillance. While reiterating the partial nature of a case study approach, the section shed some (dark) light on the congruence of the EDP impact with the overall policy objectives of the Pact and the Semester arm of the framework. Indeed, the EDP often runs against prescriptions within the CSRs especially for sensitive areas of the budget such as education and social spending, which in parallel translate into diverging trends also for inequality mitigation spending and investment. That is to say that while within the EMU fiscal discipline should be conjoined with the parallel objective of fostering pro-growth and inclusion spending, reality differs for countries under excessive deficit surveillance. While the analysis does not consider CSRs implementation, empirical budgetary dynamics – for countries under the EDP – suggest that there may be little room for high adherence given the countering restructuring of spending taking place. Furthermore, heterogeneity is not limited to the two arms of EU economic governance as trends are far from unified across the core and periphery, with more damning clashes between the CSRs and EDP and negative social and economic implications emerging for Southern countries. In moving forward with the analysis such finding is of high interest in reinforcing that EDP dynamics should be explored also concerning the differences between core and periphery, in line with the extensive literature on diverging trends especially in the context and aftermath of the Eurozone crisis (e.g. Lin & Treichel, 2012; Censolo & Colombo, 2016; Matthis, 2017; Howarth & Verdun, 2020).

Table 5. 21 - Summary of results for [RQ1] *when and how the SGP affects the composition of national budgets.*

[HP1.A] *falling under EDP surveillance leads to consolidation-driven higher structural changes in national budgets.*	Corroborated: for Eurozone countries: significant increase in changes to budget structure and decreased spending in some budget components.
[HP1.B] *the impact of EDP surveillance on the composition of national budgets substantially increases with the 2011 reform of the SGP*	Corroborated: significantly higher impact on the budget structure post-2011, even more substantial for the Fiscal Compact.
[HP1.C] *the impact of EDP surveillance on national budget structures is congruent with the CSRs.*	Refuted: cases - especially in the periphery - were the impact of the EDP runs against prescriptions of the CSRs.

As summarised in Table 5. 21 overall the chapter, in investigating the research question of when and how the EU economic governance framework affects the composition of the budget, verified the sub-hypotheses of (A) the EDP leading to higher structural changes in national budgets and (B) a substantial increase of the EDP impact with the 2011 reform and with the Fiscal Compact. Conversely, the case studies analysis offers preliminary evidence against the sub-hypothesis (C) rejecting the congruence of the impact of the EDP on the fiscal policy mix with the prescriptions of the CSRs under the Semester.

6. EU economic governance in times of crisis

Having assessed the diversified impact of the different mechanisms and iterations of EU economic governance in addressing RQ[1] dedicated to when and how the SGP affects national budget structures in chapter five, chapter six shifts the focus to what happens during a negative economic cycle. In chapter four, in developing the analytical framework, it was highlighted how times of crisis may be characterised by a different functioning of the EU fiscal surveillance framework as (i) the policy objectives concerning public expenditures change compared to the positive cycle and (ii) the nature of the supranational fiscal rule itself may change either with escape clauses kicking in or – at the very least – with the prospect of sanctioning taken off the table.

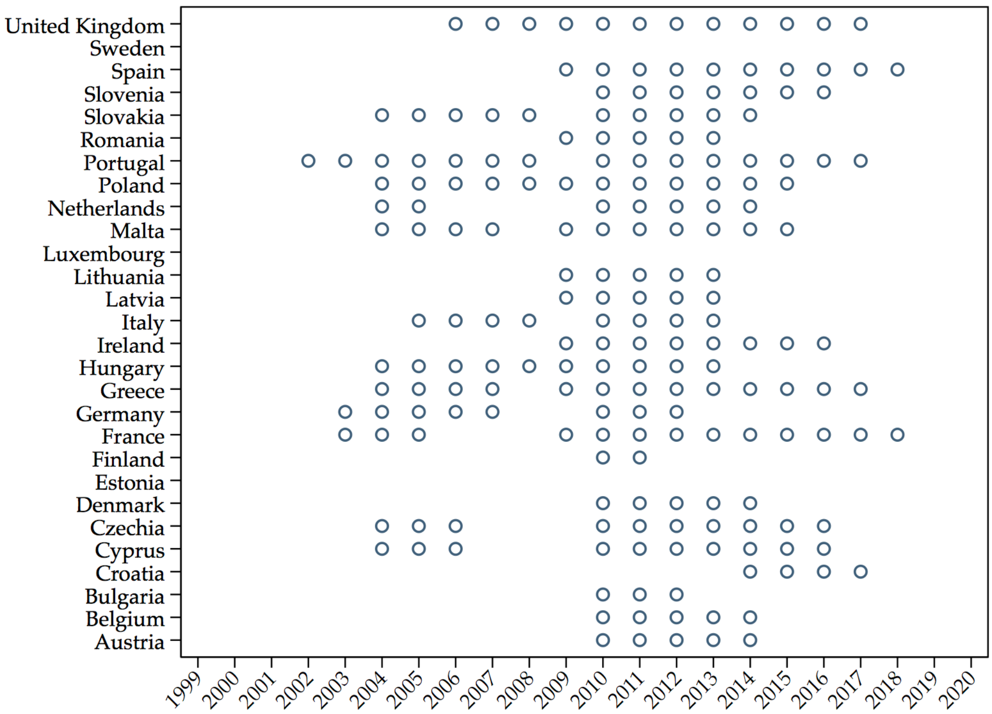


Figure 6. 1 - Member States under EDP surveillance over the years

Policy objectives are not necessarily well representative of expectations regarding recession years, as the effectiveness and appropriateness of the supranational fiscal framework have been openly questioned, not without empirical backing. At face value, unlike with the 2003 crisis, the SGP somehow can be seen as to have passed the “bad-weather test” through the Great Recession and Euro crisis. Probably also in light of the previous negative track record and the resulting need to ensure the credibility of the framework, the Pact was not suspended tout court as invoked by several of the Member States in the outbreak of the crisis (Heipertz & Verdun, 2010, p. 174). However, while excessive deficit procedures continued to be opened as illustrated in Figure 6. 1, the laxity and flexibility of the phase two EU economic governance framework implied that no sanctioning was foreseen under the built-in exceptional circumstances clause associated with a negative cycle.

As such, the ability of the SGP and EDP to restrict spending behaviour in bad times – especially in the context of the Great Recession and phase two EU economic governance – has been questioned due to its excessive flexibility (Larch et al., 2010). On the opposite side of the spectrum, the supranational fiscal framework has been associated with pro-austerity measure even in the negative economic environment, in arguing that in the context of the Euro crisis "premature exit strategies" were imposed (Creel et al., 2012, p. 539). The criticism of the EU economic governance infrastructure in times of crisis has been widespread. The pre-existing weak regulatory framework is blamed for failing to control deficits in good times resulting in the imbalances that exacerbated by the Great Recession led to the sovereign debt crisis (Wyplosz, 2017). At the same time, the overall mechanisms and philosophy in crisis largely untouched by the reform are also considered problematic (e.g. Lane, 2012; Heise, 2015; Wyplosz, 2017; Howarth & Verdun, 2020).

Specifically, there is broad agreement on the failure of the framework to deliver both in terms of speed and scope (e.g. Lane, 2012; Heise, 2015; Wyplosz, 2017; Howarth & Verdun, 2020). The central role of intergovernmental processes breeds division and paralysis in a conflictual arena with divergent national interest and fiscal paradigms that were present since the very beginning of the SGP and enshrined in the compromise resulting in the EU economic governance framework as illustrated in chapter two. Along these lines, the supranational fiscal rule has been considered as slowing elements in the recovery, by forcing premature termination of the stimulus effort into a consolidation of budgetary positions (Lane, 2012). The SGP – and its most impactful contractionary component of the EDP – has been deemed not only ineffective in the management of the crisis but even counterproductive (Heise, 2015).

The limits of the SGP in crisis and to some extent its impact on the size of spending and other aggregate fiscal variables had received substantial attention. The same is not the case for the distributional implications within national budgets and specifically, the extent to which the fiscal policy mix is affected and how. Given the discouraging and problematic findings – which have fed the rhetoric against the EU and the common currency – a closer analysis of budgetary dynamics is of high value in understanding overall trends as well as the impact on specific categories of interest such as social spending. In this context, it is of high value to assess separately the specificity of the crisis years together with dynamics affecting given categories of public expenditure exploiting the increased granularity of COFOG group-level data for the later years of the panel. Looking at the period of the Great Recession and the ensuing Eurozone crisis starting from 2009 to 2011, the analysis addresses:

> [RQ2] *if and how the SGP has affected the domestic composition of public expenditures during the Great Recession and Eurozone crisis.*

The derived three sub-hypotheses span a broad array of issues going from the aggregate cross-cycle impact of the EDP to distinguishing for categories of spending such as investment and transfers, as well as specific division and group dynamics, especially in a key domain of interest such as social expenditures. Under such premises, this chapter is devoted to [HP2.A] considering the (contractionary) impact of the EDP-in-crisis on national budget structures across the three levels of disaggregation. Starting from the aggregate synthetic indicator of budget distance, the analysis assesses whether there is an overall impact of the supranational fiscal rule for Eurozone countries during the negative phase of the cycle, deriving some preliminary consideration on the compatibility of dynamics with a consolidation effort. Further exploring trends at the disaggregated broad division level and for group budget lines confirms the directional dimension of the impact of the EDP-in-crisis.

Additionally, the disaggregated assessments paint a picture of where the EDP led consolidation hit the most during the Great Recession and Eurozone crisis, pinpointing homogeneity and variation across and within divisions. Such analysis provides a partial view on the contribution of individual budget lines to the macro fiscal policy components, setting the stage for the assessment of [HP2.B] of dynamics across investments, transfers and inequality mitigation and [HP2.C] dedicated to social spending in chapter seven.

6.1 The SGP-at-crisis and the budget structure

This chapter is dedicated to the impact of the SGP-at-crisis, starting with the analysis of the overall budgetary structure implication of EU economic governance during the Great Recession. In verifying whether the SGP adheres to its policy objectives, the analysis considers how escape clauses and countercyclical commitments fare in practice. Specifically, looking at crisis years the test is on the presence of any impact on the fiscal policy mix during the Great Recession paired with a consolidation drive. If the SGP behaviour is in line with its nominal objectives, no such effect should emerge in times of crisis. However, the EU economic governance framework has enacted pro-cyclical austerity measures in bad-times (e.g. Ayuso-i-Casals et al., 2009; Creel & Saraceno, 2010; Heins & De La Porte, 2015; Kuusi, 2017; Larch et al., 2010;

Tomann, 2017; Wyplosz, 2016). Under such premises, the overarching hypothesis tested throughout the chapter is the alignment with the 'real-life' behaviour of the policy, assessing if:

> [HP2.A] *the SGP contravenes its countercyclical policy objectives in enforcing consolidation in times of crisis.*

Before developing a granular understanding of crisis dynamics, the first step is the assessment at the aggregate level of changes in the composition of public spending to which this section is dedicated. Informed by the findings already emerged concerning the mechanisms within the EU governance framework associated with a consolidation driven shift in the national fiscal policy mix, the EDP remains the key component considered.

It is of use to recall some of the key lessons for a crisis-proof methodological approach. Firstly, it should be highlighted that some countries fell outside the scope of the SGP during the crisis – beyond the mere special circumstances clause – in accessing Financial Assistance Programs of various nature. Additionally, preliminary descriptive statistics of budgetary dynamics in the crisis years put forward in developing the research design and methodological approach – including total expenditures strictly speaking outside the scope of the analysis – have shown that the negative economic cycle is characterised by high variation in both the overall size and composition of fiscal policies, especially concerning social expenditures.

Moreover, crisis dynamics may not be of a homogeneous nature across the Great Recession and the Euro crisis. The two periods may indeed be subject to diverging dynamics, with an initial rush to provide fiscal stimulus to the national economies, later followed by constraints on expenditures and austerity measure to restore market credibility in the stability and sustainability of national fiscal stances after the outbreak of the sovereign debt crisis. Accordingly, it may be valuable (but potentially unfeasible given the sample-sizes) to further distinguish across the early and late phase of the crisis as well as across Eurozone membership, given that the Euro crisis affected primarily if not exclusively the Euro area.

Model specification(s)

The variable matrix is unchanged from the baseline model, expanded to account for the interaction with crisis years. The analysis for the dependent variable(s) is segmented across the three sections based on the level of granularity, starting from the synthetic aggregate budget distance indicator. In line with the findings of chapter five, while briefly considering the role of the SGP-at-crisis per se, the central independent variable for the analysis remains the EDP, identified as the central driver – together with Eurozone membership

– in determining the impact of EU economic governance on the budget structure.

A distinction in this regard compared to previous considerations lies in the change in the nature of the SGP during the negative cycle. The corrective arm is the mechanism with the strongest 'bite' within the EU economic governance framework – on a procedural level – chiefly because of its pathway to sanctioning if the excessive deficit is not reigned in. Results show whether the impact remains even in the absence – at least in the short term – of the stick of sanctioning, taken off the table with the special circumstances clause coming into play. That is to say, the baseline model is restricted to the crisis subsample in verifying whether the EDP retains significance. Additionally, the interaction between the EDP and the crisis indicates cross-cycle changes in the impact on the budget structure. As usual, patterns are compared across Eurozone Membership and observations associated with Financial Assistance Programmes are excluded. Looking at countries under Financial Assistance is strictly speaking outside of the scope of the analysis of the Pact, however, it should be noted that the interaction of 'dangerous times' with the EU economic governance may provide valuable insights concerning the EU approach for countries under extreme duress and is thus explored in chapter seven.

Additionally, two distinct but overlapping elements are addressed. Firstly, the period under consideration spans across two SGP regulatory frameworks due to the crisis-driven 2011 reform so that any difference in the interaction between the governance and the cycle should be assessed across the two phases. Moreover, the budgetary dynamics explored in defining the methodological approach highlighted a distinction in spending patterns across the early years of the Great Recession hitting the old continent and the homegrown mayhem caused by the sovereign debt crisis within the Eurozone. However, these two within-crisis distinctions can hardly be disentangled due to their overlap, which should be accounted for in deriving any consideration from differences emerging across the early-late crisis subsamples.

Finally, leaving the assessment of disaggregate dynamics to later in the chapter, the overall change in the budget accounting for directional dynamics is considered in assisting in the interpretation of the results for the synthetic indicator. In evidencing if consolidation dynamics are at play, the overall change in the budget allows for a full preliminary assessment of [HP2.A].

Descriptive analysis

The years of the Great Recession and Euro crisis capturing observation starting from 2009 up to 2011 included account for 84 observations associated with the SGP-at-crisis. Looking at the independent variable in this period, during the Great Recession and Euro crisis the EDP skyrockets to account for 70 per cent of the observations, compared to 23 per cent in good times. Consequently, the overwhelming majority of crisis observations (59) fall under the corrective arm, remaining numerous (47) even when excluding countries under Financial Assistance Programmes, which count only 12 crisis observations of the 30 falling under FAP overall. Specifically, those observations relate to Greece, Hungary, Ireland, Latvia and Romania, with only the two latter completely excluded tout-court from the SGP-in-crisis analysis as they fall under FAP for the full period under consideration. Figure 6. 2 shows countries having an excessive deficit during the crisis years, distinguishing across observations for countries at the time under a Financial Assistance Programme.

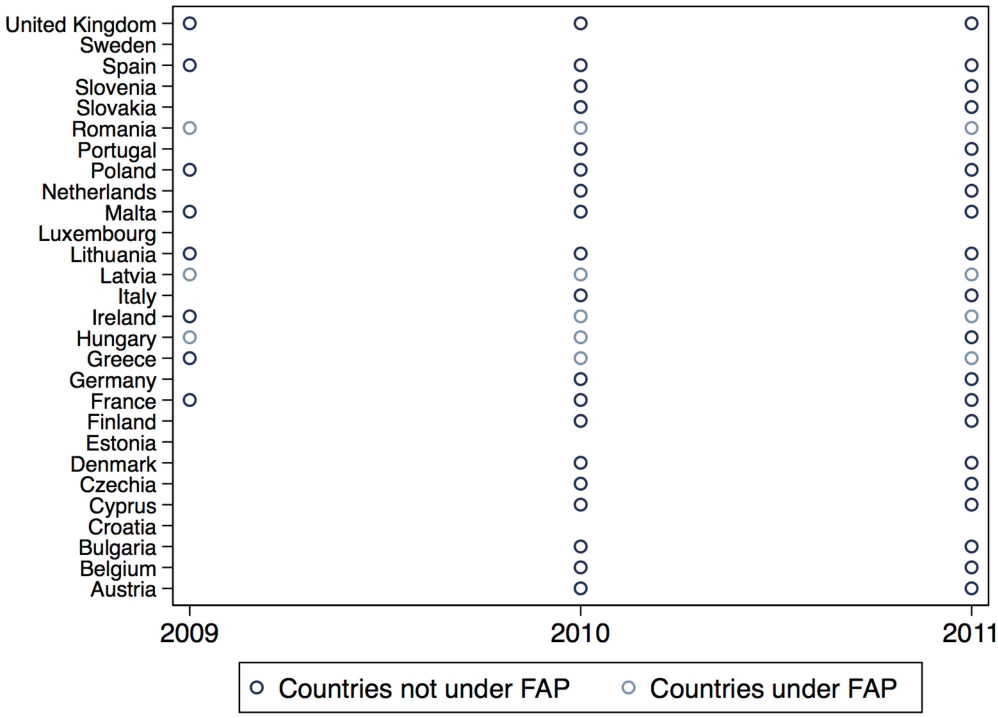


Figure 6. 2 - Countries in excessive deficit during the crisis, distinguishing for *FAP*

Looking at the cross-phase distribution of the 'bad times' sub-sample, the observations are concentrated in phase two, with 56 instances, leaving only 28 in phase three. As such, sample restrictions across the two phases already appear as potentially problematic. Additionally, countries in excessive deficit are themselves not equally distributed across the two sub-samples, amounting to 63 per cent of the sample in phase two against 86 per cent in phase three. In numbers that correspond to 35 observations falling under the corrective arm in phase two and 24 in phase three, further dropping to 27 and 20 respectively once instances under FAP are excluded. As such the numbers in question are quite limited, with just a handful remaining associated with Eurozone countries (18 and 13 respectively in phase two and three). Under this scenario, it could be hardly expected to successfully identify significant changes in the crisis-impact across the two phases.

Table 6. 1 - Budget distance across the crisis, Financial Assistance (FAP), Eurozone membership and EDP

	Budget disance across:	N	mean	sd	min	max
(1.0)	non-crisis	554	1.353	1.565	0.100	13.13
(1.1)	in-crisis	84	2.069	2.728	0.224	18.52
(2.0)	in-crisis, FAP excluded	72	1.630	1.038	0.224	4.663
(2.1)	in-crisis, FAP	12	4.706	6.354	1.039	18.52
(3.0)	in-crisis, FAP excluded, non-EZ	27	1.860	1.252	0.436	4.663
(3.1)	in-crisis, FAP excluded, EZ	45	1.492	0.872	0.224	3.460
(4.0)	in-crisis, non-under EDP	25	2.148	0.914	0.663	4.292
(4.1)	in-crisis, under under EDP	59	2.036	3.210	0.224	18.52
(5.0)	in-crisis, under EDP, FAP excluded	47	1.355	1.002	0.224	4.663
(5.1)	in-crisis, under EDP, FAP	12	4.706	6345	1039	18517
(6.0)	in-crisis, under EDP, FAP excluded, non-EZ	16	1.650	1.328	0.436	4.663
(6.1)	in-crisis, under EDP, FAP excluded, EZ	31	1.202	0.767	0.224	3.194

Table 6. 1 offers a preliminary overview of the dependent variable under different configurations of the independent variable(s) and the cycle. Looking at configuration(s) (1.0) and (1.1), the mean budget distance is substantially higher during the crisis (2.07) than outside that period (1.35). Within crisis years, the second comparison across configurations shows the mean of budget distance for countries not under Financial Assistance (1.63) and those having adhered to a FAP (4.71), with an over three-point gap. Across those countries not within a Programme shown in (3), those outside the Eurozone display higher budget distances on average (1.86) than Euro Area countries (1.49). Moving onto differences across countries falling under the corrective arm, (4) looks at averages during the crisis, finding them slightly lower (2.04) for countries under an excessive deficit procedure compared to the other Member States (2.15). The Programmes are once again confirmed as a source of substantial divergence in budgetary patterns in (5), with countries with excessive deficits having sizeably higher shifts in the fiscal policy mix when under FAP (4.706) compared to the remaining Member States (1.36). Within the latter, patterns across Eurozone membership (6) are confirmed, with a higher budget distance for countries outside of the Euro Area (1.65) compared to members (1.20).

In summary, excluding as usual FAP countries, the emerging pattern is a decrease in changes to the fiscal policy mix during the crisis for countries under the EDP compared to those remaining within the preventive arm of the SGP. The pattern is opposite to dynamics across the full cycle and specifically non-crisis years. In that context, the increase in the budget distance could be read as a consolidation driven restructuring of the fiscal policy mix in light of the broader budgetary trends. How is the decrease in the change in the budget structure to be interpreted during the negative phase of the cycle? Contrary to the contractionary fiscal pattern in good times, overall the spending dynamics in bad times display an expansionary trend, as emerged in chapter four. In a time of budgetary expansions, a decrease in the budget distance under the EDP may indicate a slowing down of positive changes to allocations. In this context, lower averages under the corrective arm – further decreasing for Eurozone countries – suggest that the EU economic governance may act in containing the national pressures toward expansionary trends countering the cycle.

The last element to be considered concerns divergent patterns within the crisis years across the initial recession period and the outbreak of the sovereign debt crisis. Having looked at the evolution of EU Member States public finances in chapter four there is some indication of multifaceted dynamics as already in 2011 there is an overall tendency to correct for the deteriorating fiscal stance during the early years of the recession. To test the potential divergence a distinction can be made across the 2009-2010 and the 2011-2012 timeframes. The crisis subsample – expanded to include an additional year – is evenly split across the two stages, each counting 56 observations. In looking at the patterns of shifts in the budget structure across the two periods, compared to the non-crisis average of 1.35, the mean increases sharply to 2.21 in the early stage of the crisis, falling back to 1.59 in the second. Excluding observations associated with Financial Assistance, the pattern within the crisis is not only confirmed, with a mean of 1.91 in stage one and 1.11 in stage two, but the latter is also lower than the average across non-crisis years of 1.28. These dynamics are replicated both for Eurozone and non-Eurozone countries, with the latter being higher than the former within each stage, giving some preliminary confirmation of diverging trends.

Results

Starting from the baseline model considering the impact of the SGP across the EU and the Eurozone in its interaction with the cycle, no change is foreseen concerning the effect on the budget distance during the crisis[4]. Both EU and – to a lesser extent – Eurozone membership retain a negative and significant impact on changes in the structure of the budget. While results for the EU

[4] Regression results in Appendix 6 (see Table A. 6)

should be read with caution given the very limited instance of non-EU countries within the dataset at the time of the Great Recession, the same is not the case for the Eurozone, confirming the insensitivity to the cycle of the impact of the SGP.

Table 6. 2 - Impact of the EDP on the budget distance and change in total spending across the cycle

	(1)	(2)	(3)	(4)
	BD	BD (no crisis)	BD (crisis)	Change in total spending
EDP	0.193	0.277	-1.166***	-0.417**
	(0.160)	(0.173)	(0.112)	(0.193)
crisis	1.146***			1.933***
	(0.262)			(0.564)
EDP#crisis	-1.161***			-1.867***
	(0.363)			(0.569)
ideology	0.00934*	0.0115*	0.0112	0.0115*
	(0.00567)	(0.00672)	(0.0145)	(0.00672)
ideological distance	-0.000738	-0.000633	-0.0220***	-0.000633
	(0.000830)	(0.000950)	(0.00816)	(0.000950)
alternation	0.000693	0.000561	-0.00218	0.000561
	(0.000808)	(0.000694)	(0.0136)	(0.000694)
Δ unemployment rate	0.0510	-0.0766	0.229***	-0.0766
	(0.0590)	(0.0824)	(0.0491)	(0.0824)
Δ old-age dependency rate	0.0720	-0.0647	-0.0939	-0.0647
	(0.175)	(0.192)	(0.361)	(0.192)
decentralisation	-0.103**	-0.153***	0.124	-0.153***
	(0.0511)	(0.0565)	(0.128)	(0.0565)
national fiscal rule preferences	-0.303**	-0.290*	-0.472**	-0.290*
	(0.135)	(0.165)	(0.233)	(0.165)
Constant	1.192***	1.205***	2.718***	1.205***
	(0.147)	(0.158)	(0.268)	(0.158)
Observations	279	234	45	234
R-squared	0.110	0.065	0.592	0.065
Number of countries	19	19	17	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

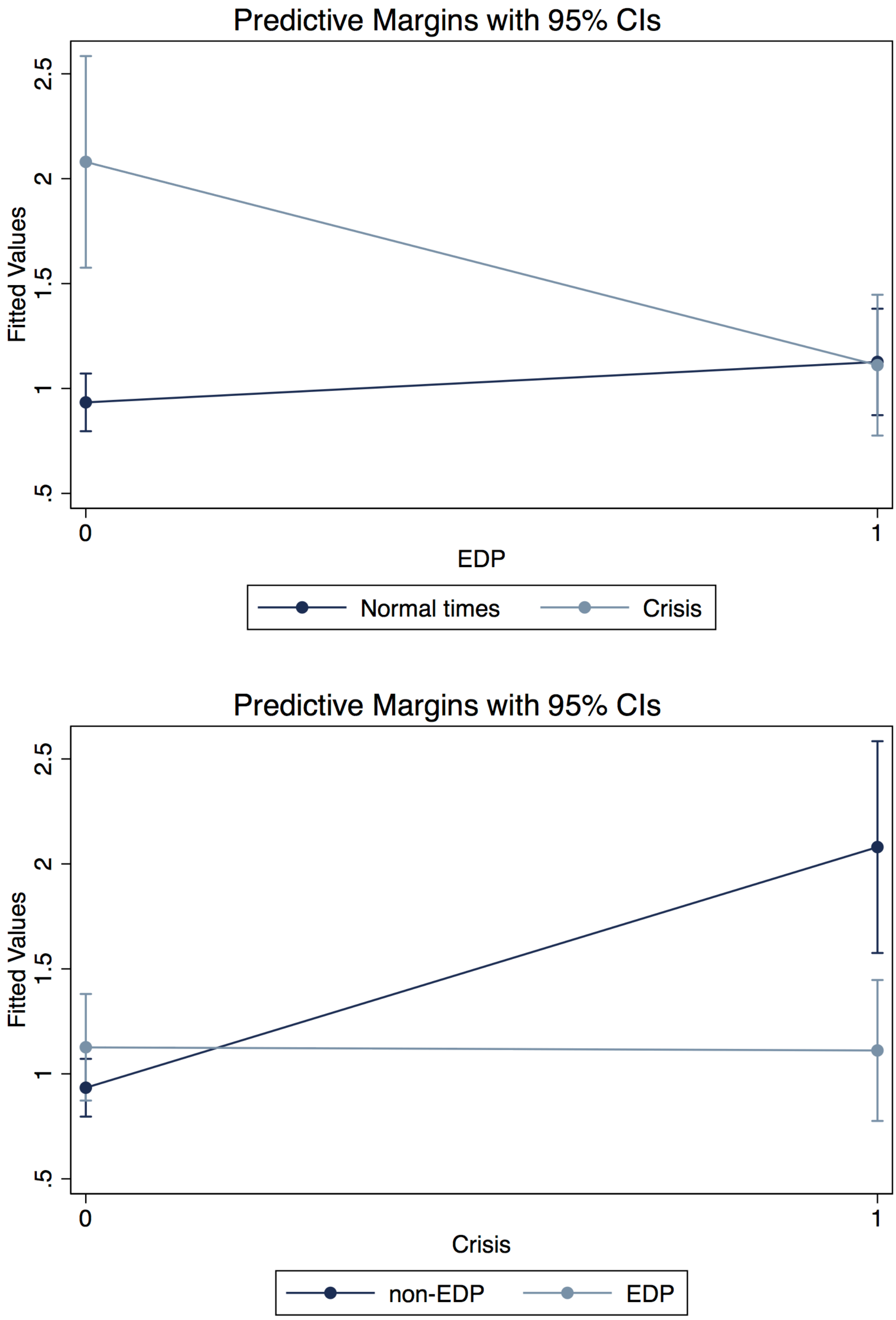


Figure 6. 3 - Budget distance across the cycle and EDP

The picture changes when shifting the focus onto the key dependent variable, EDP, within the Eurozone. Accounting for the crisis, the EDP is no longer significant over the full sample. Conversely, as shown in Table 6. 2, the interaction between the EDP and the cycle is negative and significant. The interaction effect of -1.16 (over one standard deviation) compared to the positive effect of 1.15 of the crisis indicates that the impact of the EDP on the budget structure in bad times more than compensates for the upward pressure of the recession on national spending. Figure 6. 3 shows the divergent impact of having an excessive deficit across the cycle, which is confirmed in assessing the EDP within the subsamples of normal and bad times. Table 6. 2 shows that to a negative significant and sizeable impact of the EDP on the budget structure during the crisis corresponds a mild positive and non-significant impact outside of that timeframe. Another element emerging from Figure 6. 3 is a divergence in cross-cycle dynamics for the preventive and corrective arm. While there is a clear distinction across the cycle outside of the EDP with substantially higher budget distances during the crisis, the same is not the case for countries under the excessive deficit procedure for which the negative cycle hardly results in any upward trend. It appears that the EDP is a powerful force reigning in any cycle adjustment in choices on the budgetary composition at the aggregate level.

Having verified that regardless of the escape clauses there is an impact on the budget structure even - if not mainly - in times of crisis, further confirmation of the directional fiscal trends is per usual necessary for interpreting the implication of dynamics at the budget distance level. Leaving the analysis of single budget items at division and group level for the sections to follow, . Table 6. 2 shows regression results of the interaction model considering total changes in spending as a dependent variable. To a positive impact of the crisis on spending (1.93 percentage point of GDP) correspond a negative and significant interaction effect (-1.87) which nearly fully compensates for the upward budgetary pressure of the recession. The constraining effect on national public expenditures of the EDP-in-crisis is confirmed as the latter nearly balances away any cyclical adjustment.

Finally, it remains to consider whether the crisis years are homogeneous or rather distinctions emerge across the regulatory framework and with the outbreak of the sovereign debt crisis in the Eurozone, for which full results are available in Appendix 6 (see Table A. 7). As anticipated, the data may not allow for such a granular distinction given the 45 non-FAP Eurozone observations are unevenly split across the two phases, leaving only 15 observations in phase 3, of which 13 fall under the EDP. While 60 per cent of the observations of the selected sample fall under EDP in phase 2, more than 86 per cent do in phase 3. Considering the interaction model restricted to phase 2, the additional significant negative impact of the EDP-in crisis nearly compensates for the significant upward push of the crisis on national budget distance, while the EDP is not significant for the full sample. Turning to phase 3, only the positive overall impact of the EDP retains significance. Considering instead the early and late stages of the crisis allows for comparing the impact of the EDP within the two subsamples. Considering the early years of the crisis - across 2009 and

2010 - the negative and significant impact of the EDP on changes to the national budget structure reaches -1.15, accounting for nearly two standard deviations of the budget distance variable in the considered timeframe. Shifting to the later stage, the direction and significance of the impact of the EDP remain, downsized, however, to -0.62, slightly above one standard deviation. How to interpret the lower negative impact on structural budgetary changes in the Euro crisis is far from straightforward in light of the expenditure patterns already emerged. The dynamics are not compatible with a weakening of the constraining effect of the EDP in a context where overall expenditures changes turn from positive under the pressure of the Great Recession to negative after the outbreak of the sovereign debt crisis in the Eurozone. Conversely, the two dimensions of recession-upward-pressure-restraint and consolidation driven restructuring may be concomitantly at play as further explored in the subsequent sections. In addition, chapter five showed that the effect of the Pact for Eurozone countries unlike in the previous regulatory frameworks remains post-crisis (and to a limited extent expands also to countries not under EDP surveillance) which would be compatible with a less dramatic shift in the impact at the domestic levels from good to bad times.

Implications

A first look at the dynamics of the impact of the EDP within the Eurozone across good and bad times, suggests that the opposite relationship among the former and the budget structure takes place under diverging economic climates. While the negative free-riding compatible impact of the SGP remains strong and consistent across the full sample, the same is not the case for the EDP. On one side, in good times the EDP retains the positive impact on the budget distance emerged over the full sample. On the other side, in bad times, in finding no significant effect at all of the SGP, one could conclude that when the exceptional circumstances clause kicked in, taking sanctioning off the table, the EU economic governance framework ceased to bind national fiscal policies. However, the emerging picture is more complex as the relationship between the excessive deficits and the budget distance turns negative: during the crisis being under the EDP is associated with a decrease in changes of the budget structure. The implication is that escape clauses do not hinder the ability of the EDP to affect national fiscal policy mixes. Conversely, the impact, especially in earlier iterations of the framework, may be fully restricted to the negative side of the cycle.

The significant impact of the EDP even in times of crisis and sanction temporary side-lining offers a crucial indication that there may be scope for an impact on Member States behaviour even in the absence of hard enforcement mechanisms. The extent to which crisis-dynamics put into question the importance of the prospective risk of sanctioning as an enforcement mechanism is, however, unclear. Crisis-driven leniency within the framework is temporary and does not exclude that uncorrected budgetary violations would incur in sanctioning down the line. Coherently with this view Eurozone membership remains a necessary condition for any significant impact, confirming the fundamentally different framework binding the Euro area. Against this backdrop, future punishment may indicate prudential behaviour even in contexts of procedural leniency. At the same time, an effect of the Pact even without the backing of sanctioning reinforces as well the argument of the importance of political peer pressure and maintaining the credibility of fiscal discipline and the supranational surveillance framework, even in times of economic pressure. Faced with increased demands of expenditures to counter the recessions, countries under EDP surveillance – even if able to avail themselves of flexibility mechanisms – opted to contain increased spending, as reinforced by the sections to come. At least accompanying procedural consequences, hence political costs and pressures derived from supranational commitments can be expected to play an important role in shaping domestic budgetary choices.

In testing [HP2.A] on whether the SGP is unable to affect budget structures and push for consolidation when the escape clauses come into play during the recession, it remains to be verified whether the impact of the EDP in crisis contravenes the countercyclical objective of the EU economic governance framework. While the broader interpretation of fiscal policy trajectories associated with a given trend in the budget distance indicator is not straightforward at the aggregate level, two elements provide insights on spending patterns in the negative phase of the cycle. Firstly, already from the analysis of the interaction between the independent variable and the economic climate, the EDP in crisis emerges as a counterbalance to the cyclical impact on the structure of national spending, nearly fully countering the upward push of the recession. Additionally, the overall trajectory of public expenditures in bad times portrayed in chapter four shows a generalised increase in total expenditures in crisis years albeit changing in extension across the Member States. Under such premises of increased spending, a negative impact of the budget distance – that is to say smaller changes to the fiscal policy mix – may be interpreted as excessive deficits putting a break in the fiscal response to the crisis. Such interpretation is further confirmed considering the (directional) total change in spending to which excessive deficits in crisis contributes negatively. Findings suggest that countries having excessive deficits had to enact more restraints in countering the cycle compared to those remaining within the preventive arm of the SGP. While the picture may be further clarified by the analysis of disaggregated budget line dynamics, the preliminary aggregate analysis confirms a contractionary pro-cyclical impact of the EDP in bad times.

Turning to the potentially varied patterns across the early and late stages of the crisis, the negative relationship between the SGP and the budget distance remains for the early years of the crisis, in limiting changes to the budget structure (e.g. expansionary fiscal policies) for countries under the corrective arm. The trend weakens and even abruptly changes in the later stages of the negative cycle associated with the Euro crisis. Conclusive evidence on the later stage is problematic as a function of the limited observations. However, different forces could be argued to be at play compatible with the overall trend of spending reduction, suggesting that countries having excessive deficits may have been pushed to rapidly bring in prudent fiscal adjustments. Additionally, patterns revealing a strong effect of the EDP in limiting the expansion of fiscal policies early into the crisis, exclude that the findings are driven largely by other factors – such as market pressure – predominantly at play in the second stage.

Results confirm the importance of considering crisis years for the understanding of the relationship between the supranational fiscal rule and national budgetary choices. At the same time, separate consideration of crisis dynamics is warranted as there is a divergent behaviour of the EU economic governance in impacting the budget across the cycle. Additionally, given the restraining impact of the EDP in crisis, the analysis across the disaggregated budgetary items and relevant typologies of spending in the sections to follow is of value to fully understand the economic and social implications of the EU economic governance framework.

6.2 Where the EDP-at-crisis bites

The EDP pro-cyclical role in impacting the budget structure at crisis poses the critical question of which expenditures are predominantly affected by the supranational fiscal rule in the negative phase of the cycle. The remainder of the chapter explores the in-crisis dynamics at the disaggregated level, considering first broad division data and afterwards group budget lines. In doing so this section contributes to a more granular understanding of the EDP role in restraining fiscal policy from countering the cycle in the context of [HP2.A]. At the same time, the disaggregated analysis sets the stage for the assessment of [RQ2.B] on EDP-induced changes in investment, transfers and inequality mitigation and [RQ2.C] on those on social spending during the crisis.

Model specifications remain unchanged from section one, with the sole exception of the dependent variables consisting of the yearly changes of the ten divisions of general affairs, defence, public order and safety, economic affairs, environmental protection, housing, health, culture and social protection.

Descriptive analysis

Having already considered descriptive statistics for the independent variables and key interacting factors at play in the previous section, the overview here will concentrate on the dynamics of the dependent variables at the division level across the configurations of interest of the former. Across the ten divisions, there are substantially different cross-country patterns both in the scale and timing of expenses restructuring in crisis, as displayed in chapter four. Figure 6. 4 depicts changes in spending in the four categories most relevant both as among the most subject to change during the negative cycle and because of their broader implications. With the sole exception of a generalised increase in social spending in 2009, patterns diverge for the Eurozone Member States shown below, some displaying early negative trends in 2010 and 2011 in addition to spending increases and cuts affecting economic affairs, health, education and social protection to a variegated extent.

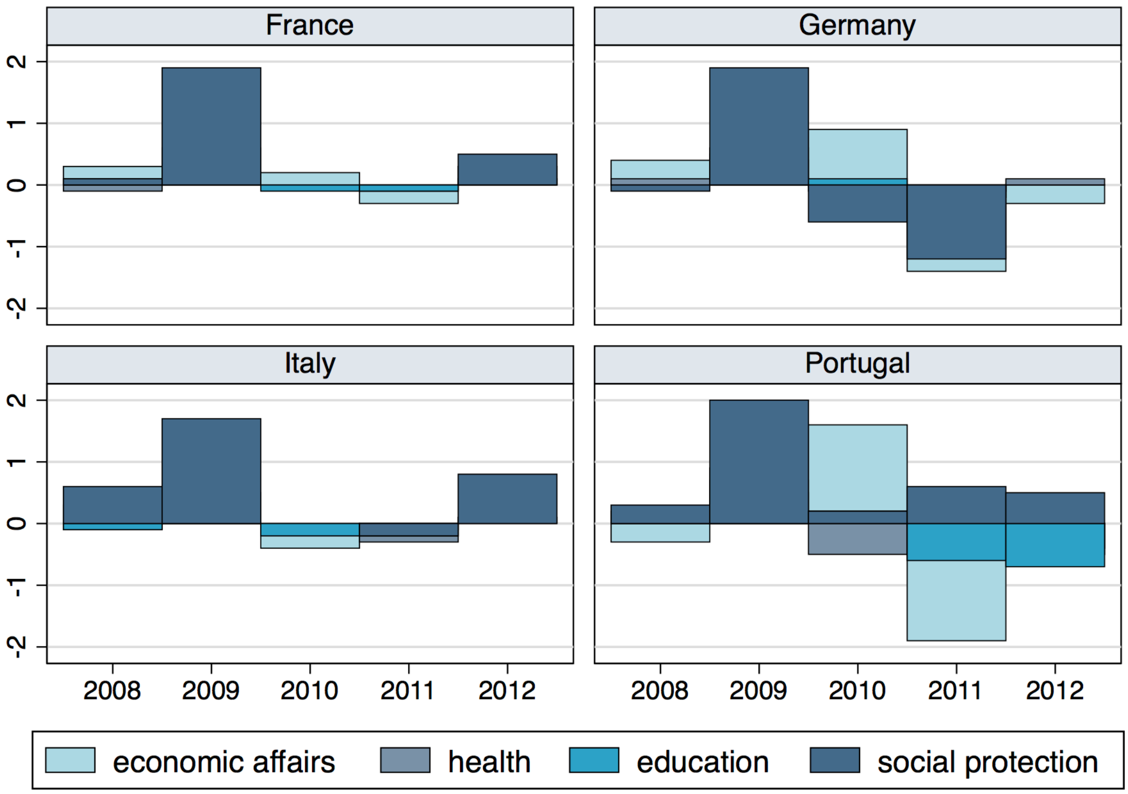


Figure 6. 4 - Changes in selected divisions during the crisis in selected Eurozone countries

Across the cycle, the trend is not uniform. Many divisions – namely general public services, economic affairs, health, education and social protection – display higher means in bad times, while others shrink - namely defence, public order and safety, environmental protection, housing, recreation and culture - in the same period. The social budget line is – as would be expected – the one changing the most in the context of a negative economic cycle. With few exceptions, the most notable being general public services, the trend is aligned across budget items in comparing countries under financial assistance to the other Member States, with lower means associated with having adhered to a program. Excluding those instances, during the crisis, Eurozone countries display higher means compared to the Member States outside the Euro area, with the sole exception of general public services.

Table 6. 3 - Budget items across the crisis, FAP, EZ Membership

	(1.0)		(1.1)		(2.0)		(2.1)		(3.0)		(3.1)	
	no crisis		crisis		crisis, excluding FAP		crisis, under FAP		crisis, excluding FAP, non-Eurozone		crisis, excluding FAP, Eurozone	
	N	mean	N	mean	N	mean	N	mean	N	mean	N	mean
Δgeneral affairs	554	-0.168	84	0.165	72	0.151	12	0.250	27	0.170	45	0.140
Δ defence	554	-0.0116	84	-0.0310	72	-0.0111	12	-0.150	27	-0.0407	45	0.00667
Δ public order	554	0.000722	84	-0.00357	72	0.00556	12	-0.0583	27	-0.0296	45	0.0267
Δ economic affairs	554	-0.0635	84	0.0238	72	0.0319	12	-0.0250	27	-0.0296	45	0.0689
Δ environment	554	0.00144	84	-0.00595	72	-0.00694	12	-1.24e-09	27	-0.0407	45	0.0133
Δ housing & community	554	-0.0186	84	-0.0464	72	-0.0417	12	-0.0750	27	-0.0593	45	-0.0311
Δ health	554	0.0433	84	0.114	72	0.135	12	-0.00833	27	0.122	45	0.142
Δ culture	554	0.00776	84	0.00357	72	0.00278	12	0.00833	27	-0.0185	45	0.0156
Δ education	554	-0.0247	84	0.0524	72	0.0569	12	0.0250	27	-0.0111	45	0.0978
Δ social protection	554	-0.0713	84	0.554	72	0.578	12	0.408	27	0.459	45	0.649

Moving on to dynamics across the preventive and corrective arm, overall during the crisis averages are lower for countries under the EDP. The sole exception is environmental protection. On the opposite side of the spectrum, the most substantial drop is associated with social protection that goes from an average increase of 1.19 for countries not having an excessive deficit to a mere 0.28 increase for those that do. Excluding countries under financial assistance and comparing Eurozone and non-Eurozone countries with an excessive deficit, patterns are more mixed. Eurozone countries have a higher average for general public sector, defence, public order and safety as well as education and social expenditures, while lower for economic affairs, environmental protection, housing, health, as well as recreation and culture.

Table 6. 4 - Budget items across the crisis, FAP, EZ Membership and the EDP

	(4.0)		(4.1)		(5.0)		(5.1)		(6.0)		(6.1)	
	crisis, non-EDP		crisis, EDP		crisis, EDP, excluding FAP		crisis, EDP, under FAP		crisis, EDP, excluding FAP, non-Eurozone		crisis, EDP, excluding FAP, Eurozone	
	N	mean	N	mean	N	mean	N	mean	N	mean	N	mean
Δgeneral affairs	25	0.428	59	0.0542	47	0.00426	12	0.250	16	-0.0687	31	0.0419
Δ defence	25	0.0280	59	-0.0559	47	-0.0319	12	-0.150	16	-0.0563	31	-0.0194
Δ public order	25	0.0720	59	-0.0356	47	-0.0298	12	-0.0583	16	-0.0500	31	-0.0194
Δ economic affairs	25	0.136	59	-0.0237	47	-0.0234	12	-0.0250	16	0.138	31	-0.106
Δ environment	25	-0.0320	59	0.00508	47	0.00638	12	-1.24e-09	16	0.0125	31	0.00323
Δ housing & community	25	0.0120	59	-0.0712	47	-0.0702	12	-0.0750	16	-0.0438	31	-0.0839
Δ health	25	0.316	59	0.0288	47	0.0383	12	-0.00833	16	0.0625	31	0.0258
Δ culture	25	0.0240	59	-0.00508	47	-0.00851	12	0.00833	16	-0.0250	31	-2.40e-10
Δ education	25	0.260	59	-0.0356	47	-0.0511	12	0.0250	16	-0.119	31	-0.0161
Δ social protection	25	1.192	59	0.283	47	0.251	12	0.408	16	0.106	31	0.326

Results

Considering non-FAP observations within the Eurozone, the cycle does not affect the impact of the EDP on national spending uniformly across all divisions at the disaggregated level, with diverging patterns emerging across the budget lines. Table 6. 5 and Table 6.6 show regression results for the eight divisions displaying a significant coefficient either across the full panel or in the interaction, which is not the case for economic affairs and environmental protection. For general affairs, the EDP is not significant over the full sample, but the additional impact of the EDP-in-crisis is negative and significant. The 0.42 interaction effect – amounting to slightly one standard deviation – more than fully compensating the upward push of the Great Recession. Conversely, for defence the impact of the EDP does not change across the cycle, remaining negative and significant for the full sample. Public order and safety, together with housing and community amenities display the same trend. In both instances, the EDP has a negative and significant impact overall, paired with the additional downward pressure on the budget items during the recession. The additional negative effect on the two budget lines more than compensates for the recession-induced expansionary push. For public order, the upward push of 0.09 crash against the stronger constraining force of the EDP-in-crisis of -0.12, well over one standard deviation. Similarly, the yearly change in housing and community amenities increases by 0.08 because of the negative cycle, countered by an additional restraining force of the EDP of -0.13, exceeding one standard deviation.

The same dynamics emerge for health, education and social protection, with a negative overall impact of the EDP further strengthening in times of crisis, as shown in Table 6. 5. However, the respective force of the upward and downward drive on the budget lines changes across the three divisions. In the case of health, the additional constraining effect of the EDP-in-crisis of -0,29, surpassing one standard deviation, well exceeds the upward thrust of 0.25 on expenditures during the recession. This is not the case for education, for which the expansionary impact of the crisis of 0.32 surpasses the additional EDP restraint during the negative cycle of -0.28, well over one standard deviation. Similarly, the crisis is associated with an additional negative impact of -0.94 of the EDP on social protection - amounting to well over one standard deviation - that does not fully compensate for the upward push of the recession of 0.97. Finally, like public order and safety, culture does not display an additional negative impact of the EDP during the crisis, while retaining a negative and significant effect across the cycle.

Table 6. 5 - Impact of the EDP on changes culture, defence, public order & safety and housing & recreation across the cycle

	(1)	(2)	(3)	(4)
	Δ general affairs	Δ defence	Δ public order	Δ housing
EDP	0.0883	-0.0551**	-0.0317**	-0.0309*
	(0.0702)	(0.0231)	(0.0159)	(0.0164)
crisis	0.411***	0.0505	0.0949***	0.0804**
	(0.144)	(0.0543)	(0.0311)	(0.0313)
EDP#crisis	-0.424**	-0.0333	-0.124***	-0.134***
	(0.176)	(0.0638)	(0.0360)	(0.0288)
ideology	-0.00149	-6.92e-05	-0.000107	-7.69e-05
	(0.00166)	(0.000706)	(0.000424)	(0.000555)
ideological distance	0.000258	2.13e-05	-0.000130**	2.21e-05
	(0.000291)	(0.000124)	(5.69e-05)	(8.23e-05)
alternation	-0.000469	-4.87e-05	-0.000181**	9.28e-05
	(0.000601)	(0.000208)	(7.45e-05)	(0.000192)
Δ unemployment rate	0.119***	0.00245	0.0253***	-0.00290
	(0.0262)	(0.0106)	(0.00510)	(0.00878)
Δ old-age dependency rate	0.0163	0.0279	-0.00514	-0.0266
	(0.0767)	(0.0263)	(0.0149)	(0.0222)
decentralisation	-0.0281	-0.00883	0.00533	-0.00457
	(0.0220)	(0.00870)	(0.00635)	(0.00683)
national fiscal rule preferences	0.00561	-0.00532	-0.0154	-0.0139
	(0.0517)	(0.0168)	(0.0110)	(0.0131)
Constant	-0.136*	0.0125	0.0278**	0.0188
	(0.0699)	(0.0236)	(0.0118)	(0.0170)
Observations	279	279	279	279
R-squared	0.208	0.038	0.205	0.099
Number of countries	19	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table 6. 6 - Impact of the EDP on changes in health, recreation & culture, education and social protection across the cycle

	(5)	(6)	(7)	(8)
	Δ health	Δ culture	Δ education	Δ social protection
EDP	-0.0964**	-0.0611***	-0.0998***	-0.201**
	(0.0399)	(0.0148)	(0.0341)	(0.0835)
crisis	0.253***	0.0213	0.318***	0.967***
	(0.0743)	(0.0368)	(0.0927)	(0.218)
EDP#crisis	-0.288***	0.00144	-0.278***	-0.936***
	(0.0731)	(0.0397)	(0.0902)	(0.201)
ideology	0.00111	-0.000784	-0.000869	0.00104
	(0.00137)	(0.000488)	(0.000957)	(0.00253)
ideological distance	-4.38e-05	1.62e-05	6.16e-05	-0.000395
	(0.000178)	(7.93e-05)	(0.000173)	(0.000448)
alternation	-0.000164	0.000114	-0.000314	-0.00120**
	(0.000305)	(0.000192)	(0.000261)	(0.000518)
Δ unemployment rate	0.0740***	0.00996**	0.0425***	0.368***
	(0.0166)	(0.00494)	(0.0141)	(0.0378)
Δ old-age dependency rate	-0.0146	0.0259	-0.000214	0.0781
	(0.0550)	(0.0228)	(0.0394)	(0.117)
decentralisation	0.00349	0.00550	0.0167	-0.00174
	(0.0157)	(0.00836)	(0.0129)	(0.0286)
national fiscal rule preferences	0.0164	-0.0194	0.000889	-0.0909
	(0.0301)	(0.0140)	(0.0244)	(0.0726)
Constant	0.101**	0.0191	-0.00504	0.214*
	(0.0487)	(0.0152)	(0.0355)	(0.110)
Observations	279	279	279	279
R-squared	0.178	0.075	0.233	0.497
Number of countries	19	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table 6. 7 below presents a taxonomy of the impact of the EDP on the division level components of national public expenditures. It indicates a (negative) significant impact across the full cycle with no significant change during the Great Recession for defence and culture. Conversely, an increasing (negative) impact in bad time emerges for other budget lines. At times fully compensates the upward drive of the crisis – as for general affairs, public order, housing and health. That is, however, not the case for education and social protection.

Table 6. 7 - The taxonomy of the impact of the EDP on changes in national spending across divisions and the cycle

	general affairs	defence	public order & safety	economic affairs	environmental proteection
	housing & community	health	culture & recreation	education	social protection
EDP impact:	negative, full cycle	increasingly negative in crisis		increasingly negative fully compensating the crisis	

These patterns translate for many budget components into a convergence of expenditure under the EDP to the non-crisis trend or even further below it. While most expenditures are associated with an upward trend in the crisis years, such expansion hardly manifests for countries with an excessive deficit. Figure 6. 5 shows, for example, dynamics for housing & community, a budget line which is – for non-EDP countries – associated with a positive increase in expenditures in crisis years. However, that is not the case for countries under EDP for which not only are crisis expenditures undistinguishable from those outside the recession period but also firmly down in the negative quadrant. The EDP in this instance fully reverses the direction of change in expenditures shifting a category for which the crisis exerts an expansionary pressure into consolidation.

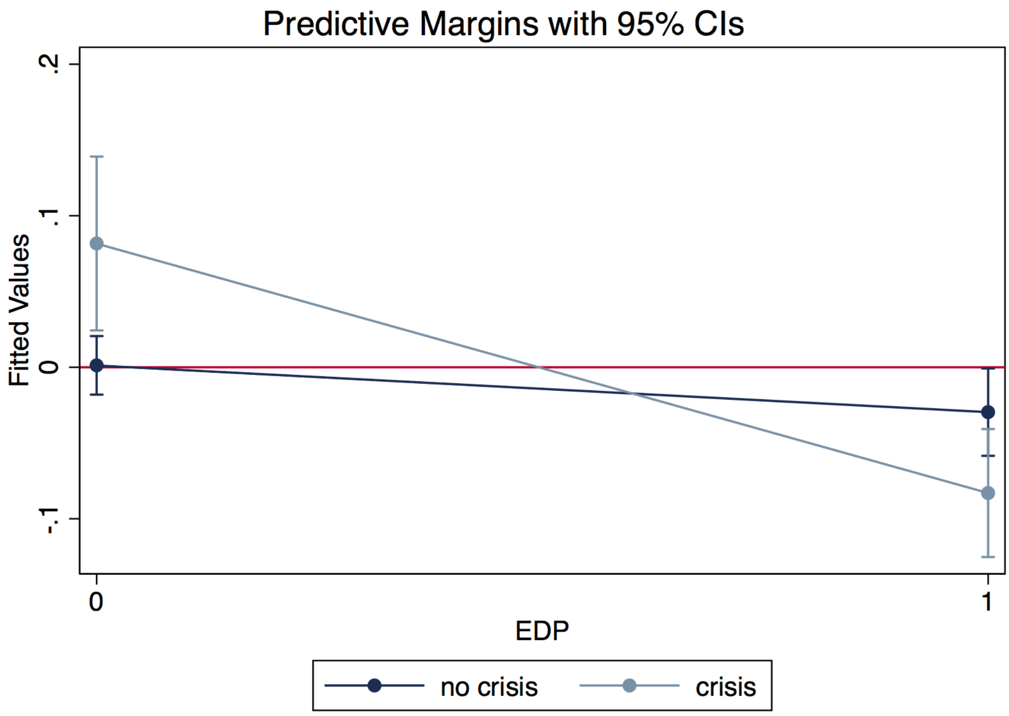


Figure 6. 5 - Patterns in spending on housing & recreation across the EDP and the cycle in selected Eurozone countries

In addition to the cross-cycle comparison, it is also of value to consider specifically within the subsample the dynamics across the preventive and corrective arm, thus comparing in-crisis spending patterns for countries subject or not to the EDP. Such a view is of particular value for those budget components for which no significant effects emerged in the interaction model. Within Eurozone countries and during the crisis, being under the EDP is associated with significantly lower spending on economic affairs of -0.66 (slightly below one standard deviation), bringing changes in spending from above to below the zero-reference line. A significant shift downward in changes in allocations emerges for environmental protection as well, but in this case, the impact is minimal, stopping at -0.03, corresponding to about one-fourth of a standard deviation. Across the remaining components, the vast majority display a negative impact of the EDP corresponding to around one standard deviation in the respective budget line. A more modest impact emerges for culture and recreation – whose shift is only of about a half standard deviation – while for general affairs and defence the EDP coefficient does not achieve significance.

Implications

The division level analysis further confirms the consolidation drive of the EDP-in-crisis in impacting the national composition of public expenditures within the Euro area. It contributes to a more granular understanding of where the supranational fiscal rule hits the most, especially in the crisis. For the majority of expenditures, the EDP has a significant and negative impact in crisis consistent with a consolidation-led impact on the budget structure. As shown in Figure 6. 5, these patterns amount to the EDP enacting a cross-cycle convergence of expenditure dynamics. While in-crisis spending is higher than in normal times for the majority of budget components, such a distinction does not remain under the EDP, for some budget lines not only rendering good times and in-crisis outcomes indistinguishable but bringing the latter below zero. The result for some budget lines is the EDP enforcing an overall contraction in the given expenditure during the recession net of the expansionary push of the crisis.

Additionally, it appears that while in some instances the bite of the EDP is constant throughout the cycle, in other instances either manifests only or predominantly in bad times. Leaving the comparison with the non-crisis subsample to chapter eight, except for defence and culture and recreation, the negative phase of the cycle is associated with a more stringent impact of the EDP. Such dynamic runs in direct contradiction with the countercyclical policy objectives, confirming one of the key criticisms to the EMU within the literature. Additionally, the mere existence of escape clauses temporary halting the immediate risk of sanctioning does not hinder the constraining ability of the

EDP. In this context, countries may anticipate the need for future convergence to regain adherence to the supranational fiscal rule. Accordingly, they may restrain expansionary fiscal dynamics or the risk of less benevolent treatment post-crisis if availing themselves of the SGP flexibility. Even more convincingly, the political peer-pressure and cost for profligacy and diminishing the credibility of the supranational surveillance framework does not weaken in parallel with escape clauses. Conversely, domestic budgetary choices for fiscal delinquents of the Pact within the Eurozone are conscious of the deficit rule even when formally they may be given some leeway. Having excluded countries under Financial Assistance, findings are robust to conditioning linked to access to financial support.

Divergences across budget lines are of interest in themselves given their distributional and broader implications, explored in depth in chapter seven. However, a preliminary picture emerges at the division level, with the taxonomy presented in Table 6. 7. Considering the full or over-compensation for the crisis expansionary push as the most impactful recession-EDP interaction, four budget lines fall under such predicament: general affairs, public order and safety, housing and community and health. While a significant expansionary thrust emerges for all four budget lines, indicating higher spending needs associated with the economic downturn, housing and especially health dynamics signal potentially detrimental effect for inequality and wellbeing during a recession. Furthering the pro-inequality pattern, two areas of high interest in this domain, education and social spending do not escape a tightening of the restraining effect of the EDP in the negative phase of the cycle.

6.3 A granular analysis of national expenditures in-crisis

Building on the already variegated in-crisis effect emerged in section two, the assessment of the cross-cycle impact on national spending components at the group level offers a fine-drawn portrait of the distributional consequences of the supranational fiscal rule for countries under EDP. The analysis details how the restraining effect of the EDP varies across the cycle for 69 sub-components within each division, enumerated in Table 6. 8 below. For example, within public order and safety the higher level of disaggregation distinguishes across police, fire protection, courts, prisons and R&D. At the group level, expenditures differentiate across age group and typology in the realm of education, while within the domain of social protection they pinpoint interventions in favour of different age-groups such as children, working-age and elderly population.

Table 6. 8 - Group level disaggregation across divisions of national public spending

Division	Group	
General public services	GF0101	Executive and legislative organs, financial and fiscal affairs, external affairs
	GF0102	Foreign economic aid
	GF0103	General services
	GF0104	Basic research
	GF0105	R&D General public services
	GF0106	General public services n.e.c.
	GF0107	Public debt transactions
	GF0108	Transfers of a general character between different levels of government
Defence	GF0201	Military defence
	GF0202	Civil defence
	GF0203	Foreign military aid
	GF0204	R&D Defence
	GF0205	Defence n.e.c.
Public order and safety	GF0301	Police services
	GF0302	Fire-protection services
	GF0303	Law courts
	GF0304	Prisons
	GF0305	R&D Public order and safety
	GF0306	Public order and safety n.e.c.
Economic affairs	GF0401	General economic, commercial and labour affairs
	GF0402	Agriculture, forestry, fishing and hunting
	GF0403	Fuel and energy
	GF0404	Mining, manufacturing and construction
	GF0405	Transport
	GF0406	Communication
	GF0407	Other industries
	GF0408	R&D Economic affairs
	GF0409	Economic affairs n.e.c.
Environmental protection	GF0501	Waste management
	GF0502	Waste water management
	GF0503	Pollution abatement
	GF0504	Protection of biodiversity and landscape
	GF0505	R&D Environmental protection
	GF0506	Environmental protection n.e.c.
Housing and community amenities	GF0601	Housing development
	GF0602	Community development
	GF0603	Water supply
	GF0604	Street lighting
	GF0605	R&D Housing and community amenities
	GF0606	Housing and community amenities n.e.c.
Health	GF0701	Medical products, appliances and equipment
	GF0702	Outpatient services
	GF0703	Hospital services
	GF0704	Public health services
	GF0705	R&D Health
	GF0706	Health n.e.c.
Recreation, culture and religion	GF0801	Recreational and sporting services
	GF0802	Cultural services
	GF0803	Broadcasting and publishing services
	GF0804	Religious and other community services
	GF0805	R&D Recreation, culture and religion
	GF0806	Recreation, culture and religion n.e.c.
Education	GF0901	Pre-primary and primary education
	GF0902	Secondary education
	GF0903	Post-secondary non-tertiary education
	GF0904	Tertiary education
	GF0905	Education not definable by level
	GF0906	Subsidiary services to education
	GF0907	R&D Education
	GF0908	Education n.e.c.
Social protection	GF1001	Sickness and disability
	GF1002	Old age
	GF1003	Survivors
	GF1004	Family and children
	GF1005	Unemployment
	GF1006	Housing
	GF1007	Social exclusion n.e.c.
	GF1008	R&D Social protection
	GF1009	Social protection n.e.c.

Sub-distinctions are of particular value within some divisions, such as, for example, welfare spending because of the intergenerational distributive implications of spending allocations. Additionally, by providing a fine differentiation of the typology of expenditures, group-level analysis sets the scene for the assessment in chapter seven of the EDP impact across broad categories of public spending such as investment and transfers.

As in section two, model specifications remain unchanged with the sole exception of the dependent variables which consist of the 69 group level budget components. Given the number of models under consideration, regression results are presented in full in Appendix 7 (see Table A. 8 through Table A. 15), while in this section a brief overview of findings is put forward based on the taxonomy of the impact of the EDP on changes in national spending across the cycle developed for the division level analysis.

Descriptive analysis

The cross-time and country variation does not stop at the division level. Distinct patterns emerge also within divisions. For example, across the selected sample of Member States considered in section two, dynamics vary within the education division concerning age-group allocation national preferences. Figure 6. 6 shows how to the limited changes in terms of aggregate spending emerging at division level – with the sole exception of Portugal – correspond divergent choices across education level allocations.

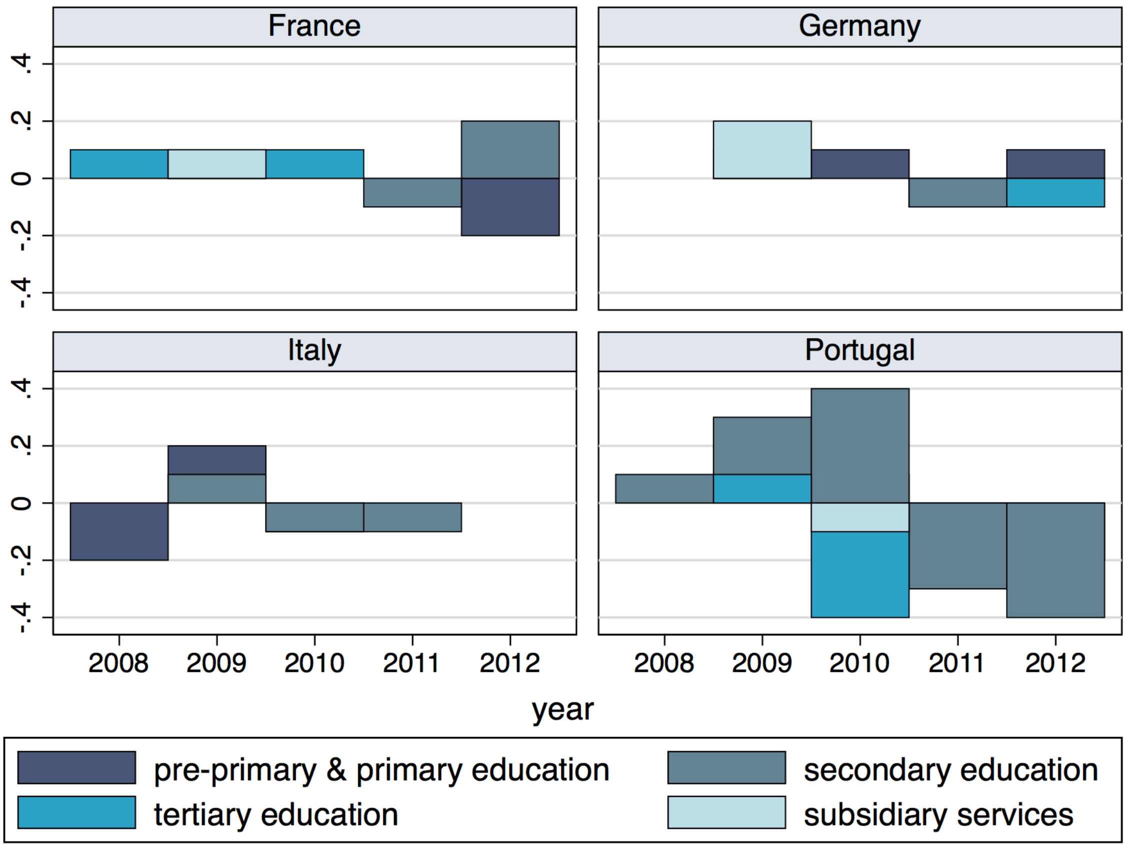


Figure 6. 6 - Changes in key education group allocations during the crisis in selected Eurozone countries

For example, in the late crisis in France, the overall zero change in education spending entails a 0.2 percentage point of GDP shift from pre-primary and primary towards secondary education. Similarly, in Portugal, in 2010 to an increase in allocations for secondary education correspond cuts in tertiary education and subsidiary services. Furthermore, what gets cut and what receives additional spending in crisis is not univocal, with only France and Italy resorting to cutting pre and primary education, only Germany and Portugal opting for cuts in tertiary spending, only Portugal cutting subsidiary services and all countries to a varied extent curtailing secondary education spending during the Great Recession. Figure 6. 6 offers a detailed dive into one division across four Eurozone Member States. The patterns indicate budgetary outcomes vary within divisions, suggesting there is a scope for diverging dynamics concerning the cross-cycle interaction of the supranational fiscal rule for countries under the EDP.

Table 6. 9 - Budget items in-crisis across EDP surveillance

	crisis, non-EDP							crisis, EDP					
Division	Variable		Obs	Mean	Std. Dev.	Min	Max	Variable	Obs	Mean	Std. Dev.	Min	Max
General public services	Executive and legislative organs, financial and fiscal affairs, external affairs	ΔGF0101	25	.26	.4949747	-.3	1.9	ΔGF0101	59	-.1101695	.4633815	-3	.5
	Foreign economic aid	ΔGF0102	25	.012	.0665833	-.2	.1	ΔGF0102	59	0	.0415227	-.2	.1
	General services	ΔGF0103	25	.08	.147196	-.1	.4	ΔGF0103	59	-.0220339	.2026274	-.9	.6
	Basic research	ΔGF0104	25	.036	.0757188	-.2	.2	ΔGF0104	59	.0084746	.0915162	-.2	.5
	R&D General public services	ΔGF0105	25	-.004	.02	-.1	0	ΔGF0105	59	-.0084746	.0427024	-.3	0
	General public services n.e.c.	ΔGF0106	25	.004	.0454606	-.1	.2	ΔGF0106	59	-.0152542	.0714711	-.4	.2
	Public debt transactions	ΔGF0107	25	.06	.2565801	-.4	.5	ΔGF0107	59	.1881356	.4026142	-.4	1.5
	Transfers of a general character between different levels of government	ΔGF0108	25	-.004	.02	-.1	0	ΔGF0108	59	.0016949	.0130189	0	.1
Defence	Military defence	ΔGF0201	25	.036	.1912241	-.5	.5	ΔGF0201	59	-.0559322	.2222698	-.6	.5
	Civil defence	ΔGF0202	25	.004	.02	0	.1	ΔGF0202	59	-.0016949	.0226786	-.1	.1
	Foreign military aid	ΔGF0203	25	0	.0288675	-.1	.1	ΔGF0203	59	.0016949	.0393548	-.1	.1
	R&D Defence	ΔGF0204	25	0	0	0	0	ΔGF0204	59	.0016949	.0130189	0	.1
	Defence n.e.c.	ΔGF0205	25	.004	.02	0	.1	ΔGF0205	59	-.0118644	.0326145	-.1	0
Public order and safety	Police services	ΔGF0301	25	.028	.0737111	-.2	.1	ΔGF0301	59	-.0237288	.0727276	-.2	.2
	Fire-protection services	ΔGF0302	25	.012	.06	-.1	.2	ΔGF0302	59	-.0067797	.0552874	-.2	.1
	Law courts	ΔGF0303	25	.008	.0276887	0	.1	ΔGF0303	59	-.0033898	.0369814	-.1	.1
	Prisons	ΔGF0304	25	-.008	.0702377	-.3	.1	ΔGF0304	59	-.0016949	.0393548	-.1	.1
	R&D Public order and safety	ΔGF0305	25	0	0	0	0	ΔGF0305	59	0	0	0	0
	Public order and safety n.e.c.	ΔGF0306	25	.016	.0472582	0	.2	ΔGF0306	59	.0118644	.0494269	-.1	.2
Economic affairs	General economic, commercial and labour affairs	ΔGF0401	25	.172	.3611556	-.6	1.4	ΔGF0401	59	.1271186	3.031321	-15.1	16.5
	Agriculture, forestry, fishing and hunting	ΔGF0402	25	-.04	.2309401	-.8	.4	ΔGF0402	59	-.0728814	.2203684	-1.3	.3
	Fuel and energy	ΔGF0403	25	.036	.1439907	-.2	.5	ΔGF0403	59	.0254237	.1853173	-.9	.6
	Mining, manufacturing and construction	ΔGF0404	25	-.016	.1312758	-.5	.3	ΔGF0404	59	-.020339	.0689319	-.3	.2
	Transport	ΔGF0405	25	-.036	.4990658	-1.6	.6	ΔGF0405	59	-.0711864	.5834058	-2.4	2.2
	Communication	ΔGF0406	25	-.012	.06	-.2	.1	ΔGF0406	59	-.0050847	.0505955	-.1	.2
	Other industries	ΔGF0407	25	.016	.06245	-.1	.2	ΔGF0407	59	-.0101695	.0781133	-.3	.2
	R&D Economic affairs	ΔGF0408	25	.028	.0541603	-.1	.1	ΔGF0408	59	.0101695	.040236	-.1	.1
	Economic affairs n.e.c.	ΔGF0409	25	.004	.1019804	-.3	.3	ΔGF0409	59	-.0033898	.1129023	-.3	.7
Environ-mental protection	Waste management	ΔGF0501	25	0	.057735	-.1	.1	ΔGF0501	59	.0016949	.0776631	-.3	.3
	Waste water management	ΔGF0502	25	0	.05	-.1	.1	ΔGF0502	59	-.0101695	.1335134	-.6	.4
	Pollution abatement	ΔGF0503	25	-.032	.2249444	-1.1	.1	ΔGF0503	59	.0186441	.1432078	-.8	.4
	Protection of biodiversity and landscape	ΔGF0504	25	0	.0408248	-.1	.1	ΔGF0504	59	0	.0415227	-.1	.1
	R&D Environmental protection	ΔGF0505	25	0	0	0	0	ΔGF0505	59	.0033898	.0182521	0	.1
	Environmental protection n.e.c.	ΔGF0506	25	2.98e-10	.1118034	-.4	.3	ΔGF0506	59	.0016949	.0754104	-.4	.2

Legend: increasing items under EDP in light blue, decreasing in light blue

Full descriptive statistics of the 69 variables across the ten divisions within the Eurozone, during the crisis, are presented across observations under and outside of EDP surveillance in Table 6. 9 e Table 6. 10. Across each item, the table indicates in light blue means decreasing for EDP surveillance, while dark blue is deployed for budget lines with higher means associated with observations under the corrective arm. The prevailing overall dynamic is that of lower means for countries under EDP surveillance, in some cases fully representing entire division budget lines, namely for education and social protection. Public order, economic affairs and health follow suit with only one budget line with a higher mean under EDP surveillance, respectively amounting to prisons, communication and non-classified health expenditures. Across the remainder of divisions, patterns are more mixed. Within general affairs, seven groups (legislative organs, general services, foreign aid, basic research, non-classified expenditures and R&D) have lower means under EDP surveillance, with opposite dynamic emerge for two groups (public debt transactions and cross-government-levels transfers). Likewise, for defence, while military and civil defence as well as non-classified spending decreases, foreign military aid and R&D increases. Environmental protection represents an exception, with the majority of groups (waste management, pollution abatement, R&D and non-classified) displaying higher expenditures under EDP surveillance, only wastewater management lower ones and protection of biodiversity and landscapes remaining stable. Also, housing and community amenities display mixed patterns, with lower means under EDP surveillance for community development, water supply and non-classified expenditures, higher means for housing development and street lighting and stable expenditures in R&D across both the preventive and corrective arm. Similarly, culture and recreation services are associated with cross-EDP non-univocal patterns: lower expenditures when under EDP surveillance for recreational and sporting services, cultural services, broadcasting and publishing and R&D, while increasing for religious services and non-classified expenditures.

Table 6. 10 - Budget items in-crisis across the EDP

Division	crisis, non-EDP							crisis, EDP					
	Variable		Obs	Mean	Std. Dev.	Min	Max	Variable	Obs	Mean	Std. Dev.	Min	Max
Housing and community amenities	Housing development	ΔGF0601	25	-.008	.0759386	-.2	.2	ΔGF0601	59	-.0152542	.1349503	-.5	.5
	Community development	ΔGF0602	25	.028	.0890693	-.2	.3	ΔGF0602	59	-.0254237	.1043754	-.6	.1
	Water supply	ΔGF0603	25	.004	.0934523	-.1	.4	ΔGF0603	59	-.0152542	.0961564	-.3	.4
	Street lighting	ΔGF0604	25	0	.0288675	-.1	.1	ΔGF0604	59	.0016949	.0226786	-.1	.1
	R&D Housing and community amenities	ΔGF0605	25	0	.0288675	-.1	.1	ΔGF0605	59	0	0	0	0
	Housing and community amenities n.e.c.	ΔGF0606	25	-.012	.1268858	-.4	.4	ΔGF0606	59	-.0101695	.0824096	-.4	.2
Health	Medical products, appliances and equipment	ΔGF0701	25	.032	.0802081	-.1	.2	ΔGF0701	59	.0169492	.111653	-.2	.3
	Outpatient services	ΔGF0702	25	.092	.1705872	-.2	.4	ΔGF0702	59	-.0288136	.2173911	-1.3	.6
	Hospital services	ΔGF0703	25	.188	.2471841	-.3	.8	ΔGF0703	59	-.0118644	.2606919	-.7	1
	Public health services	ΔGF0704	25	.004	.0351188	-.1	.1	ΔGF0704	59	-.0016949	.0435159	-.1	.1
	R&D Health	ΔGF0705	25	.004	.0351188	-.1	.1	ΔGF0705	59	.0033898	.0319811	-.1	.2
	Health n.e.c.	ΔGF0706	25	-.012	.1201388	-.5	.1	ΔGF0706	59	.0322034	.1041231	-.1	.4
Recreation, culture and religion	Recreational and sporting services	ΔGF0801	25	.012	.0525991	-.1	.1	ΔGF0801	59	.0016949	.0860864	-.3	.3
	Cultural services	ΔGF0802	25	.008	.0812404	-.2	.1	ΔGF0802	59	-.0067797	.0666033	-.2	.2
	Broadcasting and publishing services	ΔGF0803	25	0	.0408248	-.1	.1	ΔGF0803	59	-.0050847	.0470646	-.1	.2
	Religious and other community services	ΔGF0804	25	-.008	.04	-.1	.1	ΔGF0804	59	.0050847	.0390567	-.1	.2
	R&D Recreation, culture and religion	ΔGF0805	25	.008	.0276887	0	.1	ΔGF0805	59	-.0016949	.0130189	-.1	0
	Recreation, culture and religion n.e.c.	ΔGF0806	25	0	0	0	0	ΔGF0806	59	.0033898	.0319811	-.1	.1
Education	Pre-primary and primary education	ΔGF0901	25	.08	.1384437	-.2	.4	ΔGF0901	59	-.0016949	.1456158	-.4	.4
	Secondary education	ΔGF0902	25	.068	.154704	-.3	.3	ΔGF0902	59	-.0033898	.1856639	-.4	.6
	Post-secondary non-tertiary education	ΔGF0903	25	.004	.02	0	.1	ΔGF0903	59	0	.0321634	-.1	.1
	Tertiary education	ΔGF0904	25	.06	.1	-.1	.3	ΔGF0904	59	-.0152542	.1336665	-.4	.2
	Education not definable by level	ΔGF0905	25	.008	.0640312	-.2	.1	ΔGF0905	59	-.0033898	.0490113	-.2	.2
	Subsidiary services to education	ΔGF0906	25	.024	.0597216	-.1	.2	ΔGF0906	59	0	.0371391	-.1	.1
	R&D Education	ΔGF0907	25	.008	.0276887	0	.1	ΔGF0907	59	.0016949	.0776631	-.4	.3
	Education n.e.c.	ΔGF0908	25	.016	.06245	-.1	.2	ΔGF0908	59	-.0067797	.0806534	-.3	.3
Social protection	Sickness and disability	ΔGF1001	25	.036	.5251032	-2.2	.6	ΔGF1001	59	-.0050847	.3207877	-1.2	1
	Old age	ΔGF1002	25	.584	.8581375	-.9	3.2	ΔGF1002	59	.2745763	.6404721	-1	2.9
	Survivors	ΔGF1003	25	.044	.0711805	-.1	.2	ΔGF1003	59	.0050847	.0729282	-.2	.2
	Family and children	ΔGF1004	25	.188	.2948446	-.4	1.1	ΔGF1004	59	-.0135593	.2177135	-.6	.9
	Unemployment	ΔGF1005	25	.188	.3897863	-.6	1.4	ΔGF1005	59	.0491525	.2635127	-.5	1.1
	Housing	ΔGF1006	25	.016	.0472582	-.1	.1	ΔGF1006	59	-.0101695	.0781133	-.4	.2
	Social exclusion n.e.c.	ΔGF1007	25	.076	.13	-.1	.6	ΔGF1007	59	.0254237	.1281072	-.6	.3
	R&D Social protection	ΔGF1008	25	0	0	0	0	ΔGF1008	59	0	0	0	0
	Social protection n.e.c.	ΔGF1009	25	.052	.1475353	-.1	.5	ΔGF1009	59	-.0372881	.1649434	-1	.2

Legend: increasing items under EDP surveillance in dark blue, decreasing in light blue

Results

Following the taxonomy of the cross-cycle impact of the EDP surveillance developed in the previous section, results of the 69 regressions are summarised in a heath-map distinguishing from the strongest increasing bite of the corrective arm in crisis to the least distinction across good and bad times. Across those instances for which the impact of the EDP surveillance strengthens during the negative phase of the cycle – that is to say, the interaction between the independent variable and the cycle is negative and significant – a further distinction can be made based on the relative strength of the crisis-led-expansionary pressure and the additional contractionary restraint of the corrective arm in bad times. Specifically, the in-crisis force of EDP surveillance is the strongest when the interaction fully compensates for the upward push of the crisis, while a middle ground is represented by instances for which the supranational fiscal rule becomes more stringent in the negative cycle without overpowering the effect of the recession. Table 6. 11 displays the heat-map indicating both the overall division impact of the EDP surveillance and the specific budget line effect at the group level.

A preliminary consideration concerns the within division variability in the impact of EDP surveillance across the cycle, coherent with the insight provided by a closer look into descriptive dynamics in key education budget lines in selected Member States. Six out of ten division mix more than two of the patterns of significant cross-cycle impact described in the taxonomy put forward in the previous section. Additionally, in all divisions, there are – often numerous – instances for which no significant effect emerges at all. On the opposite side of the spectrum, non-significant overall division level effects, may 'hide' a significant cross-cycle distinction in the impact of the EDP on the budget structure at the disaggregated group level. That is the case both for economic affairs, for which significant results emerge across three of the nine groups, and environmental protection, with two significant groups out of six. Finally, across three divisions – namely defence and public order – the overall aggregate effects may be driven by a single budget line, respectively military defence and fire-protection services.

Table 6. 11 - Heath-map of the impact of EDP surveillance on changes in national spending across groups and the cycle

Division	Group
General public services	Executive and legislative organs, financial and fiscal affairs, external affairs
	Foreign economic aid
	General services
	Basic research
	R&D General public services
	General public services n.e.c.
	Public debt transactions
	Transfers of a general character between different levels of government
Defence	Military defence
	Civil defence
	Foreign military aid
	R&D Defence
	Defence n.e.c.
Public order and safety	Police services
	Fire-protection services
	Law courts
	Prisons
	R&D Public order and safety
	Public order and safety n.e.c.
Economic affairs	General economic, commercial and labour affairs
	Agriculture, forestry, fishing and hunting
	Fuel and energy
	Mining, manufacturing and construction
	Transport
	Communication
	Other industries
	R&D Economic affairs
	Economic affairs n.e.c.
Environmental protection	Waste management
	Waste water management
	Pollution abatement
	Protection of biodiversity and landscape
	R&D Environmental protection
	Environmental protection n.e.c.

Division	Group
Housing and community amenities	Housing development
	Community development
	Water supply
	Street lighting
	R&D Housing and community amenities
	Housing and community amenities n.e.c.
Health	Medical products, appliances and equipment
	Outpatient services
	Hospital services
	Public health services
	R&D Health
	Health n.e.c. (^)
Recreation, culture and religion	Recreational and sporting services
	Cultural services
	Broadcasting and publishing services
	Religious and other community services
	R&D Recreation, culture and religion (^)
	Recreation, culture and religion n.e.c.
Education	Pre-primary and primary education
	Secondary education
	Post-secondary non-tertiary education
	Tertiary education
	Education not definable by level
	Subsidiary services to education
	R&D Education
	Education n.e.c.
Social protection	Sickness and disability
	Old age
	Survivors
	Family and children (§)
	Unemployment (§)
	Housing
	Social exclusion n.e.c.
	R&D Social protection
	Social protection n.e.c.

EDP impact:	negative, full sample	increasingly negative in crisis	increasingly negative and fully compensating the crisis

(^) Crisis negative and significant impact, interaction positive and significance

(§) additionally to signalled effect EDP surveillance also negative and significant across the full sample

Taking a closer look within each division, the cross-cycle changing and fully crisis-compensating impact of the EDP surveillance at the division level for general affairs is confirmed for the group level budget lines for which any significant effect emerges, namely legislative services and basic research. The same is the case for the above-mentioned defence and public order divisions. Along the same line, a fully coherent division-group pattern aligned with that of general affairs emerges for housing and community amenities, driven by the community development and water supply budget lines. Shifting the focus to mixed divisions, within economic affairs, all three levels of impact emerge from the least cycle-dependent for other industries, to the cycle-middle-ground for divisional R&D and the sharpest crisis-corrective impact for mining, manufacture and construction. Also, environmental protection displays different EDP-in-crisis impact for significant groups, on one side with a cycle constant negative impact for waste management and on the other with a cycle-compensating effect for sectorial R&D. Within health, along with distinctions among two significant budget lines, the cycle-constant medical equipment and crisis-compensating hospital services, an unusual pattern emerges for non-classified health expenditures. For this group, the crisis has a negative and significant rather than positive impact, while the interaction effect with EDP surveillance is positive and significant: the crisis drags expenditures downward while the in-crisis corrective arm pushes in the opposite direction. Within the recreation division, the same unusual pattern emerges for sectorial R&D, while – with the sole exception of the crisis-compensating non-classified expenditures – the majority of significant divisions do not display a cycle-variant impact of the SGP. Within the education division, a mixed pattern is revealed at the group level. The impact of EDP surveillance on pre-primary and primary education is crisis invariant. Conversely, the remaining of significant groups are associated with an increasing restraint of the EDP surveillance in crisis, which fully compensates for the cycle for secondary education and subsidiary services, while only partially mitigating expansionary trends for tertiary education. Finally, social protection is also a mixed-group-effects division, where, however, a cycle-variant effect of the supranational fiscal rule prevails for all significant groups with the sole exception of non-classified social expenditures. Among the remaining groups, the impact of the EDP surveillance increases in crisis without fully compensating for the cycle for sickness and disability, old-age and survivor pensions. Conversely, the increasing bites of the EDP cancels away cyclical trends for family benefits and unemployment, for which additionally – and as an unicum across the 69 variable – the full panel impact of the corrective arm is also negative and significant.

Table 6. 12 - Impact of EDP surveillance across the cycle on selected groups of interest in the health and education division

	(1)	(2)	(3)	(4)
	Δ hospital services	Δ pre-primary & primary education	Δ secondary education	Δ tertiary education
EDP	-0.00378	-0.0394***	-0.0301	-0.0150
	(0.0239)	(0.0131)	(0.0190)	(0.0141)
crisis	0.199***	0.0707**	0.120***	0.0780***
	(0.0431)	(0.0323)	(0.0335)	(0.0276)
EDP#crisis	-0.217***	-0.0395	-0.130***	-0.0689**
	(0.0486)	(0.0324)	(0.0362)	(0.0339)
ideology	0.000303	-6.89e-05	-0.000520	0.000162
	(0.000708)	(0.000381)	(0.000571)	(0.000503)
ideological distance	6.21e-05	5.73e-05	-2.33e-05	2.95e-05
	(0.000130)	(6.62e-05)	(8.66e-05)	(8.13e-05)
alternation	-0.000185	-4.81e-05	-1.27e-05	-1.58e-05
	(0.000238)	(0.000130)	(0.000135)	(0.000165)
Δ unemployment rate	0.0193**	0.0179***	0.0165**	0.00260
	(0.00839)	(0.00539)	(0.00656)	(0.00450)
Δ old-age dependency rate	0.0376	0.00623	-0.00972	-0.00404
	(0.0282)	(0.0155)	(0.0190)	(0.0173)
decentralisation	0.000777	0.00502	0.00370	0.00586
	(0.00745)	(0.00601)	(0.00647)	(0.00604)
national fiscal rule preferences	0.00392	-0.00267	-0.000983	-0.0145
	(0.0186)	(0.0108)	(0.0132)	(0.0107)
Constant	-0.00382	0.00783	-0.00323	0.00530
	(0.0213)	(0.0150)	(0.0176)	(0.0109)
Observations	267	267	267	267
R-squared	0.128	0.116	0.146	0.061
Number of countries	19	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Further detailing dynamics across all groups is beyond the scope of the analysis and the relevance for the research question at hand, in linking the in-crisis EDP impact on the budget structure with consolidation dynamics on one side and – in preparation for the assessment of [RQ2.B] on investments, transfers and inequality mitigation in chapter seven – distinguishing across the typologies of spending. The latter is of particular value given the broader implications of shifts - for example - in welfare or inequality reduction measures – whose understanding is well served by a close look of patterns across relevant disaggregated group-level variables. Leaving the in-depth assessment of social expenditures to chapter seven and [RQ2.C], health and education may offer a valuable entree towards the cross-typology analysis to follow. Starting from the health division, the cycle-sensitive group of hospital services displays an additional in-crisis impact of the EDP of -0.22, over 1.5 standard deviations and the expansionary push of the recession of 0.20, as shown in Table 6. 12. Under such circumstances, while outside of the corrective arm hospital services expenditures increase with the Great Recession, displaying an average well above non-crisis years, under the restraining force of EDP surveillance such difference no longer emerges, with a downward convergence of changes in spending, shown in Figure 6. 7 below.

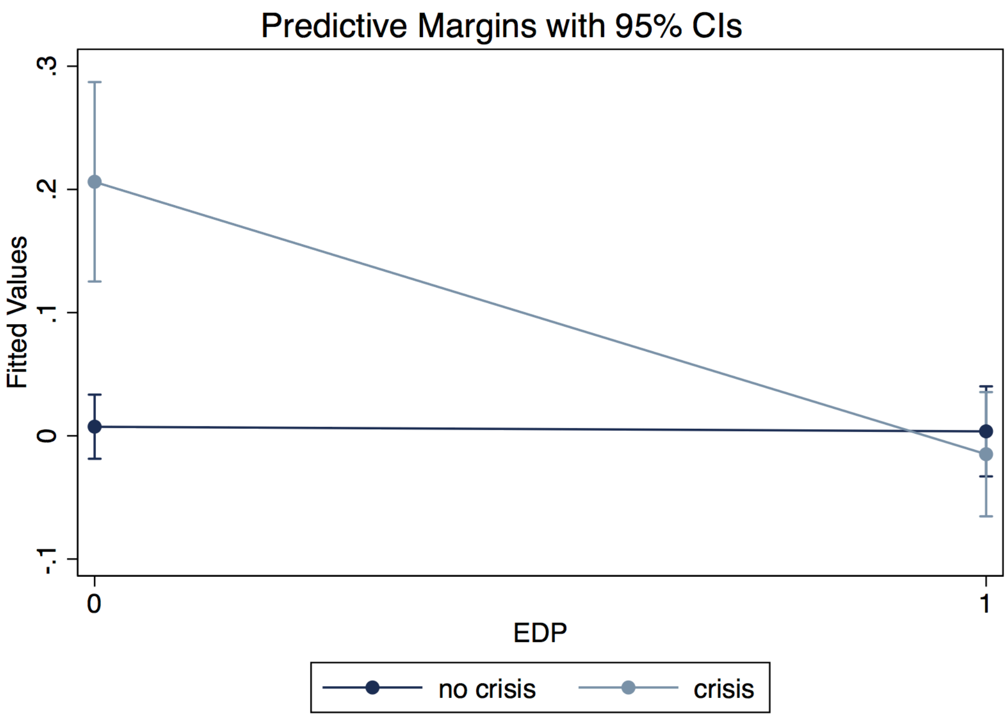


Figure 6. 7 - Changes in hospital services spending across the cycle and EDP surveillance

Turning to education, the non-cyclical affected impact of EDP surveillance on pre-primary and primary services while significant is modest in size (about one-third of a standard deviation) and compensated by the impact of the crisis. Among the budget line with cross-cycle variation in the impact of the EDP, for secondary schooling, the additional restraining impact of the corrective arm in bad times amounting to -0.13 – well over one standard deviation – surpasses the upward pressure of the crisis (0.12). For tertiary education, the pattern is the same, without the overcompensation for the impact of the recession of 0.78, with the additional constraint of the EDP-in-crisis stopping at -0.69, which amounts to only 0.8 standard deviations.

Implications

The evidence shows how – even within the same division – the bite of EDP surveillance in bad times may vary in strength, hurting, in particular, some spending at division and group level, which does include, however, budget lines with substantial social implications. Furthermore, the additional negative impact of the EDP-in-crisis on education and health also provide some preliminary insight of investment being negatively affected by the EU economic governance during the Great Recession, as to be further explored in chapter seven.

Looking at Figure 6. 7, which is representative of patterns in several groups of expenditures, provides a further finding with regards to cross-cycle patterns. In-crisis changes in the budget lines are marked when crossing from the preventive to the corrective arm sharply converging toward good times trends. The same is often not the case outside of the negative phase of the cycle, for which – if any – the impact of the EDP is modest and more often than not failing to achieve significance. One can thus derive that rather than disappearing when escape clauses come into play in a negative cycle – triggering the exceptional circumstances clause taking sanctioning off the table – for the overwhelming majority of budget lines not only does the binding powers of the EDP remain but it also is either further increased or may even appear for items unaffected in normal times. In several instances, the impact of the EU economic governance framework – for countries under EDP surveillance – may concentrate exactly in the negative phase of the cycle, contrary to the counter-cyclical commitment of the policy.

An additional distinction emerged from the division level regression results summarised in the heath-map above relates to the cohesiveness and prevalence within each division. If for general affairs, defence, public order, housing and health division level results are driven by few (or even one) budget lines, for recreation, education and social protection a majority if not near entirety of groups contribute although not always homogeneously.

Finally, it is already evident that EDP surveillance affects both investment and transfers during the negative phase of the cycle, with social spending but also education and to some extent health heavily impacted by the supranational fiscal rule during the Great Recession. However, the precise aggregate cross-cycle dynamics and the relative 'bite' across the two categories remain unclear and to be assessed in chapter 7 in the context of [HP2.B].

Conclusions

The chapter analyses EU economic governance in times of crisis, with results confirming diverging dynamics during the Great Recession and Eurozone crisis in comparison to normal times. In this context, two elements could have been argued to affect results in interplaying with the functioning with the SGP in a recession, namely the changing nature of the EU economic governance framework – given that amid the recession the exceptional circumstances clause taking temporarily sanctions of the table kicked in – and the potentially diverging fiscal policy objectives of smoothing the cycle. Additionally, thanks to COFOG group-level data becoming available well before the crisis, the analysis in this chapter could proceed to consider trends and heterogeneities at a granular level, providing information on the – at times mixed – impact on each specific budget line.

Throughout the analysis firstly adherence of the supranational fiscal rule to its counter-cyclical policy objective is refuted. Conversely, [HP2.A] is verified in line with the pro-cyclical argument within the literature. Firstly, the 'armed branch' of the Stability and Growth Pact – the EDP – is alive and well in times of crisis, affecting the composition of the national budgets. Such impact – often emerging or being reinforced in the negative phase of the cycle – counteracts the expansionary pressure of the recession. In fact, with only two exceptions at the group level (non-classified health expenditure and sectorial cultural R&D), any significant impact of the EDP pushes national expenditures toward consolidation. In addition, more often than not, the effect of the supranational fiscal rule is indeed sensitive to the cycle but not as would be expected at 'face value' based on its nominal policy objectives. Rather than loosening the leash on national expenditures to support the economy in the downturn, for Eurozone countries under the additional scrutiny of the Excessive Deficit Procedure, the dynamics are reversed with a further tightening of the supranational-level derived restraint on spending. In several instances, the bite of the EDP even fully overpowers the recession expansionary pressure on fiscal policy, to the point that budgetary performance may be undistinguishable across the cycle for countries within the corrective arm of the Pact. Such dynamics may support the argument that the EU economic governance framework acts to counter the functioning of automatic stabilisers in line with an underlying contractionary bias that is characteristic of the philosophy of the Pact (Eichengreen & Wyplosz, 1998; Pasinetti, 1998; Heise, 2015).

One may question the validity of the results beyond the specifics of the period under consideration. The magnitude of the Great Recession is undoubtedly on its own scale, although it is easily overtaken by the successive existential crisis for the EMU infrastructure with the Covid-19 pandemic.

Additionally, the Eurozone crisis and the sovereign debt financial and political pressure can be expected to play a role in determining the dynamics that emerged in the chapter. However, the within-crisis analysis distinguishing between the early and late phase of the post-2009 downturn provides some mitigation against the specificity of the period under consideration and results being entirely driven by the Eurozone crisis. Specifically, while dynamics in the late crisis are harder to pinpoint due to the small number of observations not under EDP at the time, the early crisis confirms the overall patterns indicating that results are representative of dynamics before the outburst of the sovereign debt crisis.

At the same time, the relevance for future scenarios of severe recession should be evaluated against the change in the regulatory framework. On one side, the bite of the weaker governance of phase two may be only expected to increase in parallel with the higher stringency emerged in the latest iteration of the supranational fiscal rule, especially after the introduction of the Fiscal Compact. On such premises, dynamics may further worsen in terms of the Pact providing sufficient allowances for countering the cycle during a recession. Conversely, the strengthening of the framework post-2011 may yield different conclusions with regards to the impact of the EDP and its cross-cycle heterogeneity. In fact, unlike in phase two, chapter five showed a significant impact of the EDP also outside of crisis years in the latest iterations of the framework. Beyond the synthetic budget distance level, the pattern emerges also for some division associated with an increasing in-crisis impact, at times fully compensating for the recession. Under this scenario, the implication hinges on what drives the cyclical pattern in the impact of the Pact for countries contravening the supranational fiscal rule. If the failure in constraining spending in good times is the culprit, facilitating convergence by not enacting expansion in times of need rather than cutting expenditures in normal times, a better consolidation performance outside crisis years may allow for increased leniency in bad times. If rather, the Pact is inherently pro-cyclical, pushing countries toward caution even in a recession to avoid a worsening of the excessiveness of their deficit that would risk going well beyond the leniency allowed by the escape clauses, dynamics may further worsen with increased stringency. Along this line, the increasing restraint of the framework in bad times would remain, potentially broadening the components of the budget for which an additional EDP-derived consolidation pressures adds to an already significant and negative impact in normal times. Partial evidence of this scenario may be found in the latest 'test' of the Pact with the pandemic-driven recession leading to the invocation of the general escape clause to allow for additional fiscal space for national responses to the Covid-19 crisis, loosening the supranational grip on domestic public expenditures (EUCO, 2020a).

Under these premises not only was RQ[2.A] confirmed with a varied effect of the SGP associated with normal and crisis times, but a further finding of interest can be identified in any impact at all emerging at a time in which – albeit temporarily – sanctions are not foreseen. The evidence, partially contradicting previous conclusions in the context of chapter five, may suggest that there is a potential for an impact of the supranational economic governance framework on the fiscal policy mix even in the absence of sanctioning. However, the specificity of the situation under consideration – that is a temporary exception under given conditions that may be reversed in the future – may not be easily argued to extend beyond this scenario to the context in which no hard enforcement mechanisms are foreseen at all. At the same time, in the presence of substantial 'bite' in crisis, the impact of the EDP may span beyond its nominal ability to affect the fiscal policy mix, even when in principle it does not carry an enforceable indirect effect through the impact on the national budget constraint. Indeed political pressure may continue to bind budgetary choices even when procedures foresee built in flexibility and leniency.

Looking at the specifics at the disaggregated level provides some insight on the distributional consequences of the EDP-in-crisis. The heath-map put forward in the last section of the chapter shows that general affairs, public order, housing and health at division level are the domains with the sharpest cross-cyclical impact, with the additional stringency of the EDP during the recession fully compensating the expansionary pressure of the crisis. Education and social protection follow suit with the same cross-cyclical pattern, although the EU economic governance does not in this instance fully control away the recession. However, the group-level analysis showed how those two divisions have some of the most pervasive impact of the EDP across all budget lines, including numerous instances in which the effect is among the most constraining. Leaving social protection to the in-depth analysis in chapter seven, a closer look at group dynamics in the key divisions of (social) interest uncovered heterogeneity paired with heavy in-crisis impact on some budget lines such as secondary education and hospital services. The contractionary push of the EDP during the Great Recession on hospital services is of particular interest in light of the 2020 pandemic and the centre stage taken by the preparedness of the health infrastructure to face the crisis. The dynamics of spending in this domain show instances of a contraction of health spending over the crisis years – decreasing for example in Italy (OECD, 2019) – and a parallel slashing of hospital beds, which for example in France went from 706 per 100000 inhabitants in 2007 to 590 in 2018 (Eurostat, 2020). The latter element may be particularly problematic given this domain is associated with beneficial implications both in terms of growth – being among investment yielding the most positive impact – and inequalities (Fournier & Johansson, 2016). Furthermore, findings in this chapter indicate a contribution of the EDP to the emerging pattern, which may have negatively affected the resilience of the Member States entering the Covid-19 outbreak with a heavy legacy from the Great Recession and Eurozone crisis.

Table 6. 13 - Summary of results for [HP2.A] *the SGP contravenes its countercyclical policy objectives in enforcing consolidation in times of crisis*

Aggregate level a lack of bite of the EDP-in-crisis on the budget structure is refuted confirming an impact which increases in bad times compensating for the upward push on spending of the crisis, compatible with consolidation.
Division level a push toward consolidation is confirmed at the disaggregated level with heterogeneity across the budget components some are negatively impacted by EDP surveillance with no distinction between good and bad times (defence and culture & recreation), while for other the impact either emerges only during the crisis (education, social protection) or if further reinforced completely compensating for the recession entailing a net decrease in spending (general affairs, public order & safety, housing & community, health)
Group level heterogeneity extends within divisions, in some cases with a single or few budget lines showing a significant impact compensating the crisis (e.g. basic research, fire protection, water, community development, hospital services, secondary education, family & children, unemployment). Beyond the social domain, results are particularly worrisome in the health domain and for education, for which spending is cut in a stable way across the cycle, while only in bad times for secondary and tertiary education.

With the picture emerging in chapter six – outlined in Table 6. 13 – indicating already a failure of the supranational fiscal rule in its counter-cyclical policy objective and preliminary findings supporting EDP-in-crisis driven contraction both in investments, transfers and inequality mitigation, the disaggregated analysis sets the stage for the relative comparison of dynamics across macro sub-components of public spending in the next chapter in addressing the open sub-hypotheses within [RQ2] on the in-crisis (pro-cyclical) impact of the SGP on the budget structure.

7. The distributional consequences of the EDP-in-crisis

The chapter continues the analysis of in-crisis dynamics commenced in chapter six, focusing on the distributional EDP induced outcomes and their implications. Chapter six established that the SGP and the EDP retain the capacity of affecting the national fiscal policy mix during the Great Recession and uncovered how all the categories under investigation (investment, transfers, social spending) are negatively affected for Eurozone countries in the corrective arm during the negative phase of the cycle. The analysis appraises eventual comparative distinctions among the macro sub-categories of expenditures, then shifting the (in-depth) focus toward social spending.

Specifically, the first step is the assessment of the adherence of the Pact with its policy objective of promoting growth-enhancing national fiscal policies, namely in verifying whether:

> [HP2.B] *the SGP-at-crisis in pushing toward an investment rich response to the recession came at the expenses of transfers and inequality mitigating expenditures.*

The first two sections are dedicated to [HP2.B] in addressing the impact of the EDP-in-crisis on investment and transfers and exploring the sub-classification of expenditures mitigating inequality, looking as well at the intergenerational allocation of resources. The research sub-question sheds some light on the effectiveness of the policy with respects to its nominal goals. In parallel, the distinction of the impact of the supranational fiscal rule across the typology of national expenditures furthers the analysis of where the EU economic governance framework bites the most in bad times, with substantive broader implications for some of the harsher criticism of inequality enhancing social retrenchment (e.g. Addabo et al., 2018; De Grauwe & Ji, 2013; Heins & De La Porte, 2015; Guillén, & Pavolini, 2015; Marques & Hörisch, 2020; Pavolini et al., 2015). Within this arena a further critical element is highlighted in the literature with regards to Eurozone-crisis-led divergence across Euro Area countries: the core-periphery divide (e.g. Magone, 2011; Laffan, 2014; Armingeon et al., 2016; Censolo & Colombo, 2016; Cesaroni et al., 2019; De Grauwe & Ji, 2018; Dooley, 2019; Howarth & Verdun, 2020; Notermans & Piattoni, 2020). The analysis is repeated across the core and periphery subsample in uncovering potential differences in dynamics or their strength across the most and less Great Recession affected the Member States.

Along the same reasoning, the last section of the chapter focuses on the social dimension, taking a closer look at the cross-cyclical trend in group-level expenditures within the social protection division. Building on the preliminary evidence emerged in chapter six indicating a negative effect of the EDP during the Great Recession for social spending, section three verifies whether:

> [HP2.C] *the SGP-at-crisis furthered the social cost of the recession by negatively impacting social spending dynamics.*

The effect of the recession and Eurozone crisis on the social arena across Europe have received substantial attention, with welfare consequences and the social brutality of the crisis impact even associated with the erosion of support for democracy (Pennings, 2017). The implications for the relationship between the most restraining dimension of the EU supranational fiscal rule and welfare policies are thus substantial, together with eventual distinctions along the core-periphery divide.

Completing the analysis of the EU economic framework constraining force on national fiscal policy in crisis allows for addressing the research question(s) at hand – without disregarding the specificity of the negative phase of the cycle in which fiscal policies face substantial (distributive) challenges. Additionally, it also contributes to the debate on the pro-cyclical nature of the EU fiscal rule and its detrimental consequence for inequality and the resilience of the social fabric, with the supranational induce consolidation pressure argued as a driver of (permanent) crisis-induced welfare retrenchment (Hemerijck et al., 2012).

7.1 The EDP at crisis across macro-types of public expenditures

Building on the findings of the previous chapter, RQ[2.B] takes a closer look at the distributional conflict across investment and transfer-like expenditures and its relationship with the supranational fiscal rule across the cycle. In line with chapter six, a quick look at the cross-cyclical impact of the SGP on the macro-categories assesses whether the overall free-riding effect and its insensitivity to the economic climate remain when spending is disaggregated. Similarly, the analysis allows uncovering differences across typology of expenditure in their crisis dynamics, depicting if the effect is equally distributed across categories of spending or rather diverges.

Switching the attention back to the central independent variable – the EDP – the analysis similarly searches for common trends and divergencies across the first two macro typologies of expenditures. At the same time, the assessment of whether their relationship with the EDP changes across crisis years develop a complete overview of how specific categories are affected in bad times. Table 6. 14 below recalls the classification outlined in chapter four distinguishing across investment and transfers, highlighting how the former can be assessed across two specifications, capturing either investment in broader terms or more restrictively including only basic research, health, education and sectorial R&D, in line with heterogeneous approaches within the literature.

Table 6. 14 - COFOG division and group level classification of public expenditures across investments and transfers

Division	Group	Investments	Transfers
General public services	Executive and legislative organs, financial and fiscal affairs, external affairs		
	Foreign economic aid		
	General services		
	Basic research		
	R&D General public services		
	General public services n.e.c.		
	Public debt transactions		
	Transfers of a general character between different levels of government		
Defence	Military defence		
	Civil defence		
	Foreign military aid		
	R&D Defence		
	Defence n.e.c.		
Public order and safety	Police services		
	Fire-protection services		
	Law courts		
	Prisons		
	R&D Public order and safety		
	Public order and safety n.e.c.		
Economic affairs	General economic, commercial and labour affairs		
	Agriculture, forestry, fishing and hunting		
	Fuel and energy		
	Mining, manufacturing and construction		
	Transport		
	Communication		
	Other industries		
	R&D Economic affairs		
	Economic affairs n.e.c.		
Environmental protection	Waste management		
	Waste water management		
	Pollution abatement		
	Protection of biodiversity and landscape		
	R&D Environmental protection		
	Environmental protection n.e.c.		

Division	Group	Investments	Transfers
Housing and community amenities	Housing development		
	Community development		
	Water supply		
	Street lighting		
	R&D Housing and community amenities		
	Housing and community amenities n.e.c.		
Health	Medical products, appliances and equipment		
	Outpatient services		
	Hospital services		
	Public health services		
	R&D Health		
	Health n.e.c.		
Recreation, culture and religion	Recreational and sporting services		
	Cultural services		
	Broadcasting and publishing services		
	Religious and other community services		
	R&D Recreation, culture and religion		
	Recreation, culture and religion n.e.c.		
Education	Pre-primary and primary education		
	Secondary education		
	Post-secondary non-tertiary education		
	Tertiary education		
	Education not definable by level		
	Subsidiary services to education		
	R&D Education		
	Education n.e.c.		
Social protection	Sickness and disability		
	Old age		
	Survivors		
	Family and children		
	Unemployment		
	Housing		
	Social exclusion n.e.c.		
	R&D Social protection		
	Social protection n.e.c.		

Note: dark green = restrictive investment specification, light green = extension to broader specification

Model specification(s)

The model is in full continuity with the analysis in chapter six, with two notable exceptions: (i) the dependent variables and (ii) the subsamples considered. The dependent variable departs from the aggregated synthetic indicator or disaggregated COFOG components, re-aggregating the latter across sub-types of public expenditures identified based on classifications within the literature. The result is three macro-classes within the fiscal policy corresponding to divergent broader societal implications. This section focuses on the first distinction across investment and transfers, which can in parallel separate growth-enhancing spending – which the EU economic governance framework ought to favour – and transfers.

The second innovation concerns the core-periphery analysis. Often at the centre of the criticism of the Great Recession dynamics, cross-regional divergencies have even called into question the political and economic sustainability of the EMU itself (e.g. Dooley, 2017; Magnone et al., 2016; Notermans & Piattoni, 2020; Thalassinos & Dafnos, 2015; Schweiger & Magone, 2014; Wortman & Stahl, 2016; Wyplosz, 2017). The analysis of the cross-cycle variation in the EDP impact within the core and periphery subsamples highlights diverging dynamics or variations in the size of the effect within the Eurozone. Specifically, the first sub-sample considers Austria, Belgium, Finland, France, Germany, Luxembourg, the Netherlands and Sweden. Conversely, the periphery subsample accounts for Cyprus, Greece, Italy, Malta, Portugal and Spain.

One final word of caution relates to missing values, which surpass 100 (15 per cent of the sample) for the macro-aggregates under consideration. However, on a positive note, being concentrated in the early years and in the data gap of Croatia, the Eurozone subsample is largely unaffected along with the crisis (and post-crisis) years.

Descriptive analysis

Having already considered statistics for the independent variables and key interacting factors at play in the previous chapter, the descriptive overview concentrates on the dynamics of the dependent variables over the configurations of interest of cross-cycle and EDP variation for the first two macro sub-categories of expenditures: investments and transfers. The re-aggregation of group expenditures into meaningful agglomerates associated with diverging social and economic implication aids in developing a clearer picture of the relative bite of the crisis and the EDP against its policy objectives of protecting growth-enhancing spending.

Table 7. 1 - Descriptive statistics for investments and transfers

	non-crisis					crisis				
Variable	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
Δ investment	484	-.0506198	1.77284	-12.8	10.3	84	.1142857	3.109106	-17.5	17.9
Δ investment (restricted)	484	-.0002066	.5637974	-4	4.7	84	.1964286	.7032534	-1.1	2.2
Δ tranfers	485	-.2348454	1.074153	-9.099999	5.9	84	.7095238	1.766463	-3.1	5.8
	crisis, excluding FAP					crisis, under FAP				
Variable	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
Δ investment	72	.1861111	1.491979	-3.9	3	12	-.3166667	7.637686	-17.5	17.9
Δ investment (restricted)	72	.2277778	.7227144	-1.1	2.2	12	.0083333	.561586	-.8	.9
Δ tranfers	72	.7083333	1.735199	-3.1	5	12	.7166667	2.027463	-2	5.8
	crisis, excluding FAP, under EDP, outside Eurozone					crisis, excluding FAP, under EDP, Eurozone				
Variable	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
Δ investment	16	-.03125	1.109185	-1.8	2	31	-.2225807	1.251855	-3.9	2
Δ investment (restricted)	16	-.0125	.7392564	-.7	2.2	31	.016129	.4754624	-1.1	1.3
Δ tranfers	16	-.0125	1.8246	-3.1	5	31	.3548387	1.217878	-1.5	3.5

Both subcategories display higher averages during the crisis, also when excluding Programme countries. During the crisis – excluding, as usual, countries under Financial assistance – Eurozone countries display higher averages across the board. Finally, focusing on countries under the corrective arm, dynamics are variegated across Eurozone membership, with Euro area countries displaying lower averages in the broader categorisation of investment expenditures (but higher in the restrictive one only considering education, health and expenditures directly connected with research across all other divisions), while means are higher for transfers and inequality addressing expenditures. The descriptive patterns emerging above is of interest especially in highlighting how dynamics may vary across investments and transfers, suggesting a preliminary confirmation of the value of the cross-type analysis. Additionally, dynamics, at first sight, seem to run counter to the EMU policy objective of promoting investment, because of the decreasing trend in this category (at least in the broad specification) among Eurozone countries under EDP, compared to the increasing one for transfers.

Results

A glance at the cross-cyclical variation in the impact of the SGP on investments and transfers reveals a distinction across the two macro-categories. While – in line with aggregate results – no cyclical influence emerges for the effect of the EMU for investment, at the Eurozone level, that is not the case for transfers. For transfers, the interaction effect between Euro area membership and the negative cycle is positive and significant, indicating an increase free-riding effect associated with the Eurozone in bad times for this category of expenditure. In a way, the intuition that can be derived is that during the Great Recession, the safety blanket of the EMU affects primarily transfers, compatible with primacy of social spending in bad times. At a very preliminary level, such finding runs against a (successful) push toward investment during the negative cycle arising from the EU economic governance framework.

Table 7. 2 - variation in the impact of EDP surveillance on investments and transfers across the cycle

	(1) Δ investment	(2) Δ investment (restricted)	(3) Δ transfers
EDP	-0.416*	-0.186***	-0.204
	(0.220)	(0.0709)	(0.136)
crisis	1.202***	0.674***	1.295***
	(0.463)	(0.174)	(0.313)
EDP#crisis	-1.409***	-0.672***	-1.262***
	(0.537)	(0.172)	(0.320)
ideology	0.00770	-0.000167	0.000213
	(0.00715)	(0.00217)	(0.00365)
ideological distance	-3.65e-06	0.000186	-4.00e-05
	(0.00113)	(0.000337)	(0.000530)
alternation	-0.00127	-0.000485	-0.00181*
	(0.00161)	(0.000492)	(0.00102)
Δ unemployment rate	0.195**	0.118***	0.500***
	(0.0823)	(0.0305)	(0.0557)
Δ old-age dependency rate	-0.143	-0.0505	0.142
	(0.249)	(0.0915)	(0.170)
decentralisation	0.0197	0.0346	-0.0424
	(0.0645)	(0.0241)	(0.0408)
national fiscal rule preferences	-0.102	0.0158	-0.0873
	(0.191)	(0.0557)	(0.107)
Constant	0.378	0.0949	0.124
	(0.231)	(0.0831)	(0.163)
Observations	267	267	267
R-squared	0.106	0.267	0.478
Number of countries	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs) Standard errors in parentheses			
*** p<0.01, ** p<0.05, * p<0.1			

Shifting the focus to the cross-cyclical impact of the EDP some divergences also emerge, even if within the common trends of a negative and significant interaction indicating a further restraining effect of the supranational fiscal rule in bad times, as shown in Table 7. 2. Starting from investment, the EDP is significant across the full sample, albeit with a limited impact amounting to one-third of a standard deviation. The additional in-crisis EDP derived restraint of -1.41 (about one standard deviation) more than compensate the 1.2 recession-driven expansionary push. Considering instead the restrictive specification, overall patterns do not change except for the latter dimension. To the overall -0.19 EDP impact (about 40 per cent of a standard deviation) corresponds a recessionary upward pressure of 0.67, barely matched by the parallel additional leash of the supranational fiscal rule, amounts to nearly one and a half standard deviation. Regardless of the minimal cross-specification distinction, the key divergence between investment and transfers concerns what happens in good times. In fact, for transfers, the EDP is not significant across the full sample, rather concentrating its restraining force only in the negative phase of the cycle. Additionally, the in-crisis-EDP impact of -1.26 (well over one standard deviation) falls quite short of compensating for the 1.30 recession-driven expansionary pressure. Comparatively, investment does not only seem to have the worst of the EDP restraint in the negative phase of the cycle but is also disproportionally penalised in good times.

A further element of (sharp) divergence emerges across core and periphery. Firstly, for investment, to the limited overcompensation of the additional crisis-driven EDP restraint over the recessionary expansion pressure in the core, correspond a considerably more dramatic overshooting in the periphery, respectively amounting to -1.41 (1.5 standard deviations) vs 1.32 in the core and -2.46 (over two standard deviations) vs 1.82 in the periphery. For transfers, divergences are not limited to the relative size of the impact. While in the core the EDP assumes a significant negative impact over the full sample, the opposite directional effect emerges in the periphery: countries with excessive deficit display overall increasing trends in transfers. Specifically, the impact of the EDP on transfers outside of crisis years in the periphery is positive and significant, amounting to 0.28, which corresponds to slightly above one-third of a standard deviation. However, the ranking of the restraining force of the EDP reverses in crisis. In the core, the additional bite of -1.10 (over one standard deviation) falls quite short of the recessionary upward pressure of 1.42. Conversely, in the periphery the crisis-enhanced EDP impact of -1.46 (well over 1.5 standard deviations) more than compensate the expansionary effect of the recession of 1.42. That is to say, that while it remains the case that investment is more impacted during the Great Recession, this is especially the case in the periphery. Additionally, within macro-categories, the periphery is always the area where the supranational fiscal rule yields the most pro-cyclical dynamics, in both instances more than compensating away the crisis hunger for expansionary fiscal policy.

Table 7. 3 - variation in the impact of the EDP on investments and transfers across the cycle in the core and periphery

	(1)	(2)	(3)	(4)
	Δ investment (core)	Δ investment (periphery)	Δ transfers (core)	Δ transfers (periphery)
EDP	-0.138	-0.0598	-0.268**	0.261*
	(0.166)	(0.268)	(0.132)	(0.151)
crisis	1.319***	1.818**	1.421***	1.416***
	(0.390)	(0.736)	(0.391)	(0.297)
EDP#crisis	-1.406***	-2.459***	-1.098***	-1.456***
	(0.385)	(0.800)	(0.385)	(0.361)
ideology	0.000192	-0.0154*	0.00306	0.00269
	(0.00671)	(0.00880)	(0.00431)	(0.00476)
ideological distance	0.000260	4.50e-05	-0.000243	-0.000296
	(0.00120)	(0.00107)	(0.000534)	(0.000547)
alternation	0.000496	-0.00226	0.0129	-0.00188*
	(0.0106)	(0.00156)	(0.00940)	(0.00108)
Δ unemployment rate	0.307**	0.107	0.571***	0.366***
	(0.123)	(0.0845)	(0.117)	(0.0455)
Δ old-age dependency rate	-0.178	-0.429	0.242	-0.267
	(0.186)	(0.339)	(0.161)	(0.233)
decentralisation	0.0442	-0.0544	-0.0466	-0.00257
	(0.0878)	(0.122)	(0.0434)	(0.0776)
national fiscal rule preferences	0.0269	0.147	-0.169	-0.276**
	(0.182)	(0.221)	(0.136)	(0.125)
Constant	0.0481	0.129	-0.0596	0.229
	(0.223)	(0.286)	(0.195)	(0.177)
Observations	132	93	132	93
R-squared	0.226	0.196	0.444	0.589
Number of countries	7	6	7	6
Linear regression, correlated panels corrected standard errors (PCSEs) Standard errors in parentheses				
*** p<0.01, ** p<0.05, * p<0.1				

Implications

Starting from the most general considerations, the analysis in addressing RQ[2.B] confirms varied patterns across the cycle and expenditures types, which may be summarised as a generally increasing negative impact of the EDP in bad times, varying in the extent to which the latter compensates the recessionary pressure on the budget. However, the divergence in the ranking of the type of expenditures penalised in times of crisis does not follow the nominal objectives of the EU economic governance framework. The hypothesis under assessment is not confirmed. Conversely, findings reject the claim that the supranational fiscal rule pushes towards an investment rich recovery proportionally constraining preferably transfers.

Indeed, the restraint of the EDP does not seem to favour investment nor does the free-riding dimension of the SGP concentrate on this category. Rather, the EDP fully cancels away the crisis for investment while that is not the case for transfers. Even distinguishing across core and periphery, the better positioned Member States still display such distinction, with an additional in-crisis-effect of the EDP more than compensating the recessionary pressure for investment, while falling well short of that for transfers. While periphery countries see overcompensation across both categories of expenditures, the relative size of the in-crisis additional EDP impact is larger for investment, which displays a substantial overshooting gap over the recessionary pressure: if transfers for periphery countries are fully contained, investment is the category which is penalised the most in response to the pressure for consolidation.

However, this is not to say that transfers are not negatively affected by the EDP. Comparing the interaction effect with the upward push of the crisis, one can see their containment as coming to 97 per cent over the full sample of Eurozone countries, surpassing 103 per cent for the Member States at the periphery and still coming to 73 per cent even in the core. That is to say that the EDP substantially, when not fully, interferes with fiscal adjustments in the negative cycle. While not the topic for this it is highly indicative that the overcompensation trend remains even in an area which is at the heart of stabilisation in a recession. The in-crisis dynamics show the opposite trend: while transfers remain largely unaffected in good times, they become the target of the EDP axe in the negative phase of the cycle, constraining their adjustment to the needs of the crisis.

Looking at the cross-cycle trend for investment, the increased restraint of the EDP in crisis does not imply the shielding in good times, unlike transfers. Conversely, a negative and significant pressure remains over the full cycle both for the restrictive and generous specifications of investment. It is of value to note a partial divergence across the two specifications along with the intuition that one may derive. The overcompensation arising in the generalised specification does not remain in the restrictive one indicating that defence, public order, economic and environmental affairs, together with housing may be the prime target of consolidation relatively to R&D, basic research, health and education.

Conversely to policy objectives and the prescriptions for optimal fiscal policy choices – especially in times of crisis – of devoting part of the stimulus to counter the cycle to investment to sustain a positive growth trend, the EU economic governance framework acts in the opposite direction. From this perspective, an optimal course of action in terms of adjustment of the budget structure to promote investment may be indicated to Member States – for example concerning spending on education as emerged from the CSRs in chapter five. The indirect effect on the national fiscal policy mix through the imposition of a budget constraint dictated by the supranational fiscal rule, however, translates into suboptimal trends in allocations across investments and transfers. Furthermore, such problematic indirect effect of the SGP is not limited to bad times as investment is the primary recipients of the EU economic governance contraction bind over the full cycle. Conversely, the reduction (or rather restraint) of transfers is treated as a last resort, only taking place in bad times and on a higher scale for the worst positioned periphery countries compared to the core.

7.2 The Great recession, the EDP and inequality

Having compared the effect of the EDP across investment and transfers, a further classification can aid in deriving implications of the in-crisis impact of the supranational fiscal rule, at the same time concluding the assessment of the relative penalisation across investment and the other macro-categories of expenditures. Additionally, within the arena of inequalities, another element of interest concerns the intergenerational distributional impact of the EU economic governance framework, in considering if expenditures catering to the younger or elderly cohort are affected to a different extent.

In parallel with section one, the analysis proceeds to consider the cross-cycle impact on inequality mitigating spending of the SGP and EDP, distinguishing for the latter between core and periphery. Additionally, the subsamples of inequality-correcting-measures aimed at the two extremes of the age distribution are considered. In doing so model specifications are unchanged with the sole exception of the dependent variable(s) adapted to the macro-category of expenditures under consideration and its sub-components. Table 7. 4 below recalls the groups contributing to each of the three dependent variables.

Table 7. 4 - COFOG division and group level classification of public expenditures across inequality and its intergenerational subcomponents

Division	Group	Elderly	Youth	Inequality
Health	Medical products, appliances and equipment			
	Outpatient services			
	Hospital services			
	Public health services			
	R&D Health			
	Health n.e.c.			
Education	Pre-primary and primary education			
	Secondary education			
	Post-secondary non-tertiary education			
	Tertiary education			
	Education not definable by level			
	Subsidiary services to education			
	R&D Education			
	Education n.e.c.			
Social protection	Sickness and disability			
	Old age			
	Survivors			
	Family and children			
	Unemployment			
	Housing			
	Social exclusion n.e.c.			
	R&D Social protection			
	Social protection n.e.c.			

Descriptive analysis

Inequality addressing measures consist of both investments and transfers, thus incorporating dimensions which take different cross-cyclical patterns. Dynamics at the level of this macro-category offer a picture of the overall net effect for spending directed at reducing inequality across both investment and transfers. Table 7. 5 below offers a preliminary overview of trends and where the overall effect on inequality falls for the categories analysed in the previous section. While inequality addressing spending increases in crisis, such a trend is more marked for countries not under FAP rather than those receiving financial assistance, as for investment. Similarly, the further lowering of means among countries under EDP is more marked for those outside rather than inside the Euro area. Within the non-FAP Eurozone subgroup, the overall in crisis average of changes in this macro-area of 0.89 rises to 2.11 for countries not under EDP, while falling to 0.33 for those under the EDP. Unlike investment, however, the direction of changes in spending on inequality remains in the positive even for countries under EDP.

Table 7. 5 - Descriptive statistics for inequality

	non-crisis					crisis				
Δ inequality	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
	554	-.0527076	.9600906	-5.9	5.7	84	.7202381	1.93626	-3	6.5
	crisis, excluding FAP					crisis, under FAP				
	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
	72	.7694444	1.93257	-3	6.5	12	.425	2.017706	-2.4	5.6
	crisis, excluding FAP, under EDP, outside Eurozone					crisis, excluding FAP, under EDP, Eurozone				
	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
	16	.05	2.180826	-3	6.5	31	.3354839	1.193747	-1.5	3.6

Overall inequality already preliminarily seems to follow more closely the path of investment. However, it remains to determine whether the intergenerational distribution of spending is aligned and homogeneous across the age-groups. Spending catered to young people in the Eurozone – as usual excluding FAP – increases on average by 0.1 percentage points of GDP, jumping to 0.38 for countries in the preventive arm while falling to -0.03 for those under EDP. Unlike the broader inequality addressing macro-type, the shift in spending for countries under EDP is not just restrained to some extent, but fully switched to the negative side indicating an overall reduction in spending on youth. The same is not the case for expenditures catered to the elderly population. In this context, the average increase of 0.40 GDP percentage points in crisis jumps to 0.65 outside of the EDP, limited to only 0.29 for countries under the corrective arm. While the EDP is associated with a lower increase in spending the direction is not reversed toward the negative side for spending associated with old-age.

The preliminary descriptive overview shows that (i) inequality follows the path of investment, being more penalised than transfers. However, (ii) not all spending is treated equally within this domain with intergenerational divergences which indicate (iii) young people are the most penalised with conversely (iv) the elderly population partially escaping the restraints of the EDP.

Results

Starting from the cross-cycle impact of the SGP, inequality addressing expenditures follow the path of transfers rather than investment. A cyclical change in the impact of the SGP emerges for the Eurozone with a positive and significant interaction coefficient of 0.59, amounting to 60 per cent of a standard deviation. A free-riding effect of the SGP is recorded for inequality related expenditures, which however is concentrated in the negative phase of the cycle.

Shifting the focus to the EDP in the Eurozone, inequality remains aligned with transfers with the additional negative impact of the corrective arm during the negative phase of the cycle not fully compensating for the upward pressure of the crisis. However, it mirrors investment with its significance remaining across the full cycle and not just during crisis years. The overall impact of the EDP of -0.40 is increased by -1.50 percentage points of GDP in the negative phase of the cycle (about 1.5 standard deviations), falling short of the recession expansionary push of 1.54, as shown in Table 7. 6. In the cycle sub-samples, it corresponds to an impact of the EDP of just -0.28 (one-third of a standard deviation) in good times, compared to -2.09 (well over a standard deviation). If on one side inequality is more impacted than transfers, with consolidation taking place also in good times, the cyclical impact of the supranational fiscal rule does not reach the overcompensation to which investment is subjected.

Core-periphery dynamics confirm the overall patterns in the relative strength of the recessionary expansion and EDP additional constraint. However, substantial differences emerge in how much of a positive gap escape the chains of the supranational fiscal rule. While in neither subsample the overall impact of the EDP is significant, divergences arise both in the impact of the recession and its compensation. In the periphery, countries in the corrective arm barely fall short of compensating the 1.79 upward pressure with an interaction of -1.78 (140 per cent of a standard deviation). Conversely in the core, the lower recessionary expansion of 1.70 is far from fully compensated by the additional in-crisis impact of the EDP stopping at -1.47 (only 80 per cent of a standard deviation). The additional impact of the EDP is lower in the core than in the periphery, with the first controlling away 'only' 86 per cent of the impact of the recession, compared to 99 per cent in the periphery.

Table 7. 6 - variation in the impact of EDP surveillance on inequality related spending across the cycle in the Eurozone, the core and the periphery

	(1)	(2)	(3)
	Δ inequality	Δ inequality (core)	Δ inequality (periphery)
EDP	-0.397***	-0.193	-0.205
	(0.132)	(0.185)	(0.156)
crisis	1.538***	1.787***	1.701***
	(0.357)	(0.485)	(0.447)
EDP#crisis	-1.502***	-1.779***	-1.470***
	(0.322)	(0.517)	(0.445)
ideology	0.00129	-0.00521	0.00531
	(0.00401)	(0.00548)	(0.00497)
ideological distance	-0.000377	-0.00174	-0.000391
	(0.000685)	(0.00463)	(0.000696)
alternation	-0.00168***	-0.00271***	0.0154
	(0.000651)	(0.000824)	(0.0103)
Δ unemployment rate	0.484***	0.265***	0.635***
	(0.0611)	(0.0544)	(0.128)
Δ old-age dependency rate	0.0632	-0.180	-0.0158
	(0.189)	(0.259)	(0.194)
decentralisation	0.0184	0.00774	0.0100
	(0.0480)	(0.0784)	(0.0534)
national fiscal rule preferences	-0.0737	-0.0259	-0.152
	(0.109)	(0.139)	(0.153)
Constant	0.310*	0.423**	0.121
	(0.180)	(0.204)	(0.225)
Observations	279	84	140
R-squared	0.440	0.535	0.438
Number of countries	19	6	7
Linear regression, correlated panels corrected standard errors (PCSEs) Standard errors in parentheses			
*** p<0.01, ** p<0.05, * p<0.1			

Table 7. 7 - variation in the impact of EDP surveillance on the intergenerational dimensions of inequality related spending across the cycle

	(1)	(2)
	Δ youth expenditure	Δ old-age expenditures
EDP	-0.149***	-0.0339
	(0.0395)	(0.0589)
crisis	0.308***	0.439***
	(0.109)	(0.127)
EDP#crisis	-0.277***	-0.385***
	(0.101)	(0.117)
ideology	-0.000638	0.00201
	(0.00121)	(0.00171)
ideological distance	-0.000139	-0.000143
	(0.000252)	(0.000259)
alternation	-0.000120	-0.000936*
	(0.000282)	(0.000493)
Δ unemployment rate	0.0675***	0.181***
	(0.0176)	(0.0218)
Δ old-age dependency rate	0.00860	0.0786
	(0.0493)	(0.0747)
decentralisation	0.0198	-0.00945
	(0.0167)	(0.0234)
national fiscal rule preferences	0.00933	-0.0902**
	(0.0348)	(0.0445)
Constant	0.0136	0.151**
	(0.0485)	(0.0683)
Observations	267	267
R-squared	0.220	0.362
Number of countries	19	19

Linear regression, correlated panels corrected standard errors (PCSEs)
Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

For intergenerational divergences, there is a clear ranking of who is worse impacted by the EDP across the two tails of the age distribution. For expenditures strictly catering youth, the EDP is significant across the full sample, thus restraining addressing inequality for this age-group both in good and bad times. Nevertheless, the bite of the EDP increases by -0.28 (one standard deviation) in the negative phase of the cycle, compared to a 0.31 impact of the crisis. Looking at the elderly population, the EDP is not significant overall, while its cross-cycle additional impact amounts to -0.39 (0.8 standard deviations), compared to the upward pressure from the recession of 0.44. Divergences across core and periphery are even more marked in the intergenerational distribution of inequality mitigation. Firstly, for youth, in both sub-samples, the overall EDP impact on youth spending is not significant. Previously emerged patterns are confirmed in the periphery, with an interaction of -0.44 and a crisis impact of 0.51. Conversely, full compensation takes place in the core, with an interaction and crisis effect both equal to 0.37 in absolute value. The opposite is the case in the core for elderly-related expenditures for which the interaction is not significant, while there is a modest cycle-stable impact of the EDP of -0.12 (about one-fifth of a standard deviation). In the periphery, however, the cross-cycle variation in the EDP impact remains with an interaction of -0.52 (well over a standard deviation) against a crisis effect of 0.65. That is to say that while in the periphery the usual approach of containment in crisis emerges, in the core there is a continuous non-cycle specific consolidation effort that allows for the recession to run its course.

Table 7. 8 - variation in the impact of EDP surveillance on the intergenerational dimensions of inequality related spending across the cycle in the core and periphery

	(1)	(2)	(3)	(4)
	Δ youth expenditure (periphery)	Δ youth expenditure (core)	Δ old-age expenditure (periphery)	Δ old-age expenditure (core)
EDP	0.105	-0.117*	-0.0731	-0.0470
	(0.100)	(0.0621)	(0.0699)	(0.0443)
crisis	0.648***	0.427**	0.512***	0.368***
	(0.210)	(0.180)	(0.163)	(0.122)
EDP#crisis	-0.518**	-0.279	-0.445***	-0.373***
	(0.204)	(0.184)	(0.159)	(0.118)
ideology	0.00297	0.00298	-0.00532**	0.00155
	(0.00313)	(0.00221)	(0.00216)	(0.00144)
ideological distance	-0.00565*	-0.000120	0.00112	-0.000167
	(0.00334)	(0.000314)	(0.00267)	(0.000217)
alternation	-0.00107*	0.00270	-0.000362	0.00348
	(0.000619)	(0.00482)	(0.000295)	(0.00307)
Δ unemployment rate	0.0888***	0.247***	0.00611	0.0501
	(0.0238)	(0.0512)	(0.0194)	(0.0355)
Δ old-age dependency rate	-0.200	0.133	-0.0816	-0.0367
	(0.151)	(0.0812)	(0.0869)	(0.0527)
decentralisation	-0.0337	-0.0218	0.0113	0.0140
	(0.0520)	(0.0196)	(0.0325)	(0.0174)
national fiscal rule preferences	-0.139*	-0.133**	0.0273	0.0182
	(0.0740)	(0.0629)	(0.0638)	(0.0423)
Constant	0.320***	0.144	-0.0149	-0.0400
	(0.104)	(0.0941)	(0.0738)	(0.0667)
Observations	80	132	80	132
R-squared	0.413	0.334	0.253	0.244
Number of countries	6	7	6	7
Linear regression, correlated panels corrected standard errors (PCSEs) Standard errors in parentheses				
*** p<0.01, ** p<0.05, * p<0.1				

Implications

The cross-cycle dynamics of the impact of the EU economic governance framework on inequality falls in between those of transfers and investments. Alike transfers, they are a prime target for free-riding off of the EMU within the Eurozone. Similarly, overall within the Eurozone, the recessionary pressure is not completely controlled away by the tightening of the EDP leash on national government spending. On the opposite side of the spectrum, consolidation in this area – alike investment – is not limited to bad times. While the negative impact skyrockets during the crisis, a significant constraining effect emerges over all phases of the cycle. Core-periphery patterns diverge in the length of the leash that is left for the recession by the increased grip of the EDP, penalising the most periphery countries, which at the same time are hit the hardest by the negative cycle.

Core-periphery divergencies are even more marked in the intergenerational distribution of national measure to counter inequality. The youth-elderly ranking of restrictions over the full sample indicates clear winners and losers. The EDP – reinforced in crisis – always displays a significant restraint of spending for youth, and comparatively a sharper increase in the restraint during the recession compared to spending for the elderly population. The latter is also not significantly hit by the EDP over the full sample, although the cross-cycle impact is indeed significant. If the periphery mirrors those overall trends, the core departs from them on both accounts. Youth spending is hit with additional restraints during bad times, fully cancelling away the recession, while for old-age there is no in-crisis change in the impact of the EDP – which is pushed toward consolidation across the cycle. It is somehow less straightforward to determine who is most impacted within the core between young at old people at first sight. However, the non-cyclical impact of the EDP on spending for the elderly is modest and the recession is allowed to run its course for this category of expenditures, while fully restrained for spending towards the younger generation indicating that the latter may remain the losers of the intergenerational fiscal struggle.

The overall picture that emerges for inequality confirms the rejection of [HP2.B] as inequality-mitigation spending is not worse impacted than investments. However, as for transfer, that is not to say that there is not a substantial EDP push towards consolidation during the crisis. While investment tops the podium for the supranational fiscal rule consolidation drive, inequality shortly follows and even the third-runner of transfers has a remarkable constraining performance. The implication is that while the policy objective of favouring investment – just as a counter-cyclical approach – is violated in practice, the negative impact on inequality and welfare of in-crisis-EDP is evidenced as well, in line with the criticisms of the EU economic governance framework during the Great Recession and Eurozone crisis within the literature. From this perspective, it is of little consolation that slashing of investments comes first to that of transfers and inequality mitigation. Furthermore, the intergenerational trends indicate a further penalisation of youth compared to the elderly population. The evidence of substantial distributional divergencies within macro-areas opens the scene for the in-depth analysis of social spending dynamics in the next section.

7.3. EDP-in-crisis: social butchering during the Great Recession?

What the EDP did to social spending and its component during the Great Recession is an area of key interest as the target for extensive criticism for the EU economic governance framework crisis management. The social cost of austerity policies imposed by the supranational fiscal rule has been long debated, with the push toward consolidation of domestic spending hardly escaping the largest budget component of social spending (Heins & De La Porte, 2015). In the EMU infrastructure restraining deficits and debt and correcting imbalances through consolidations take priority and harsh enforcement mechanism, leaving social concerns to the margin, even in times of crisis (Heins & De La Porte, 2015). The restraint on the fiscal policy of the Member States deriving from the supranational fiscal rule paired with the lack of common instruments for EU-wide response has been linked with staggering high level of unemployment, especially in the periphery with countries in healthier fiscal shape better able to cater to the domestic social and economic needs (Cameron, 2013). In this context, southern economies have seen the worst of the consolidation pressure, even excluding countries under programmes, leading to dire consequences for social spending through welfare retrenchment taking place, for example, in Italy and Spain (Pavolini et al., 2015).

Given the worrisome dynamics that have emerged during the Great Recession, it is of interest to consider the link between the EDP and social spending, together with its cross-cycle and geographical distinctions. In doing so, this section tests the last in-crisis hypothesis on the detrimental role of the supranational fiscal rule for social spending during the Great Recession. At the same time, all social spending is not equal in terms of outcomes and distributional consequence. The intergenerational divergencies in the allocation of the in-crisis social cost of the EU economic governance make the case for a close analysis of trends at the disaggregated group level. Model specifications are adapted to include the dependent variable(s) addressing the sub-question at hand. The analysis commences at the aggregate division level, considering cross-cycle variation overall and in the core-periphery sub-samples, before turning to the group level dynamics and their implications.

Descriptive analysis

Table 7. 9 below shows division level aggregate cross-cycle dynamics. Social protection displays a positive trend during the Great Recession compared to non-crisis years, with an average decrease of -0.07 in good times compared to an increase 0.55 in bad times. Overall, the emerging pattern is that of an increase in social expenditures in crisis years. However, this pattern is less marked for Programme countries (0.41), than those not under financial assistance (0.58), while the opposite is true across Eurozone (0.65) and non-Euro area countries (0.46). Taking a closer look at dynamics across the preventive and corrective arm during the crisis, the divergence is substantial, with those not having an excessive deficit seeing average yearly increases above one (1.19) compared to those under the corrective arm with a much more restrained mean of 0.28. Across the Member States with an excessive deficit (excluding programme countries) means are higher in the Eurozone (0.33) compare to those outside of the Euro area (0.11).

Table 7. 9 - Overall social expenditure across crisis, FAP, Eurozone membership and corrective arm

	non-crisis		crisis		crisis, excluding FAP		crisis, under FAP		crisis, excluding FAP, under EDP, outside Eurozone		crisis, excluding FAP, under EDP, Eurozone	
	N	mean	N	mean	N	mean	N	mean	N	mean	N	mean
Δ social protection	554	-0.0713	84	0.554	72	0.578	12	0.408	16	0.106	31	0.326

Turning to group-level indicators for which descriptive statistics are presented in Table 7. 10 below, trends are homogeneous when comparing good and bad times, with all social protection groups displaying higher average during the crisis, with the sole exception of non-classified social protection. In seven out of the nine groups, the sign is reversed turning from a contraction to an expansion. In the remaining ones the mean increases through the slowing of the reduction of spending in the budget lines. Comparing within crisis years countries falling under a Programme to those that do not receive financial assistance, patterns are not univocal. Averages turn negative for sickness and disability, housing as well as social exclusion, and more generally decrease for survivors and unemployment. The opposite is the case for old-age, family and children, as well as non-classified expenditures. Considering only non-programme countries, the picture is also mixed across Eurozone insiders and outsiders. If for the latter a negative sign is retained for sickness and disability and one emerges for survivors, the same is not the case across both groups for Euro area countries. Means are also higher for old-age and unemployment while the opposite occurs for family and children, as well as housing, social exclusion and non-classified social protection expenditures, with the mean turning negative for the latter.

Table 7. 10 - Social protection group expenditure across crisis, FAP, Eurozone Membership and corrective arm

Variable	non-crisis		crisis		crisis, excluding FAP		crisis, under FAP		crisis, excluding FAP, under EDP, outside Eurozone		crisis, excluding FAP, under EDP, Eurozone	
	Obs	Mean	Obs	Mean	Obs	Mean	Obs	Mean	Obs	Mean	Obs	Mean
Sickness and disability	485	-.0086598	84	.0071429	72	.0152778	12	-.0416667	27	-.0814815	45	.0733333
Old age	485	-.0086598	84	.3666667	72	.3527778	12	.45	27	.3259259	45	.3688889
Survivors	485	-.0096907	84	.0166667	72	.0194444	12	0	27	-.0037037	45	.0333333
Family and children	485	-.0018557	84	.0464286	72	.0430556	12	.0666667	27	.0555556	45	.0355556
Unemployment	485	-.0410309	84	.0904762	72	.0902778	12	.0916667	27	.0740741	45	.1
Housing	485	-.0053608	84	-.002381	72	.0069444	12	-.0583333	27	.0111111	45	.0044444
Social exclusion n.e.c.	485	.0039175	84	.0404762	72	.0555556	12	-.05	27	.0703704	45	.0466667
R&D Social protection	485	-.0002062	84	0	72	0	12	0	27	0	45	0
Social protection n.e.c.	485	-.0070103	84	-.0107143	72	-.0069444	12	-.0333333	27	.0185185	45	-.0222222

As already highlighted by the heat-map of cross-cycle EDP impact, social spending is not an area within which trends are homogeneous. However, in highlighting preliminary patterns descriptive dynamics overall and for several groups are compatible with an EDP-derived restraining of the expansion of welfare spending during the Great Recession.

Results

Starting from the cross-cycle impact of the SGP, as expected social spending follows the path of transfers rather than investment. A cyclical change in the impact of the SGP emerges for the Eurozone with a positive and significant interaction coefficient amounting to 0.33, nearly half of a standard deviation. A free-riding effect of the SGP is recorded for welfare policies, however, concentrated in the negative phase of the cycle. Shifting the focus to the EDP, as emerged in chapter six, the always-significant impact of the EDP of -0.20 percentage points of GDP further increases by -0.94 percentage points during the Great Recession (well over one standard deviation). It falls, however, short of the positive impact of the crisis on social spending of 0.97. That amounts to an EDP impact during the sub-sample of the negative cycle of -1.22 percentage points of GDP. As shown in Table 7. 11, the geographical patterns are somewhat homogenous for the division level budget component, with however a substantial difference in the extent to which the increased restraint of the EDP compensates for the recessionary pressure on social expenditures. While in the core the extra push towards the consolidation of the corrective arm erases 'only'

83 per cent of the expansionary pressure of the recession, the proportion rises to 95 per cent in the periphery. At the aggregate level, findings provide some backing to the hypothesis of the EDP worsening the social cost of the Great Recession within the Eurozone, even more markedly for weaker periphery economies.

Table 7. 11 - cross-cycle variation in the impact of the EDP on social protection spending overall and across core and periphery

	(1)	(2)	(3)
	Δ social protection	Δ social protection (periphery)	Δ social protection (core)
EDP	-0.201**	0.0109	-0.174*
	(0.0835)	(0.106)	(0.105)
crisis	0.967***	1.115***	1.064***
	(0.218)	(0.232)	(0.294)
EDP#crisis	-0.936***	-1.058***	-0.883***
	(0.201)	(0.261)	(0.300)
ideology	0.00104	0.00168	0.00139
	(0.00253)	(0.00337)	(0.00317)
ideological distance	-0.000395	-0.00436	-0.000278
	(0.000448)	(0.00317)	(0.000481)
alternation	-0.00120**	-0.00172***	0.00978
	(0.000518)	(0.000630)	(0.00688)
Δ unemployment rate	0.368***	0.228***	0.500***
	(0.0378)	(0.0278)	(0.0849)
Δ old-age dependency rate	0.0781	-0.229	0.0933
	(0.117)	(0.162)	(0.130)
decentralisation	-0.00174	-0.0139	0.00926
	(0.0286)	(0.0519)	(0.0304)
national fiscal rule preferences	-0.0909	-0.0534	-0.180*
	(0.0726)	(0.0799)	(0.0987)
Constant	0.214*	0.359***	0.0784
	(0.110)	(0.121)	(0.144)
Observations	279	84	140
R-squared	0.497	0.652	0.473
Number of countries	19	6	7
Linear regression, correlated panels corrected standard errors (PCSEs) Standard errors in parentheses			
*** p<0.01, ** p<0.05, * p<0.1			

It remains to assess whether patterns are homogeneous across budget lines within the social spending division. The heat-map presented in chapter six highlighted how it is not the case, calling for a closer investigation of disaggregated dynamics to pinpoint at the granular level how social allocations are affected by the EU economic governance during the negative phase of the cycle. Only two groups fail to display any significant impact of the EDP, namely housing and R&D, while one group – non-classified social exclusion – does not display a cross-cyclical changing impact of the corrective arm, with a modest stable effect amounting to one-fourth of a standard deviation. The remaining fall across two broad categories. On one side, in addition to the significance of the interaction coefficient, the EDP is significant overall or at least overcompensates for the impact of the crisis for three budget lines. On the other side, there are three budget lines – to some extent more mildly impacted – for which that is not the case. Starting from the latter, the budget items relate to pensions covering old-age, survivors and sickness and disability, for which regression results are shown in Table 7. 12. In none of the three instances does the increased in-crisis impact of the EDP match the recession expansionary pressure on spending. Comparatively, sickness and disability display the sharpest containment (91 per cent), followed by old-age (88 per cent), with survivors as the least mitigated (84 per cent). However, the interaction effect only amounts to 60 per cent of a standard deviation for sickness, raising to 81 per cent to old age and 86 per cent for survivors, reversing the ranking in terms of the additional impact of the EDP per se.

Table 7. 12 - cross-cycle variation in the impact of the EDP on pensions

	(1)	(2)	(3)
	Δ sickness & disalbility	Δ old-age	Δ survivors
EDP	-0.0359	-0.0225	-0.0114
	(0.0231)	(0.0557)	(0.00876)
crisis	0.118**	0.376***	0.0634***
	(0.0543)	(0.122)	(0.0144)
EDP#crisis	-0.107*	-0.329***	-0.0561***
	(0.0628)	(0.113)	(0.0187)
ideology	-0.000422	0.00178	0.000236
	(0.000914)	(0.00162)	(0.000294)
ideological distance	2.33e-05	-6.37e-05	-7.98e-05
	(9.70e-05)	(0.000236)	(5.50e-05)
alternation	-0.000177	-0.000776*	-0.000161
	(0.000167)	(0.000411)	(0.000106)
Δ unemployment rate	0.0328***	0.160***	0.0211***
	(0.0107)	(0.0206)	(0.00361)
Δ old-age dependency rate	-0.0486	0.0927	-0.0141
	(0.0346)	(0.0715)	(0.0101)
decentralisation	0.00981	-0.00189	-0.00756*
	(0.00925)	(0.0235)	(0.00458)
national fiscal rule preferences	-0.0111	-0.0835**	-0.00677
	(0.0246)	(0.0418)	(0.00781)
Constant	0.0424	0.136**	0.0147*
	(0.0283)	(0.0658)	(0.00852)
Observations	267	267	267
R-squared	0.123	0.324	0.289
Number of countries	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs) Standard errors in parentheses			
*** p<0.01, ** p<0.05, * p<0.1			

Concerning geographic heterogeneity, pension spending displays diverging patterns across core and periphery, as shown in Table 7. 13 which displays regression for which either the overall or cyclical EDP coefficient is significant. The overall dynamics are confirmed in the weaker Member States, however, with a substantially increasing containment skyrocketing from 60 to 88 per cent and an interaction effect well surpassing one standard deviation. The same is not the case in the core of the Eurozone, for which no significant cross-cycle or overall effect of the EDP emerges for sickness and disability spending. Divergences also emerge for old-age. However, in this case, there is a significant effect of the EDP, which does not change across the cycle. Additionally, the impact amounts to barely one-third of a standard deviation and even less compared to the expansionary pressure of the recession. The periphery, on the other hand, maintains the usual pattern of a significant interaction amount to nearly one standard deviation and 74 per cent of the upward push of the crisis. Dynamics for survivors across the core and periphery mimic those of sickness and disability, with no significant impact emerging in the core. Conversely, overall patterns are confirmed in the periphery where the interaction effect is significant and overcompensates for the expansionary pressure of the recession.

Table 7. 13 - Core-periphery significant impact of the EDP on pensions and its cross-cycle variation

	(1)	(2)	(3)	(4)
	Δ sickness & disability (periphery)	Δ old-age (periphery	Δ survivors (periphery)	Δ old-age (core)
EDP	-0.0193	0.0927	0.0121	-0.104*
	(0.0216)	(0.0941)	(0.0166)	(0.0605)
crisis	0.114**	0.524***	0.124***	0.375**
	(0.0524)	(0.194)	(0.0375)	(0.171)
interaction	-0.0979*	-0.387**	-0.131***	-0.239
	(0.0576)	(0.185)	(0.0424)	(0.181)
ideology	0.00151*	0.00250	0.000466	0.00295
	(0.000910)	(0.00278)	(0.000653)	(0.00205)
ideological distance	-0.00139	-0.00535*	-0.000295	-4.91e-05
	(0.000866)	(0.00295)	(0.000634)	(0.000291)
alternation	-0.000285**	-0.000910*	-0.000163	0.00281
	(0.000142)	(0.000528)	(0.000116)	(0.00473)
Δ unemployment rate	0.0111*	0.0686***	0.0202***	0.230***
	(0.00619)	(0.0223)	(0.00499)	(0.0487)
Δ old-age dependency rate	0.0122	-0.164	-0.0357	0.142*
	(0.0328)	(0.137)	(0.0285)	(0.0797)
decentralisation	0.0105	-0.0375	0.00382	-0.0141
	(0.0132)	(0.0475)	(0.0111)	(0.0198)
national fiscal rule preferences	0.0228	-0.124*	-0.0149	-0.126**
	(0.0218)	(0.0680)	(0.0146)	(0.0604)
Constant	-0.00170	0.294***	0.0255	0.142
	(0.0207)	(0.0977)	(0.0185)	(0.0935)
Observations	80	80	80	132
R-squared	0.229	0.366	0.382	0.311
Number of countries	6	6	6	7
Linear regression, correlated panels corrected standard errors (PCSEs)				
Standard errors in parentheses				
*** p<0.01, ** p<0.05, * p<0.1				

Table 7. 14 - cross-cycle variation in the impact of the EDP on family, unemployment and non-classified social policies

	(1)	(2)	(3)	(4)
	Δ sickness & disability (periphery)	Δ old-age (periphery	Δ survivors (periphery)	Δ old-age (core)
EDP	-0.0193	0.0927	0.0121	-0.104*
	(0.0216)	(0.0941)	(0.0166)	(0.0605)
crisis	0.114**	0.524***	0.124***	0.375**
	(0.0524)	(0.194)	(0.0375)	(0.171)
EDP#crisis	-0.0979*	-0.387**	-0.131***	-0.239
	(0.0576)	(0.185)	(0.0424)	(0.181)
ideology	0.00151*	0.00250	0.000466	0.00295
	(0.000910)	(0.00278)	(0.000653)	(0.00205)
ideological distance	-0.00139	-0.00535*	-0.000295	-4.91e-05
	(0.000866)	(0.00295)	(0.000634)	(0.000291)
alternation	-0.000285**	-0.000910*	-0.000163	0.00281
	(0.000142)	(0.000528)	(0.000116)	(0.00473)
Δ unemployment rate	0.0111*	0.0686***	0.0202***	0.230***
	(0.00619)	(0.0223)	(0.00499)	(0.0487)
Δ old-age dependency rate	0.0122	-0.164	-0.0357	0.142*
	(0.0328)	(0.137)	(0.0285)	(0.0797)
decentralisation	0.0105	-0.0375	0.00382	-0.0141
	(0.0132)	(0.0475)	(0.0111)	(0.0198)
national fiscal rule preferences	0.0228	-0.124*	-0.0149	-0.126**
	(0.0218)	(0.0680)	(0.0146)	(0.0604)
Constant	-0.00170	0.294***	0.0255	0.142
	(0.0207)	(0.0977)	(0.0185)	(0.0935)
Observations	80	80	80	132
R-squared	0.229	0.366	0.382	0.311
Number of countries	6	6	6	7
Linear regression, correlated panels corrected standard errors (PCSEs)				
Standard errors in parentheses				
*** p<0.01, ** p<0.05, * p<0.1				

Moving on to the second set of budget items shown in Table 7. 14, both family and children and unemployment policies display an overall and cyclical-significant impact of the EDP. That is not the case for non-classified social protection expenditures, whose additional EDP-in-crisis restraining effect, however, is more than double the upwards pressure of the Great Recession. The three lines are thus associated with an overall negative trend during the crisis. The relative impact of the interaction coefficient, however, varies amounting to one standard deviation for family and children policies, as well as non-classified expenditures, while not reaching 70 per cent for unemployment. The emerging picture is that of the restraining impact of the corrective arm biting especially in times of crisis. Even when the full model displays a significant EDP coefficient overall, distinguishing across the sub-samples indicates how the tightness of the supranational leash on social spending changes over the cycle. For example, for family and children to a modest impact of -0.045 in good times corresponds a more than fourfold downshift in spending of 0.185 in crisis.

To fully appreciate the in-crisis outcome of the emerged dynamics it may be of value to see intuitively what being under the preventive or corrective arm means for spending patterns in good and bad times for a variable of key interest in deriving broader social implications: unemployment. Figure 7. 1 shows the marginal effects across the cycle for Eurozone countries that do and do not fall under the EDP. Firstly, the direction of unemployment spending is always negative under the EDP, regardless of the cycle. That is to say that countries which are found in excessive deficit decrease allocation to this budget component. More remarkably, for those countries, there is full convergence across the cycle. While under the preventive arm there is a difference in unemployment spending dynamics in good and bad times, that is no longer the case under the EDP, where any upward pressure of the recession is controlled away by the supranational fiscal rule.

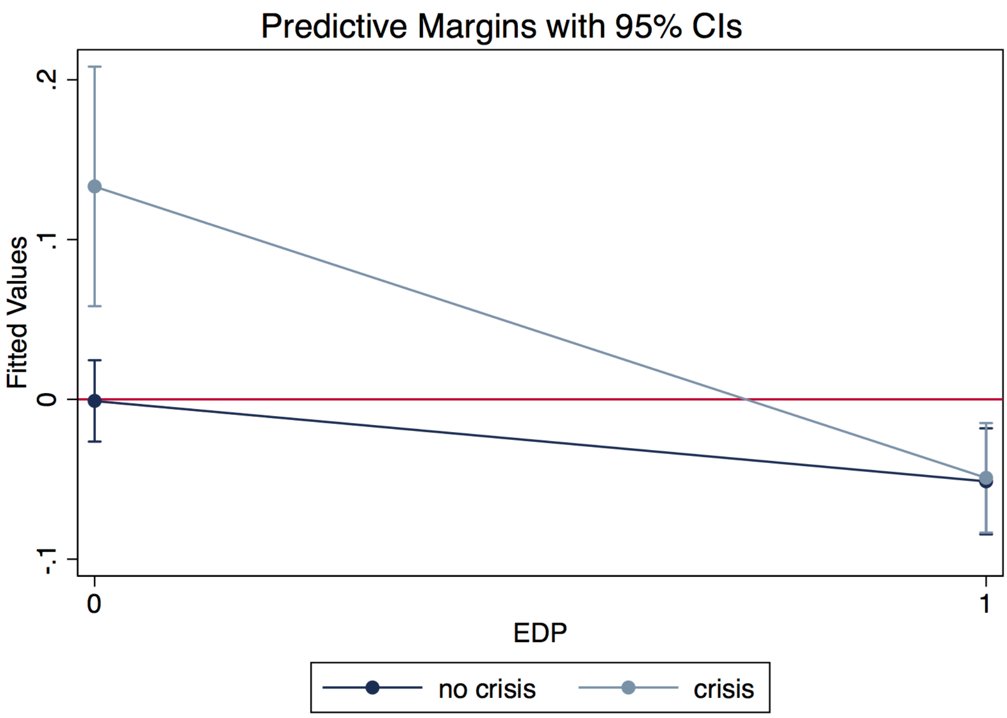


Figure 7. 1 - Changes in unemployment spending across the cycle and the EDP

Dynamics are not homogeneously distributed geographically, with changing trends across the three budget lines. Family and children is the only component for which cross-cycle spending is aligned. A significant interaction coefficient in both core and periphery overcompensates for the upward pressure of the crisis. The proportion of the effect is, however, more marked in the periphery, where the additional bite of the EDP-in-crisis amount to 124 per cent of that of the recession compared to the 115 per cent in the core. Likewise, while the interaction amounts to nearly two standard deviations in the periphery, it stops at 1.5 standards deviations in the core. Conversely, patterns diverge for unemployment and non-classified expenditures, in both cases differently from the dynamics emerged so far. In fact, for unemployment, it is the core which is aligned with overall dynamics of an EDP impact varying across the cycle whose additional in-crisis bite – amounting to over one standard deviation – compensates more than 95 per cent of the upward pressure of the recession. That is not the case in the periphery, for which the impact of the EDP on unemployment is not cycle-dependent and is rather significant over the full cycle, although modest amounting to just one-third of a standard deviation. An additional element to consider is that in the periphery the Great Recession itself does not play a role for unemployment spending dynamics, which other than the EDP are only affected by the unemployment rate. Finally, there is a clear reversal of geographical ranking for non-classified spending as significance is only achieved in the core – with an impact of the EDP which varies cross-cycle – and not in the periphery.

Table 7. 15 - Core-periphery significant impact of the EDP on family and unemployment benefits and its cross-cycle variation

	(1)	(2)	(3)	(4)
	Δ family & children (core)	Δ family & children (periphery)	Δ unemployment (core)	Δ unemployment (periphery)
EDP	-0.0244	0.00370	-0.000764	-0.0658*
	(0.0230)	(0.0267)	(0.0306)	(0.0340)
crisis	0.147**	0.154***	0.221***	-0.0164
	(0.0609)	(0.0544)	(0.0684)	(0.0633)
EDP#crisis	-0.169***	-0.187***	-0.210**	-0.00765
	(0.0648)	(0.0569)	(0.0851)	(0.0720)
ideology	0.000846	-0.000936	-0.000416	0.000311
	(0.000795)	(0.000979)	(0.00102)	(0.00107)
ideological distance	-0.000162	0.000319	-3.10e-05	-0.00117
	(0.000122)	(0.00105)	(8.60e-05)	(0.00117)
alternation	0.00139	-9.79e-05	0.00413*	-0.000149
	(0.00149)	(0.000193)	(0.00212)	(0.000142)
Δ unemployment rate	0.0138	0.00495	0.152***	0.113***
	(0.0175)	(0.00698)	(0.0213)	(0.0119)
Δ old-age dependency rate	-0.0203	-0.0347	0.0585	0.00482
	(0.0250)	(0.0405)	(0.0385)	(0.0435)
decentralisation	0.000821	0.0105	-0.00453	0.00646
	(0.00779)	(0.0131)	(0.0115)	(0.0214)
national fiscal rule preferences	0.000186	0.00239	0.0236	-0.000755
	(0.0220)	(0.0255)	(0.0268)	(0.0350)
Constant	0.00878	0.00779	-0.103**	0.0679**
	(0.0321)	(0.0307)	(0.0430)	(0.0322)
Observations	132	80	132	80
R-squared	0.179	0.159	0.444	0.707
Number of countries	7	6	7	6
Linear regression, correlated panels corrected standard errors (PCSEs)				
Standard errors in parentheses				
*** p<0.01, ** p<0.05, * p<0.1				

Implications

The analysis verified [HP2.C] in showing how within the Eurozone being under the EDP does increase the social cost of the Great Recession. Indeed, aggregate social spending and the majority of its subcomponents are sensitive to the cycle. The cross-cycle variation in the impact of the supranational fiscal rule, however, tightens rather than relaxing the constraint on social protection in bad times. That is to say that the detrimental impact of the EDP on social protection is concentrated in the negative phase of the cycle. The implications could be twofold. It could be that cutting social spending takes place as a last resort and is thus avoided if there is alternative budgetary space, which may not be the case in bad times given the extensive share of the budget welfare accounts for. Alternatively, in direct relation with crisis dynamics, the strong binding effect of the EDP during the negative cycle acts in countering the upward pressure to social spending caused by the recession, so that the negative impact represents a containment of the increase in expenditures rather than outright slashing. The former is the case at the aggregate level in the Eurozone, given that the overall impact not constrained to cyclical dynamics. Together with the additional impact of the EDP in crisis, overall consolidation dominates over the recession expansionary pressure, resulting in a downward trend in social spending. The channel through which such outcome manifest does, however, rely primarily on the containment of the increase of spending of the Great Recession if allowed to run its budgetary course, as is the case for the Eurozone Member States steering clear of the corrective arm. The supranational fiscal rule thus manages to contain a budget line that is especially sensitive to the crisis, eliminating most national adjustments to accommodate the recession and alleviate its social costs.

The analysis points towards two further broad findings. Firstly, the axe of the EDP-in-crisis does not fall equally hard on all social spending. Measures linked with pension spending (old-age, survivors and disability) are penalised less than benefits for families and unemployment, in line with the unequal intergenerational impact emerged in the previous section. Furthermore, heterogeneity also arises geographically, with not only varied strength of the cyclical impact of the supranational fiscal rule but also fully divergent dynamics for some budget lines. At the geographical level, with few exceptions, the periphery social budget during the Great Recession is worse impacted compared to the core, regardless of experiencing disproportionally the impact of the crisis. Divergences are the most marked for pension benefits. The overall patterns are only confirmed in the periphery, while only old-age in the core fails to completely escape the chains of the EDP, with a non-cyclical limited impact that is not even one-third of the recession-driven increase in spending. The raking does not, however, remain the same for all budget lines. Patterns align geographically for family benefits, albeit with the periphery coming first place in terms of the additional EDP tightness in crisis. The podium is, however, reversed for unemployment: while the core controls away nearly all increase due to the Great Recession, the periphery fails to do so, rather enforcing a non-cyclical modest reduction of unemployment under the EDP. How can such results be interpreted? Firstly, the increase in the social cost of the Great Recession brought forward by the EDP does penalise the periphery the most. Conversely, the core manages to shield away especially spending related to old-age, not having thus to resort to containment measures in crisis.

The only exception to this pattern – unemployment – raises questions that cannot easily find a univocal resolution. To what extent is the non-cyclical change in the impact of the EDP on this budget line in the periphery driven by a higher non-crisis impact? Is the in-crisis change in unemployment spending relatively less substantial either because of the former or given the more limited fiscal space of periphery countries especially with the outbreak of the Eurozone crisis? Looking at cycle phase sub-subsamples indicate the impact of the EDP is limited to good times, not being at all significant in the negative phase of the cycle. In this context, the periphery does not come into the crisis dedicating more to unemployment benefit spending as a share of GDP than the core, respectively amounting on average to 0.93 percentage point in the periphery and more than doubled to 1.92 percentage points in the core. In the Great Recession, the ranking is confirmed, but the increase is much higher on average for the periphery, namely reaching respectively 1.99 and 1.25 percentage points of GDP. There are two further elements to consider in terms of the inputs contributing to unemployment benefit budgetary outcomes across core and periphery: the Great Recession and change in unemployment rates. On top of the additional spending associated with a one percentage point increase in the unemployment rate (larger in the core), for the core only there is an additional recession-driven increase in benefits, which is not significant in the periphery. Such dynamics compound with unemployment trends which see only a 0.16 (ranging from -1.15 to 1.88) average increase in the core compared to an average 1.40 in the periphery (ranging from -0.5 to 6.6, which is that of Spain in 2009). While a conclusive resolution would require ulterior analysis beyond the scope of the research questions at hand, the lack of impact of the recession per se independently of unemployment and the limited increase in spending compared to the stark rise in unemployment rates in the periphery may provide some evidence in favour of a constraining role of the fiscal space available to weaker economies regardless of their position concerning the supranational fiscal rule.

In drawing some conclusion in regards to RQ[2.C] together with relevant implications overall, the EDP in crisis has a significant negative impact on social expenditures. Specifically, the additional downward pressure of the EU economic governance in the negative cycle acts in countering the upward pressure of the crisis, limiting adjustments of welfare policy in bad times. Additionally, the distributional impact across generations is also not equal. The EDP more than counters the crisis – and always has a negative impact – only for youth expenditure. Additionally, the corrective arm has a higher impact both in absolute terms and proportionally – when considering the much more limited scope within social expenditures – for budget lines aimed at the younger generations.

Conclusions

The chapter has completed the puzzle of the EDP-in-crisis, investigating the distributional dynamics deriving from the constraints of the supranational fiscal rule during the Great Recession. The first domain findings address relates to policy objectives. In short: does the EDP indirect impact on budget composition through the budget constraint imposed on the Member State aligns with the EU economic governance policy objectives?

The betrayal of its own policy goals during the Great Recession is twofold. Counter-cyclicality is strongly refuted at any disaggregation by the emerged dynamics. The supranational fiscal rule is quite successful in cancelling or strongly limiting any recession-driven spending expansion. Unlike for the Member States steering clear of the corrective arm, for Eurozone countries under the EDP spending patterns at the aggregated and disaggregated level largely converge. As a result, patterns are often undistinguishable across the cycle. Although with non-trivial geographical and macro-type divergencies – assessed in this chapter – a substantial component of the adjustment that one would enact in crisis is prevented by the EDP within the Euro area.

The second violation of policy objectives – as outlined in Table 7. 16 – is located in one of such divergencies: the unequal distribution of the increased recessionary bind of the supranational fiscal framework across categories of public expenditures. [HP2.B] tested the prioritisation of investment over other components of national budgets in line with the objective of fostering a growth-enhancing recovery. The claim is refuted on both accounts of the ranking compared to transfers and inequality mitigation as investment is the relatively most penalised category. The resulting ranking across the three macro-areas can be depicted with investment at the podium, followed by inequality policies and with transfers at the tail. Two elements contribute the most to the making of the podium. Macro-components vary in whether the impact is significant over the full cycle. Moreover, the additional in-crisis restraint of the EDP (over)compensation of the recessionary pressure provides a ranking of its impact. Both investment and inequality satisfy the first criteria, while only the first wins the overcompensation game.

As highlighted, however, that is not to say that the EDP-in-crisis does not affect expenditures with substantive implication for social and inequality outcomes. For both the negative impact of the supranational fiscal rule increases during the Great Recession, with inequality also affected across the full cycle. That is to say that the EU economic governance framework, for Eurozone countries under the EDP, did indeed increase the social cost of the Great Recession, with a severe (and heterogeneous) restraint to the adjustment of social spending to accommodate for the negative cycle.

In terms of heterogeneity, two dimensions spanning beyond the sole domain of social protection determine a further divergence in terms of where the EDP bites the most: age and space. Across generations, young people are worst impacted. Across space, periphery countries experience in most instances a tighter restraint, notwithstanding the often stronger impact of the crisis on their weaker economies and consequent additional pressure on their domestic budgets. Together findings inform a potential further way in which the EDP runs against explicit Union goals: through the supranational fiscal rule, it fosters core-periphery divergence and the increase of inequality especially for the younger generation. The divides do not align well with the convergence goal and need within the EMU during the Great Recession and afterwards thanks to its heavy legacy.

In confirming RQ[2] and their three sub-dimension chapters six and seven paint a not so rosy picture of the EU economic governance framework. Findings suggest that the indirect effect of the supra-nationally imposed budget constraint translates to shifts to the policy mix that have suboptimal implications in terms of efficiency, geographical convergence and concerning the impact on social outcomes and inequality, running also against intergenerational fairness. However, a limitation to the relevance to future crisis and the in-crisis performance of the current EU economic governance infrastructure rests on its latest reform. A different framework was in play at the time of the first years of the crisis, before the 2011 revamp of the supranational fiscal surveillance infrastructure. It remains to be seen how the latter fares in crisis and whether within this context it is potentially better equipped not only to bind more effectively expenditures but also to direct them toward a preferable pattern. In this context, the post-Fiscal Compact framework was put through the stress-test of a deep crisis with the unprecedented shock deriving from the Covid-19 pandemic. However, the exogenous natural-disaster-like nature of the crisis (Bremer & Genschel, 2020) – which fast led to the invocation of the general escape clause of the Pact (EUCO, 2020a) – prevents any generalisation from 2020 dynamics. Paired with the debate on deeper reform of the EMU in light of the weaknesses further highlighted by the Covid-19 pandemic and the undergoing Economic Governance review preceding the outbreak, a fully-fledged test of how the post-Fiscal Compact framework fares in a ‘regular’ deep recession may never occur.

Table 7. 16 - Summary of results for [RQ2] *if and how the SGP has affected the domestic composition of public expenditures during the Great Recession and Eurozone crisis.*

[HP2.B] *the SGP-at-crisis in pushing toward an investment rich response to the recession came at the expenses of transfers and inequality mitigating expenditures.*
The hypothesis is partially refuted as investment is the spending component worst hit by EDP surveillance overall and during the crisis. However, austerity in crisis hits social spending and inequality mitigation measures as well. Investment contrary to policy objective of the Pact is always negatively affected by EDP surveillance, an effect reinforced during crisis time supporting a crowding-out of investment as a result of austerity. Both in the core and the periphery the pattern remains but the size of the cyclical component – always overcompensating the effect of the downturn – is doubled in the Southern Member States. Transfers EDP surveillance is only significant in bad times, nearly compensating for the upward push of the crisis. Such an effect seems to run counter to how Eurozone countries allocate spending during the crisis outside of EDP surveillance, with an increase of social expenditures. The most marked core-periphery divergence is in transfers. Dynamics align with investments, albeit the increased impact of the EDP-in-crisis does not compensate fully for the recession in the core. The opposite is the case for the periphery for which EDP surveillance during the downturn mitigates expansion in spending, which is, however higher for southern countries in the corrective arm outside of crisis years. Inequality mitigation For these components dynamics sit in between investments and transfers: the EDP always limits spending but increasingly so during the crisis without fully compensating for its upward push. Core-periphery patterns are more closely aligned if anything with a worse impact in crisis in the former.
[HP2.C] *the SGP-at-crisis furthered the social cost of the recession by negatively impacting social spending dynamics.*
It is confirmed that EDP surveillance negative impact social spending and increasingly so during the crisis, nearly constraining away all upward pressure of the recession. The effect is heterogeneous in the core and periphery. In the core the impact of EDP surveillance is always significant and its increase in the crisis only constraints 85% of the recessionary pressure compared to 95% in the periphery where the bind of the EDP is limited to bad times.

Nevertheless, in answering the question of how the latest governance performed in terms of its alignment with broader policy goals, the analysis of the framework beyond fiscal rules and whether the EDP indirect impact runs in the same direction offers some insight to this point. The same detrimental effect of EDP surveillance for investment remains post crisis under the Fiscal Compact – together with inequality mitigation and at division level social protection – as shown in investigating alignment with the CSRs in chapter five. So, does heterogeneity across core and periphery with the former mostly escaping any bind at all and the latter the most heavily impacted overall. Additionally, the effect concentrates on social protection with negative implications both for transfers and inequality mitigation. Moreover, the European Commission working document for the review recognises the need to improve the ability of the Pact to foster growth and convergence (COM(2020) 55 final). As highlighted, the festering bleak legacy of the Great Recession for the economies of several Member States, never fully recovering to their pre-crisis performance (COM(2020) 55 final). At the same time, findings in this chapter run against the claim of Commission's Economic Governance review report that fiscal rules do not play a role in the decline of investment associated with economic downturns (COM(2020) 55 final).

Chapter eight will further consider the extent to which findings differ across varied configurations of the domestic dynamics both across the political, institutional and economic dimension, partially also reconsidering these findings in assessing the role of the interplay with the domestic arena. Among those dynamics for countries falling under a program may be indicative of the intended and unintended consequences of the supranational fiscal framework. Being outside of the scope of the Pact, countries under a programme combine financial difficulties with even more intrusive, direct and unbeatably intended indications about the fiscal policy mix, explored in chapter eight.

8. EU economic governance and the domestic arena

The last empirical chapter is dedicated to RQ[3] considering how the domestic determinants of the budget structure interact with the supranational fiscal surveillance framework. Previous findings confirmed the effect of the Pact varying across the relevant policy mechanisms – with its constraining effect concentrated in its corrective component – and its three iterations across policy reform, as well as in relation to the economic climate. As such it may be expected that different domestic environments may offer to a varied degree scope to accommodate the prescriptions of the supranational fiscal rule. National factors may interact with the EU-imposed budget constraint resulting in divergent dynamics within the budget structure. Along these lines, the chapter assesses whether:

> [HP.3] *the impact of EDP surveillance is greater for national political, institutional and economic configurations favourable for fiscal consolidation.*

Across all three dimensions, the national drivers of public expenditures may be argued not only to affect the budget structure directly but also to influence the impact of the EU economic governance framework on adjustments to the composition of public spending. For instance, within the political arena, smaller ideological distance is associated within the literature (Tsebelis & Chang, 2004) with more scope for changes in the budget structure. Hence it may be argued that varied domestic conditions may be heterogeneously receptive to the supranational constraints and derived adjustments to the fiscal policy mix. Specifically, the three domains of domestic political, institutional and economic determinants are considered across the three respective sub-questions within RQ[3] addressed respectively in the three sections to follow.

Section one explores the interaction between the Pact and the domestic political arena from a veto player perspective. It tests if the government and political system characteristics more conducive to changes to the fiscal policy mix yield to an increased impact of the supranational fiscal rule. The impact of the interaction between the EDP and both ideological distance and alternation on the budget distance is assessed, together with individual (division level) indicators. The disaggregated picture is indicative of the scope for domestic responsiveness, which translate in heterogeneous distributional impacts on the budget structure.

Additionally it facilitates the directional interpretation of the synthetic indicator testing whether:

> [HP3.A] *the effect of the Pact on the budget structure is larger for government coalition characteristics (e.g. low ideological distance, high alternation) more conducive to changes in the budget structure.*

Along the institutional dimension, the interaction with the Pact of the federal structure of the Member States and the country-level preferences concerning the strictness of national fiscal rules are assessed. National institutions may interact with the EU economic governance framework because of diverging fragmentations of the budgetary choices translating in a different national-level ability to respond to the supranational constraints. At the same time, decentralisations may deliberately translate fiscal restraint commitments into constraint to given expenditures that may fall under the purview of varied levels of government, shifting the cost of EU-driven consolidation. The interplay between national and supranational fiscal rules adds to the complexity of the context under consideration. It is not straightforward to disentangle their respective effects. They may be argued to reciprocally strengthen one another in the interpretation of national presence as varied strength of national enforcement mechanisms especially in the context of the fiscal compact. Conversely, preference for restrained spending may render supranational governance irrelevant when national preferences already implement a more stringent fiscal policy orientation. In this composite institutional environment, section two tests whether:

> [HP3.B] *the effect of the Pact on the budget structure is larger if domestic institutional configurations are more conducive to fiscal consolidation.*

Finally, for what concerns the domestic economic arena, the analysis builds in part on findings of chapter six and seven concerning the crisis, in considering (i) a comprehensive synthetic overview of the cross-cycle impact of the EDP; (ii) the interaction with the domestic economic controls identified as the main national sources of variation of the fiscal policy mix and (iii) what happens to countries under a Programme, as for the reasoning put forwards in concluding chapter six it may offer valuable insights in the intended impact of the supranational fiscal surveillance framework on countries under economic duress. The consequent overall fil rouge of section three consists of testing whether:

> [HP3.C] *the effect of the Pact on the budget structure is smaller when running against opposing domestic economic conditions.*

8.. The EDP interaction with the national political arena

The starting point of the analysis within the domestic arena considers in this section the national political factors at play and how they may interact with the EU economic governance framework in resulting in a varied impact of the supranational fiscal rule across different political configurations. Specifically, two elements are considered within the political arena in line with Tsebelis and Chang (2004) study on the political determinants of the budget structure: the ideological distance within a governing coalition and the alternation across two consecutive governments.

In order to build a dataset covering all the Member States and the time-period at hand – not possible across both dimension in using Tsebelis data – as indicated in chapter four the needed information starts from data on the coalition members and their ideological position from the ParlGov database (Döring & Manow 2019), in utilising the left\right variable associated with each party within a governing coalition from the Manifesto Project (Volkens et al., 2020). Based on such information as illustrated in the methodological chapter the minimum and maximum within each coalition are calculated together with the consequent ideological distance and alternation associated with each government then weighted in proportion to their duration for years characterised by government change. In this context, the veto player key variables (ideological distance and alternation) represent the central focus of the analysis given their direct connection with space for fiscal change available to accommodate supranational constraints. At the same time, sensitivity analysis assesses as well the role of other political variables. In this context, the weighted ideological index of the coalition, similarly scaled to a yearly value, has been accounted for throughout the analysis and offers additional information on the political characteristics of the national environment and interplay with the supranational arena. For example, it may provide a direct account for spending preferences across the different divisions, although the role of this variable once considering the supranational fiscal rule has proven limited in findings so far especially in crisis years. However, it may be expected to play a role in directing where the Pact hits at home which is assessed in the chapter.

Going back to the two main political variables, the expected impact on the budget structure, based on veto player theory indicates that the higher the ideological distance the less scope for changes in the fiscal policy mix – or more in general in the overall size of spending – while the closer the government partners the easier it will be, for example, to carry out consolidation (Tsebelis & Chang, 2004). The opposite is true for alternation: the bigger the distance across two consecutive governments, the farther away the status quo derived from the preferences of the previous government and thus the scope for change in the size of spending and budget structure (Tsebelis & Chang, 2004). In line with the theoretical expectation empirically validated for spending in the nineties by Tsebelis and Chang (2004), one could argue that when politically there is scope for change in the level of expenditures and the budget structure at the domestic level, then it is feasible for the Member State to follow supranational prescriptions or to consolidate in case of violations. As such, having the scope for change can be expected to reinforce the EU economic governance, while the opposite would be the case for configuration less conducive for an alteration of the fiscal policy mix. In normal time, the effect of the EDP on the budget distance is positive, so that being under the corrective arm induces greater consolidation-driven changes to the budget structure. Consequently, the interaction with the supranational fiscal rule and ideological distance could be expected to be negative as a higher ideological distance is linked with lower scope for change. The opposite is the case for alternation, of which higher values indicate more room for manoeuvre for budgetary reforms so that its interaction coefficient with the EDP can be expected to be positive. Having recalled theoretical expectations for the interaction between the independent variable and the political factors considered at the domestic level, the following section adapts the model employed in the previous analysis to account for national political interactions.

Model specification(s)

Building on the previous findings in chapter five, the models focus on the configurations of the Pact and the countries that have been already found to be associated with a significant impact on the budget structure, namely under the corrective arm within the subsample of the Eurozone for which sanctioning is envisaged, as well as the Fiscal Compact for which supranational constraints are translated into direct domestic restraints. Along these lines, the interaction between the political variables is considered in parallel with the approach put forward in the previous chapter.

Starting from the dependent variables the impact is assessed at the aggregated synthetic level of budget distance, as well as at the disaggregated division and macro sub-components level. The model is expanded to account for the interaction between the independent variable and the political factors. A further element to consider given the divergent functioning of the EU economic governance framework across the two groups relates to Eurozone Membership, as well as countries bound by Title III of the Fiscal Compact given that having implemented supranational constraints domestically may yield to a different degree not only of the effect of the Pact but also of freedom of action within the political arena. Similarly, likewise in previous instances, the aggregate analysis of the synthetic indicator BD needs to be complemented with directionally sensitive assessment at budget line level, if not to see how different expenditures may be affected to provide at the very least additional guidance in interpreting the results in terms of the budget structure.

In assessing the interplay between ideological distance and alternation and the supranational fiscal rule, in line with the reasoning put forward in chapter five in developing the baseline model, the analysis is restricted to the EU15 in excluding non-western countries. Similarly, in restricting the analysis to non-crisis years, only the phase three economic governance is considered given that an impact of the EDP overall is constrained to the post-2011 timeframe.

Descriptive analysis

Table 8. 1 presents descriptive statistics of the three main domestic political variables included as controls throughout the analysis. Descriptive statistics are provided for the main sub-sample – EU-15 restricted to the post-crisis years – as well as across the key variables in determining the national impact of EU economic governance, that is to say, financial assistance, Eurozone membership and being under the EDP.

Table 8. 1 - descriptive statistics for national political variables

	EU-15 post 2011					EU-15 post 2011, excluding FAP				
Variable	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
ideology	105	-5.773746	15.02349	-47.8669	25.26604	93	-6.026488	15.06262	-47.8669	25.26604
ideological distance	105	19.2675	17.34878	0	76.2114	93	17.98241	14.42994	0	58.517
alternation	105	10.36812	9.425256	0	41.083	93	9.839233	9.784066	0	41.083
	EU-15 post 2011, excluding FAP, non Eurozone					EU-15 post 2011, excluding FAP, Eurozone				
Variable	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
ideology	21	-4.892324	23.40696	-47.8669	25.26604	72	-6.357285	11.79675	-33.0172	14.63027
ideological distance	21	17.87683	15.17857	0	44.631	72	18.01321	14.3146	0	58.517
alternation	21	16.86124	12.85154	0	41.083	72	7.791149	7.660246	0	31.722
	EU-15 post 2011, excluding FAP, Eurozone, no EDP					EU-15 post 2011, excluding FAP, Eurozone, EDP				
Variable	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
ideology	40	-6.550809	9.266876	-22.8282	9.768797	32	-6.115381	14.51151	-33.0172	14.63027
ideological distance	40	22.27755	14.36944	0	58.517	32	12.68278	12.51977	0	39.339
alternation	40	7.030316	7.302201	0	31.722	32	8.74219	8.101321	0	22.339

Starting from ideology, with a virtually unchanged range, the negative mean decreases when excluding countries under financial assistance implying a leftward change. Distinguishing across Eurozone and non-Eurozone countries, the latter displays a broader range of (weighted) averages of ideologies within governing coalitions, together with a higher but still negative mean, while the range is reduced both at the left and right extreme within the Eurozone, however with a mean to the left of the non-Eurozone and the overall EU-15 sub-samples. Comparing observations within and outside of the EDP, the former displays a slightly higher average, together with a broader range. Conversely, the range is reduced and the mean moves slightly to the left in considering countries remaining under the preventive arm of the SGP.

Moving on to the ideological distance, both the range and the average decrease once FAP countries are excluded. Across Eurozone membership, the opposite is the case with lower averages and ranges outside the Euro area compared to members. Among the latter, the sharpest distinction arises when comparing countries that steer clear of and are under the EDP. Countries under the corrective arm are associate with a ten-point lower average in ideological distance than those in the preventive arm, together with a nearly twenty points lower range. What may that imply for the national transmission of EU economic governance? As smaller ideological distances imply more scope for change in the budget distance, countries under the EDP show a favouring domestic environment for changes in the budget structure.

Looking at alternation, patterns differ to some extent from those relating to ideological distance, both in the dimension across which the biggest shift occurs and in the ranking over the key independent variable. Alike ideological distance, alternation decreases once FAP countries are excluded, although across an unchanged range. The sharpest difference, in this case, emerges across Eurozone membership. Countries outside of the Euro area display a more than doubled alternation average compared to countries within the Eurozone, whose range is also smaller by almost ten points. If the jump across the preventive and corrective arm is less marked in the case of alternation, the patter is reversed compared to ideological distance. The average is lower in the preventive arm than in the corrective arm, although the range is smaller for countries under the EDP. Expectations for the two veto player variables are thus aligned across the preventive and corrective arm: the political domestic environment of countries under the EDP is more conducive to changes in the budget structure. However, it remains to be seen if the political variables have an impact independent of the EDP status of their country or rather do interact with EU economic governance altering its domestic effect.

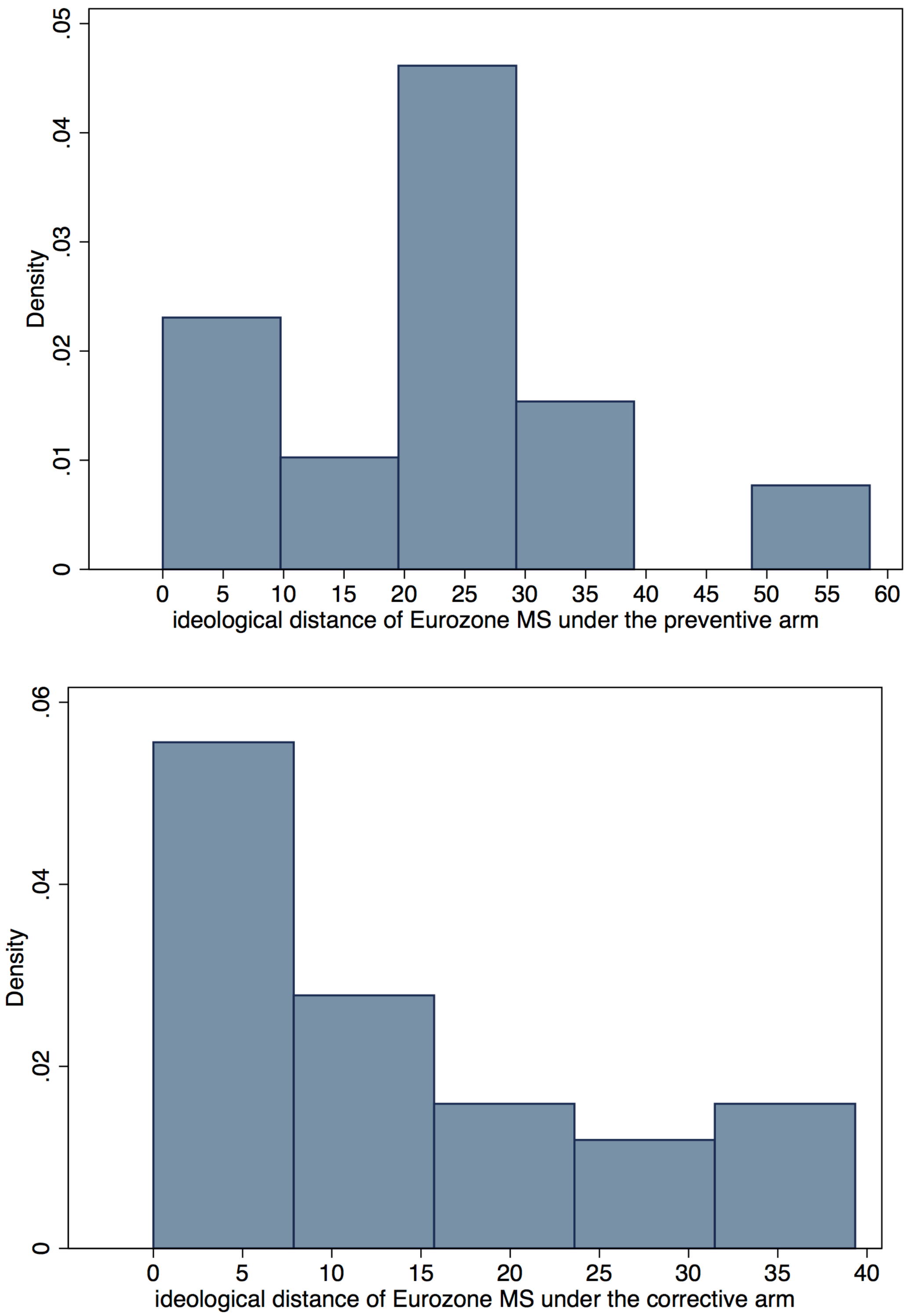


Figure 8. 1 - Distribution of ideological distance in the EU15 Eurozone subsample across the preventive and corrective arm

A final consideration with regards to the political variables relates to their distribution. While ideology is centred around its mean and not skewed, the same is not the case for ideological distance and alternation. Firstly, both variables are skewed to the left. For ideological distance to a first large group concentrated in the 0-5 range corresponds a second nearly as sizeable group centred around 25. Such pattern translates into divergent trends within and outside of the EDP, corresponding to the two peaks. While for countries under the EDP, shown on the right in Figure 8. 1, the distribution of ideological distance is highly skewed to the left, the same is not the case under the preventive arm, where there is a high concentration around 25. Conversely, for alternation patterns do not change across the independent variable, with the distribution remaining highly skewed to the left overall and in the subsamples. The emerging picture is that, along with changes in the average, changes in the distribution indicate that at least for the ideological distance the subsamples may be quite different across the preventive and corrective arm, which should be kept under consideration in assessing results and their implications.

Results

Given the substantial differences in the distribution of the political variables of interest across the dependent variable, in assessing the interplay between the two it is of value to compare budgetary outcomes across the independent variable within homogeneous domestic political environments. The overall sub-sample of reference, restricted to the post-crisis years and the EU-15 Member States offers a benchmark for further distinctions across the domestic political variables.

Starting from the ideological distance, the first word of caution refers to the behaviour of the variable once EU economic governance is accounted for. Unlike for the analysis of the baseline model, where the expected sign emerged without accounting for the EDP, although without strong significance and with limited size, the same is no longer the case once the EU economic governance comes into play. Furthermore, in the post-crisis period, the relationship appears reversed, albeit once again with significance only achieved at the 10 per cent level and a very modest coefficient in comparison to other political variables. For small ideological distances, the impact of the EDP jumps to 0.84 – amounting to 1.5 standard deviations – compared to 0.45 in the overall EU-15 Eurozone non-FAP post-2011 sample. Additionally, all controls except alternation are significant and an inverse relationship (re)emerges between ideological distance and changes to the budget structure. Broadening the spectrum to ideological distances below 20 weakens the impact of the EDP to 0.57, still above the overall results. For the subsample of large ideological distances (above 20), the EDP ceases to be significant. That is to say that the impact of the EDP is greater for national government coalitions more conducive to changes in the composition of public expenditures. Moving on to alternation, the same patterns emerge, with a large and significant impact of the EDP on the budget distance across configurations for which a larger restructuring is politically feasible, as shown in Table 8. 3. Specifically, while for below-average values of alternation (under 8) the EDP is not significant, the opposite is the case for above-average observations for which the corrective arm has a significant and sizeable effect of 0.703, little short of doubling the full-sample average effect.

Table 8. 2 - regression results across ideological distance

	(1)	(2)	(3)	(4)
	BD overall	BD ideological distance<5	BD ideological distance<20	BD ideological distance>20
EDP	0.452***	0.840***	0.570**	0.0558
	(0.167)	(0.105)	(0.224)	(0.129)
ideology	0.00961*	0.0350***	0.0278***	-0.00583
	(0.00527)	(0.00507)	(0.00687)	(0.00820)
ideological distance	0.00918*	-0.0721***	0.00153	0.0175***
	(0.00544)	(0.0247)	(0.0146)	(0.00469)
alternation	0.0250***	-0.000390	0.0136*	0.00212
	(0.00817)	(0.00378)	(0.00700)	(0.00670)
Δ unemployment rate	-0.282***	-0.191***	-0.383***	0.0153
	(0.0775)	(0.0400)	(0.0773)	(0.0761)
Δ old-age dependency rate	-0.274*	0.686**	-0.577	-0.167
	(0.154)	(0.336)	(0.490)	(0.190)
decentralisation	-0.318***	-0.642***	-0.591***	-0.0884*
	(0.0589)	(0.0626)	(0.138)	(0.0504)
national fiscal rule preferences	-0.308**	0.316**	-0.467*	-0.0955
	(0.152)	(0.130)	(0.279)	(0.116)
Constant	0.717***	0.267	1.324**	0.231
	(0.184)	(0.198)	(0.535)	(0.158)
Observations	72	18	37	35
R-squared	0.446	0.937	0.635	0.463
Number of countries	11	7	10	8
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table 8. 3 - regression results across alternation

	(5)	(6)
	BD alternation <8	BD alternation >8
EDP	-0.0748	0.704**
	(0.0705)	(0.339)
ideology	0.00209	0.0186
	(0.00317)	(0.0129)
ideological distance	0.00436	0.0155
	(0.00280)	(0.0174)
alternation	-0.00558	0.0524
	(0.0146)	(0.0378)
Δ unemployment rate	-0.00885	-0.547***
	(0.0456)	(0.179)
Δ old-age dependency rate	0.0517	-1.338
	(0.0820)	(1.208)
decentralisation	0.00895	-0.447***
	(0.0500)	(0.169)
national fiscal rule preferences	-0.144**	-0.625
	(0.0640)	(0.410)
Constant	0.640***	0.681
	(0.121)	(1.318)
Observations	45	27
R-squared	0.227	0.535
Number of countries	10	8
Linear regression, correlated panels corrected standard		
*** p<0.01, ** p<0.05, * p<0.1		

Finally, shifting the focus to the (weighted) average ideological position of the government coalitions, a first preliminary distinction across values below and above zero shows that coalitions to the left of the spectrum are associated with a larger impact of the EDP on the budget structure of 0.51, compared to that of 0.34 on the right side of the spectrum. A closer inspection reveals that the while patterns are strengthened or confirmed on both the left and right side in proximity to the centre, the same is not the case at the extremes. On the left side, concentrating the analysis for ideologies spanning from -10 to 0 leads to a further strengthening of the effect to 0.62, while further away from the centre the EDP ceases to be significant. The same is the case to the right side of the spectrum, where for ideologies below 20 the effect is confirmed at 0.34, while not significant outside this sub-sample. That is to say that while a stronger impact is confirmed for coalition left of zero, being on a range reasonably close to the middle-ground is a pre-requisite for any impact which is excluded at the two extremes of the distribution.

Table 8. 4 - regression results across ideology

	(7)	(8)	(9)	(10)
	BD ideology<0	BD ideology>0	BD -10<ideology<0	BD 0<ideology<20
EDP	0.510***	0.338***	0.624***	0.338***
	(0.177)	(0.124)	(0.114)	(0.124)
ideology	0.0202***	0.222***	0.0549**	0.222***
	(0.00609)	(0.0508)	(0.0238)	(0.0508)
ideological distance	0.0143**	0.0405*	0.0217**	0.0405*
	(0.00573)	(0.0225)	(0.00882)	(0.0225)
alternation	0.0330***	0.0182	0.0404***	0.0182
	(0.00964)	(0.0162)	(0.00901)	(0.0162)
Δ unemployment rate	-0.277***	-0.549***	-0.439***	-0.549***
	(0.0872)	(0.0716)	(0.132)	(0.0716)
Δ old-age dependency rate	-0.318**	-0.189	-0.691	-0.189
	(0.126)	(0.363)	(0.531)	(0.363)
decentralisation	-0.391***	0.347*	-0.459***	0.347*
	(0.0779)	(0.199)	(0.149)	(0.199)
national fiscal rule preferences	-0.295*	-0.930***	-0.836***	-0.930***
	(0.152)	(0.241)	(0.310)	(0.241)
Constant	0.787***	-1.716**	1.325***	-1.716**
	(0.173)	(0.807)	(0.505)	(0.807)
Observations	52	19	30	19
R-squared	0.540	0.807	0.758	0.807
Number of countries	10	6	8	6
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

A final word of caution on results regards two elements: (i) the sensitivity to the threshold and (ii) the (in)precision of the estimates, whose confidence intervals are quite extensive, also given the relatively small numbers when moving away from the centre of the distribution. Even considering such caveats, however, there can be sufficient confidence in the relative ranking of results across the subsample given the sharp distinctions that emerge across sub-samples, especially in the case of the two key variables of interest, ideological distance and alternation. It is hence confirmed that domestic configurations more conducive to changes to the fiscal policy mix facilitate the work of the EDP, while they may represent an insurmountable necessary condition for any impact to materialise when the political environment is more problematic for any restructuring to take place.

Implications

Overall, results confirm an interplay between the domestic political arena and the national transmission of EU economic governance prescriptions. Specifically, findings verify [HP3.A]: domestic political configurations more conducive to changes in the composition of national expenditure result in a greater impact of the EDP.

The two key veto-player theory-driven political variables determining the fiscal wiggle room for changing the budget structure at the national level affect the strength of the bind of the supranational fiscal rule. Their importance is not secondary to the extent that they may represent a necessary condition to having any impact at all from the EDP procedure on the national budget structure. Specifically, for both variables, the supranational impact on the composition of public spending strengthens for domestic political configurations more conducive to the restructuring of the national budget. Conversely, when coalition ranges are big enough or alternation is sufficiently limited the EDP ceases to have any restructuring impact on the domestic fiscal policy mix. Findings confirm there is a central role to be played by the domestic arena in shaping the indirect transmission channel of the supranational fiscal rule onto the budget composition. That is to say that countries under EDP are more prone to extensive restructuring when the governing coalition is more ideologically aligned or when it faces a status quo farther away from its own policy preferences.

A further precondition for the effectiveness of the EU economic governance transmission mechanism on the national fiscal policy mix pertains to the ideological composition of governing coalitions. While there is a difference in impact across the left and right side of the spectrum in favour of the first, the relative proximity to the centre in both directions plays an essential role as a prerequisite for any effect to materialise at all. In this context, findings concerning the political domestic determinants of budget composition indicate there is indeed the need to better understand the national-supranational interplay in identifying those configurations within the Member States working along with the EU economic governance framework and those conversely hindering or limiting its impact.

8.2 The EDP interaction with national institutions

Having considered the domestic political arena, this section shifts the focus to national institutions. As for the political dimension, the section considers the interplay between domestic institutional characteristics and the supranational fiscal framework assessing whether they determine a divergent impact of EU economic governance across different institutional configurations. Specifically, the two key national institutional drivers of the composition of the Member States' fiscal policy mix – controlled for throughout the analysis – are considered assessing the significance of the interaction among federalism and national fiscal rule strength preference indicators and the dependent variable. Within this context, the analysis assesses [HP3.B] in uncovering whether institutional configuration favourable to fiscal consolidation increase the impact of the EDP.

As discussed in chapter three, different degrees of decentralisation may yield a varied impact of EU economic governance on the overall budget distance and specific categories of public spending. The direct impact of decentralisation on the fiscal policy mix has been confirmed in the literature (e.g. Grisorio & Prota, 2015). The extent to which fiscal rules can affect the sub-national budget may vary across decentralisation levels. Specifically, the impact may only or predominantly arise when Member States display unitary institutions, given the higher fiscal autonomy of federal sub-national levels (Forenmy, 2014). The implications that unitary and federal countries may display (i) different levels of control over the overall budgetary size and allocation at central government level and (ii) there may be distributional implications associated with the ability of the central level to shift the 'bite' of the supranational constraint to lower levels of government. In this context, an impact of the SGP-derived domestic fiscal rule constraining sub-national expenditure has emerged, not only on the size of regional and local budgets but also concerning their allocations. For example, looking at the Domestic Stability Pact in Italy, Gregori (2018) found a significant impact on the budget composition, with restrictions hitting disproportionally on services – especially if the rules favoured investment – in addition to previous results confirming the impact on the size of local budgets (e.g. Grembi, Nannicini & Troiano, 2016). Under such premises, the effect of the Pact and in particular the EDP may well vary across levels of decentralisation within the Member States, given the different grip on spending and its composition at the national level. At the same time, different configurations may not be neutral to how supranational constraint within the corrective arm translates onto the national budget structure.

Parallel reasoning applies to national fiscal rules, discussed in depth in the early chapters, in diving into how to disentangle the national and supranational dimension of fiscal rules and their effect on the budget structure (e.g. the extent to which their impact may be allocated to the SGP or national preferences). The approach of distinguishing across countries displaying an above average or below average strength in the Fiscal Rule Index (FRI) – within the homogeneous supranational regulatory framework of the Eurozone – offers the opportunity to capture national 'free' choices. In this context, the National Fiscal Rules Strength preferences indicator developed for the analysis offers two possible interpretations of the supranational-national dynamics. On one side, fiscal rules at the national level may compound with supranational prescriptions: under such a premise, stricter national preferences are more conducive to EDP-led changes to the fiscal policy mix. Within this line of reasoning, after the Fiscal Compact mandated introduction of national fiscal rules translating supranational commitment into self-enforcing domestic legislation, the high or low level of the FRI may be considered as the strength of the enforcement mechanism of the Fiscal Compact. On the opposite side, fiscal rules at the two levels may be considered complementary: little work is left for the supranational framework when countries have NFRS preferences yielding on their own substantial consolidation, while the EDP may affect to greater extent countries recalcitrant to control spending. Expectations with regards to the interactions across the two levels diverge: if the national and supranational arena compound, stricter EDP domestic enforcement (high NFRS) positively interacts with the effect of the Pact on the budget structure, while if the arenas are complementary the bind of the EDP may be substantial for profligate countries (low NFRS) while rendered unnecessary when national preferences are already equally or more restrictive.

Model specification(s)

Alike for the national political arena, the model considers those configurations of the supranational fiscal governance framework associated with a significant impact on the budget structure, namely the EDP within the Eurozone and under the Fiscal Compact. Considering the dynamics under the Fiscal Compact is of high value especially for the fiscal rule dimension of the analysis given how – as illustrated above – the post-FC period offers a new light under which to interpret domestic preferences in this domain. Additionally, the effects are distinguished across crisis and non-crisis years, indicating the extent to which the national context does or does not matter homogeneously across the cycle.

Under such premises, the model(s) consider the interactions within the two institutional variable – decentralisation and national fiscal rule preferences –

with a focus on the impact on the overall budget structure. A brief overview of key (disaggregated) distributional considerations is also provided, along with an outlook at the implication of the impact of the dependent variable within the sub-samples defined by the institutional variables of interest. The dynamics at the level of the budget lines, considered in this instance at the division level, contribute to the assessment – in particular in the context of decentralisation – a clearer understanding of whether divergent dynamics affect in particular specific categories of spending. In the context of a federal setting, which budget components are affected may offer some additional insight on whether they overlap with subject matters often escaping the purview of the central government under decentralisation.

Descriptive analysis

Within the institutional arena, specifications and their implication within the dataset under consideration warrant close attention, given how they may be either far from straightforward and sensitive to the selected approach or problematic given the limited number of Member States considered under a given configuration.

The latter is indeed the case in the context of decentralisation. The vast majority of observations belong to unitary countries (576), with the remaining associated mostly to federal countries (72) and only a miniscule minority falling in the middling category (24). In terms of Member States, the non-unitary models only account for 4 of the 28, with just Austria classified as a middling country and Belgium, Germany and Spain as federal entities. Such scenario poses some challenges especially in the context of panel restrictions, considering that the representation of non-unitary countries falls to 60 and 30 respectively within the Euro area, compared to 219 observations associated with the non-decentralised Member States, and to just 15 and 5 among those subject to the fiscal compact, compared to 89 unitary-countries observations. Even excluding panel restrictions, the representation across the categories considered remains highly problematic. Additionally, the group of federal countries is far from homogeneous, with both core and periphery countries, as well as small and large Member States. While the limitations should remain in the foreground, the heterogeneity within the federal group does in part mitigate the concern of results being driven by specific Member State dynamics and not the institutional set-up.

Shifting the focus to countries' fiscal rule preferences, the sample is reasonably balanced, with 361 observations belonging to the Member States with a below-average FRI while 311 (low NFRS) to those having selected more restrictive than average fiscal rules (high NFRS). With the balance shifting slightly in the favour of the latter, the same holds within the Euro area, with 136 below-average and 163 above-average observations and for those falling under the purview of the Fiscal Compact, respectively amounting to 44 and 65 observations. Nevertheless, in the context of the national vs. supranational fiscal rules, the specificity of the indicator suggests a conservative approach in deriving broader indication on national fiscal rules, given the difficulties of disentangling the two arenas and the potential sensitivity of results to the measure considered.

Shifting the focus to the dependent variable, as shown in Table 8. 5 below, the mean budget distance is lower for higher levels of decentralisation. The difference between the unitary and federal Member States further increases within the Eurozone for which the three means are respectively 1.50 for unitary Member states, 0.97 with some decentralisation and dropping to 0.87 for federal countries. The sharpest distinction is however recorded in the subsample subject to the Fiscal Compact for which compared to a mean of 1.53 in unitary countries, mid-decentralised countries show a mean of just 0.85 further shrinking to just 0.50 in federal countries. The emerging picture is that there is overall more change in the context of unitary rather than decentralised countries, which could in a context of restrictive fiscal policy imply faster and sharper adjustments in general.

Table 8. 5 - Descriptive statistics for the budget distance across levels of decentralisation

	Eurozone					Eurozone under EDP				
	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
Unitary	219	1.498653	2.302656	.2	18.51702	92	2.14254	3.314066	.2236068	18.51702
Middling	20	.9715107	.8007673	.3	3.455431	5	.8176609	.429288	.3	1.236932
Federal	60	.8740086	.7075445	.1	3.48425	23	1.0306	.8082212	.1732051	3.48425
	Fiscal Compact					Fiscal Compact under EDP				
	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
Unitary	89	1.531396	2.043475	.2645751	12.74441	27	2.689012	3.104084	.2645751	12.74441
Middling	5	.854637	.3701277	.4358899	1.280625	1	1.204159	.	1.204159	1.204159
Federal	15	.5000085	.2360196	.1	.8717798	6	.588915	.1944608	.3	.8717798

In trying to gain a preliminary understanding also about the changes in descriptive statistics for the dependent variable across the EDP, restricting the sample under consideration to countries under the corrective arm confirms the above pattern: the budget structure changes more for unitary countries. The mean budget distance for countries having excessive deficits drops from 2.14 in the unitary Member States to 1.03 in federal countries within the Eurozone. Once again, the sharpest distinction occurs among Fiscal Compact signatories, for which under the corrective arm the average changes from 2.69 in the unitary Member States to 1.20 for middling countries, while amounting to just 0.59 in federal states. Furthermore, comparing overall and under EDP average changes in the budget structure, within the Eurozone under the corrective arm means are sizeably higher in unitary Member States (2.14 vs. 1.45), while the increase is more contained for federal countries (1.03 vs. 0.87). Similarly, within the Fiscal Compact, unitary countries under the EDP display a substantial increase in changes of the budget structure (2.69 vs. 1.53) while the difference is comparatively minor in federal countries (0.59 vs 0.5).

The pattern could suggest that sharper adjustments for countries under excessive deficit can take place when the Member States have full control of budgetary dynamics rather than when sub-national levels are granted substantial autonomy over spending. In looking for further preliminary confirmation, the trend is supported at the level of individual budget lines, with – for instance – social expenditures showing an average decrease for Fiscal Compact bound the Member States of -0.25 in the unitary Member States, -0.24 in middling and only -0.11 in federal countries, with the distance between the first and the last further increasing for those under the corrective arm respectively to -0.47 and -0.27.

Table 8. 6 – Descriptive statistics for the budget distance across national fiscal rule strength preferences

	Eurozone					Eurozone under EDP				
	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
low NFRS	136	1.724451	2.739495	.2236068	18.51702	69	2.283739	3.628143	.2236068	18.51702
high NFRS	163	1.015647	1.019741	.1	8.018728	51	1.320152	1.55433	.1732051	8.018728
	Fiscal Compact					Fiscal Compact under EDP				
	Obs	Mean	Std. Dev.	Min	Max	Obs	Mean	Std. Dev.	Min	Max
low NFRS	44	1.597204	2.446941	.2236068	12.74441	16	2.651479	3.496709	.2645751	12.74441
high NFRS	65	1.196779	1.381303	.1	8.018728	18	1.939852	2.247163	.3	8.018728

Considering budget distance across fiscal rule strength preferences, for which descriptive statistics are provided in Table 8. 6 below, overall a higher budget distance is associated with countries with a lower than average fiscal rule strength compared to those favouring more stringent budgetary restrictions. The trend is confirmed for the Euro area sub-sample, with 1.72 in low NFRS and 1.02 in high NFRS respectively, as well as for the Fiscal Compact signatories for which the mean is 1.60 for the less stringent fiscal rules and 1.20 for those with above-average strength. In this instance, being under the corrective arm further increases both the budget distance and the difference across fiscal rule preferences. The difference across fiscal rule strength further increases within the Eurozone spacing to 2.28 for low NFRS to 1.32 for high. However, the gap is to some extent mitigated under the Fiscal Compact due to the disproportionate upward shift for above-average Member States (1.94) compared to the ones with low NFRS (2.65).

At the preliminary level, aggregate dynamics suggest increased changes in the budget structure for countries that would on their own favour a less restrictive approach to fiscal choices. The increase in the budget distance when under the corrective arm compared to the overall sample is more marked in countries with lower NFRS, suggesting some level of complementarity between the national and supranational arena.

Results

At the preliminary level, decentralisation is associated with more limited changes to the budget structure. A decrease of the impact of the EDP on changes in the national fiscal policy mix for federal countries would imply a negative interaction between the supranational fiscal rule and decentralisation. Table 8. 7 displays regression results within the Eurozone and for the sub-sample of countries bound by title III of the Fiscal Compact, further taking into account the potential for divergent patterns across the cycle. Within the Eurozone in good times expectations are confirmed: to the positive impact of the EDP on the budget distance correspond a negative interaction for federal entities. That is to say that decentralisation decreases the impact of the EDP on the composition of national public spending. The negative interaction more than compensates for the impact of the EDP. Trends – in good times – are likewise confirmed for countries under the Fiscal Compact. However, remarking the divergent dynamics during the Great Recession, the same is not the case for the crisis sub-sample, for which the overall sizeable negative impact of the EDP does not change across levels of decentralisation. The crisis is confirmed as quite powerful indicating it may 'wipe out' the relevance of the differences within the domestic arena under the extensive pressure coming from the supranational level.

Bringing back the focus to good times, where differences in the impact of the EDP emerge, at the disaggregated level divergences once again arise across divisions. In this context, a significant impact of the EDP does not emerge for all categories of spending. Moreover, within the Eurozone, a cross-decentralisation change in the impact of the supranational fiscal rule only occurs for two components: defence and education. While the first is somewhat unexpected given the central government role in the domain of defence, education is often one of the main areas falling under the purview of the sub-national level of government. As shown in Table 8. 7 the negative effect of the EDP is more than fully compensated in federal countries, indicating this division escapes the bind of the supranational fiscal rules in the decentralised Member States when sub-national entities have autonomy over this budget line. Given that both budget lines for which the EDP translates in less or no budget cuts in federal countries represent investment, decentralised countries may be – at least a partially – in a better position to preserve investment even when under the corrective arm. Likewise, education indicates patterns for federal countries more favourable to youth in intergenerational terms.

Table 8. 7 - Impact of the EDP on the budget distance across unitary and federal states

	(1)	(2)	(3)	(4)
	BD	BD	BD	Δ education
	(Eurozone, no crisis)	(Eurozone, crisis)	(Fiscal compact, no crisis)	(Eurozone, no crisis)
EDP	0.425**	-1.216***	0.691**	-0.114***
	(0.211)	(0.206)	(0.338)	(0.0434)
EDP#middling	-0.679	0.378	-0.251	0.123
	(0.580)	(0.331)	(0.459)	(0.0840)
EDP#federal	-0.543**	0.0693	-1.141***	0.123**
	(0.276)	(0.502)	(0.375)	(0.0514)
ideology	0.0118*	0.0128	0.0218***	2.74e-05
	(0.00658)	(0.0162)	(0.00814)	(0.000909)
ideological distance	-0.000885	-0.0225***	-0.00165***	7.37e-05
	(0.000944)	(0.00811)	(0.000480)	(0.000168)
alternation	0.000352	-2.49e-05	0.000907	-0.000264
	(0.000812)	(0.0129)	(0.000973)	(0.000244)
Δ unemployment rate	-0.0974	0.234***	-0.648***	0.0283
	(0.0842)	(0.0517)	(0.194)	(0.0189)
Δ old-age dependency rate	-0.0418	-0.0356	-0.108	-0.0384
	(0.193)	(0.361)	(0.554)	(0.0424)
decentralisation:middling	0.196	0.316	0.659***	-0.0602
	(0.268)	(0.315)	(0.201)	(0.0410)
decentralisation:federal	-0.175	0.195	-0.438	-0.0117
	(0.126)	(0.431)	(0.321)	(0.0265)
national fiscal rule preferences	-0.291*	-0.545*	-0.344	0.0192
	(0.169)	(0.278)	(0.278)	(0.0255)
Constant	1.142***	2.732***	0.870***	0.00950
	(0.160)	(0.285)	(0.279)	(0.0394)
Observations	234	45	100	234
R-squared	0.078	0.608	0.276	0.092
Number of countries	19	17	21	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Shifting the focus to national fiscal rules preferences, the interaction coefficients between the below-or-above average strength of domestic fiscal rules and the EDP alike for the other institutional factor changes across the cycle. Once again, no significant change in the (negative) impact of the EDP takes place in the context of the Great Recession. Conversely, both within the Eurozone and the Fiscal Compact signatories to a positive impact of the EDP corresponds a negative interaction with national fiscal rule preferences. That is to say that the impact of the EDP on changes to the budget structure decreases for countries favouring on their own more stringent fiscal rules.

Table 8. 8 - Impact of the EDP on the budget distance across national fiscal rule strength preferences

	(1)	(2)	(3)
	BD (Eurozone, no crisis)	BD (Eurozone, crisis)	BD (Fiscal compact, no crisis)
EDP	0.542*	-1.083***	1.128*
	(0.301)	(0.207)	(0.611)
EDP#NFRS	-0.520*	-0.184	-1.062*
	(0.302)	(0.285)	(0.567)
ideology	0.0125*	0.0114	0.0240***
	(0.00668)	(0.0148)	(0.00839)
ideological distance	-0.000799	-0.0217**	-0.000782
	(0.000943)	(0.00865)	(0.000879)
alternation	0.000861	-0.00141	0.00199**
	(0.000722)	(0.0146)	(0.000845)
Δ unemployment rate	-0.0963	0.235***	-0.610***
	(0.0829)	(0.0494)	(0.187)
Δ old-age dependency rate	-0.0712	-0.0745	-0.396
	(0.194)	(0.373)	(0.510)
decentralisation	-0.149***	0.135	-0.322***
	(0.0562)	(0.126)	(0.0901)
national fiscal rule preferences (NFRS)	-0.134	-0.346	-0.192
	(0.185)	(0.288)	(0.269)
Constant	1.102***	2.632***	1.015***
	(0.173)	(0.344)	(0.218)
Observations	234	45	100
R-squared	0.076	0.594	0.266
Number of countries	19	17	21
Linear regression, correlated panels corrected standard errors (PCSEs)			
*** p<0.01, ** p<0.05, * p<0.1			

The intuition would be that the constraint of the EDP is more important for countries favouring a less restrictive approach to fiscal policy while for those already imposing more restrained public spending at the national level the supranational dimension is less of a driver of their budgetary dynamics. Results are thus consistent with a complementary role of supranational and national fiscal rules, even under the Fiscal Compact. Rather than acting as an enforcement mechanism for supranational commitments, the Fiscal Rule Index – under the same regulatory framework for all signatory countries – is an indicator for national preferences. In this context, conservative spending preferences rather than reinforcing the supranational fiscal rule make it redundant if deficits are more prone to be corrected promptly by the Member States, regardless of the EU economic framework and falling under the corrective arm. However, the interaction effect does not fully compensate for the impact of the EDP. That is to say that the impact of the supranational fiscal framework on national budgetary dynamics is indeed substantially weakened but does not fully disappear. Nevertheless, looking at the subsamples across the variable of interest shows sharply divergent patterns across countries preferring above and below-average fiscal rule strength. A significant impact of the EDP is retained only for countries with low NFRS, while significance is never achieved for the Member States with high NFRS. The trend is confirmed both within the Eurozone sub-sample and among Fiscal Compact signatories. Under the Fiscal Compact to a change to the budget structure of over 2 percentage points of GDP in profligate countries corresponds a non-significant one in fiscally prudent Member States.

Table 8. 9 - Impact of the EDP on the budget distance for high and low national fiscal rule strength preferences

	(1)	(2)	(3)	(4)
	BD (Eurozone, no crisis low NFRS)	BD (Eurozone, no crisis high NFRS)	BD (Fiscal Compact, low NFRS)	BD (Fiscal Compact, high NFRS)
EDP	0.606*	0.108	2.014*	0.140
	(0.352)	(0.169)	(1.047)	(0.217)
ideology	0.0455***	-0.00514	0.0621	0.00713
	(0.0164)	(0.00446)	(0.0410)	(0.00956)
ideological distance	-0.00440	-0.000422	0.00424	-0.000287
	(0.00978)	(0.000936)	(0.0214)	(0.000485)
alternation	-0.0309*	0.000501	-0.106	0.000998
	(0.0174)	(0.000429)	(0.0788)	(0.000720)
Δ unemployment rate	-0.0846	-0.0994*	-0.631	-0.475***
	(0.170)	(0.0576)	(0.510)	(0.105)
Δ old-age dependency rate	-0.176	-0.120	-1.046	0.500*
	(0.492)	(0.130)	(0.804)	(0.256)
decentralisation	-0.286*	-0.136**	0.154	-0.253***
	(0.148)	(0.0599)	(0.262)	(0.0808)
Constant	1.753***	0.878***	1.967*	0.278
	(0.390)	(0.0701)	(1.140)	(0.239)
Observations	98	136	38	62
R-squared	0.124	0.082	0.315	0.413
Number of countries	15	16	11	17
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Looking at the division level budget items, interaction effects are only significant for three instances: general affairs, defence and housing and community amenities. General affairs represent the only budget line with a significant non-negative impact of the EDP, consistent with similar dynamics emerged in earlier chapters for this division. However, also in this instance, the interaction runs against the overall effect, with a negative and significant coefficient. The remaining significant coefficients are always negative: the EDP is associated with lower spending in defence, housing, culture, education and social protection. In this context, the effect for defence and housing changes across national fiscal rule preferences: the bind of the EDP is less severe for countries themselves adopting a more restrictive approach to spending. Beyond the specific dynamics of each budget line, the general takeaway for the interpretation of the emerged trends in the budget distance indicator across the interaction between the EDP and national fiscal rule confirms that the higher budget distances associated with weak-fiscal-rules countries are indicative of sharper budgetary adjustments taking place among those countries at the hands of the EDP rather than in countries already restricting their budgetary outcomes on their own.

National fiscal rule preferences also yield different patterns with regards to the pathway to consolidation. Such differences are reflected by the impact of the EDP on the macro-components of fiscal policy, namely investment and transfers. The EDP – for the Eurozone outside of the crisis – is significant for both the sub-sample of low NFRS and high NFRS Member States, albeit only at the ten per cent level and with a more modest coefficient for the Member States with more stringent fiscal rules. However, patterns diverge across the remaining components. For investment – in its restrictive specification – a significant and negative effect emerges only for countries with a low NFRS and not for countries with more stringent preferences. The opposite is true for transfers: a significant impact of the EDP on this budget area emerges only for countries with a high NFRS, while those favouring laxer fiscal rule do not show a significant impact of the supranational fiscal rule. That is to say that national fiscal rule preferences are associated with a different approach to consolidation: the investment penalising trend emerged during the crisis remains in good times in countries antagonising stringent rules, while restrictive Member States favour cutting transfers, as shown in Table 8.10.

Table 8. 10 - Impact of the EDP on investment and transfers for high and low national fiscal rule strength preferences

	(1) Investment (Eurozone, no crisis low NFRS)	(2) Investment (Eurozone, no crisis high NFRS)	(3) Transfers (Eurozone, no crisis low NFRS)	(4) Transfers (Eurozone, no crisis high NFRS)
EDP	-0.142**	-0.115	-0.196	-0.203*
	(0.0702)	(0.0726)	(0.182)	(0.122)
ideology	-0.00410	0.00444	0.00503	0.000860
	(0.00426)	(0.00317)	(0.00536)	(0.00451)
ideological distance	0.00175	9.68e-05	-0.00886	-2.44e-05
	(0.00331)	(0.000315)	(0.00612)	(0.000456)
alternation	0.00242	-0.000423	0.00320	-0.00218***
	(0.00549)	(0.000286)	(0.00715)	(0.000675)
Δ unemployment rate	0.0287	0.0675*	0.556***	0.324***
	(0.0637)	(0.0353)	(0.0968)	(0.0713)
Δ old-age dependency rate	-0.139	-0.187*	-0.104	0.225
	(0.113)	(0.107)	(0.246)	(0.191)
decentralisation	0.0148	0.0187	-0.0803	0.0101
	(0.0586)	(0.0281)	(0.0752)	(0.0683)
Constant	-0.000471	0.176***	0.297	-0.0565
	(0.127)	(0.0659)	(0.209)	(0.143)
Observations	95	127	95	127
R-squared	0.057	0.147	0.352	0.254
Number of countries	15	16	15	16
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Implications

For both institutional factors under consideration, results confirm that the impact of EU economic governance varies across different (domestic) institutional configurations. However, [HP3.B] on a larger effect of the EDP for institutional configuration favourable to fiscal discipline is only partially confirmed. While the impact of the EDP does indeed change based on national institutions, it is not always the case that domestic institutional arrangements more conducive to fiscal consolidation result in an enhanced impact of the EDP on the budget structure. Patterns diverge across the two key institutional drivers of the composition of national spending. The interaction between the national and supranational arena may thus not be simply reduced to which domestic settings offer the necessary conditions allowing for the bind of the supranational budget constraint to alter fiscal policy choices at the Member State level. Rather the two levels may be complementary in so far as national preferences already aligned with supranational objectives imply that there is a marginal role to be played by the EU economic governance framework in orienting fiscal policy trends and thus indirectly affecting distributional choices across budget components.

Conversely, decentralisation remains within the usual patterns indicating the national arena as a precondition for the supranational fiscal rule to fully play out. In this context, federal entities create a less conducive environment for the EDP to bound and affect the budget structure, with the supranational fiscal rule showing a decreased impact in federal countries. Smaller and\or slower consolidation efforts are carried out in non-unitary countries under EDP, where – for instance – the central government has less overarching control over the budget structure across sub-national levels. One of the cases in which the divergent effect is particularly marked at a budget line level is education, often allocated to sub-national authorities in federal countries. However, it should be kept in mind that (i) the analysis considers general government expenditures without delving into the specificity of the budget allocations across levels of government and (ii) the sub-group of federal countries only counts three Member States (Belgium, Germany and Spain) which may be moreover hardly considered a homogeneous category. As such the data may not allow for deriving granular considerations on specific budgetary dynamics – especially at the disaggregated level – but rather, notwithstanding the necessary caution, offers a general insight on the overall diverging trends across different levels of decentralisation.

The complementary dynamic, however, as an exception to the general trends, emerges in the intertwined domain of fiscal rules coexisting at the national and supranational level. Their derivation is especially hard to disentangle after the introduction of the Fiscal Compact linking the two levels in a way that make it far from straightforward to associate impact to the Member State or the EU. Of the alternative possible interpretations of the relative strength of national fiscal rule, namely (i) as strength of enforcement mechanism for the Fiscal Compact or (ii) as the extent to which EU economic governance is needed to avoid fiscal profligacy, the second dimension emerges as a clear winner through the findings illustrated above. On aggregate level over the full sample, the impact of the EDP is significant only for countries with a below-average fiscal rule strength, while for those Member States favouring more stringent constraints for their national fiscal policy there is no significant effect of the supranational surveillance framework. That is to say that only those countries for which a restrained fiscal policy is not a domestic choice but rather an imposition from the EDP see an impact not only on the size of their budget but also on their structure from the supranational budget constraint, translating into greater changes in their fiscal policy mix.

In deriving broader implications from this section findings, it is of interest to look at the divergent impact across institutional factors for the aggregates of social expenditures representing investment, transfers and inequality addressing expenditures. Except for inequality, behaviour across the three macro expenditure types is diametrically opposite across national fiscal stance preferences. Specifically, while the impact of the EDP for investments is only significant for those countries favouring lower-than-average-strength in fiscal rules the opposite occurs for transfers, where a significant impact emerges only for countries favouring a more constrained budgetary approach. Figure 8. 2 below shows the average in the national fiscal rule strength indicator (NFRS) for each Member State, with those at the top displaying a mean fiscal rule strength index across the period considered above average, while the bottom ones veering toward the below average side. The display provides an insight into which countries may fall within the pattern of resorting primarily to the consolidation of investment or transfers expenditures when falling under the corrective arm of the Pact.

The broader implications are twofold: (i) national preference and dynamics do interact with the EU economic governance framework, not only in facilitating or hindering its impact but also on translating the supranational budget constraint differently in terms of its impact on the budget structure and (ii) the bite of the corrective arm is not only more substantial for countries that would prefer a less restrictive approach to fiscal policy but, for them, consolidation takes place at great expense for investment while preserving transfer, which is instead the preferred choice for intervention for countries favouring stricter budgetary restraints.

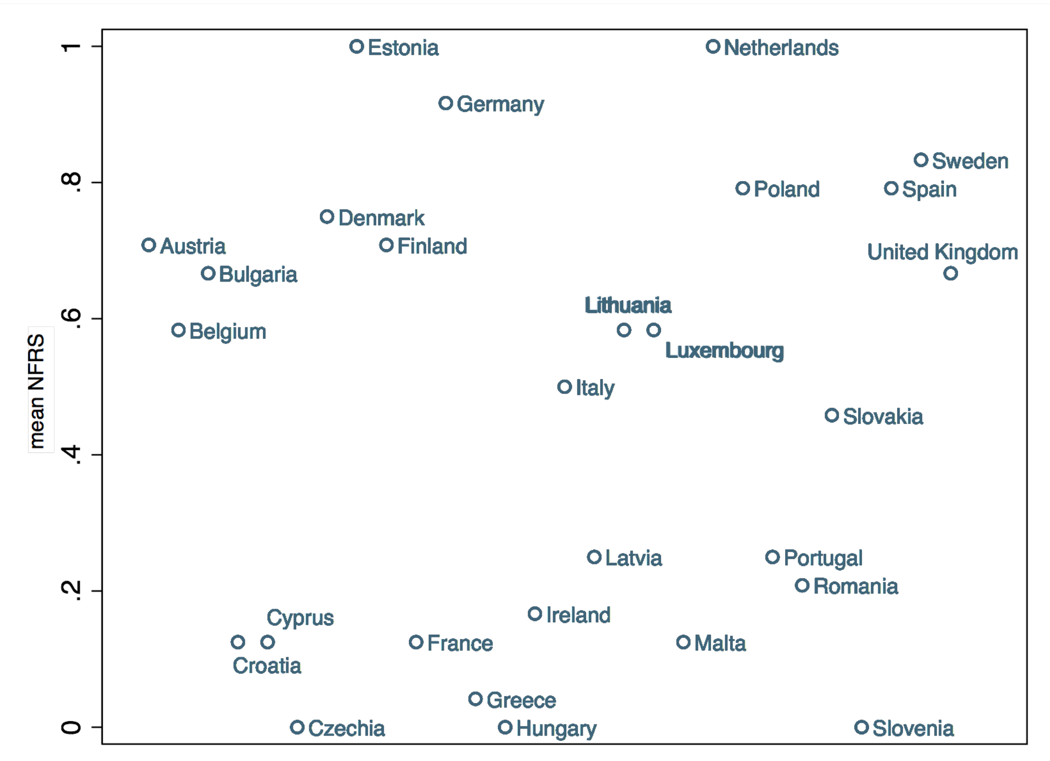


Figure 8. 2 - Member States National Fiscal Rule Strength stance

8.3 The EDP interactions with the domestic economic arena

The last empirical section of the analysis is devoted to the domestic economic arena. In assessing, [HP3.C], the section assesses the extent to which the consolidation push of the Pact is weakened when acting against domestic economic conditions running in the opposite budgetary direction. Within the domestic arena, the two key national economic drivers of the fiscal policy mix of unemployment and the old-age dependency rate are considered, together with a brief overview of cross-cycle dynamics and their determinants. Finally, the section turns to an element that while strictly speaking is outside the purview of the Pact – namely budgetary dynamics for countries under financial assistance – may offer some insight into the intended supranational impact in one of its most intrusive prescriptions for domestic budgetary choices.

Chapter six already considered extensively the in-crisis dynamics and how the negative cycle affects the impact of the EDP on the national budget structure. In further exploring the interplay between the domestic economic arena and the supranational economic governance framework, the section briefly returns to the topic shifting the focus to the comparison between bad and good times, pinpointing how dynamics change across Eurozone membership and governance phase.

In this context, the criticism to the Pact, extensively discussed in chapters six and seven, raise the question of the extent to which (i) the indirect negative effect of the Pact in crisis and on the distributional budgetary choices (e.g. on growth-enhancing investment) are fully deliberate or unintended collateral damage of faulty economic governance infrastructure and (ii) whether the dynamics are confirmed for countries 'in bad shape' coming under financial assistance. The dynamics of Programme countries – excluded so far from the analysis as strictly speaking foreign to the Pact, – shed some light on the relationship with an arguably very intrusive supranational oversight of budgetary choice and the ensuing fiscal policy mix. While excluded from the Pact commitments, Financial Assistance Member States are instead bound to the memorandum undersigned. In this context, the supranational arena may be argued to exert a more direct orientation of domestic budgetary choices going far beyond a sole EU derived binding budget constraint into a substantially 'harder' impact on domestic fiscal orientations.

Finally, in parallel with the political and institutional arena, the interaction between the Pact and economic controls within the model is considered, assessing the extent to which those argued to be the two main contributors to changes in the budget structure (Tabellini 1990, 1991) affect the ability of the supranational constraints to bind expenditure and impact the fiscal policy mix. At the same time, such analysis is likewise indicative of the power of the supranational fiscal rule in weakening the transmission into fiscal choices of two potent domestic economic factors such as unemployment and demography.

Model specification(s)

The economic climate has already emerged as an important factor in changing the behaviour of the Pact and the EDP. If in crisis the impact of the EDP on changes on the budget structure flips to the negative side, chapter six and seven showed how such dynamic is associated with restraining the expansionary pressure of the recession, thus exerting negative pressure on spending. While the route of the EDP impact changes across the cycle, its overall destination does not: containing expenditures and pushing towards consolidation. Under such premises, it is of value to devote additional attention to the comparison of the impact across the economic cycle and its determining factors. Firstly, the section recaps on previous insights to provide a coherent overview of cross-cyclical dynamics, illustrating the conditions under which a consolidation push occurs or is hindered by the economic climate affecting spending patterns at the national level. Moreover, early in the analysis, in addition to exclusion of FAP countries outside of the Pact, the sample was restricted to the Eurozone, given the sharper enforcement instrument available in the form of sanctioning for countries within the Euro Area falling under the EDP. The question remains if the national economic climate – or rather its annulment in terms of budgetary dynamics at the hands of the EDP – yields to a similar interplay with the supranational fiscal rule even in the absence of sanctioning.

The model thus employs configurations of the EU economic governance across the economic climate in assessing the interplay of the Great Recession and the EDP, as well as Eurozone membership and governance phases, through the interaction among the variables and the impact of the EDP in the subsample of interest resulting in an overview of the configurations under which consolidation takes place at the hands of the supranational fiscal rule and the latter interferes with cyclical dynamics at the national level.

The second innovation in the model reflects the sharpest departure from a focus on the EDP in the context of countries under Financial assistance. Firstly, these observations are generally also associated with the EDP, which does not, however, have any real meaning in this context rather than signifying an excessive deficit, common among programme countries. The element of comparison should not be restricted within the sole group of FAP countries but rather how their budgetary trends differ from countries steering clear of a memorandum. In this context, the model replaces the independent variable with the dummy capturing financial assistance, with the EDP rather serving as a control.

The usual approach of interacting the EDP with national factors returns in the assessment of the interplay with the economic controls of changes in unemployment and old-age dependency rate. The intuition to be tested in this regard is linked to how they greatly affect the budget structure and specifically given components within the social protection division. Expectations are however not univocal. On one hand, higher rates may push upward related social spending leaving less space for budgetary adjustments. Conversely, in considering a binding supranational budget constraint, once a more sizeable chunk of the fiscal policy mix is committed to addressing unemployment or pension needs, it may be the case that the budget has to react in consolidating other areas so that a substantial shift in the budget structure will take place. Looking from the opposite perspective, the EDP can be thought either as a restraining force in adjusting the budget structure to the pressure of the two categories above, as uncovered for the crisis or conversely a catalyst of adjustment to other categories of spending. Regardless of the direction of the changing impact across the variables under consideration, the resulting model includes the interaction between EDP surveillance and changes to the unemployment and old-age dynamics.

Descriptive analysis

Across the economic climate, the panel is unbalanced in disfavour of the crisis period, which covers 84 observations with the remaining 588 pertaining to the timeframe outside of the Great Recession and Eurozone crisis. For what concerns countries under a Programme, 30 observations reflect the Member States having accessed financial assistance, of which 12 during the crisis period and the remaining 18 in the years to follow. The associated mean change in the budget structure jumps respectively from 1.35 in normal times to 2.07 in bad times, and skyrockets from 1.31 for countries outside Programmes to 4.14 for those receiving financial assistance. Additionally, a larger average budget distance is associated with the corrective arm of the Pact (1.54) compared to the preventive (1.29) in normal times, while the opposite is the case in times of crises with countries having excessive deficit displaying more restrained mean changes in the budget structure (2.04) compared to those with a better fiscal stance (2.15).

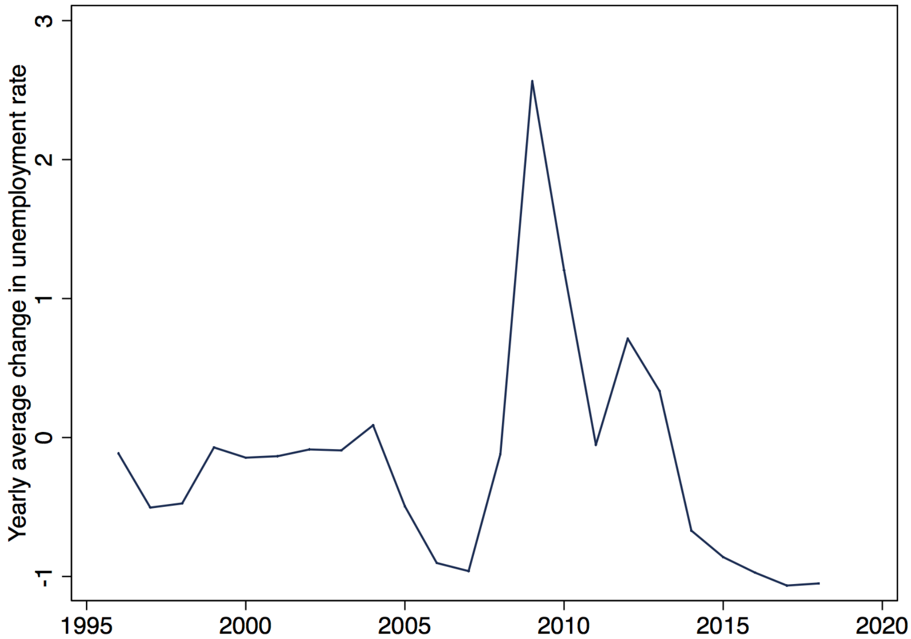


Figure 8. 3 - Yearly average change in unemployment rates

A parallel consideration for countries under a Programme shows that for countries not receiving financial assistance the latter pattern is confirmed, with more changes taking place for countries in the preventive arm (1.33) rather than in the corrective arm (1.26). For countries under a Programme, the opposite is true, with a change in the budget structure of just 1.1 in the absence of an excessive deficit for the single observation falling in this category, while for the remaining observations associated with a difficult fiscal position the mean budget distance jumps to 4.24. The single observation escaping the EDP highlights how being under excessive deficit is a nearly universal characteristic of countries receiving financial assistance rather than an element across which to distinguish. Even within the context of countries under a programme, the cycle remains a breaking point, in this instance with lower changes in the budget structure emerging in good time (3.76) compared to the Great Recession (4.71).

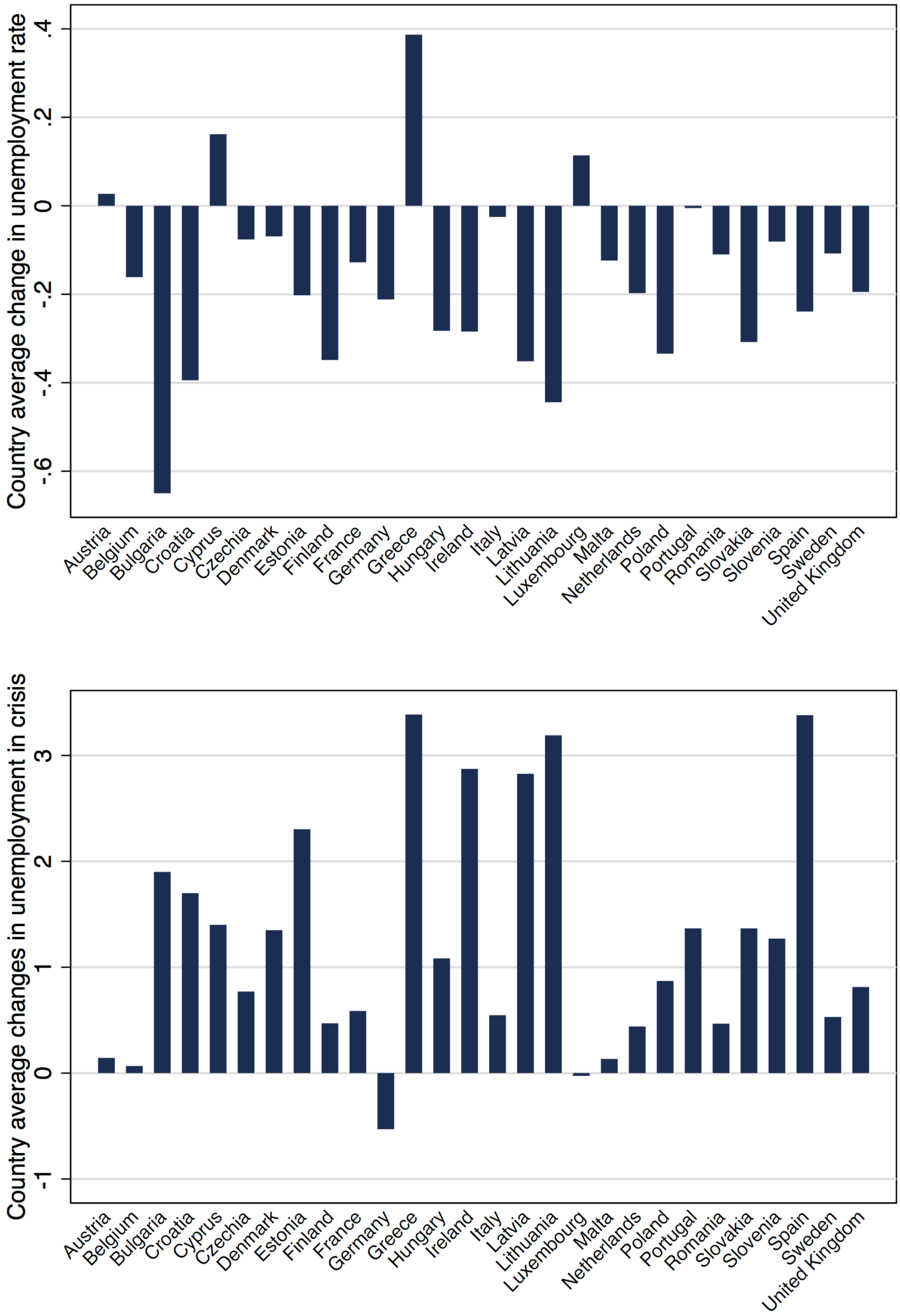


Figure 8. 4 - Country average changes in unemployment rates overall and during the crisis

Moving on to the two economic controls, starting from the change in unemployment rate more closely related to cycle dynamics, the range of this variable spans from -4.5 to 9.8 with an overall average of -0.16, with 369 observation associated with a decrease in unemployment and 237 with an increase. Dynamics diverge over the cycle with a mean value of -0.4 in good times and 1.2 in bad times, with 33 per cent of observations showing an increasing trend in normal times compared to 77 per cent during the crisis. Figures 25 and 26 show yearly dynamics as well as country averages over the full period and restricted to crisis years. Considering patterns across unemployment and the fiscal dynamics, the mean budget distance is higher (1.80) for increases in unemployment – corresponding to a positive average trend in social spending (0.35) – compared to when unemployment is contracting (1.19), for which the social protection division is shrinking (-0.24).

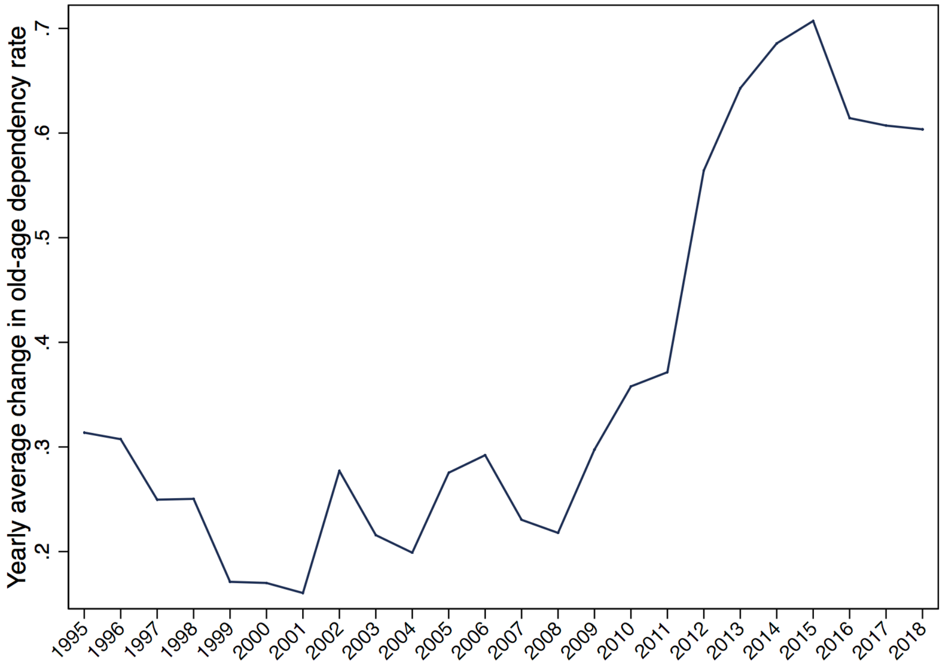


Figure 8. 5 - Yearly average change in old-age dependency rates

Shifting the focus to old-age dependency rate, the overall trend sharply increased over the years, with substantial differences across the Member States, as shown in Figure 8. 5 and Figure 8. 6. Substantial negative trends are mostly relegated to the initial year of the sample in lower-income eastern countries, except for Luxembourg and the United Kingdom. Similarly, extremes in the upper end are concentrated especially in the beginning year(s) and in Mediterranean countries. Restricting the sample post-2001 changes the range from -4 to 6 into -0.7 to 1.3, yielding to the country averages shown in Figure 8. 6. For what concerns patterns across changes in the elderly population and the dependent variable, average budget distance is higher for increasing dependency rates (1.48) than for decreasing ones (1.22), with a parallel pattern and slightly lower averages in the restricted sample (respectively 1.41 and 1.17).

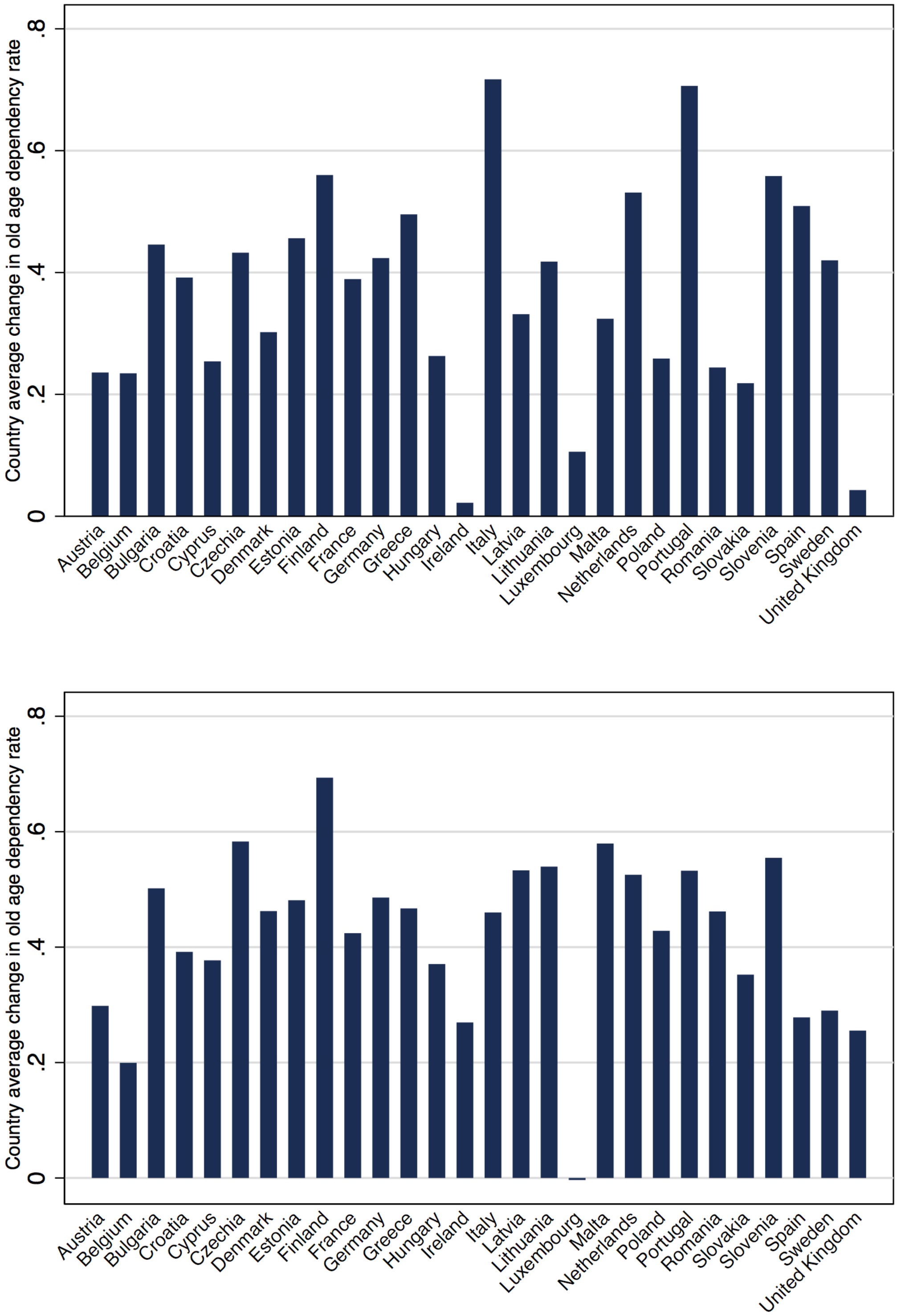


Figure 8. 6 - Country old-age dependency rate average changes overall and post 2001 (below)

Results

Coming back to the economic cycle the analysis brings previous findings together to provide a clear overview of how the climate interacts with the EU economic governance framework and the configurations under which there is an impact on the budget structure, to the extent that national spending may be extensively or fully restricted in reacting even to steep negative shocks such as that of the Great Recession and Eurozone crisis. Table 8. 11 shows the interaction between the EDP and the economic climate within and outside of the Eurozone, as well as that between the EDP and Euro area membership in good and bad times. Results reinforce how both the economic context and Euro area membership are key determinants of the interplay between the national and supranational arena. Within the Eurozone, the cross-cyclical change is marked, with the EDP only significant in bad times and its additional restraint in crisis cancelling the upward push on national spending of the Recession. The same is not the case outside of the Eurozone. Taking the opposite perspective, in good times, the impact of the EDP varies across Eurozone membership to the extent that it more than compensates for the free-riding incentive of the SGP, countering its negative push on consolidation with a positive and substantially larger impact on spending. In bad times dynamics change: once again a restraining impact of the EDP emerges only for the Eurozone, with however the incentive to free-ride no longer significant. That is to say that having excessive deficit does not necessarily link to sharp adjustment for countries not falling within the full domain of the Pact and its political and procedural pressure while that is very much the case for those that do within the Euro area.

Table 8. 11 - The interaction of the EDP, the Great Recession and Eurozone membership

	(1)	(2)	(3)	(4)
	BD (Eurozone)	BD (no Eurozone)	BD (crisis)	BD (no crisis)
EDP	0.193	-0.0646	-0.335	-0.122
	(0.160)	(0.169)	(0.258)	(0.184)
Crisis	1.146***	0.519		
	(0.262)	(0.358)		
Eurozone			0.576	-0.364***
			(0.383)	(0.103)
Interaction	-1.161***	-0.254	-0.746**	0.437*
	(0.363)	(0.429)	(0.373)	(0.235)
ideology	0.00934*	0.00116	0.0107	0.00164
	(0.00567)	(0.00396)	(0.0192)	(0.00402)
ideological distance	-0.000738	0.0153***	-0.00149	0.000418
	(0.000830)	(0.00460)	(0.00580)	(0.000918)
alternation	0.000693	-0.000448	-0.000818	-0.000176
	(0.000808)	(0.000506)	(0.0168)	(0.000562)
Δ unemployment rate	0.0510	0.112**	0.312***	-0.0156
	(0.0590)	(0.0464)	(0.0874)	(0.0451)
Δ old-age dependency rate	0.0720	-0.128	0.480	-0.101
	(0.175)	(0.228)	(0.350)	(0.144)
decentralisation	-0.103**	-0.0420	0.0119	-0.136**
	(0.0511)	(0.232)	(0.196)	(0.0610)
national fiscal rule preferences	-0.303**	-0.0562	0.0253	-0.181**
	(0.135)	(0.102)	(0.129)	(0.0901)
Constant	1.192***	1.234***	1.349***	1.454***
	(0.147)	(0.124)	(0.394)	(0.0961)
Observations	279	296	72	503
R-squared	0.110	0.069	0.474	0.046
Number of countries	19	28	26	28
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

As a result, the EDP exerts its restraining or consolidation force only within the borders of the Euro area, in different manners and to a varying extent across the economic cycle. While the Great Recession is undoubtedly at the tallest step of the podium of the impact of the supranational fiscal rule on the budget structures of the Member States, results in column four go against discarding any effect of the EDP in good times. Taking a closer look at good times dynamics, while no significance is confirmed outside of the Euro area a distinction emerges within the Eurozone across the three phases of EU economic governance. After the latest reform, a significant result emerges, although corresponding only to about half of a standard deviation compared to the nearly two standard deviations of the impact of the EDP in crisis. Table 8. 12 recaps the various configuration highlighting the only two scenarios yielding to significant results, which under the divergent overall budgetary trends correspond to a push toward consolidation of the EDP albeit more marked in its force during the Great Recession.

Table 8. 12 - When, where and how the EDP affects significantly changes in national budget structures

	crisis	no crisis		<2005	2005-2010	2011+
Eurozone	-1.66	-	⇒	-	-	0.736
No Eurozone	-	-		-	-	-

Note: outside of crisis year the impact of the EDP is shown over the three policy reforms

Shifting the focus to countries under Financial assistance (FAP) for which regression results are shown in Table 8. 13, in the full sample the impact of entering a program is an increase in changes to the budget structure, amounting to 2.67 percentage points of GDP, which corresponds to 1.5 standard deviations of the dependent variable. Model 2 indicates how even in the context of countries signatories to a memorandum, a sharp distinction remains across Eurozone Membership. Within the Euro area, the non-significant impact of programmes on budget distance jumps up by 3.656 percentage points of GDP, amounting to over two standard deviations.

Table 8. 13 - The interaction of the impact of Financial Assistance (FAP), Eurozone membership and the cycle

	(1)	(2)	(3)	(4)
	BD	BD	BD	BD (Eurozone)
FAP	2.672***	0.271	2.476***	2.807***
	(0.358)	(0.300)	(0.490)	(0.607)
Eurozone		-0.203*		
		(0.121)		
Crisis			0.348*	0.486*
			(0.194)	(0.265)
Interaction		3.659***	0.343	5.339***
		(0.547)	(0.695)	(0.940)
ideology	0.00401	0.00334	0.00426	0.0291***
	(0.00370)	(0.00371)	(0.00371)	(0.00932)
ideological distance	-0.000414	-0.000370	-0.000328	-0.00156
	(0.000903)	(0.000954)	(0.000894)	(0.00115)
alternation	0.000121	-1.39e-05	0.000223	0.00154*
	(0.00130)	(0.00120)	(0.00129)	(0.000864)
Δ unemployment rate	0.130***	0.139***	0.0973*	-0.00224
	(0.0492)	(0.0519)	(0.0517)	(0.109)
Δ old-age dependency rate	0.162	0.0807	0.172	0.187
	(0.181)	(0.188)	(0.171)	(0.222)
decentralisation	-0.206***	-0.182**	-0.202***	-0.142**
	(0.0558)	(0.0734)	(0.0562)	(0.0671)
national fiscal rule preferences	-0.173	-0.223*	-0.166	-0.423**
	(0.122)	(0.118)	(0.123)	(0.209)
Constant	1.344***	1.493***	1.282***	1.389***
	(0.109)	(0.114)	(0.102)	(0.211)
Observations	605	605	605	299
R-squared	0.176	0.227	0.182	0.398
Number of countries	28	28	28	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Switching to a cross-cycle perspective, in the full sample the interaction between the impact of FAP and the Great Recession is not significant. However, not only thus the impact of FAP per se increases once restricted to the Eurozone but also does the cross-cycle variation in its effect: the crisis heightens by a further 5.34 percentage points the impact of programmes, well over 2.5 standard deviations. That is to say that the restructuring push of the Eurozone becomes even more binding in bad times within the Euro area. The emerged dynamics are further evidenced when considering the sub-samples across Eurozone membership and the cycle. Table 8. 14 shows that the impact of FAP on the budget structure amounts to 3.81 in the Eurozone sub-sample, nearly two standard deviations. However, the impact of FAP decreases to 2.79 outside of the crisis years, 'only' 1,8 standard deviations. Conversely, during the crisis, the impact of FAP among Eurozone countries skyrockets to 8.34 and nearly 2.5 standard deviations, albeit the higher uncertainty in bad times. At the opposite side of the spectrum, no significant impact emerges for adhering to a programme outside of the Eurozone. Such difference across Euro area membership can hardly be attributed to sanctioning prospects, has strong enforcement mechanisms and conditionality are at play in the context of programmes for any adhering Member States. Conversely, it supports the importance of political peer pressure and the recognised value of preserving the credibility and stability of the common currency, along procedural factors.

Table 8. 14 - The impact of Financial Assistance (FAP) across the subsamples by Eurozone membership and the cycle

	(1)	(2)	(3)	(4)
	BD (Eurozone)	BD (Eurozone, no crisis)	BD (Eurozone, crisis)	BD (no Eurozone)
FAP	3.813***	2.787***	8.343***	0.362
	(0.534)	(0.489)	(0.724)	(0.300)
ideology	0.0239***	0.0287***	-0.00209	0.00118
	(0.00897)	(0.00963)	(0.0232)	(0.00395)
ideological distance	-0.00169	-0.00147	0.00406	0.0156***
	(0.00107)	(0.00110)	(0.0119)	(0.00456)
alternation	0.00130	0.00116*	0.114***	-0.000437
	(0.000935)	(0.000663)	(0.0322)	(0.000735)
Δ unemployment rate	0.114	0.0308	-0.308	0.161***
	(0.0989)	(0.108)	(0.323)	(0.0404)
Δ old-age dependency rate	0.114	0.179	0.424	-0.0695
	(0.279)	(0.180)	(0.770)	(0.224)
decentralisation	-0.165**	-0.183**	0.237	-0.0544
	(0.0714)	(0.0769)	(0.154)	(0.235)
national fiscal rule preferences	-0.527**	-0.427*	-0.366	-0.0254
	(0.224)	(0.232)	(0.444)	(0.0977)
Constant	1.560***	1.428***	0.613	1.228***
	(0.258)	(0.219)	(0.640)	(0.127)
Observations	299	250	49	306
R-squared	0.311	0.309	0.500	0.081
Number of countries	19	19	17	28
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Going beyond the aggregate indicator, to fully address the question of the intended distributive impact on national spending across its components, all macro-categories of expenditures are significantly (negatively) impacted when falling under financial assistance. However, also in this context, the impact is predominantly driven by bad times, while restricting to non-crisis years yields no significant results. Table 8. 15 shows the impact in times of crisis, while all categories are impacted – with the sole exception of the unrestricted specification of investments – the question remains of the respective ranking of the leash on spending exerted by the Programmes. To the 5.3 decrease in investments – 0.8 standard deviations – corresponds a downward shift of transfers of 1.68 percentage points (1.1 standard deviations), further surpassed by inequality mititgation which decreases by 2.22 percentage points of GDP (1.3

standard deviations). If the picture of where the supranational pressure hits is partially less unbalance to the disfavour of investment in the context of the more direct orientation of budgetary choices when under financial assistance, this budget component far from escapes the axe of consolidation. Conversely, findings are especially worrisome on the social and inequality dimension which are the favourite target of consolidation even in times of crisis.

Table 8. 15 - The impact of FAP on the macro-components of national budgets in the Eurozone during the crisis

	(1)	(2)	(3)	(4)
	Δ productive investment	Δ productive investment (restricted)	Δ unproductive tranfers	Δ inequality measures
FAP	-1.448	-0.530*	-1.676***	-2.216***
	(5.243)	(0.308)	(0.411)	(0.465)
ideology	-0.0477	-0.0112	-0.0252	-0.0275
	(0.0519)	(0.00703)	(0.0159)	(0.0174)
ideological distance	0.00785	0.00982***	0.00769	0.0154
	(0.0238)	(0.00331)	(0.0157)	(0.00957)
alternation	0.0951*	0.0146	0.0508*	0.0426
	(0.0541)	(0.0167)	(0.0295)	(0.0408)
Δ unemployment rate	0.223	0.145***	0.465***	0.541***
	(0.642)	(0.0402)	(0.0880)	(0.0937)
Δ old-age dependency rate	-1.358	0.132	0.0348	0.0418
	(1.124)	(0.136)	(0.514)	(0.343)
decentralisation	0.0725	-0.0120	-0.0659	-0.106
	(0.264)	(0.0465)	(0.0902)	(0.121)
national fiscal rule preferences	0.0836	0.118	-0.0980	0.0294
	(0.492)	(0.0928)	(0.331)	(0.288)
Constant	-0.710	-0.268	-0.239	-0.283
	(1.041)	(0.281)	(0.366)	(0.589)
Observations	49	49	49	49
R-squared	0.076	0.251	0.498	0.488
Number of countries	17	17	17	17
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

A granular assessment of budget line-level dynamics is beyond the scope of the analysis, in understanding which fiscal policy choices are fostered by the EU economic governance framework when they can quite directly and intrusively orient national budget structures. However, a final consideration on what happens to spending under financial assistance offers in Table 8. 16 a brief overview of the division for which a significant (negative) impact emerges – in bad times – and the comparable size in terms of standard deviations. Among investments, one line escaping the axe is education, while the opposite is the case for the other two key contributors to inequality mitigation, social protection and health, which are the most impacted budget lines. In addition, health is the sole division for which a negative and significant effect of FAP remains even in good times, confirming the considerations put forward in chapter six and seven, regarding the detrimental impact of the supranational budget constraint for spending on national healthcare systems.

Table 8. 16 - The impact of FAP on divisions in the Eurozone during the crisis

	Δ general affairs	Δ defence	Δ public safety	Δ economic affairs	Δ environmental affairs
FAP	0.122	-0.269***	-0.130**	-0.359	-0.0551
% standard deviation	23%	125%	92%	10%	39%
	Δ housing	Δ health	Δ culture	Δ education	Δ social protection
FAP	-0.134**	-0.494***	-0.109***	-0.0271	-1.694***
% standard deviation	72%	130%	92%	9%	148%

Shifting the focus to the two key domestic economic determinants of budget composition, one could expect an effect of the change in the unemployment rate on the impact of the EDP due to the commitment it imposes on social protection expenditures, which could then leave less room of manoeuvre, for example, concerning consolidation efforts. Considering the interaction at the aggregate level, the coefficient is not significant for the overall FAP excluded Eurozone panel, nor for its restriction to the latest governance iteration and non-crisis years. The marginal impact on the budget distance across EDP status and changes in unemployment rate shown in Figure 8. 7 reveals how substantial upward shifts in unemployment rates are associated with lower budget distances, e.g. less restructuring overall of the composition of expenditures. Given the additive nature of the budget distance indicator, if a substantial shift is taking place within spending directly associated with unemployment the implication of contained restructuring is indeed indicative of stiffening of budgetary dynamics in other components as a result of a limited remaining fiscal space.

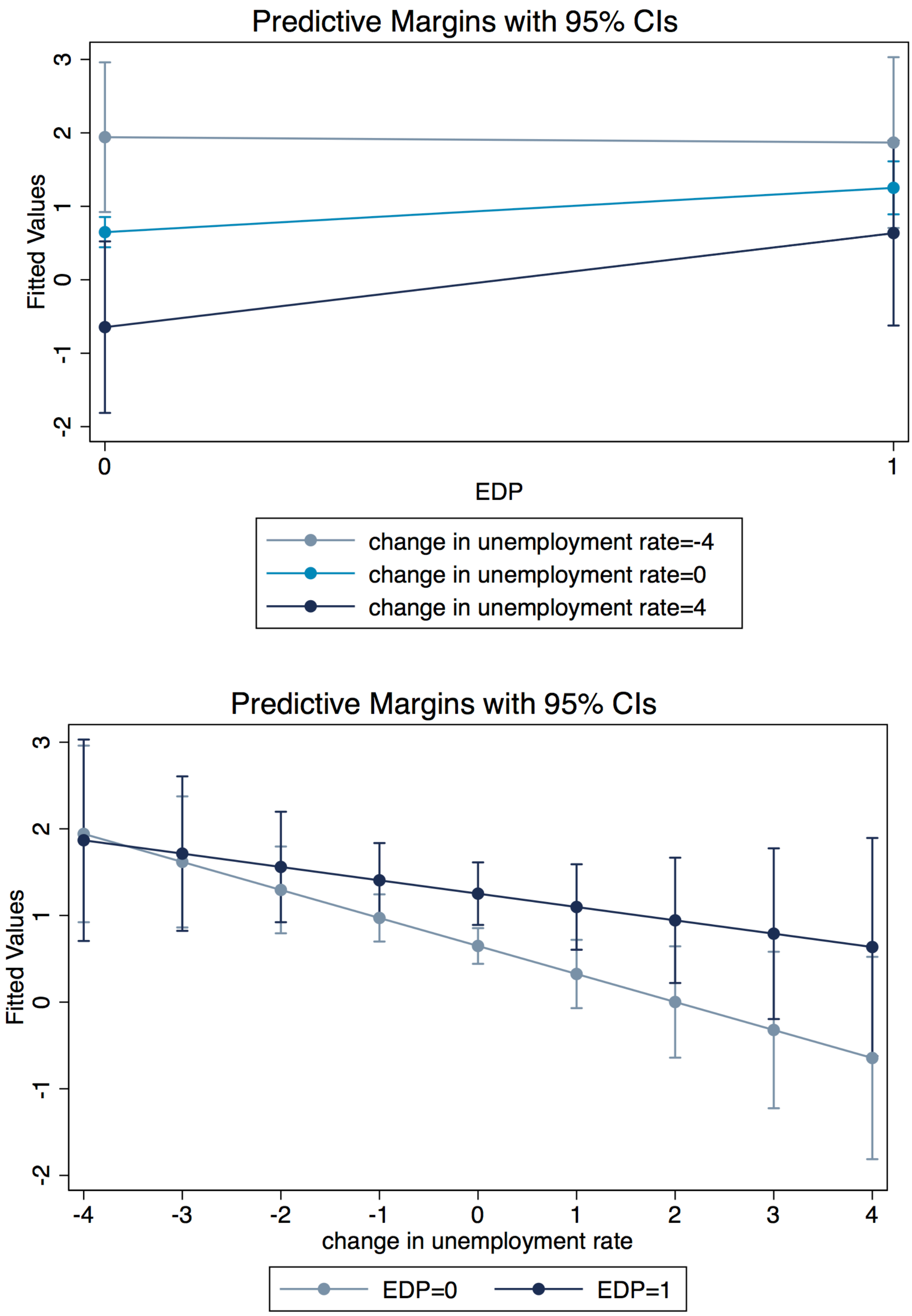


Figure 8. 7 - Marginal impact on the budget distance across the preventive and corrective arm and levels of unemployment shocks in the non-FAP Eurozone countries under the phase 3 regulatory framework

However, the EDP does impact on such dynamics and may be of particular relevance for higher shocks at the domestic level. Under the corrective arm, there is more convergence toward consolidation dynamics (e.g. higher budget distance) regardless of the national economic context, redirecting towards higher – potentially compensatory – changes in the budget structure when the pressure on expenditures of unemployment skyrockets. On such premises, the opposite perspective shows how the EDP to some extent prevents slipping towards lower changes to the budget structure which – especially in good times – are indicative of less consolidation. Further restricting the analysis to only the non-crisis years in phase three which allows for a clearer interpretation of budgetary structure dynamics further confirms the emerged trends. Figure 8. 8 shows how under the corrective arm budget distances remain higher across the board – and distinguishable for stable unemployment dynamics – mitigating the downward diversion associated with high levels of changes in unemployment under the preventive arm.

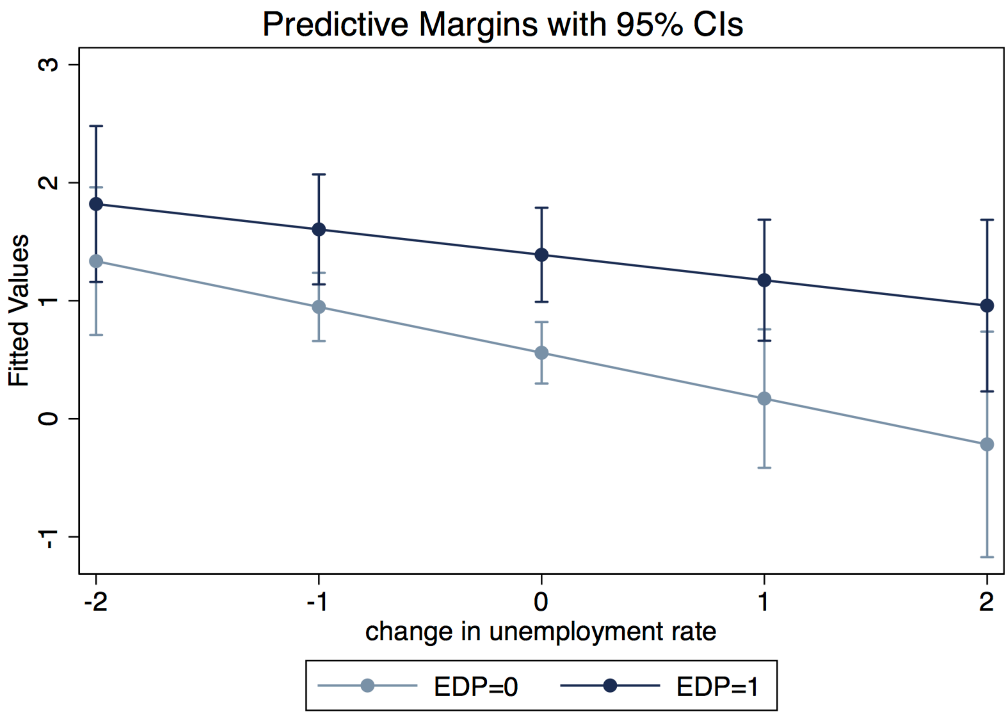


Figure 8. 8 - Marginal impact on the budget distance across the preventive and corrective arm and levels of unemployment shocks in the non-FAP Eurozone countries under the phase 3 regulatory framework in good times

However, that is not to say that the constraining impact of the EDP is the same over the full unemployment dynamics. Indeed, considering the impact of the EDP within the same sub-sample (non-FAP Eurozone good times in phase 3) for which the impact of the supranational fiscal rule is overall significant, divergent patterns emerge when further splitting the sample according to unemployment trends. Specifically, while significance at the aggregate level of budget distance is retained for downward trends in unemployment the same is not the case for positive shocks of the latter, indicating that – especially at the most extreme values – there is a limit of national economic pressure which may overpower the supranational fiscal rule. Taking a more granular view on the budget components, the interaction effect is indeed significant in the social domain: along with the overall negative impact of the EDP of -0.31, there is a negative and significant interaction of -0.14 indicating that the downward pressure of the supranational fiscal rule on social spending increases for higher levels of unemployment shocks as shown in Figure 8. 9.

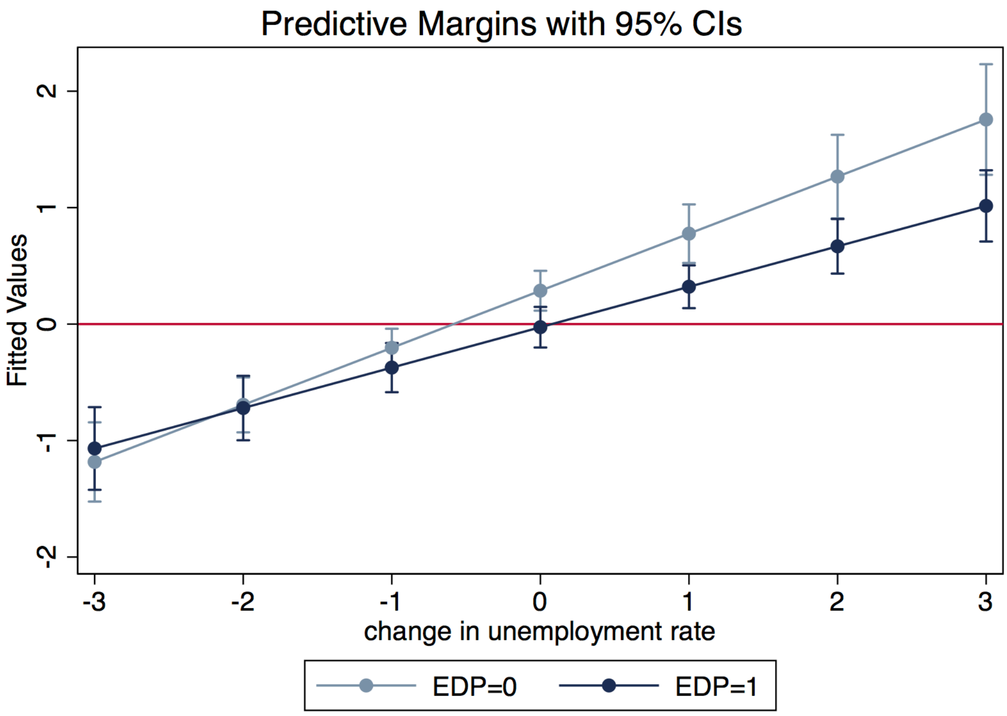


Figure 8. 9 - Marginal impact on the budget distance across the preventive and corrective arm and levels of unemployment shocks in the non-FAP Eurozone countries under the phase 3 regulatory framework in good times

Coming to the last economic variable, the change in old-age dependency rate, similar reasoning can apply with changes expected to affect the impact of the EDP by constraining a larger or smaller – and highly inelastic – chunk of the budget. However, a word of caution should be put forward against sample restriction – e.g. across the cycle or governance iteration phase – that operate over time, as the dynamics in this variable while changing across countries are worsening over time with population ageing imposing increasing pressure on national budgets. A further dynamic to be taken into account is that early years – corresponding to demographic dynamics yielding a lower burden for public finances – are less sparsely represented in the corrective arm. Under such premises, rather than distinguishing across bad and good times, the crisis is controlled for within the model, with the only sample restriction of Eurozone membership. The interaction is positive, significant and substantial, well surpassing a standard deviation at 2.19 percentage points of GDP: the EDP yields to more substantial changes to the budget structure when the pressure on public finances imposed by demographic dynamics is greater. Focusing on positive changes in the dependency rate in light of the issues raised above, the marginal effects shows how population ageing leads to greater budget restructuring under the EDP than under the preventive arm.

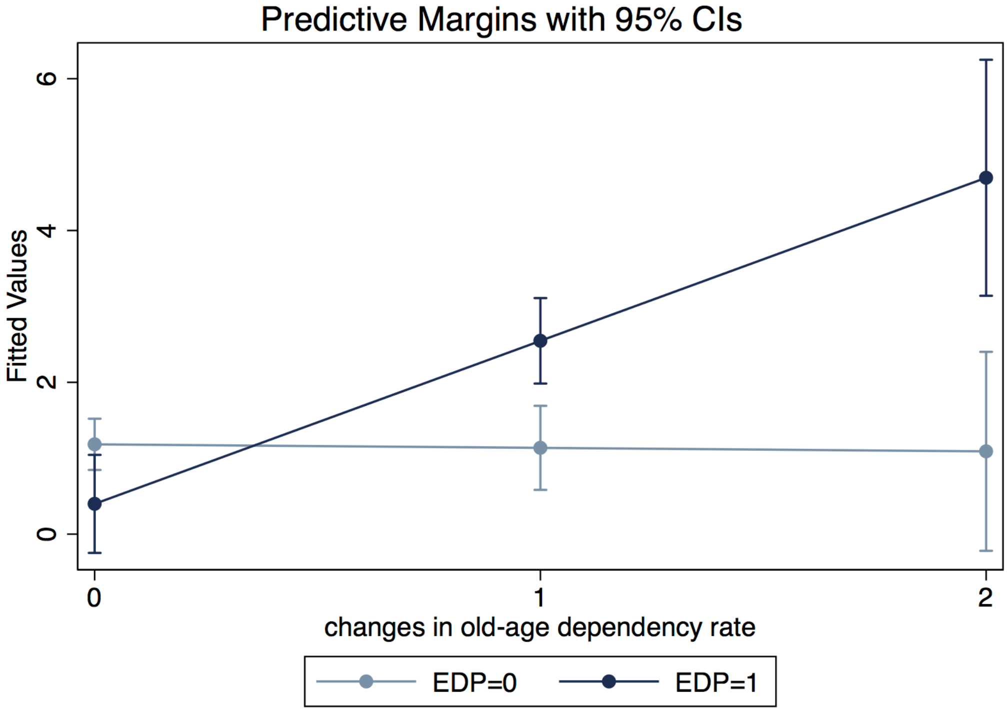


Figure 8. 10 - Marginal impact on the budget distance across the preventive and corrective arm and levels of population ageing in the Eurozone

At a disaggregated division level, the same dynamics are not confirmed when focusing on social protection: the interaction effect is not significant. The social aggregate results, however, masks divergent dynamics at the budget line level. If sickness and disability is negatively impacted regardless of demographics, the interaction effect is – as one could expect – negative and significant for old age. Family benefits and housing are negative and significantly affected constantly by the EDP across demographics with no other groups displaying a significant interaction. The EDP – as for the expansionary pressure of the crisis – acts to contain the budgetary effects of national economic dynamics even for a key variable such as demographic changes and their translation into pension spending. Such results are further confirmed by distinguishing across the preventive and corrective arm. While acknowledging that the two samples are far from homogeneous, it is of value to note that both for the social protection division and the overall budget structure, the significant impact of the change in old-age dependency rate under the preventive arm in the Eurozone is not confirmed, as shown in Table 8. 17. That is to say that within the corrective arm there is a substantial restraint of the transmission of demographic changes to the fiscal policy mix.

Table 8. 17 - Budgetary impact of the EDP and changes in old-age dependency rate

	(1)	(2)	(3)	(4)
	BD (Eurozone)	Social protection (Eurozone)	BD (no EDP)	BD (EDP)
EDP	-0.784*	-0.278*		
	(0.412)	(0.145)		
EDP#old-age	2.194***	-0.147		
	(0.716)	(0.189)		
ideology	0.0318***	-0.000432	0.00257	0.0647***
	(0.00955)	(0.00287)	(0.00779)	(0.0166)
ideological distance	-0.000943	-0.000415	-0.000571	-0.00944
	(0.00109)	(0.000483)	(0.000890)	(0.0147)
alternation	0.000516	-0.00106*	0.00104	0.00134
	(0.00228)	(0.000553)	(0.000819)	(0.00354)
Δ unemployment rate	0.156	0.299***	0.0105	0.177
	(0.117)	(0.0401)	(0.0648)	(0.204)
Δ old-age dependency rate	-0.0462	0.101	0.0254	2.241***
	(0.398)	(0.169)	(0.128)	(0.708)
decentralisation	-0.184***	0.00450	-0.0780	-0.169
	(0.0654)	(0.0263)	(0.0594)	(0.200)
national fiscal rule preferences	-0.584**	-0.0893	-0.197	-1.364***
	(0.259)	(0.0740)	(0.124)	(0.493)
crisis	0.872***	0.344	1.204***	0.860**
	(0.247)	(0.219)	(0.162)	(0.408)
Constant	1.648***	0.216*	1.060***	1.389**
	(0.300)	(0.128)	(0.159)	(0.659)
Observations	299	299	179	120
R-squared	0.162	0.381	0.199	0.160
Number of countries	19	19	19	15
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Implications

In assessing RQ[3.3] relating to the interaction between the SGP and the domestic economic environment, several aspects are considered in this section, starting from dynamics of the EDP across the cycle and how the latter intersects with the different iterations of the supranational fiscal framework. Additionally, it explores the insights offered by the impact of financial assistance programmes on domestic budget composition. Finally it looks at the interaction between the EDP and two key economic factors affecting the fiscal policy mix at the national level, unemployment and old-age dependency rate. In doing so – while specificities change across the various element analysed in the section – findings aim to assess [HP3.C] which capture national economic dynamics broadly expecting the impact of the Pact on the budget structure to decrease when running against opposing domestic economic conditions. In general terms – coherently with what emerged through crisis dynamics – that is not entirely the case: the bite of the Pact generally hits the hardest especially in circumstances bound to have the worst budgetary implications in the eyes of the supranational fiscal rule. In doing so the compensatory leash of the Pact in the Great Recession can be found also for the two key domestic economic drivers of budget composition: the corrective arm tends to severely limit if not to annul the pressure of national dynamics, including in sensitive domains such as unemployment and demography.

Delving briefly into the implications that can be derived across the four elements considered in the chapter, the cross-cycle overview bringing together synthetically the impact of the EDP across the configurations considered throughout the analysis confirms that (i) the Pact bites especially in bad times, (ii) how the cycle containment\annulment dynamics only take place under the corrective arm and in the Eurozone and (iii) pinpoints how there is indeed some impact also in good times but only for the latest iteration of the supranational fiscal rule, indicating how it may be better equipped to constrain fiscal policy even under less extreme circumstances. Financial assistance countries confirm the trend, with also in this case a concentration of the consolidation push of the supranational fiscal rule in the negative phase of the cycle. Moreover, they confirm an intended negative impact across all three macro-budgetary components, albeit the ranking of the force of the supranational axe does differ compared to the indirect impact observed under the EDP outside of programmes dynamics. Indeed, the emerging picture is to some extend less dire for investment, which is the least affected compared to transfers and inequality mititgation which capture some of the most impacted budget components. The implication is that the intended direction of fiscal policy restructuring for countries under extreme duress may indeed be less dreadful in terms of growth-enhancing investment, while however more worrisome in terms of its social impact. It is worth to note that while an element taking an important share of the investment budget – education – does escape the guillotine of the EDP, another key division does not fare as well Health spending is the second-worst affected budget line after social protection and the only one for which an impact remains also in good times. Circling back to the concerns expressed in the crisis chapters, there is an indication that the negative trends within the health domain at the hand of the supranational fiscal rule may not be so unintended collateral damage after all, as further confirmed by several CSRs prescribing consolidation and rationalisation of health spending. Finally, the analysis of the interplay of the two key domestic economic determinants of the budget composition and the supranational fiscal rule confirms the power of the EDP in restraining expansionary dynamics and pushing towards budget restructuring. Across both domains, the corrective arm of the pact can be seen as mitigating national economic trends, to the point that under the EDP a significant budgetary impact may not emerge at all as for demographic dynamics. The supranational fiscal rule is confirmed as an extremely powerful force, capable even of containing demographics from affecting the budget structure.

Conclusions

Diving into national dynamics and their interplay with the supranational fiscal rule, the chapter shows how the domestic environment does indeed play a role in determining the scope for the EDP to constrain and nudge towards consolidation spending in the Member States, affecting their budget structure, as shown in Table 8. 18. At the same time, findings reveal the power of the corrective arm of the pact in containing when not nullifying national dynamics for countries with excessive deficits. The overall hypothesis guiding the analysis across this chapter is verified as the supranational and national determinants of the fiscal policy mix do interact in determining a varied effect of the Pact across different domestic configurations. Likewise, EDP surveillance yields varied – namely restrained – expansionary effects of political, institutional and economic domestic factors.

Table 8. 18 - Summary of results for [RQ.3] *if and how the impact of the SGP changes across different domestic political, institutional and economic conditions*

[HP3.A] *the effect of the Pact on the budget structure is larger for government coalition characteristics (e.g. low ideological distance, high alternation) more conducive to changes in the budget structure.*	Corroborated: smaller ideological distances, high alternation, moderate ideology (higher for centre-left) is associated with a larger effect of EDP
[HP3.B] *the effect of the Pact on the budget structure is larger if domestic institutional configurations are more conducive to fiscal consolidation.*	Mixed results: verified for unitary vs federal states; national fiscal rule strength preference is complementary to EDP
[HP3.C] *the effect of the Pact on the budget structure is smaller when running against opposing domestic economic conditions.*	Refuted: the effect of the EDP is stronger in mitigating expansionary national dynamics (e.g. recessions, ageing and unemployment)

Across the political and institutional arena, the specific sub-hypotheses are verified insofar that findings confirm that the effect of the Pact on the budget structure increases across domestic political and institutional configurations more conducive to changes in the budget structure and fiscal consolidation. Within the political arena, configurations suitable for policy change in terms of the composition of the governing coalition act as a precondition for transmission of supranational prescriptions into changes in the domestic budget structure. Likewise, the ideological stance of the national government also hinders or facilitate the impact of the EDP on the fiscal policy mix. Specifically, the bind of the corrective arm is the strongest for sufficiently moderate governments, while more extreme values at the left and right of the political spectrum run against effective implementation of supranational prescriptions and constraints. Similarly, institutional factors do play a role. Control over the full scope of spending in the Member States is a facilitator of the EDP domestic transmission, with central countries more impacted than decentralised ones and some indication that in federal context decentralised spending may be able to escape the axe of the corrective arm. A separate dynamic emerges instead for national fiscal rules: rather than an enforcement mechanism strengthening the reach and force of the Pact the two levels are largely complementary. There is limited need for the supranational fiscal rule in countries favouring a restrictive approach to public spending so that their budget structures are largely unaffected by the EDP. Rather profligate Member States are those for which the corrective arm matters the most in fiscal dynamics and the composition of spending.

A similar pattern arises within the economic arena, where – against the expectations of [HP3.C] and coherently with crisis dynamics – the effect of the Pact on the budget structure does not decrease when running against opposing domestic economic conditions. Rather, its spending containment power is concentrated exactly in the context in which domestic conditions push toward an expansion of public spending. Nevertheless, it is confirmed that substantial interactions emerge across this domain and the supranational fiscal rule, with the negative phase of the cycle – also for countries under a programme – and the higher shock in unemployment and demographic trends associated with a more substantial impact of the EDP on the budget structure. However, one may consider a further key takeaway which may not relate to the extent to which a different domestic environment is conducive to a greater or more restrained impact of the corrective arm but rather to the far-reaching power of the Pact and more specifically the EDP. A clear example is how the corrective arm may even allow for the containment of demographic dynamics on top of rendering the budget distance undistinguishable across the economic cycle.

In concluding, if the power of the EU economic governance framework in binding national fiscal policies appears hard to doubt, the same is not the case for the optimality of its impact, not only in negatively affecting growth-enhancing investment but also in targeting spending associated with inequality mitigation with far-reaching social implications. The dynamics emerging for financial assistance countries also put into question the extent to which the negative consequences of the EDP are unintended or rather the result of the underlying fiscal paradigm of the EMU architecture that appears, however, to clash with its own growth-enhancing objectives in practice.

9. Discussion and Conclusion

Four empirical chapters have explored the three core research questions on the heterogeneity of the impact of EU economic governance across different configurations of the policy itself, of the economic cycle and finally the domestic context, under the overarching interrogative of whether the SGP results in distributional impacts on the national budget structure. With most of the hypotheses verified and when refuted far from because of lack of impact of EU economic governance, the SGP and especially *EDP surveillance emerges from the quantitative assessment of the thesis as a powerful force shaping significantly budgetary choices of the Member States, not only at the aggregate level but also in terms of their allocations.*

Before turning to the recap of the results and their implications, the primary contributions of the findings expand beyond the backing of the effectiveness of EU economic governance in enacting disciplinary restructuring of national public spending. Indeed, on a theoretical level, *the analysis confirms the centrality of EDP surveillance and its entailed political pressure within the EMU governance framework, departing from the simplistic accounting of EU economic governance as membership of the Euro area predominant in extant literature*. The approach allowed the uncovering of problematic shortcomings of the current governance framework: *its negative distributive implications for investment and social concerns along with its procyclical bias*. Such elements, while strengthened in times of economic duress, remain true for the reinforced post-2011 framework. As a result*, findings support a structural limit of EU economic governance – inherent to the overarching austerity philosophy and rule-based approach of the SGP*, a particular timely consideration given the troubled times during which future reforms and integration prospects are debated under the auspices of the Conference on the Future of Europe.

This chapter recaps the main findings of the thesis and their implications drawing some conclusions on the extent to which EU economic governance delivers on its policy objectives and desirable characteristics of fiscal dynamics, highlighting the shortcomings and criticisms backed by the results. In doing so the chapter situates the findings within extant literature highlighting the contribution to well-established debates previously rarely investigated in such a systematic quantitative fashion over the full life of the common currency. Against such backdrop, final considerations shed some light on the (underwhelming) revision process underway ahead of the pandemic, whose ambition falls substantially short of reform proposals within the literature. Similarly, some implications are drawn for how the Covid-19 outbreak on one hand further reinforce the findings of minimal crisis-management preparedness of the framework, while at the same time drawing reframed implications for the deeply changed context in light both of the pandemic and the innovative response instruments which (temporarily) fill the holes of the EU economic governance to face the outbreak and reconstruction effort. Finally, the thesis ends with an outline of the policy outlook that can be derived from this work, while highlighting how the substantial contribution of the analysis in bettering the understanding of the EU-MS fiscal puzzle opens the way for a rich research agenda both in relation to the Covid-19 context and an EDP-centric continuation of the quest to provide an in-depth understanding of the budgetary consequences of the supranational fiscal rule and provide a valuable contribution to the policy debate in view of the reform prospects in the context of the Conference on the future of Europe.

9.1 Key findings and implications

The thesis provides a richer account of the EU-MS fiscal puzzle than extant literature, focused mainly on aggregate spending dynamics and not considering heterogeneities in the impact of the supranational fiscal rule on national budgetary choices. *The work refutes the claim that the EU economic governance framework has failed in impacting spending in the Member States.* Nevertheless, it does align with earlier findings associating no or counter-disciplinary effect to membership to the Union and Eurozone (e.g. Dahan et al., 2013; Reuter, 2015, 2019; Tòth, 2019; Franek & Postula, 2020; Jalles et al., 2020; Losoncz & Tóth, 2020). However, it shows how such a simplistic account of the complex framework that is the SGP fails to consider the "cornerstone" of the EU economic governance framework: the Excessive deficit procedure (Hallerberger et al., 2009, p. 171). *EDP surveillance - within the Eurozone - is confirmed throughout the analysis as the key determinant of the ability of the SGP to affect the domestic budget structure*, allowing to pinpoint extensive heterogeneities and the specific configurations conducive to a restraint on spending – especially for some components – at the hands of the supranational fiscal rule.

The results of the analysis – covering the full life of the policy – reveal quite a bleak picture. If the effectiveness of the framework can hardly be put into question, the same cannot be said for the adherence of the Pact to its own policy objectives: *the supranational fiscal rule does affect national budgetary choices but goes quite in the opposite direction than fostering inclusive growth*. The most blatant violations of the aim of the EU economic governance framework confirms a trope within the literature harshly criticising the pro-cyclical SGP-at-crisis as a motor of lengthened downturns, social pain, investment crowding out and outright failure of crisis management fostering worsened core-periphery divergencies. Within the context of the analysis at hand heterogeneities do not prevent a univocal answer to the overarching question driving the work: *the impact of EU economic governance on the Member States is far from neutral for the budget structure*.

The remainder of the section discusses key findings in detail for each research question, recalling which hypotheses were verified and rejected and the implications for the supranational fiscal surveillance framework, before positioning the results of the thesis within the broader context of the undergoing revision process, reform debate and changed outlook for the EMU as a result of the Covid-19 crisis. However, it is valuable to consider a few elements against which to evaluate the discussion of the findings.

(i) The latest governance reform in the 2011-2013 wave represents indeed a breaking point in terms of the effectiveness of the framework which departs from impact concentrated primarily in times of crisis and exclusively for countries under EDP surveillance.
(ii) The most damning findings refer to the Great Recession, covering both the pre and post-2011 SGP reform. The data structure does not allow to isolate the crisis impact of the reformed framework, however, it does refute results being driven solely by the second period of the crisis as results are robust to considering only the early phase of the framework. Has the pro-cyclical problem of the SGP been overcome by the reform? The discussion below addresses this key point on the extendibility of the framework, the immediate invocation of the general escape clause in the context of the – albeit unprecedented and unlike any normal downturn – Covid-19 crisis suggests otherwise as the only way to address such difficult times has been pulling the emergency brake and temporarily set the framework aside.
(iii) *The north-south divide remaining at the forefront of the public debate in the pandemic is a permanent and pervasive characteristic of EU economic governance*: rather than foster convergence, it has the most damning impact on the fiscal policy mix (e.g. investment crowding-out, intergenerational fairness) in the periphery. A feasible pathway to address imbalances may be at the core of any politically, socially and economically sustainable way forward for the EMU.
(iv) Backing extensive literature, the latter consideration – together with the indications that the Semester alone has not changed the impact of the SGP that blatantly runs against prescriptions of the CSRs – points to questioning the appropriateness of a rule-based system acting on the budget structure indirectly and affected by domestic dynamics in orienting the fiscal stance of the Member States towards inclusive growth. The asymmetric nature of the Pact has failed in such predicament especially in more fragile countries at their worst times.

Consequently, *the SGP is far from a minor nuisance leaving (compliant) budgetary choices to the Member States, whose sovereignty and ability to deliver on key (social included) concerns of their citizens is severely impacted without a supranational counterbalance*.

When and how the Pact affects the fiscal policy mix: the key role for EDP surveillance

Table 9. 1 below shows which sub-hypothesis within RQ1 dedicated to pinpointing when and how the Pact affects national budgets are verified, under the main umbrella of confirmation of heterogeneity across the multi-faceted dimensions of the Pact. As recalled above the thesis confirms earlier results of little or reversed disciplinary effect of Membership to the EU and the Eurozone on fiscal choices of the Member States. The conclusion of the supranational fiscal rule being an ineffective failure is, however, strongly refuted. The SGP does not indeed always affect national budget structures. But in the instances in which a significant impact emerges, it may be quite sizeable.

Table 9. 1 - Summary of results for [RQ1] *when and how the SGP affects the composition of national budgets.*

[HP1.A] *falling under EDP surveillance leads to consolidation-driven higher structural changes in national budgets.*	Corroborated: for Eurozone countries: significant increase in changes to budget structure and decreased spending in some budget components.
[HP1.B] *the impact of EDP surveillance on the composition of national budgets substantially increases with the 2011 reform of the SGP*	Corroborated: significantly higher impact on the budget structure post-2011, even more substantial for the Fiscal Compact.
[HP1.C] *the impact of EDP surveillance on national budget structures is congruent with the CSRs.*	Refuted: cases – especially in the periphery – were the impact of the EDP runs against prescriptions of the CSRs.

In this regard, Eurozone membership – with its peculiar characteristic of a tougher sanction-backed stick – is a precondition for any effect on the Pact on domestic fiscal policy mixes. At the same time the supranational budget constraint matters for the composition of national spending only when it binds: for countries over the deficit threshold and under EDP surveillance. A first key contribution of the work – which aligns with previous findings on national fiscal rules (Reuter, 2015) – shows how the Pact affects spending regardless of its poor track record of compliance. As such, studies on the EU and especially Eurozone countries cannot disregard it. However, it may as well not be optimal to simply consider membership, at the bare minimum accounting indeed for EDP status at any given time. Beyond the academic domain, the policy implications are extensive: when the budget constraint binds the Pact ties substantially budgetary sovereignty of the Member States not only in the scale of fiscal policy but at its core of distributive choices on the allocation of spending. To make matters potentially more problematic, the political Council-centric nature of the process may lead to extensive differences in outcomes between Member States in similar fiscal positions. The Pact may hence be far from neutral not only to the budget structure but also to political dynamics and interests across the Member States, with little accountability to match.

Results support heterogeneity also across policy reform, suggesting a weakening if anything of EU economic governance post-2005 and strongly confirming a sharp breaking point post-2011. Not only does EDP surveillance carry different implications over the life of the Pact but also the dynamics potentially backing a free-riding effect of EU and Eurozone Membership in the early phases of the EMU reversed after the latest wave of reform. Such patterns indicate that the preventive arm which lacked any bite earlier on becomes more impactful in recent times, which does not however diminish the gap in budgetary dynamics under EDP surveillance. As pre-crisis imbalances have been held – together with mismanagement – at the core of the sovereign debt crisis within the Eurozone (Wyplosz, 2017), an improvement of the preventive arm may bode well for the avoidance of a repeat of the previous dynamics. However, post-crisis austerity-driven policies at the hands of the SGP and Fiscal Compact have furthered heterogeneities and divergences across the core and periphery, with the pandemic set to put ulterior stress to such trend even in the presence of common corrective mechanisms (Ceron et al., 2020).

Hence the improved effectiveness of the Pact post-2011 may not ameliorate prospects for national fiscal policy mixes and integration. The refutation of the third hypothesis of congruence between CSRs prescriptions and the impact of EDP surveillance backs such assessment. EDP surveillance post-2011 and even more so under the Fiscal Compact is bad news for investment and inequality mitigation policies, with a decrease in spending across key domains such as social protection, health, education and culture. To make matters worse the effect is more marked in the periphery, while partially reversed in the core. Post Fiscal Compact being under EDP surveillance is associated with such a negative trend for social protection that net dynamics for transfers turn negative unlike in the Eurozone in general. These patterns diverge from the prescription of the CSRs, once again especially in periphery countries, for which more often than not social investment does find a place in the policy recommendation but not necessarily in the domestic budgets. That is to say that socialisation of the CSRs with the Semester (i) need not carry a similar impact on actual fiscal choice (ii) may run against the indirect effect on the spending of EDP surveillance and (iv) given actual budgetary trends – albeit preliminary and partial to the selected countries considered in the case studies – does have implications for the debate on whether fiscal discipline remains the driving force of the EU economic governance framework. Indeed, preached social investment in the CSRs may run into the brick of limited fiscal space and adjustment needs for countries under EDP surveillance, especially in the periphery.

The detrimental effects of the SGP-at-crisis

As explored in chapter two much ink has been dedicated to (criticising) the SGP-at-crisis and the ensuing reinforcement of the austerity paradigm in the aftermath of the Great Recession and Sovereign debt crisis. The analysis putting to the test if the SGP abide by its objectives of countering the cycle and foster inclusive growth confirms the problematic reputation of the Pact in handling the crisis especially in the Southern side of the Continent. Alike non-compliance to the SGP does not prevent it from impacting the fiscal policy mix of Member States under EDP surveillance, escape clauses in times of recession similarly do little to shield the national budget structure from the supranational austerity axe. Results in relations to in-crisis dynamics shown in Table 9. 2 are indeed quite damning for the Pact, once again for countries falling under EDP surveillance within the Eurozone. For those Member States, the leash of the supranational fiscal rule restrains away most expansionary pressure derived from the economic downturn substantially mitigating increases in expenditures and as a result leading to smaller shifts in the budget structures at the aggregate level. That is to say that the Pact during the Great Recession is so powerful for countries under EDP surveillance that cyclical dynamics nearly disappear.

Table 9. 2 - Summary of results for [RQ2] *if and how the SGP has affected the domestic composition of public expenditures during the Great Recession and Eurozone crisis.*

[HP2.A] *the SGP contravenes its countercyclical policy objectives in enforcing consolidation in times of crisis.*
<u>Aggregate level</u> a lack of bite of the EDP-in-crisis on the budget structure is refuted confirming an impact which increases in bad times compensating for the upward push on spending of the crisis, compatible with consolidation.

Division level a push toward consolidation is confirmed at the disaggregated level with heterogeneity across the budget components some are negatively impacted by EDP surveillance with no distinction between good and bad times (defence and culture & recreation), while for other the impact either emerges only during the crisis (education, social protection) or if further reinforced completely compensating for the recession entailing a net decrease in spending (general affairs, public order & safety, housing & community, health).
Group level heterogeneity extends within divisions, in some cases with a single or few budget lines showing a significant impact compensating the crisis (e.g. basic research, fire protection, water, community development, hospital services, secondary education, family & children, unemployment). Beyond the social domain, results are particularly worrisome in the health domain and for education, for which spending is cut in a stable way across the cycle, while only in bad times for secondary and tertiary education.
[HP2.B] *the SGP-at-crisis in pushing toward an investment rich response to the recession came at the expenses of transfers and inequality mitigating expenditures.*
The hypothesis is partially refuted as investment is the spending component worst hit by EDP surveillance overall and during the crisis. However, austerity in crisis hits social spending and inequality mitigation measures as well. Investment contrary to policy objective of the Pact investment is always negatively impacted by EDP surveillance, an effect reinforced during crisis time supporting a crowding-out of investment as a result of austerity. Both in the core and the periphery the pattern remains but the size of the cyclical component – always overcompensating the effect of the downturn – is doubled in the Southern Member States. Transfers EDP surveillance is only significant in bad times, nearly compensating for the upward push of the crisis. Such an effect seems to run counter to how Eurozone countries allocate spending during the crisis outside of EDP surveillance, with an increase of social spending. The most marked core-periphery divergence is in transfers. Dynamics align with investments, albeit the increased impact of the EDP-in-crisis does not compensate fully for the recession, in the core. The opposite is the case for the periphery for which EDP surveillance during the downturn does mitigate expansion in spending, which is, however higher for southern countries in the corrective arm outside of crisis years.

<u>Inequality mitigation</u> For these components dynamics sit in between investments and transfers: the EDP always limits spending but increasingly so during the crisis without fully compensating for its upward push. Core-periphery patterns are more closely aligned with a worse impact in crisis in the former.
[HP2.C] *the SGP-at-crisis furthered the social cost of the recession by negatively impacting social spending dynamics.*
It is confirmed that EDP surveillance negative impacts social spending and increasingly so during the crisis, nearly constraining away all upward pressure of the recession. The effect is heterogeneous in the core and periphery. In the core the impact of EDP surveillance is always significant and its increase in the crisis only constraints 85% of the recessionary pressure compared to 95% in the periphery where the bind of the EDP is limited to bad times.

Before the 2011 reform in general and overall for some budget lines, the impact of EDP surveillance is indeed concentrated in the crisis years. Such results are coherent with findings illustrated above showing that the fiscal restructuring power of the SGP materialise when the supranational budget constraints become binding, a predicament under which most countries found themselves especially in the timeframe of the crisis. Nevertheless, the impact of the EDP at the aggregate level of the budget distance is indeed heterogeneous across the cycle increasing during the downturn. However, the impact of the supranational fiscal rule is far from neutral to spending components, some display no significant effect under any circumstance, other such as defence display a constant restraint in good and bad times. A sizeable group however does display changing impact over the cycle either becoming significant or increasing during the crisis such as education and social protection. A final group – among which one finds health policies – adds to such patterns the full compensation of the upward push of the recession. Heterogeneity emerges also within divisions. The implications are of great policy relevance as not only the policy is far from counter-cyclical but it alters the fiscal policy mix in a way that may be particularly damning for given categories of spending. A notable one among them is health and especially hospital services for which the net effect is negative of being under EDP surveillance during the crisis. Confirming earlier – generally country-specific – case studies, the findings are worrisome especially when read through the lenses of the pandemic and the potential for blatant unpreparedness especially in the austerity riddled periphery which results confirms had been slaying health spending for years under the pressure of EU economic governance.

Coming back to the purpose of supporting inclusive growth that is also not the case for countries under EDP surveillance during the crisis. At the same time, the second sub-question is partially refuted as there is no evidence supporting a push toward investment crowding out social spending. Rather, investment is the worst-hit budget component with a net negative prospect, which does not prevent the EDP-in-crisis to impact inequality mitigation measures and transfers, in this order. However, it should be noted that while the first two categories are always impacted even though increasingly so during the recession, transfers are affected only during the crisis. Geographically heterogeneities emerge as well, both in dynamics and size of effects, generally to the detriment of the periphery. The backlash against the SGP and its crisis-management seems quite well-deserved in the face of the data pointing toward counterproductive dynamics for national budgetary policies and the speed of the recovery. *The SGP may hence be quite a failure after all not for its ineffectiveness in enacting fiscal discipline but for its excessiveness in doing so in a pro-cyclical fashion, lengthening the turmoil, endangering growth and weakening the social safety net in the times of most need*. While the reformed pact is yet to fully be tested in bad waters and may never undergo such assessment in view of the pandemic and reform debate, the unfitness of the framework may be structural rather than limited to the circumstances of the Great Recession and sovereign debt crisis. As problematic impacts on investment remain under the Fiscal Compact the limits of the SGP are persistent unless the architecture of the SGP is altered in a way that such indirect negative effects can be effectively prevented.

The same reasoning applies to the third sub-question dedicated to social spending which is indeed verified. Eurozone countries under EDP surveillance saw an increased constraint on social protection during the crisis. Most of the upward pressure of the crisis in this domain was controlled away by the supranational fiscal rule. However, heterogeneities remain within specific budget lines and across geographical divides. In general, family policies and unemployment have it worse than pension and old-age related spending more in general. The intergenerational impact of the crisis falls predominantly on younger generations, especially in the periphery. If the overcompensation of the EDP-in-crisis yielding an overall negative effect for family policies is already a striking result, unemployment spending dynamics are especially noteworthy. The effect of the cycle is fully controlled away for countries under EDP surveillance while those remaining within the preventive arm show a sizeable cyclical difference in this domain chiefly impacted by the recession. Putting the data on the stand, *results validate the anti-austerity narrative and accusations against the pact of detrimental subjugation of social spending to the primacy of fiscal discipline even in the context of a severe downturn such as that of the Great Recession and Eurozone crisis.*

The supranational - national interplay and the configuration conducive to the transmission of the EU fiscal rule prescriptions

The final part of the analysis has explored heterogeneity in the impact of EDP surveillance on national budget structure as a function of the domestic political, institutional and economic conditions, recapped in Table 9. 3. However, while in the political domain and in the federal-unitary divide a conducive domestic context is a pre-condition for the effectiveness of EDP surveillance, the opposite is true in the economic arena. The harsher constraining power of the supranational fiscal rules materialises exactly when the domestic context is more problematic for fiscal discipline to mitigate when not completely annihilate the expansionary push of domestic factors such as a recession, unemployment or ageing.

Table 9. 3 - Summary of results for [RQ.3] *if and how the impact of the SGP changes across different domestic political, institutional and economic conditions*

[HP3.A] *the effect of the Pact on the budget structure is larger for government coalition characteristics (e.g. low ideological distance, high alternation) more conducive to changes in the budget structure.*	Corroborated: smaller ideological distances, high alternation, moderate ideology (higher for centre-left) is associated with a larger effect of EDP
[HP3.B] *the effect of the Pact on the budget structure is larger if domestic institutional configurations are more conducive to fiscal consolidation.*	Mixed results: verified for unitary vs federal states; national fiscal rule strength preference is complementary to EDP
[HP3.C] *the effect of the Pact on the budget structure is smaller when running against opposing domestic economic conditions.*	Refuted: the effect of the EDP is stronger in mitigating expansionary national dynamics (e.g. recessions, ageing and unemployment)

Considering systematically the three sub-hypotheses tested in chapter eight, the first is verified as a larger effect of the Pact is found for homogeneous sufficiently moderate governing coalitions, in the context of a high alternation. Specifically, conducive characteristics of the national government act as a precondition for any impact of EDP surveillance to materialise, as the latter ceases to be significant outside the ranges indicated above. That is to say that changes to the budget structure need to be politically feasible (e.g. low ideological distance, high alternation) to allow for the transmission of the supranational fiscal rules onto the domestic fiscal policy mix. Ideology acts along the same lines as moderate enough coalitions are necessary for restructuring to take place under EDP surveillance. However, results confirm greater fiscal consolidation of the left side of the spectrum for which the size of the impact of the EDP is greater. Political heterogeneity in the effect of the Pact carries the implication that there is scope for political interference against EU economic governance.

Moving on to the institutional arena, results are less univocal. Decentralisation acts alike political characteristics, with a unitary system facilitating the work of EDP surveillance, conversely hinder by federalism. Findings suggest, as case studies have previously argued (e.g. Heipertz & Verdun, 2010) that EDP-driven adjustments are more easily successful when the central government has overarching control over spending compared to when substantial shares of the budget are delegated to the fairly autonomous spending power of regional entities in federal states, in line with findings on national fiscal rules. The same is not the case for fiscal rules, and more specifically the preference at the national level for their strength. The national and supranational level appear complementary in pursuing fiscal discipline. In the well-disciplined Member States, EDP surveillance plays a marginal if not absent role in affecting the composition of the budget through its consolidation drive. The opposite emerges for domestic profligate preferences where EU austerity is key in mitigating expansionary pressure or putting the national budget on a diet, concurrently yielding a substantial restructuring of spending. That is to say that *if the effects of the Pact are not neutral – and in several ways sub-optimal – for the composition of national budgets, such problematic dynamics tend to be worse if not concentrate predominantly in the periphery, hitting harshly on countries already often facing substantial challenges, for example during the crisis*.

Coming to the final dimension, coherently with the dynamics regarding fiscal rule strength preferences, the EDP hit the hardest when it is needed the most to keep spending under control, that is to say when national economic dynamics exert larger expansionary demands on the budget. The crisis is one example. Following closely is increased unemployment. For both, EDP surveillance has the remarkable power to constrain away the budgetary impact of such usually central drivers of fiscal policy choices by leading to a sustained compensatory budget restructuring. Finally, considering the impact of Financial Assistance, one overarching thread in the analysis is confirmed: the crucial distinction along the Euro area fault lines even in a context in which the EDP per se is not at play but rather countries are bound to the specific Memorandum undersigned. That is to say that the recognition of interdependence and the pressure to fall in line may materialise mostly for members of the common currency club. At the same time results – while marking a partial sparing of investment from the guillotine of austerity – confirms a critical impact on social spending and – noteworthy especially in pandemic times – heath expenditures, respectively the first and second most hit budget lines. As worryingly, comparatively the scars of financial assistance are the deepest for inequality mitigation. Against such results, which mark a much less indirect impact on affected Member States budget structures in the context of a Memorandum, the problematic distributional consequences are harder to even partially discard as (unintended) collateral damage of the fiscal discipline mantra of the SGP. At the same time, the picture has far-reaching implications for the future of European societies when facing severe budget constraints and the need to reign in negative fiscal dynamics.

From this dire perspective, the chapter proceeds to situate the result in the context of the undergoing revision effort and ongoing reform debate, as well as against the potentially game-changing developments of the tragedy of the Covid-19 pandemics, before drawing some final consideration on the policy outlook and future research agenda.

9.2 The Review and reform debate

This section briefly groups some of the major criticisms to EU economic governance and the extent to which they are corroborated by the findings, before turning to whether such shortcoming could be overcome by the planned revision of the policy and how they situate in the broader context of the reform debate ahead of the Covid-19 crisis. The criticism against the SGP and the EMU architecture more in general has been wide and loud, breaching with the crisis past a debate of elites into one of public opinions, often staked against European integration. At the same time, the alleged shortcomings are themselves variegated as the framework has been accused of many at times contradictory crimes, spanning from lack of function in enacting discipline to over-effective dysfunction in increasing the turbulence and cost of the crisis.

Refuting the failure of the supranational fiscal rule in affecting budgetary dynamics, the systematic analysis of the thesis corroborates some of the more damning arguments for the framework illustrated below. At the same time, while many of such weaknesses are recognised by the institutions in the context of the review, the ambition in departing from the status quo appears underwhelming against the overwhelming policy failures that emerged in this work . A more extensive overhaul is instead supported in the academic debate on the future of EU economic governance, offering a benchmark – in the pre-Covid era – for how little improvements at the margin of an asymmetric rule-based framework can fix the challenges at hand.

An assessment of criticism of the EU economic governance in the light of the findings

How do the claims on the EU-MS fiscal puzzle measure up against the outcomes of the analysis? With the ineffectiveness of the policy in binding national spending already self-evidently and eloquently refuted by the findings, it is worth considering the extent to which results lend support to some of the mainstream criticisms in extant literature.

- pro-cyclical in crisis (e.g. Van Ewijk et al., 2015; Herzog, 2018; Tamborini & Tomaselli, 2020): the evidence of a constraining effect on several budget components in times of crisis is overwhelming, as EDP surveillance is effective under such context even before the 2011 reform and even afterwards holds a much tighter grip over public finances under an economic downturn.

- inequality increasing (e.g. Heins & De La Porte, 2015; Angelaki, 2016; Perugini et al., 2019): the macro-aggregate analysis does confirm the negative outlook for inequality mitigating spending both in the context of the crisis and post-Fiscal Compact for Eurozone Member States under EDP surveillance.

- fiscal discipline primacy over social concerns (e.g. Pavolini et al., 2015; Andor, 2017; Bongardt & Torres, 2018; Costamagna, 2018; Crespy, 2020; Rasnača & Theodoropoulou, 2020): while the analysis does not consider budget deficits or total spending dynamics per se, the evidence of contraction and restraint to spending, especially in the social domain, is incontestable concurring with such assessment of EU economic governance. Further support emerges in the interplay with national dynamics as the leash of EDP surveillance is the shortest when high spending pressure is exerted by unemployment and demography forcing compensatory budget restructuring.

- core-periphery divide (e.g. Bongardt & Torres, 2018; Cesaroni et al., 2019; Coudert et al., 2020; Terzi, 2020): findings strongly support heterogeneity in EDP surveillance derived spending dynamics across geographical fault lines, with the periphery more negatively impacted to name few examples in the misalignment of the impact of the SGP compared to CSRs prescription, intergenerational fairness and investment crowding out during the crisis.

- sovereignty and legitimacy (e.g. De Witte, 2015; Fabbrini, 2016; Louis, 2016; Gocaj & Meunier,2016; Dawson, 2018; Abels, 2019; Tesche, 2019; Tkalec, 2019): refuting the ineffectiveness of the SGP and its neutrality for the budget structure does point in the direction of a problematic constraint and restructuring of spending at the hands of an asymmetric framework meant to leave the Member States free to make their own choices under the sole condition of disciplined spending, hence falling well short of the legitimacy that would be required for the marked distributional consequences entailed by the EU economic governance framework in the findings of the thesis.

The list could continue, with some criticisms such as unsustainability of the lack of stabilisers and monetary primacy more difficult to corroborate or refute given the focus of the analysis (e.g. De Grauwe et al., 2018; Terzi, 2020). A similar inconclusive stance has to be taken concerning the rich stream of debate on intergovernmental decision making and its contribution to problematic outcomes (e.g. Fabbrini, 2016; Maris & Sklias, 2016; Martínez Alarcón & Lagos Rodríguez, 2017; Dawson, 2018; Tkalec, 2019; Wasserfallen et al., 2019; Schild, 2020). Nevertheless, claims within the same overarching group of EMU incompleteness specifically in relation to common fiscal instruments and transnational solidarity deserve some preliminary evaluation in light of the findings (e.g. Andor, 2017; Donnelly, 2018; Ederer & Reschenhofer, 2018; Foglia et al., 2018; Van Der Heijden et al., 2018; Constâncio, 2020; Scholler, 2020). Findings have highlighted how countries under EDP surveillance may be left with little fiscal space to adjust, for example, to cyclical pressure often converging to similar dynamics regardless of the economic context faced by the Member States. Under such premises, if the hand of national fiscal policies is so far tied, especially in difficult times and in the periphery, that does indeed support some scope for alternative mechanisms to smooth the cycle, prevent the crowding out of investments, relieve social costs and mitigate the pronounced geographical divergences within the current architecture.

The brief overview suggests that considering the findings if one has to give a synthetic verdict on the main alleged offences of the SGP against national budgetary dynamics EU economic governance would be easily found guilty by most juries. Such prospects raise the question of the extent to which the outlook for the ongoing revision does stitch a sufficient patch over those gaps and shortcomings or rather a more radical reform is essential for a sustainable future of the EMU.

The undergoing review process: a sufficient fix?

In February 2020 the European Commission presented a review of the performance of EU economic governance setting forth a consultation on the future of the framework, whose early-stage ended in the following June. This step fits into a broader reform process commenced five years earlier with the Five President Report (Juncker et al., 2015) on the completion of the Economic and Monetary Union through an economic, financial, fiscal and political union, of which the first measures saw the light of day already in 2015, for example, with the renewed Semester. The review assesses the current framework over its ability to enact fiscal discipline and sustainable finances while promoting growth, allow for close economic cooperation and yield convergence across the Member States.

If one sees the second account as adherence with the Semester, findings point in the direction of a substantial failure of the policy, with the sole exception of indeed affecting budgetary choices, albeit with controversial outcomes concerning sustainability and outright inability to protect growth-enhancing investments. On the first account, the revision considers the framework a success as the near entirety of Member States fell under the EDP at some point or another during the crisis while all exited having sufficiently corrected imbalances by 2018 – while recognising the contribution of a positive economic climate (COM(2020)55; SWD(2020) 210). The argument of cost containment dynamics does find backing in the findings as well as that of improvement of the performance of the preventive arm supported by a reversal of the sign of the impact of Eurozone membership post-2011 aligning with that of EDP surveillance albeit to an extensively smaller scale. That budgetary dynamics as influenced by the EU economic governance framework suggest a sustainable outlook is far more controversial in light of the various problematic implications underlined in the previous section.

Considering the economic stabilisation output of the policy, the review itself admits defeat in light of the pro-cyclical dynamics, with substantial consolidation during crisis times well documented in the analysis (COM(2020)55; SWD(2020) 210). Their assessment of the post-crisis dynamics is likely pessimistic with good times not exploited to provide cushioning to smooth future downturns. Another criticality highlighted is the asymmetry between overspending and underspending within the framework with no 'stick' available to push the Member States to provide larger stimulus when appropriate. At the same time, the limited scope for centrality of the Semester in shaping budgetary allocation choices is also highlighted, somewhat in agreement with results showing dynamics that contradict prescriptions of the CSRs. Similarly, the issue of monetary dominance and lack of common fiscal capacity is also recognised.

The review admits substantial failure of the supranational fiscal rule also in relation to the quality of public finances, specifically in relation to the investment crowding-out effect of consolidation to be expected if numerical fiscal rules are deployed without specific corrective mechanisms to address the issue and protect growth-enhancing spending. Such effect, with geographical heterogeneity in its gravity, is well documented in the work of this thesis, supporting indeed a pejorative effect of the Pact for growth prospect of countries under EDP surveillance (within the Eurozone). Even such a device with the implementation of investment clauses is judged by the report as a failure in pursuing the policy objective of growth-friendly consolidation.

National political ownership is also called into question and the increasingly intrusive reach of the supranational framework in domestic budgetary choices recognised – for example through reliance on expenditure benchmarks directing supranational pressure towards specific budget lines. In line with the non-neutrality of the SGP to the budget structure, such considerations partially admit to intentionality in imposing such distributive impulses on national fiscal policy mixes. At the same time, national fiscal frameworks implemented under the mandate of the EU economic governance regulatory framework are argued to increase ownership (and compliance) while heterogeneity is recognised as far from eradicated with the substantial difference emerging in the impact of the supranational fiscal rule across countries with above or below average preferences within this domain.

While the overall assessment in the review is far more positive than the findings suggest – albeit crucial weaknesses are recognised – the key element for these final considerations on the outlooks are the issues raised for the debate on the future prospects of EU economic governance among which:

- improvement of sustainability of public finances while allowing for stabilisation in crisis;
- the role to be played by EU economic governance in guiding and directing the reform processes in the Member States;
- improvement of enforcement and focus on the most problematic Member States.

The reform agenda which the review suggests address only marginally some of the shortcomings raised in the extant literature and confirmed by the findings, such as the failure in promoting convergence to the extent of the opposite trend being reinforced by EU economic governance especially during the crisis and in its aftermath. The call for greater enforcement (and even an increased role of sanctioning) also seems to miss the mark as the policy is far from ineffective in its impact but rather in its budgetary orientation. The call for matching improved discipline and sustainability with scope for stabilisation and investment worryingly echoes the – to this time – empty commitments of the original policy objective largely unmet in practice. From such an albeit brief overview the setting of the stage toward the future of EU economic governance by the Commission is not up to par with the scope and scale of the challenges and structural shortcomings of the framework, remaining anchored to the same failing rhetoric and architecture.

The broader ongoing reform debate before the pandemic

Against this context, the academic and policy reform debate has been quite prolific, with a variegated array of solutions to the incompleteness and unfitness of the EU economic governance framework put forward. While a comprehensive survey of such debate is beyond the ambition of this concluding chapter, a quick overview of how the pre-pandemic reform debates relate to the findings sets the stage for a more grounded discussion of recent developments in the context of the Covid-19 outbreak and their implication for future integration scenarios.

An overarching consideration rests on the structural nature of some of the central challenges of the policy, as highlighted, albeit with quite different proposed resolutions, for example, by Wyplosz (2017) and Jones et al. (2016). The problem is not only the specific little details of the policy design but rather the overarching architecture and entailed asymmetry and unbalances. The latter may be further complicated by the unfitness of the governance and decision making feeding into a self-reinforcing cycle of failures and crises. From this perspective, a broad theme within the debate agrees with the scale of ambition necessary to rise above the challenges of the current system by offering comprehensive completion of integration through a fully-fledged political dimension. On a more practical level, proposals put forward range from Eurobonds (e.g. Pisani-Ferry, 2016; Corsetti et al., 2019; Nicoli, 2019; Hodson, 2020) to a Eurozone budget (e.g. Bibow, 2016; Louis, 2016; Lionello, 2017; Mathieu & Sterdyniak, 2019; Scholler, 2020; Terzi, 2020) passing through stabilisation mechanisms such as EUBS (e.g. Hebous & Weichenrieder, 2016; Davis et al., 2017; Farvaque & Huart,2018; Moyen et al., 2018), partially and temporarily introduced with SURE in the context of the pandemic response. With substantial differences, the above-mentioned proposals share improved prospects in terms of core-periphery divergences as well as allowing for some solidarity while not necessarily crowding out spending in central domains with substantial social implications.

A more impactful regulatory framework – as with the post-2011 reform and as shown in benchmarking the SGP against the CSRs with the Fiscal Compact - does not overcome the problematic distributional consequences of the framework. Heterogeneity in the domestic context of the Member States still leads to substantially diverging budgetary outcomes, far more damning for the periphery in terms of investments and inequality as well as social spending and health. The (lack-of) effective crisis management and pro-cyclical bias of the governance imply further pejorative fiscal effects in bad times. Such powerful weaknesses (i) leave little positive expectations in the face of the unprecedented challenge of the pandemic and (ii) suggest that if the problem is structural and in the architecture of the framework limited improvements can be made within the scope of the current framework as laid down by the Treaties.

A rule-based system delegating fiscal policy in a monetary union to the national level is asymmetric by design and some of these unwanted collateral damages are unsurmountable with limited reform at the margin that does not entail a strong ability to directly influence domestic policy choices. Furthermore, it would not take ownership and accountability for the distributive consequences while failing to have the tools to correct and reconcile dynamics with the policy objectives of inclusive investment-rich growth. The findings support the view that EU economic governance as it is today is not on par with the challenges of the current times. The reform proposals introduced briefly above jointly support some level of centralisation either of budgetary choices per se or of investment or shock absorption. At the same time, they raise the issue of legitimacy in a context of severe constraining of domestic political choices. In practice, budgetary sovereignty has been shown in the thesis to be severely downsized for countries under the EDP even in a framework that in principles leave national hands free except for the adherence to the budget constraint. In such context, a governance structure that acknowledges head-on such limitations at the national level and fills the sovereignty void created by the SGP may hence be far superior both in principle and practice. If that was the reform debate ahead of the pandemic crisis, the section to follow shows how the Covid-19 outbreak and crisis-management at the EU level provide a further case of the weaknesses of the governance, raising the bar at the same time for the reform debate.

9.3 Covid-19 and the outlook for future reform

Alike for the review and reform debate considered in the previous section, it is of high value to weigh the finding through the lenses of the current developments in (i) connecting them with the arising circumstances of the pandemic response and prospective reforms and (ii) assessing the extent to which some elements emerged in addressing the research questions may be surpassed by recent evolutions or rather still well persist in the current crisis-adjusted architecture.

The pandemic outbreak has put unprecedented stress on the European Union institutional framework, highlighting substantial governance weaknesses both in the economic domain and in the realm of public health coordination. Focusing on the former, which is within the purview of the research questions at hand, the Great Recession and the Eurozone crisis being the first real "bad weather test" of the EMU architecture and the SGP infrastructure (Heipertz & Verdun, 2010, p. 174), the Covid-19 response is by far the most far-reaching challenge for the Union and the Member States in its history. In this context, war-like restrictive measures were put in place to contain the health crisis requiring a parallel reconstruction effort for the revival and relaunch of economic activities shattered by the protracted lockdowns (Fabbrini, 2020), still at play in 2021.

However, the economic response poses enormous challenges in the European environment, considering the bind of the SGP on the action of the Member States, together with the de-facto absence of common instruments to intervene effectively at the supranational level. Due to the illustrated dynamics (i) no joint response could take place in a timely manner, within the limited scope of the EU budget, and (ii) the only feasible course of action was to resort to national budgets, as recognised by the European Commission early on in the crisis, which consequently recommended freeing domestic fiscal policies from the leash of the SGP (EUCO, 2020a). Under this scenario three elements could lead to valuable insights in the assessment of the governance framework within the scope of the research questions at hand – and especially in drawing some further implications in relation to crisis dynamics: (i) the extent to which the economic governance framework was still unequipped for crisis management after the latest reform; (ii) if and how the national response can be considered an adequate pathway in the pandemic recovery (and more generally in large-scale crises); (iii) the governance development against the shortcomings evidenced in the previous section and in the thesis along with their implication for the future.

The section will continue in addressing the three elements and the derived research and policy implications in the presented order. The starting point is the analysis of the toolbox of the EMU at the onset of the crisis and the extent to which it failed to provide for the necessary instruments to address the pandemic response, in light of the political developments and the policy innovations that emerged throughout the crisis.

The reformed EMU and pandemic crisis readiness

Concerning the functioning of the SGP-at-crisis in the context of the Great Recession findings corroborate that the supranational fiscal rule remained binding – actually increasingly so – in the crisis for the Member States under EDP surveillance, with an unbalanced impact on the budget composition penalising especially investments. While the early years of the crisis fell enitrely under the previous governance framework, gradually modified to become the fully fledged current SGP architecture only after the timeframe considered in chapter six, the previous section highlighted how several problematic design flaws within the EMU were not addressed in the reform efforts onset by the Eurozone sovereign debt crisis (Wyplosz, 2017) and remained key areas of concern within the academic and policy debate in the years to follow.

The pandemic crisis and its consequences are still unfolding, together with the common and national policy responses. Substantial attention can reasonably be expected within this domain, with preliminary considerations to be drawn from the parallel with the lessons from the SGP against the even more earth-shattering challenges prospected by the pandemic. Valuable elements can be derived in the assessment of the crisis readiness of the current EMU infrastructure and the lack thereof evidenced by the need for the introduction of emergency and ad-hoc instruments in the heat of the crisis. Within the first domain, multiple scholars (e.g. Fabbrini, 2020; Howarth & Verdun, 2020; Schularick, 2020) raised stark criticism regarding the capabilities of the EU governance that emerged in the previous crisis, further reinforced in the current troubling times. For example, Howarth and Verdun (2020) in presenting the shortcomings of the SGP in the Great Recession, highlighted how the unaddressed asymmetries in the monetary and fiscal dimension of the EMU weighted on the ability of the Eurozone pack to introduce the much-needed emergency measures in a timely and effective manner.

As extensively discussed in chapter two, the infrastructure of the EMU was not born with extensive scope for joint fiscal action in the Eurozone, nor can that role be taken by the capped miniscule EU budget. In this context, the Commission itself acknowledged the architectural challenges of a joint response indicating that the fiscal response to the crisis would have to come from national balance sheets (COM(2020)112). The Commission proposed the attenuation of state aid restrictions together with the activation of the SGP general escape clause, in order to allow the Member States the freedom to act at the national level, quickly endorsed by the Council. In continuity with the repeat of previous crisis dynamics, also in the pandemic, in the absence of instruments for a quick joint fiscal response and with lagging political consensus on how to complement domestic action with new common tools – easily justified by the symmetric blameless nature of the crisis – at the supranational level the initial burden of intervention remained once again on the shoulders of monetary policy. Even with the cautionary tale of the Great Recession, political consensus faltered also on this dimension. The ECB protective umbrella allowing greater scope for action also for the Eurozone Member States in a more precarious fiscal position through the *Pandemic Emergency Purchase Programme* did not go uncontested. Specifically, with 750 million committed in March and expanded by ulterior 600 million in June (ECB, 2020), it could be argued that through its palliative effect, the PEPP bought time for a political compromise on a joint fiscal solution. In line with the imbalances emerged in the past, the lack of appropriate fiscal instruments is confirmed in a framework reformed in 2011 without addressing the fundamental asymmetries enshrined (Jones et al., 2016), as confronted by the ECB itself in highlighting how monetary policy should not be forced to act in substitute of the fiscal policy failures and shortcomings in the absence of joint supranational budgetary action.

Limited resources mobilisation through emergency instruments did take place. Early on, the only limited scope feasible path consisted in the reallocation of available EU budget resources, for example letting the Member States keep and repurpose unused structural fund bound to be returned to the common pot (COM(2020)112). The insufficiently of the available EU level resource was, however, self-evident and widely acknowledged in the political debate – paired with sharp disagreement on how to address the challenge of ensuring sufficient resources for the pandemic response to the worst impacted Member States (Ceron et al., 2020). The perennial divisions over the SGP hinted in chapter two – playing a key role in determining the institutional framework in place – persisted even in the face of such a historic and unprecedented tragedy. Dynamics without active and direct coordination of fiscal priorities of the Eurozone have been extensively shown to hold indirect – potentially unintended and surely undesirable – effects on the strict budget constraint shown by the findings to over-penalise investment and intergenerational fairness. In this context, the traditional conflict across the need to complete the toolset of the Eurozone through risk-sharing or risk-reduction remained the basis of the disagreement on how to handle the current crisis (Fabbrini,2020). While the compromise was speedier than in the botched Euro-crisis response, political resolution still took months and countless summits of muddling through and divisions (Ceron et al., 2020). The early agreement on emergency measure remained within the comfort zone of the camp opposing any real solidarity and burden sharing through sole-reliance on lending as a relief for the strained Member States, for example through a dedicated pandemic ESM credit line, with limited and contested concession of foregoing conditionality for the restricted use of financing in direct and indirect response to the public health emergency (e.g. Battaglia, 2020; Ceron et al., 2020; Trabucco, 2020). Even under the unprecedented pressure of the pandemic and the existential threat the inability to come to terms with an effective response at the European level poses to the Eurozone and the integration process at large, any budge from the recalcitrant camp was slow and hard to materialise. The political agreement on a Recovery Plan only saw the light of day at the very last second of a four-day-summit and endless negotiations following 5 largely unsuccessful previous attempts (Ceron et al., 2020).

Deferring the evaluation of the extent to which the introduced instruments may be resolutive of the previous shortcomings to the end of the section, the need itself for the emergency introduction of new mechanisms enabling a pandemic response evidences that the reformed framework remains unfit to handle large scale crises. Under such premises, the current framework can be considered at the very least to remain sub-par in terms of crisis readiness. Additionally, the lack of effective common instruments is even more remarkable in connection to the protection of public health in which the Union retains only mere coordination and support competence blatantly insufficient to orchestrate pandemic response measures across the continent (e.g. Ceron et al., 2020; Palermo, 2020). In the face of crisis readiness shortcomings in the two key sectors called to act against the pandemic, notably public health policy coordination and economic governance, the weight of the response – with a key support role played by the ECB at the supranational level in the latter dimension – remains primarily on the shoulder of domestic budgets. It is thus of value to consider the extent to which the approach runs the risk of a fragmented response with the potential of further feeding divergencies and which may yield largely sub-optimal outcomes compared to the alternative of joint fiscal action at the EU level.

The sub-optimality of decentralised national fiscal response

In this context, the allocation of the recovery responsibility primarily at the national level emerges as sub-optimal in view of the divergent domestic responses given the varied fiscal space available to governments entering the emergency in good or mediocre to bad fiscal shape (Ceron et al., 2020). Such dynamics are not unexpected in view of the deep geographical divide corroborated by the thesis. To further complicate the scenario, while the crisis is symmetric in nature – reinforcing the justification for common action in the absence of moral hazard concern as the past choices of the Member States can hardly be blamed for the onset of the pandemic (Botta et al., 2020) – it is highly asymmetric in its impact. That is the case because of the timing and scope of the health crisis, with the first hit Member States presented with a more challenging progression of the pandemic that required more drastic containment measures with consequent additional negative implications for their economies (Ceron et al., 2020; Schularick, 2020). In parallel, as southern countries such as Italy and Spain were hit the worst, their weaker economic position left them often with more fragile healthcare systems – largely imputable to the SGP in view of the results of the thesis – and public sectors more in general after years of budgetary consolidation (Ceron et al., 2020). At the same time, those Member States fall within the group that had to be more prudent in their economic response in connection to their fiscal stance and space (Ceron et al., 2020). In view of the findings of chapter seven in relation to the SGP-in-crisis, it should also be considered that not only the crisis emerged as a driver of growth hindering fiscal policy mix developments, but also heterogeneity carries the worse prospects especially for investment for the periphery. Such patterns thus applied to the countries hit the worst by the pandemic at the same time having less fiscal space. The findings may suggest that in having to prioritise areas of intervention in the recovery effort the balance may lean in favour of transfers rather than the much-needed productive investments to fuel the rebooting of the economy.

Consequently, leaving the Member States to fend for themselves in the pandemic crisis may yield a multitude of sub-optimal dynamics as the response may be downscaled compared to the required stimulus in the worst-hit countries having a less solid fiscal foothold to rely on. As they entered the Covid-19 outbreak with larger debt stocks and weaker economies and budgetary choices may resort to the uncovered pattern of sacrificing investment to favour transfers, further hindering their ability to grow out of the crisis. While the crisis and hence national fiscal responses are still unfolding, preliminary patterns confirm that the countries heading the podium of the human and economic cost of the pandemics are far from the top in the ranking of fiscal support measures (Ceron et al., 2020; Schularick, 2020). Specifically, while Italy was the first and the worst hit in the initial phase of the crisis, imposing in parallel the toughest restrictions to economic activities, the country is far from primacy in the economic response, with Germany far distancing all other Member States (Ceron et al., 2020; Schularick, 2020). Similarly, in considering the badly hit and already out of shape Mediterranean Member States, Spain shows an even starker discrepancy between the negative impact and the substantially limited stimulus (Ceron et al., 2020; Schularick, 2020). Member States responses may hence sharp diverge both in overall size and mix, especially early in the crisis, preceding a full-scale EU response with the implementation of the Recovery Plan but also of sizeable distributional support to the worst affected countries – for example with the deployment decision of SURE funds in August 2020 (European Commission, 2020).

National management of the recovery appears problematic, reinforcing divergencies that may have long-lasting consequences and further weaken the prospective for convergence even within the Eurozone. In this context, two further elements are of interest to consider. Firstly, sub-optimality of national responses to a large-scale crisis is not a pandemic specific dynamic but instead a characteristic design weakness of the EMU infrastructure (Heipertz & Verdun 2010), corroborated by the findings of this work. Second, the course of action already proven counterproductive in the Euro crisis both in terms of its impact on the recovery and on public trust in the supranational institutions could come with even more perilious consequences in the perceived output legitimacy of the EU (Sabat et al., 2020). Additionally, in parallel with the difficult aftermath of the Great Recession and the excessive deficit inheritance following the weaker economies to these days (Wyplosz, 2017), the imbalances highlighted are not only a problem of crisis times, as confirmed empirically in the analysis. That is to say that their consequences are likely to remain well after the immediate storm has passed. Specifically, there is the concrete risk for an even more detrimental and growth hindering legacy after the Covid crisis (Sabat et al., 2020). The depicted scenario not only justifies joint action in the midst of the emergency but also poses the threat of increasing divergencies afterwards that may further distance the position of Members States with conflicting priorities (Ceron et al., 2020). Progress could also become problematic if not unfeasible absent the pressure of the crisis long connected with the furthering of European Integration (Botta et al., 2020). As such the window of opportunity for overarching reform may soon shut closed heightening the stakes for the current innovations and the prospective for an EMU revamp in the context of the Conference on the Future of Europe. In this context, if the governance framework is not crisis-ready with inexistent common instruments and problematic decentralisation, the question remains of whether the novel instruments may prove sufficient in addressing the architectural weaknesses highlighted in the thesis and if not the policy implication for the necessary reform process.

Novel instruments and future perspectives

Against such an underwhelming prospective, the innovative response instruments and their overcoming of long-standing vetoes for the pandemic response cannot be overlooked. SURE is unimaginable progress in the context of the lengthy unsuccessful discussion on EUBS, argued to be rendered feasible only by the Covid-19 outbreak and the temporality of the measures (e.g. Andor, 2016; Beblavý et al., 2015; Dullien, 2017; Hemerijck & Ronchi 2020; Schmid, 2020). A similar breaking point is represented by Next Generation EU (NGEU), which has been argued by some as a Hamiltonian moment for European integration while generating in others a fair level of scepticism (Issing, 2020). Facilitated by the natural disaster-like support for transnational solidarity (Bremer & Genschel, 2020), the programme mobilises 750 billion for the recovery, distributed according to the economic and social cost (e.g. changes in GDP and unemployment) of the pandemic, hence benefitting predominantly harshly impacted countries in Southern Europe (EUCO, 2020b). A major innovation in the face of the recent standstill and high contestation is that a non-trivial part of the plan amounts to grants rather than loans, together with the financing with common debt which in consideration of the first dimension will eventually require some likewise joint form of taxation.

However substantial interrogatives remain on whether such innovations fully overcome the structural imbalances and shortcomings of the Pact and if they amount to a sufficient permanent departure from the long unsustainable muddling-through ineffective governance post-crisis (Jones et al., 2016). The simple answer to both accounts cannot be positive. If the weakness is structural a temporary albeit innovative measure within the existing treaties can hardly overcome it. In the fiscal domain, the common resources are conditioned to the extraordinary and temporary nature of the joint -borrowing-backed response, far from a fully-fledged common fiscal (fire) power that would be required (Botta et al., 2020; Galli et al., 2020). In adopting such an approach, the recovery effort itself carries no impact on the current framework. Looking at the history of the EMU and the lessons from the past crisis, it is unconvincing to argue that such developments are revolutionary and automatically entail a departure from the current asymmetries and shortcomings of EMU towards a fiscal union (Ceron et al., 2020) Vetoes are far from overcome, at most suspended in extraordinary times. Extraordinary is also the window of opportunity for reform and solidarity linked with the pandemic, which may quickly close with the darkest phases of this crisis (Ceron et al., 2020). The road ahead is yet to be forged in a narrowing path for deeper integration capable of equipping the Union and Eurozone with the necessary tools to face the global challenges of our times.

The dissertation highlights some of the characteristics of such a framework. Firstly, a better grip between the regulatory framework and its practical distributive impact on fiscal policy is essential. The governance framework needs to square the circle of guaranteeing sufficient discipline – departing from a pro-cyclical effect – protect productive investments and at the same time recognise as equal to economic concerns those linked with social spending and inequality mitigation. An impossible task for any architecture relying primarily on an indirect influence on the composition of spending. In this context, the long in the making reform prospects illustrated in the previous section rendered even more blatantly urgent by the Covid-19 crisis are set to see the light of day through the upcoming conference on the future of Europe. Given the scale and depth of the emerged shortcomings enshrined in the very essence of the European economic governance architecture, the ambitiousness of the proposed reform in this domain needs to be in parallel systemic. Specifically, the underlying asymmetries that have been argued to play a central role in determining the policy misshapes need to be addressed. To that objective, the emerged picture shows how guiding fiscal policy across the Union through soft instruments together with indirect impact through a budget constraint derived from the supranational level is risky at best and unfit to carry out the objectives of the SGP and EMU more in general. In this context, direct ability to orient fiscal choices appears as an absolute must, so that adequate joint fiscal capacity may be a long term need beyond the temporary measures of NGEU.

A debate on the prospects of the continent was already underway in the context of the Conference on the Future of Europe. Covid-19 has affected directly the Conference delaying its launch and further heightening the stakes in the newly emerged urgency of reforming a blatantly unfit governance architecture. In this context, the Franco-German leadership in the definition of a roadmap for reform to address the weaknesses of the EU and render it better equipped to deliver for citizens and face up to the Eurosceptic criticisms was already embraced by the Commission and the Parliament before the health crisis, notably with more lukewarm aspirations coming from the intergovernmental institutions. In the delays caused by the pandemic the endorsement for the Conference as a transformative tool for future-proofing the Union emerged loudly from the European Parliament. Its vision for tackling the Covid crisis calls for the Conference to put forward an overhaul to make the EU "more effective, united, democratic and resilient" (European Parliament, 2020, 2020/2616(RSP)). Key Member States – starting from the Franco-German tandem – agree in considering the overcoming of institutional weaknesses in the European project as a key element of effective long-term recovery from the crisis (Fabbrini, 2020).

In practice, however, the road ahead remains long and the prognosis for the future of integration far from certain. Nevertheless, the pandemic has contributed a further evidencing of the weaknesses that emerged from this thesis while at the same time corroborating the need for closer coordination at the European level, especially in crucial domains for managing the outbreak and the recovery such as that of public health and economic governance. Do instruments such as NGEU represent a dress rehearsal for long term solutions? With the full development and consequences of the most recent crisis in the history of the Union yet to be seen, the thesis contributes some preliminary policy insight and open an extensive research agenda, outlined in the final conclusions of this work.

Conclusions: policy outlook and a research agenda

In terms of both the research and policy outlook, the thesis makes a substantial contribution to the understanding of EU economic governance which results show as far away both from an irrelevant and ineffective minor nuisance and from neutrality with respect to national budget structures. On the first account, the ability of EU economic governance to impact national fiscal choices has positive implications for the health of the EMU architecture. While not the focus of the analysis, findings are consistent with non-compliant countries falling under EMU surveillance reigning in their spending substantially. On the second distributional account at the core of the analysis, evidence is stacked against positive conclusions. If the SGP does not fail to impact the domestic fiscal policy mix, the success of the policy may stop shortly after. Measured against its own policy objectives the SGP fails in facilitating inclusive growth and acts pro-cyclically, with deleterious effects for investments, social spending and especially health – a budget component that has come to the centre stage as the Covid-19 pandemic hit in 2020. To make matters worse, the core-periphery divergence argued within the literature to threaten the sustainability of EMU (e.g. Jones et al., 2016; Wyplosz, 2017), further worsened by Covid-19 (Ceron et al., 2020), finds strong confirmation in the analysis. The prospects for the SGP are hence far from rosy: the evidence emerged from the thesis backs the call for a deep rethinking of fiscal coordination within the EMU and Eurozone. The undergoing revision falls substantially short of such task and unless the window of opportunity opened by the pandemic crisis is exploited for a permanent structural change of the EU economic governance framework, so do the unprecedented innovative – but temporary – instruments introduced in the wake of the outbreak and to facilitate the reconstruction effort (Ceron et al., 2020).

Along with answering substantive questions in relations to when and how EU economic governance shapes national fiscal choices, the results of the thesis recapped in section one of this chapter, open a broad array of additional interrogatives which deserve further consideration. Firstly, in devising the methodological approach the choice for this work has been considering the most comprehensive account of Member State budgetary dynamics as the dependent variable, general spending. However, further disaggregation, as anticipated in discussing the methodological approach, can be made across spending by the central government and sub-national entities. Such approach would open further avenues of research on the extent to which the prevalence of certain categories under the dieting force of the supranational fiscal rule is partially explained by their responsibility falling onto regional or local government so that central entities can shift the cost of adjustment to comply with the SGP.

Going back to the supranational level, section one of the chapter recalled the political nature of the Excessive Deficit Procedure and EU economic governance at large. Political meddling and deviation from Commission recommendations and their drivers have been well documented both in the early stages and recent times in the context of the Semester and the CSRs (e.g. Heipertz & Verdun, 2010; Baerg & Hallerberg, 2016; Mariotto, 2018). The work here considers the impact of being under EDP surveillance and not the violation of the threshold itself, along the line of the corrective arm amounting to a powerful signal of indiscipline and political and procedural pressure for redress. Further research is warranted in this domain in evaluating the extent to which it is the fiscal conditions or the surveillance that makes a difference and in the latter case on the distributive implications of the politics behind the policy. For instance, political dynamics may have indeed imposed sharp social costs to some Member States while sparing others, a particularly problematic consideration when matched to the geographical divide for the distributional effects on spending components even among those countries within the corrective arm of the Pact. A further avenue of research in this domain pinpointing the mechanisms through which EDP surveillance affects the budget structure could compare similar deficits which do and do not results in a notification under the Excessive Deficit Procedure.

Remaining in the context of differences across the Member States, the needs of the analysis carry limitations concerning the depth with which the national context was assessed in relation to its interaction with the supranational fiscal framework. At the same time, confirming national preconditions do emerge, the work sets the stage for further investigation of the interplay between the supranational and national arena in shaping the fiscal policy mix. That is the case for the anticipated issue of Euroscepticism in the political system and government, for which the effect has been explored in relation to the CSRs but not quite as much in relation to the SGP and the EDP in particular. If in line with the reasoning above one may wonder if governments at the margin or outside of the usual moderate European party families receive less favourable treatment in being subjected to EDP surveillance, in view of moderate ideologies as a precondition for an impact of the supranational fiscal rule the question can be raised on the extent to which Eurosceptic governments carry out composition-altering consolidation when found non-compliant with the SGP. Timing effects have also not been considered in the analysis and their assessment would further enrich the understanding of how the supranational and national arena interplay especially ahead of elections. Similarly, in the domain of fiscal rules, the analysis has only considered broad groupings according to a higher and lower level of stringency preferences, driven by the methodological difficulty of disentangling the attribution of the effect across the supranational and national domains. While results indicate some complementarity between own national preferences for fiscal discipline and the need for the leash of the EDP, the arena of how characteristics of fiscal rules facilitate or hinder the supranational effectiveness in binding spending and shaping the budget structure remains to be investigated. Similarly, the work does not account for heterogeneity within EDP status, which is just a dummy capturing notification and resolution of the Excessive Deficit Procedure by the Council. A more detailed approach quantifying, for example, the excessive deficit may uncover further heterogeneities within the broad group of countries under EDP surveillance, or give some indication of whether this dimension is among the drivers of the marked geographical differences in impact.

Another limit in the focus of the research questions at hand which warrants further consideration regards the interplay between the CSRs and the Pact. If their congruence is refuted, the analysis has not considered the implications of misalignment for their actual implementation by the Member States. Is compliance more likely when the driving force of the Pact – EDP surveillance - pull the national fiscal policy mix in the same direction? Is the implementation of the CSRs in general improved by the extra scrutiny of the EDP surveillance? Is that the case only for those recommendations which do not endanger fiscal discipline? Can hence the Pact and EDP surveillance, in particular, be conceived as the stick of the CSRs? While coherence within the framework is harshly called into question by the results, the bind of the Pact in a context – such as that of the crisis – in which at face value it has very limited coercive power does open the way for the potential for soft mechanisms and political pressure to become far from non-trivial possibly in view of the inter-temporal or cross-policy backing of the hard side of the Pact suggesting the answer to some of the above questions may be positive and warrants further investigation.

Furthermore, the impact on some components of spending is striking. Health is always impacted regardless of the cycle and at least in the selected Member States considered in the case studies – especially in the early years of the Semester coinciding with the late crisis – even in the CSRs there is a widespread focus on cost efficiency. This raises the question of what EMU and the Pact may mean for health policies, against the background of some empirical analyses showing the detrimental effect of EU economic governance on health spending and outcomes in times of crisis. In light of 2020 and the heterogeneity in the human cost of Covid-19 especially in the early phase ravaging through southern countries with a striking mortality gap compare to the core (Ceron et al., 2020), dynamics beg the question of the extent to which SGP derived austerity in health spending may have contributed to decreased pandemic crisis-management preparedness in the periphery. A similar pattern arose in the late second wave in some Central and Eastern European countries raising doubts on the substantially different prospects across Member States within the Union which may carry a non-negligible cost not only in financial, social and political terms but also measured in lives as brought to centre stage in 2020. Core-periphery dynamics, at the centre of substantial divergences in the literature backed by the findings of the thesis, remain hence at the forefront of the current pandemic debate, arguably with the prospect of future worsening making at the same time advances essential and urgent while threatening their feasibility (Ceron et al., 2020). As such core-periphery dynamics warrant particular attention today, which should not be limited to the Southern Member States but expanded to the highly under-researched domain of Central and Eastern European countries.

Even in the newfound solidarity in the midst of the pandemic with programs such as SURE and NGEU both researchers and policymakers are faced with substantive and existential questions of what recent developments and shortcomings may mean for the future of the Union. The continent remains highly disunited in multiple dimensions. The pandemic has brought progress under the spotlight in these arenas, such as that of the Health Union, with unprecedented joint procurement efforts for vaccines and in terms of economic transnational solidarity. The question – the distributive implications of which is reinforced by the findings of the thesis – remains on where integration should lead and the role of EU economic governance in such prospects. With the pandemic still progressing and the common albeit temporary reconstruction program of NGEU still to be implemented in the Member States, findings open the way to consider the relevance of SGP-at-crisis biases in this unprecedented context. At face value, the comparison makes little sense in times of suspension of the SGP and EDP. However, findings show that even when sanctioning is off the table as during the Great Recession the Pact had a substantial effect, which may hence not be entirely disregarded. If that is the case the novel instruments offer a similarly unprecedented scenario of conditionality in orienting national budgetary choices within NGEU. While choosing the policy mix remains to the Member States, joint financing may be a game-changer from the negotiation dynamics of the Semester dealing a much stronger hand to the Commission and the Council in amending the national plans. At the same time, the shaping ex-ante of budgetary orientations is similarly far more advanced in NGEU than in the Semester. Another key question in this domain with respect to the findings of this work is whether the indirect bias and shortcomings of the SGP – especially for the periphery – in some budget lines are overcome or at the very least mitigated by the specific commitments of NGEU to investments and (re)building socially resilient societies.

The thesis develops a powerful baseline on which to build a renewed attention on EU economic governance and especially the sharp sword of the EDP surveillance. The contribution of the work analyses in detail the distributional consequences of the policy furthering the debate in several subfields spanning from the political economy of fiscal rules and budget composition to those on the EMU, the effectiveness of the SGP, its interplay with the Semester, the core-periphery divide and the implications for the long-time struggle between economic (fiscal discipline) primacy against the rebalancing toward social objective as with the recent introduction of the European Pillar of Social Rights. In doing so the analysis puts forward robust answers to the overarching research question on the neutrality of EU economic governance to the fiscal policy mix and the sub-focus on the heterogeneity of its impact over the lifetime of the SGP, its components, the economic climate and the national context. At the same time, the work opens the pathway to the rich research agenda outlined in this section, in a juncture in which the academic, policy and political relevance of bettering the understanding of EU economic governance is hard to refute in light of recent developments and the pandemic reinforced urgency for reform in the context of the Conference on the Future of Europe.

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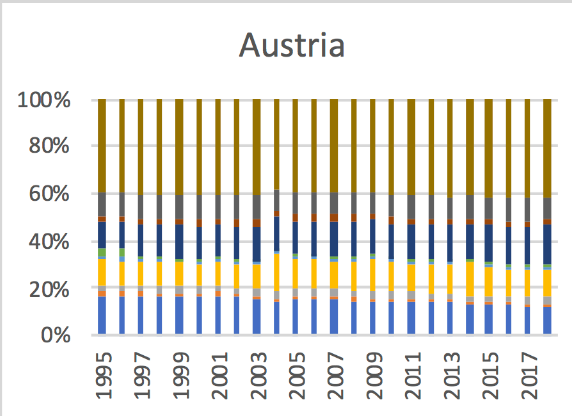
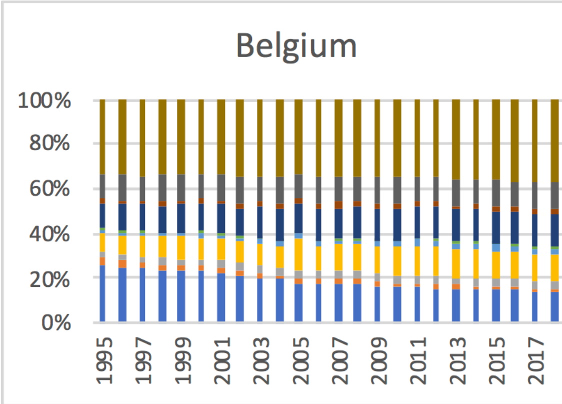
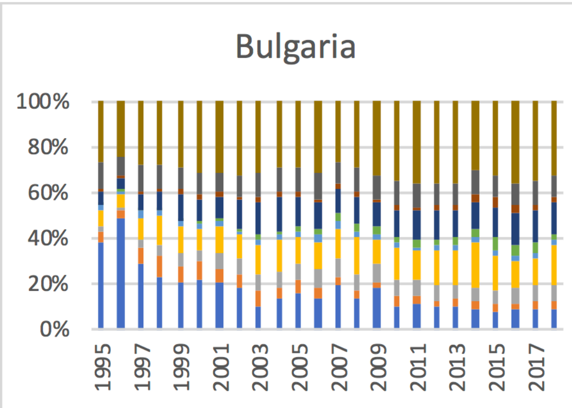
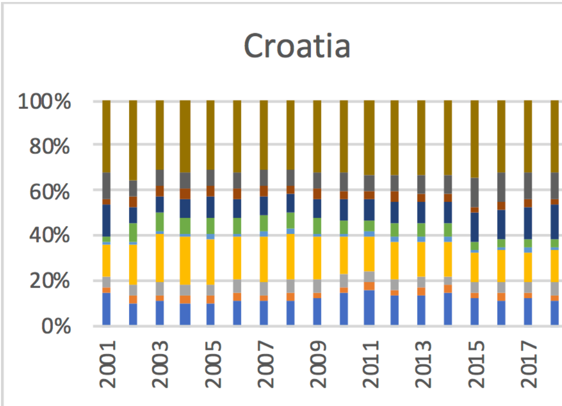
Appendices

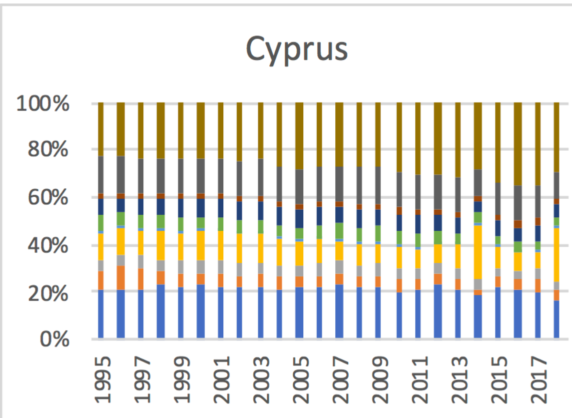
Appendix 1

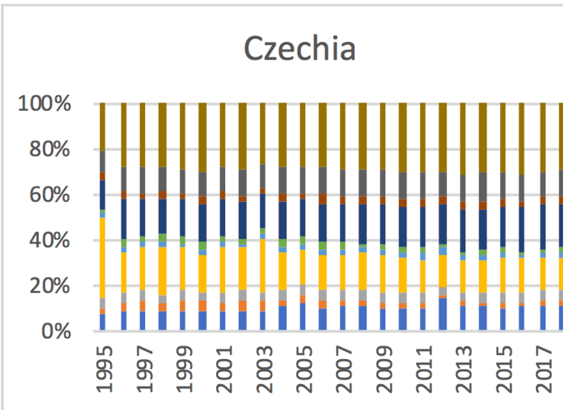


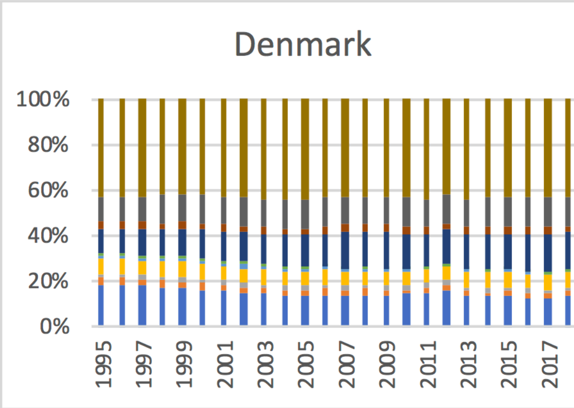








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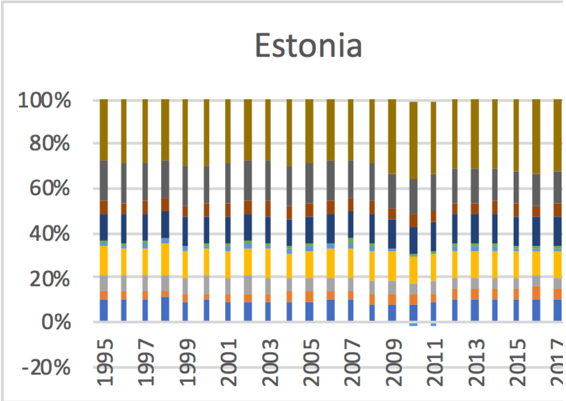
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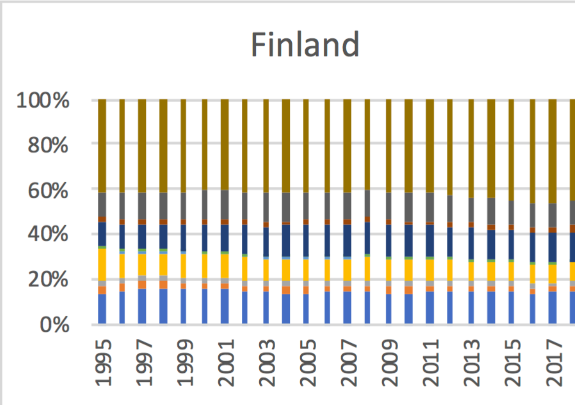
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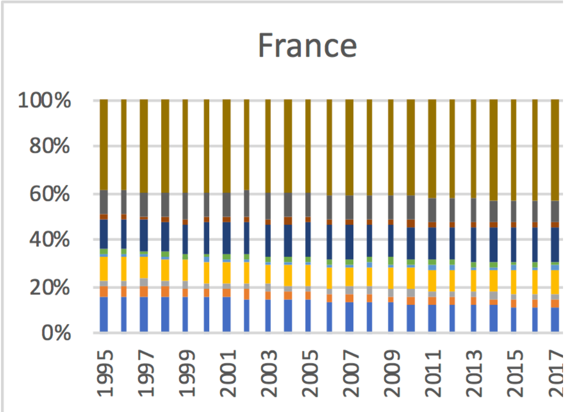
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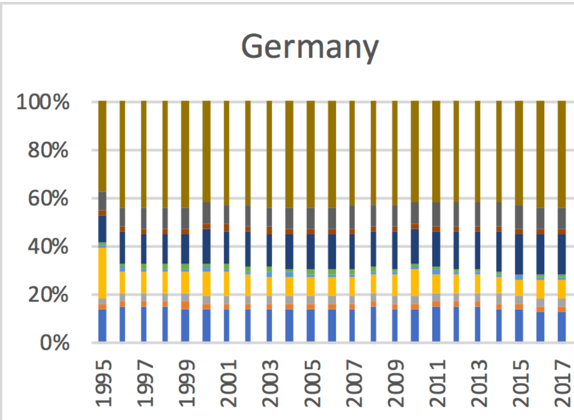
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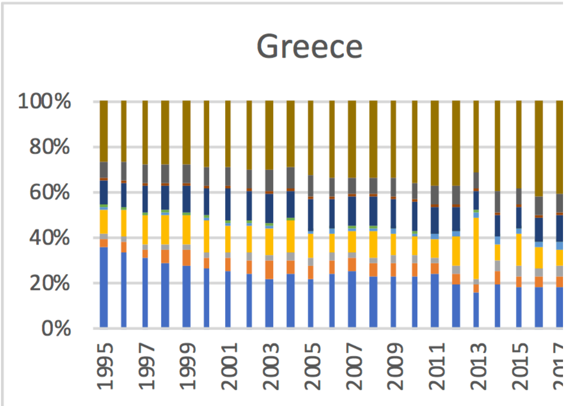
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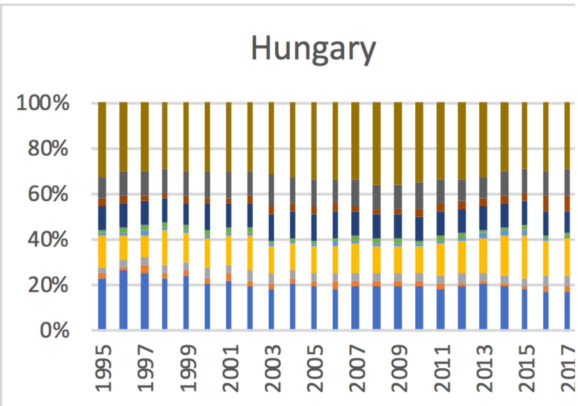
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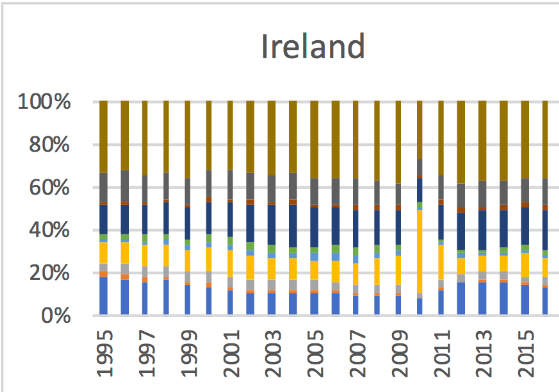
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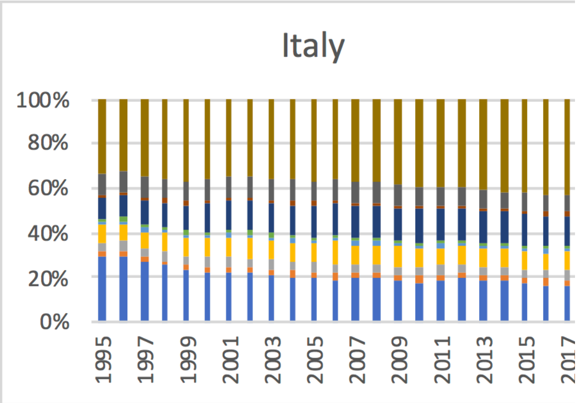
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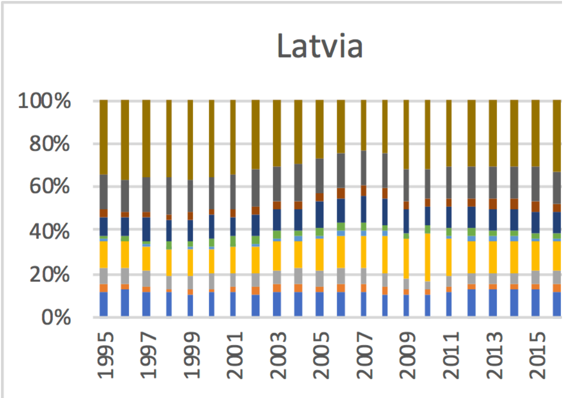
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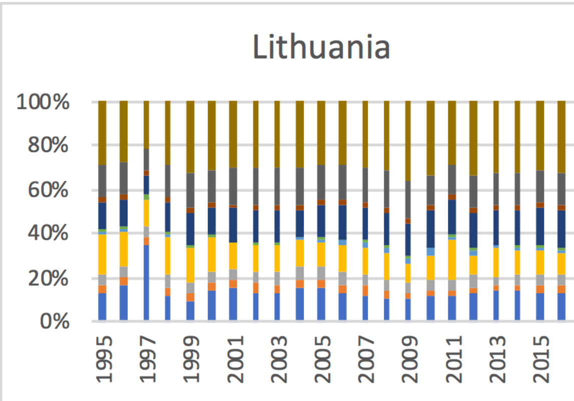
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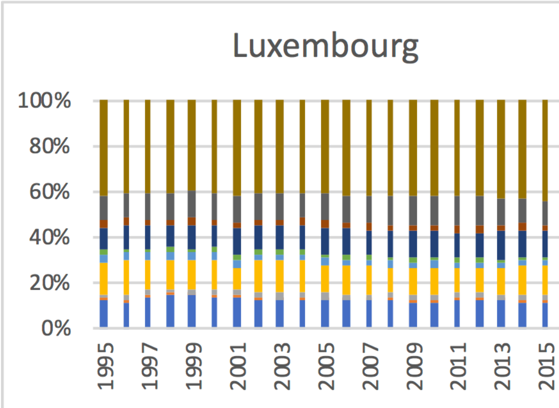
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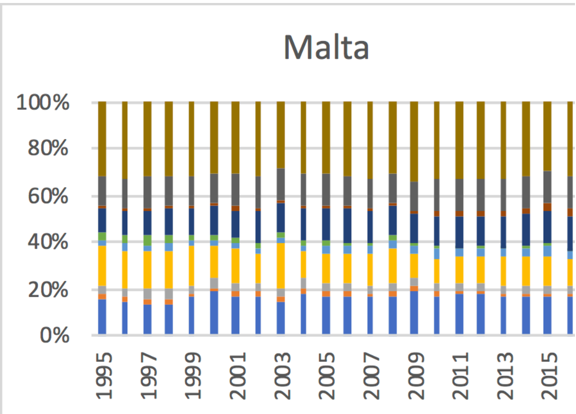
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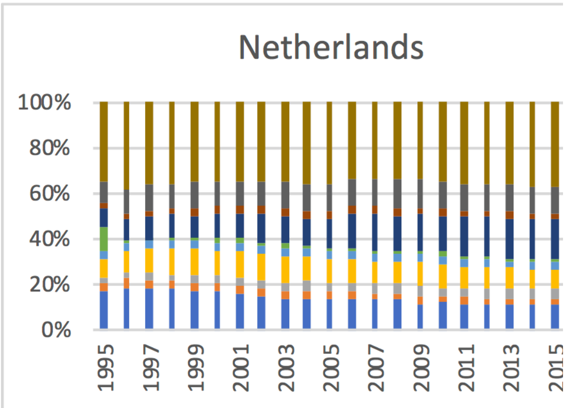
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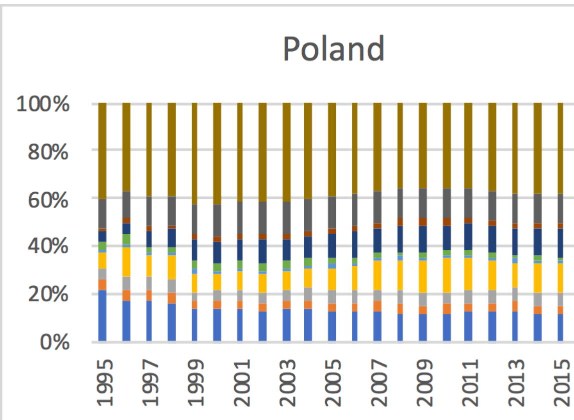
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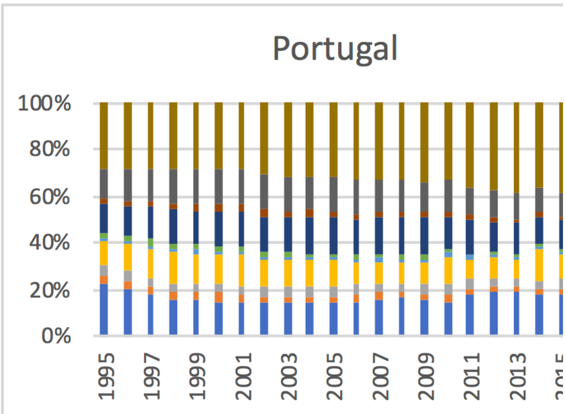
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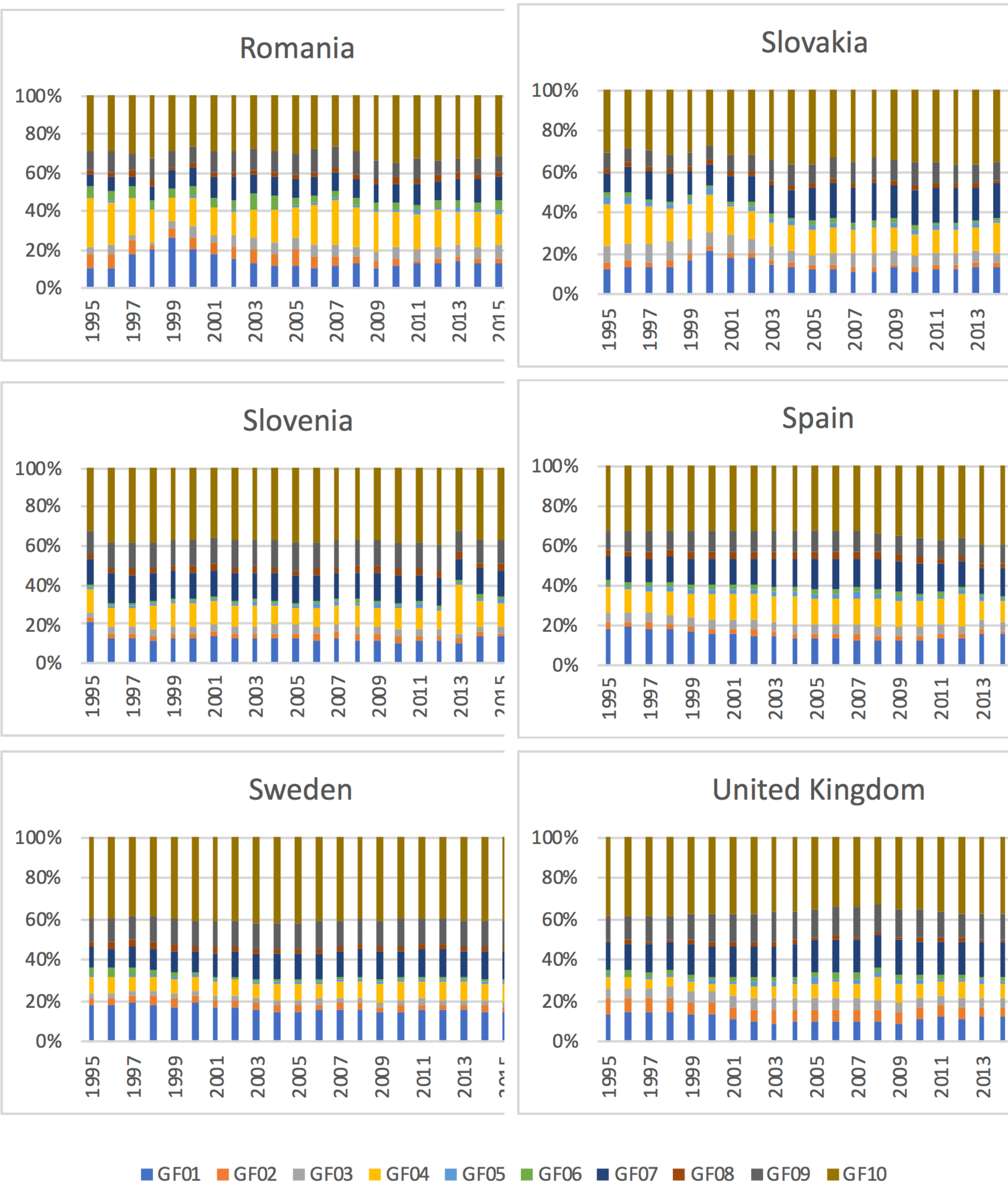

Source: Eurostat

Figure A. 1 - The budget structure of the 28 countries over time

Appendix 2

Table A. 1 - Periods under EDP for the 28 Member States

Country	Periods under EDP		
Austria	19 January 2010 - 20 June 2014		
Belgium	19 January 2010 - 17 june 2014		
Bulgaria	13 July 2010 - 22 June 2012		
Croatia	28 January 2014 - 16 June 2017		
Cyprus	5 July 2004 - 11 July 2006	13 July 2010 -17 June 2016	
Czechia	5 July 2004 - 3 June 2008	19 January 2010 - 20 June 2014	
Denmark	13 July 2010 - 20 June 2014		
Estonia			
Finland	13 July 2010 - 12 July 2011		
France	3 June 2003 - 30 January 2007	27 April 2009 - 22 June 2018	
Germany	21 January 2003 - 5 June 2007	19 January 2010 - 22 June 2012	
Greece	5 July 2004 - 5 June 2007	27 April 2009 - 25 September 2017	
Hungary	5 July 2004 - 21 June 2013		
Ireland	27 April 2009 - 17 June 2016		
Italy	28 July 2005 - 3 June 2008	19 January 2010 - 21 June 2013	
Latvia	7 July 2009 - 21 June 2013		
Lithuania	7 July 2009 - 21 June 2013		
Luxembourg			
Malta	5 July 2004 - 5 June 2007	7 July 2009 - 4 December 2012	21 June 2013 - 19 June 2015
Netherlands	2 June 2004 - 7 June 2005	9 January 2010 - 20 June 2014	
Poland	5 July 2004 - 8 July 2008	7 July 2009 - 19 June 2015	
Portugal	5 November 2002 - 11 May 2004	20 September 2005 - 3 June 2008	19 January 2010 - 16 June 2017
Romania	7 July 2009 - 21 June 2013		
Slovakia	5 July 2004 - 3 June 2008	19 January 2010 - 20 June 2014	
Slovenia	19 January 2010 - 17 June 2016		
Spain	27 April 2009 - 4 June 2019		
Sweden			
UK	24 January 2006 - 9 October 2007	8 July 2008 - 5 December 2017	

Appendix 3

Table A. 2 – Membership impact on defence and social protection

	(1)	(2)
	defence	social
EU	-0.0249	0.111
	(0.0317)	(0.107)
EZ	0.0409**	0.117**
	(0.0193)	(0.0546)
ideology	0.000187	-0.000831
	(0.000502)	(0.00141)
ideological distance	0.000075	-0.000221
	(0.0000925)	(0.000521)
alternation	0.0000167	-0.00112***
	(0.000082)	(0.000344)
Δ unemployment rate	-0.00173	0.295***
	(0.00526)	(0.0239)
Δ old-age dependency rate	0.0265	0.0613
	(0.0211)	(0.0881)
decentralisation	-0.00851	-0.0143
	(0.00695)	(0.025)
national fiscal rule preferences	-0.00148	-0.0617
	(0.0132)	(0.0558)
Constant	-0.022	-0.0664
	(0.0307)	(0.108)
Observations	575	575
R-squared	0.013	0.288
Number of countries	28	28
Linear regression, correlated panels corrected standard		
*** p<0.01, ** p<0.05, * p<0.1		

Table A. 3 - Sensitivity analysis for suspension and accession

	(1)	(2)	(3)	(4)	(5)
	BD (with suspension)	BD (accession dummy)	BD (EZ includes pre-accession)	BD (EZ includes pre-accession, no crisis)	BD (EZ includes pre-accession, no crisis, EU
EU	-0.408***	-0.388***	-0.496***	-0.627***	
	(0.150)	(0.149)	(0.144)	(0.135)	
EZ	-0.125	-0.187***	-1.167***	-1.270***	-0.594***
	(0.0784)	(0.0720)	(0.228)	(0.145)	(0.200)
accession		-0.246			
		(0.204)			
ideology	0.00108	0.000967	0.000948	0.000726	0.00563*
	(0.00231)	(0.00230)	(0.00233)	(0.00247)	(0.00292)
ideological distance	-1.74e-05	9.74e-06	-0.000114	-9.04e-05	-0.000492
	(0.00109)	(0.00113)	(0.00112)	(0.00122)	(0.000858)
alternation	-2.69e-05	-6.82e-05	-0.000247	-0.000260	9.97e-05
	(0.000677)	(0.000673)	(0.000689)	(0.000707)	(0.000596)
Δ unemployment rate	0.120***	0.118***	0.115***	-0.0408	-0.0531
	(0.0268)	(0.0271)	(0.0259)	(0.0295)	(0.0541)
Δ old-age dependency rate	0.0652	0.0451	0.0870	0.0487	0.0645
	(0.103)	(0.107)	(0.100)	(0.101)	(0.128)
decentralisation	-0.123**	-0.104*	-0.160***	-0.156**	-0.147***
	(0.0537)	(0.0559)	(0.0523)	(0.0609)	(0.0532)
national fiscal rule preferences	-0.105*	-0.110*	-0.0807	-0.118*	-0.109
	(0.0619)	(0.0625)	(0.0618)	(0.0650)	(0.0981)
Constant	1.717***	1.754***	2.865***	2.993***	1.708***
	(0.126)	-0.127	(0.259)	(0.194)	(0.206)
Observations	575	575	575	503	422
R-squared	0.064	0.067	0.088	0.095	0.037
Number of countries	28	28	28	28	28
Linear regression, correlated panels corrected standard errors (PCSEs)					
*** p<0.01, ** p<0.05, * p<0.1					

Appendix 4

Table A. 4 – Regression results for BD (full sample) and budget divisions

	(1) BD (full sample)	(2) defence (Eurozone)	(3) public order (Eurozone)	(4) housing & community (Eurozone)
EDP	0.302**	-0.0515**	-0.0505***	-0.0599***
	(0.145)	(0.0225)	(0.0116)	(0.0160)
ideology	0.00465**	0.000644	-0.000106	2.68e-05
	(0.00215)	(0.000831)	(0.000273)	(0.000472)
ideological distance	6.31e-05	-3.92e-05	-0.000118*	1.33e-05
	(0.000980)	(0.000113)	(6.34e-05)	(8.25e-05)
alternation	4.27e-05	-2.96e-05	-0.000145**	0.000137
	(0.00163)	(0.000213)	(6.10e-05)	(0.000141)
Δ unemployment rate	0.189***	-0.00295	0.0225***	-0.000227
	(0.0617)	(0.0128)	(0.00369)	(0.00516)
Δ old-age dependency rate	0.367*	0.0134	-0.0110	-0.0255
	(0.194)	(0.0242)	(0.0139)	(0.0213)
decentralisation	-0.204***	-0.00719	0.00337	-0.00386
	(0.0481)	(0.00682)	(0.00413)	(0.00418)
national fiscal rule preferences	-0.252	-0.00317	-0.0199**	-0.0113
	(0.156)	(0.0191)	(0.00960)	(0.0121)
Constant	1.341***	0.0193	0.0393***	0.0241
	(0.141)	(0.0205)	(0.0104)	(0.0183)
Observations	605	299	299	299
R-squared	0.068	0.029	0.140	0.070
Number of countries	28	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table A. 5 – Regression results for budget divisions (continued)

	(1)	(2)	(3)	(4)
	health (Eurozone)	culture (Eurozone)	education (Eurozone)	social protection (Eurozone)
EDP	-0.125***	-0.0556***	-0.119***	-0.279***
	(0.0366)	(0.0109)	(0.0263)	(0.0818)
ideology	-0.000592	-0.000816**	-0.000820	-0.000588
	(0.00110)	(0.000393)	(0.000647)	(0.00214)
ideological distance	2.64e-05	3.67e-05	6.16e-05	-0.000382
	(0.000181)	(5.61e-05)	(0.000127)	(0.000501)
alternation	-0.000170	9.31e-05	-0.000306	-0.00127**
	(0.000244)	(0.000287)	(0.000273)	(0.000626)
Δ unemployment rate	0.0402***	0.00524	0.0524***	0.323***
	(0.0134)	(0.00322)	(0.00748)	(0.0291)
Δ old-age dependency rate	-0.0628	0.0216	-0.0168	-0.00408
	(0.0566)	(0.0206)	(0.0342)	(0.124)
decentralisation	0.00348	0.00257	0.0119	0.000527
	(0.0121)	(0.00464)	(0.00843)	(0.0347)
national fiscal rule preferences	0.00316	-0.0229**	-0.0110	-0.102
	(0.0323)	(0.00927)	(0.0213)	(0.0700)
Constant	0.119**	0.0238**	0.0399	0.296***
	(0.0505)	(0.0116)	(0.0287)	(0.0994)
Observations	299	299	299	299
R-squared	0.088	0.068	0.145	0.354
Number of countries	19	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

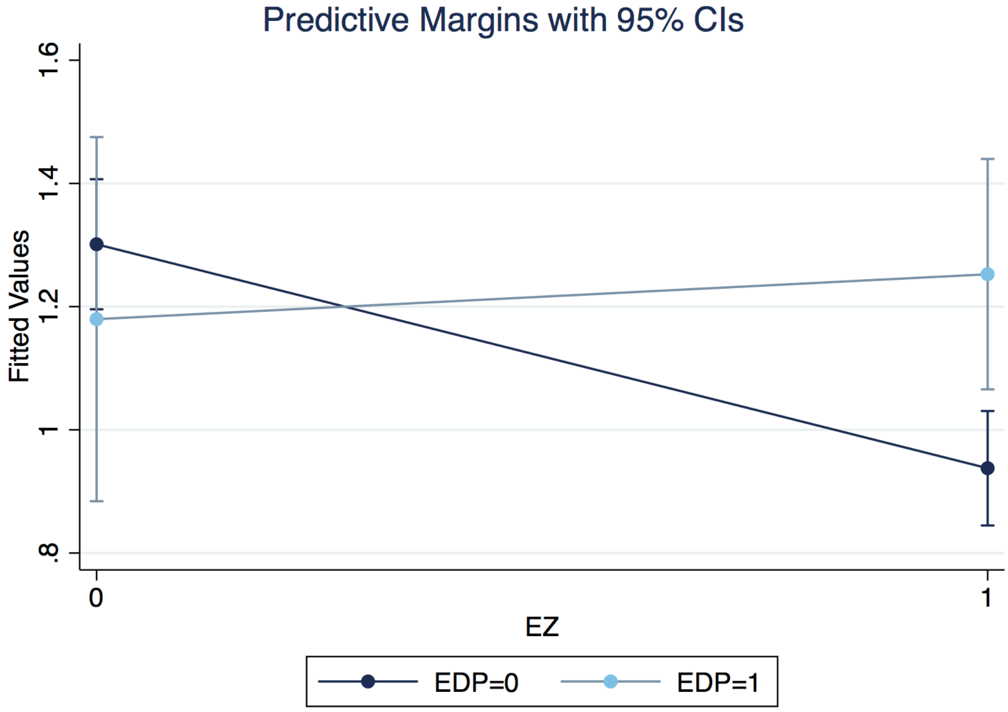

Figure A. 2 - The impact of the Eurozone membership for countries within and outside of the EDP

Appendix 5

<u>Austria</u>

- 2011: overall reduction of spending and deficit, reduction of pension and invalidity spending, efficiency in healthcare, strengthening labour market participation of women through care services and investment in education.
- 2012: overall correction of excessive deficit and consolidation trajectory consistent with MTO objectives, efficiency of spending across level of government in healthcare and education, reduction of early retirement, increase in care services, improve education performance and reduce drop-out for disadvantaged.
- 2013: overall correction of excessive deficit and consolidation trajectory consistent with MTO objectives, reduction of early retirement, increase in care services, implement healthcare reform efficiency gains, improve educational outcomes
- 2014: consolidation to meet preventive arm requirement and MTO objectives, reduction of early retirement and sustainability of pensions, cost effectiveness for healthcare, increase in care services, improvement of education performance
- 2015: avoid deviating from MTO, reduction of early retirement and

sustainability of pensions, increase in care services, improvement of education performance

- 2016: limit deviation from MTO, reduction of early retirement and sustainability of pension and healthcare, improvement of care services and education performance.
- 2017: respect requirements of the preventive arm and convergence trajectory toward MTO, reduction of early retirement and sustainability of pension and healthcare, improvement of care services and education performance.
- 2018: respect trajectory toward MTO, sustainability of pension and healthcare, improvement of care services and education performance.
-

Belgium

- 2011: accelerate correction of excessive deficit through expenditure cuts, reduction of pension spending and prevention of early retirement, introduce gradually decreasing unemployment benefits (by duration) and improve active labour market policies especially of vulnerable groups.
- 2012: correct excessive deficit by 2012, curb age-related expenditures including health expenditures and early retirement, reform unemployment benefits to reform disincentive to work and strengthen ALM policies especially for vulnerable groups, ensure progress toward greenhouse gas emission reduction.
- 2013: adopt additional measures to correct excessive deficit, reduce early retirement and reform social security towards active ageing, efficiency of spending on long term institutional care, condition unemployment benefits to job-search requirements, ensure progress toward greenhouse gas emission reduction.
- 2014: reinforce budgetary sustainability measures, contain future expenditure increases for ageing and long-term care by reducing early retirement, promoting active ageing and cost-efficiency for long term care, improve support to youth employment by reducing school leaving and improving training, ensure progress toward greenhouse gas emission reduction.
- 2015: enact fiscal adjustments toward MTO, improve labour market access for vulnerable groups by addressing skills mismatch.
- 2016: enact fiscal adjustments toward MTO, ensure effectiveness of activation policies by improving education and training to vulnerable groups, boost investment in knowledge-based capital, improve investment in transport and energy infrastructure.
- 2017: strengthen sustainability of public finances, improve composition of spending to make room for infrastructure investment, improve education, training and employment opportunities to vulnerable groups, foster investment in knowledge-based capital especially for digital

technology adoption.

- 2018: enact needed structural adjustment, improve composition of spending to make room for infrastructure investment through spending reviews, remove disincentive to work and activation especially for low-skilled and older workers paired with education and training reforms favouring STEM, invest in transport and environmental infrastructure.

France

- 2011: implement corrective measures for excessive deficit, review sustainability of pension system, support life-long learning, training and active labour market policies.
- 2012: implement corrective measures for excessive deficit, review sustainability of pension system, improve life-long learning, improve labour market participation of older workers and employability of youth through apprenticeship schemes and ALM policies, develop energy interconnection capacity.
- 2013: implement corrective measures for excessive deficit, promote a growth friendly fiscal consolidation, bring pension system into sustainable balance, increase cost-effectiveness of healthcare, strengthen energy interconnection capacity.
- 2014: implement corrective measures for excessive deficit, promote a growth friendly fiscal consolidation, reduce increase in social security spending and reform unemployment benefit system for sustainability including through training of older workers to remain in labour market, contain pension cost, ambitious healthcare cost containment tackling projected increase in spending, streamline family benefits and housing allowances, strengthen energy interconnection capacity, phase out environmentally harmful subsidies, vocational training and education reform to combat inequalities and early school leaving, including through apprenticeships.
- 2015: implement corrective measures for excessive deficit, identify saving opportunity in social spending and bring the pension and unemployment benefit system into balance and long-term sustainability.
- 2016: implement corrective measures for excessive deficit, reform apprenticeship and vocational training while improving sustainability of unemployment benefit system,
- 2017: implement corrective measures for excessive deficit through a substantial fiscal effort, improve vocational education and training, improve efficiency of public support for innovation.
- 2018: contain growth of government expenditure and accelerate debt reduction and expenditure savings, improve sustainability of pension schemes, improve vocational education and training, improve efficiency of public support for innovation.

Italy

- 2011: implement planned fiscal consolidation under the EDP, review fragmented unemployment benefit system and promote greater women participation through care facilities.
- 2012: ensure correction of excessive deficit, address youth unemployment including through education and training and hiring incentives, combat early school leaving, labour market reform for integrated unemployment benefit scheme, improve women participation through increased child and elderly care, improve infrastructure interconnection.
- 2013: limit deficit under 3% and pursue growth-friendly fiscal consolidation, foster women and youth participation through youth guarantee, vocational education and training, improved support to tertiary students and improvement of care and out-of school services, invest in teachers' professional development, upgrade infrastructure for energy interconnectivity, intermodal transport and high-speed broadband.
- 2014: reinforce budgetary measure toward consolidation while pursuing growth-friendly fiscal adjustments, preserving investment in R&D, innovation, education and essential infrastructures, work toward more comprehensive social protection and ALMP, promote female employment through improved care services, pursue the objectives of the youth guarantee, increase poverty addressing measure and family support for vulnerable children, improve education outcomes, vocational programmes and training as well as tertiary education, approve strategic energy infrastructure and import ports and their interconnectivity.
- 2015: achieve fiscal adjustment toward MTO, improve intermodal transport, tackle youth unemployment including through education and vocational training reform.
- 2016: limit deviation from required consolidation path, implement ALMP, adopt national antipoverty strategy, rationalise social spending.
- 2017: pursue a substantial fiscal effort in line with preventive SGP requirements for debt reduction, ensure effective ALMP and rationalise social spending.
- 2018: contain expenditure growth and promote a structural adjustment toward debt reduction, reduce share of old pension spending to make space for other social spending, improve ALMP and access of women through comprehensive family support strategy and increased childcare, improve digital skills and infrastructure investment including through vocational tertiary education.

Portugal

- 2014: adopt structural adjustment in line with EDP recommendation

through sustainable growth friendly consolidation, improve sustainability of pensions and healthcare, improve ALMP and tackle long-term and youth unemployment, ensure adequate coverage from social assistance, improve quality of education and training, improve energy interconnection, financial sustainability of public transport.
- 2015: ensure durable correction of EDP, improve sustainability of the pension system, improve efficiency of public employment services, ensure adequate coverage of minimum income scheme.
- 2016: ensure durable correction of EDP, improve sustainability of the healthcare system and reduce budgetary transfers for pensions.
- 2017: ensure the durability of the correction of the EDP through substantial fiscal effort, improve sustainability of pensions and healthcare, ensure activation of unemployed.
- 2018: ensure containment of growth of government expenditure, improve efficiency in the healthcare sector, improve higher education and adult training programs.

Spain

- 2011: budget in line with EDP recommendations, pension sustainability, improve lifelong learning of older workers, improve youth employability of young people, improve education and training.
- 2014: sustainable correction of excessive deficit through ambitious and growth and employment friendly structural reforms, rationalisation of healthcare spending, strengthen unemployment conditionality and employability (e.g. through hiring subsidies) together with reinforcement of employment services, improve education and training and implement the youth entrepreneurship and employment strategy, implement the action plan for social inclusion, including improved family policies support to vulnerable children
- 2015: ensure durable correction of excessive deficit, rationalise healthcare spending, increase quality and effectiveness of public employment services especially for youth.
- 2016: ensure durable correction of excessive deficit, strengthen training services, improve minimum income and family support schemes, including quality childcare and long-term care, improve tertiary education and research funding to universities.
- 2017: ensure compliance with notice under the EDP through comprehensive spending review, improve coverage of minimum income and family policies especially for childcare, improve tertiary education, ensure adequate and sustained investment in research and innovation.
- 2018: ensure compliance with notice under the EDP, improve family support and income guarantee schemes, mitigate education regional disparities, increase public investment in research and innovation.

Appendix 6

Table A. 6 – Change in the impact of EU and Eurozone membership across the cycle

	(1)			(2)
	BD			BD
	(non-FAP)			(non-FAP)
crisis	0.381		crisis	-0.211
	(0.235)			(0.854)
EZ	-0.272***		EU	-0.548***
	(0.0975)			(0.165)
EZ#crisis	0.00628		EU#crisis	0.670
	-0.226			(0.913)
ideology	0.00169		ideology	0.00134
	(0.00371)			(0.00354)
ideological distance	0.000217		ideological distance	-5.51e-05
	(0.000838)			(0.000804)
alternation	4.30e-05		alternation	9.16e-05
	(0.000541)			(0.000556)
Δ unemployment rate	0.0930**		Δ unemployment rate	0.0757*
	(0.0405)			(0.0414)
Δ old-age dependency rate	0.0105		Δ old-age dependency rate	0.0391
	(0.147)			(0.150)
decentralisation	-0.120**		decentralisation	-0.143***
	(0.0530)			(0.0467)
national fiscal rule preferences	-0.155*		national fiscal rule preferences	-0.103
	(0.0907)			(0.0840)
Constant	1.429***		Constant	1.729***
	-0.0947			-0.161
Observations	575		Observations	575
R-squared	0.064		R-squared	0.076
Number of countries	28		Number of countries	28
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table A. 7 – Regression results: early and late crisis

	(1)	(2)	(3)	(4)
	BD (phase 2: 2005-2010)	BD (phase3: post-2011)	Total spending (early crisis: 2009-2010)	total spending (late crisis: 2011-2012)
EDP	-0.251	0.664***	-1.151***	-0.618***
	(0.193)	(0.245)	(0.114)	(0.170)
crisis	0.903***	0.0836		
	(0.193)	(0.364)		
EDP#crisis	-0.839***	-0.697		
	(0.231)	(0.565)		
ideology	-0.00875	0.0346***	-0.00265	0.00808
	(0.00771)	(0.00925)	(0.0228)	(0.0101)
ideological distance	-0.00260	-0.000743	-0.0112	-0.00230
	(0.00502)	(0.000646)	(0.00849)	(0.00303)
alternation	-0.00108	0.00130*	-0.00396	0.0123
	(0.00870)	(0.000717)	(0.0145)	(0.0171)
Δ unemployment rate	0.250***	-0.206**	0.299***	-0.0268
	(0.0517)	(0.102)	(0.0944)	(0.0204)
Δ old-age dependency rate	0.270	-0.366	0.161	0.0150
	(0.201)	(0.398)	(0.688)	(0.185)
decentralisation	0.0494	-0.344***	-0.0341	0.0857
	(0.0609)	(0.115)	(0.108)	(0.194)
national fiscal rule preferences	-0.346***	-0.682**	-0.262**	-0.362***
	(0.117)	(0.280)	(0.118)	(0.0924)
Constant	1.170***	1.676***	2.294***	1.599***
	(0.213)	(0.303)	(0.343)	(0.190)
Observations	82	127	30	29
R-squared	0.483	0.190	0.640	0.263
Number of countries	16	18	16	15
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Appendix 7

Table A. 8 – Regression results for significant groups

	Executive and legislative organs, financial and fiscal affairs, external affairs	Basic research	Military defence	Fire-protection services
EDP	0.0288	-0.00239	-0.0589***	-0.00346
	(0.0357)	(0.0103)	(0.0206)	(0.00693)
crisis	0.180***	0.0414*	0.0551	0.0163
	(0.0643)	(0.0218)	(0.0491)	(0.0124)
EDP#crisis	-0.275***	-0.0473*	-0.0350	-0.0255*
	(0.0831)	(0.0253)	(0.0562)	(0.0145)
ideology	0.000214	0.000196	-0.000143	-0.000114
	(0.00108)	(0.000355)	(0.000563)	(0.000194)
ideological distance	0.000243	6.11e-05	-4.94e-05	-6.96e-06
	(0.000154)	(6.49e-05)	(0.000112)	(3.82e-05)
alternation	8.92e-05	4.93e-05	-7.68e-05	6.82e-06
	(0.000303)	(3.75e-05)	(0.000214)	(1.77e-05)
Δ unemployment rate	0.0444***	0.00104	-5.45e-05	0.00253
	(0.0141)	(0.00461)	(0.00981)	(0.00209)
Δ old-age dependency rate	0.0177	-0.0132	0.0233	-0.000246
	(0.0422)	(0.0130)	(0.0240)	(0.00709)
decentralisation	0.00407	0.00730*	-0.00896	0.000885
	(0.0120)	(0.00382)	(0.00958)	(0.00292)
national fiscal rule preferences	-0.00915	-0.0125	0.00208	-0.00357
	(0.0333)	(0.00896)	(0.0159)	(0.00565)
Constant	-0.0209	0.0135*	0.0152	0.00436
	(0.0348)	(0.00721)	(0.0222)	(0.00470)
Observations	267	267	267	267
R-squared	0.108	0.044	0.045	0.031
Number of countries	19	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table A. 9 - Regression results for significant groups continued

	Mining, manufacturing and construction	Other industries	R&D Economic affairs	Waste management
EDP	-0.00561	-0.0185**	0.00148	0.0214*
	(0.00945)	(0.00780)	(0.00787)	(0.0110)
crisis	0.0412***	0.0389***	0.0508***	0.0108
	(0.0135)	(0.00975)	(0.0151)	(0.0129)
EDP#crisis	-0.0575***	-0.0241	-0.0448**	-0.0340
	(0.0181)	(0.0147)	(0.0202)	(0.0218)
ideology	1.61e-06	0.000380	-0.000321	0.000239
	(0.000377)	(0.000284)	(0.000316)	(0.000375)
ideological distance	8.18e-06	-1.51e-05	0.000101*	-1.91e-05
	(2.65e-05)	(4.86e-05)	(5.55e-05)	(4.99e-05)
alternation	-0.000123	0.000115	-5.96e-05	-7.53e-05
	(8.05e-05)	(0.000130)	(0.000106)	(0.000267)
Δ unemployment rate	0.000656	-0.00525*	8.18e-05	0.00242
	(0.00329)	(0.00312)	(0.00260)	(0.00366)
Δ old-age dependency rate	-0.000886	0.00285	-0.00512	-0.0100
	(0.00827)	(0.00951)	(0.00929)	(0.0133)
decentralisation	0.00436	0.00200	0.00656**	0.000980
	(0.00473)	(0.00331)	(0.00274)	(0.00455)
national fiscal rule preferences	-0.00521	-0.00905	0.00115	-0.000148
	(0.00846)	(0.00718)	(0.00671)	(0.00687)
Constant	-0.00354	0.00487	-0.00604	-0.00110
	(0.00801)	(0.00851)	(0.00668)	(0.00829)
Observations	267	267	267	267
R-squared	0.052	0.071	0.075	0.028
Number of countries	19	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table A. 10 - Regression results for significant groups continued

	R&D Environmental protection	Community development	Water supply	Medical products, appliances and equipment
EDP	-5.37e-05	-0.00769	-0.00673	-0.0658**
	(0.00315)	(0.0111)	(0.00840)	(0.0258)
crisis	-0.00104	0.0421**	0.0173	-0.0406
	(0.00224)	(0.0191)	(0.0175)	(0.108)
EDP#crisis	0.00634*	-0.0604***	-0.0362**	0.0387
	(0.00364)	(0.0224)	(0.0144)	(0.108)
ideology	-5.60e-05	0.000128	0.000349	0.000101
	(8.20e-05)	(0.000337)	(0.000320)	(0.00131)
ideological distance	-4.49e-06	-5.72e-06	1.16e-05	5.59e-05
	(5.73e-06)	(4.39e-05)	(3.17e-05)	(9.07e-05)
alternation	-3.21e-06	2.57e-05	1.77e-05	5.14e-05
	(6.52e-06)	(0.000102)	(7.88e-05)	(0.000196)
Δ unemployment rate	0.00130	-0.00512	0.00105	0.0225**
	(0.000867)	(0.00522)	(0.00430)	(0.0104)
Δ old-age dependency rate	0.000298	0.00223	-0.00701	-0.0417
	(0.00243)	(0.0123)	(0.0107)	(0.0529)
decentralisation	0.000328	-0.00140	-0.000574	-0.00630
	(0.000984)	(0.00672)	(0.00446)	(0.0163)
national fiscal rule preferences	0.00230	-0.00926	-0.00401	-0.0310
	(0.00227)	(0.00895)	(0.00707)	(0.0357)
Constant	-0.00134	0.00222	0.00856	0.0788**
	(0.00176)	(0.00854)	(0.0112)	(0.0362)
Observations	267	267	267	267
R-squared	0.027	0.048	0.037	0.033
Number of countries	19	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table A. 11 - Regression results for significant groups continued

	Hospital services	Health n.e.c.	Recreational and sporting services	Cultural services
EDP	-0.00378	-0.0119	-0.0226***	-0.0210***
	(0.0239)	(0.00914)	(0.00727)	(0.00791)
crisis	0.199***	-0.0126	0.00144	0.0144
	(0.0431)	(0.0144)	(0.0166)	(0.0246)
EDP#crisis	-0.217***	0.0313**	0.00498	-0.0107
	(0.0486)	(0.0159)	(0.0192)	(0.0263)
ideology	0.000303	5.98e-05	-0.000106	-9.82e-06
	(0.000708)	(0.000279)	(0.000249)	(0.000312)
ideological distance	6.21e-05	3.60e-06	2.67e-05	1.77e-05
	(0.000130)	(2.20e-05)	(4.31e-05)	(6.24e-05)
alternation	-0.000185	3.38e-06	1.91e-05	1.66e-05
	(0.000238)	(0.000135)	(7.59e-05)	(0.000114)
Δ unemployment rate	0.0193**	0.00567**	0.00475*	0.00349
	(0.00839)	(0.00265)	(0.00244)	(0.00341)
Δ old-age dependency rate	0.0376	0.00227	0.00673	0.0109
	(0.0282)	(0.0110)	(0.0100)	(0.0125)
decentralisation	0.000777	0.000694	0.00247	0.00205
	(0.00745)	(0.00308)	(0.00369)	(0.00402)
national fiscal rule preferences	0.00392	0.00751	-0.00905	-0.00882
	(0.0186)	(0.00762)	(0.00740)	(0.00797)
Constant	-0.00382	-0.00240	0.0108*	0.00585
	(0.0213)	(0.00936)	(0.00653)	(0.0102)
Observations	267	267	267	267
R-squared	0.128	0.027	0.040	0.027
Number of countries	19	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table A. 12 - Regression results for significant groups continued

	Broadcasting and publishing services	Religious and other community services	R&D Recreation, culture and religion	Recreation, culture and religion n.e.c.
EDP	-0.0222***	-0.00306	-0.00131	-0.00243
	(0.00753)	(0.00337)	(0.00166)	(0.00362)
crisis	-0.00423	-0.0171**	0.00657*	-0.00138
	(0.0126)	(0.00804)	(0.00371)	(0.00685)
EDP#crisis	0.00848	0.0193**	-0.0101***	0.00918
	(0.0141)	(0.00911)	(0.00374)	(0.00735)
ideology	-0.000120	6.37e-05	-4.42e-07	7.31e-06
	(0.000257)	(0.000133)	(5.30e-05)	(9.59e-05)
ideological distance	1.00e-05	4.10e-06	-1.92e-05*	-2.95e-05*
	(5.09e-05)	(5.48e-05)	(1.12e-05)	(1.65e-05)
alternation	1.07e-06	8.39e-06	4.37e-06	7.95e-05**
	(4.79e-05)	(1.29e-05)	(5.23e-06)	(3.31e-05)
Δ unemployment rate	0.00613**	0.00197	0.000883	-0.000156
	(0.00240)	(0.00134)	(0.000772)	(0.00127)
Δ old-age dependency rate	0.0140*	0.00364	0.00260	-0.000496
	(0.00831)	(0.00394)	(0.00237)	(0.00357)
decentralisation	-0.00141	-0.000135	0.00157	-0.000879
	(0.00284)	(0.00105)	(0.00154)	(0.00205)
national fiscal rule preferences	0.000612	-0.00326	-0.000599	-0.000230
	(0.00648)	(0.00274)	(0.00123)	(0.00332)
Constant	0.00406	0.00268	-0.000418	0.00179
	(0.00637)	(0.00241)	(0.00103)	(0.00333)
Observations	267	267	267	267
R-squared	0.051	0.039	0.051	0.028
Number of countries	19	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table A. 13 - Regression results for significant groups continued

	Pre-primary and primary education	Secondary education	Tertiary education	Subsidiary services to education
EDP	-0.0394***	-0.0301	-0.0150	0.00320
	(0.0131)	(0.0190)	(0.0141)	(0.00625)
crisis	0.0707**	0.120***	0.0780***	0.0490***
	(0.0323)	(0.0335)	(0.0276)	(0.0128)
EDP#crisis	-0.0395	-0.130***	-0.0689**	-0.0592***
	(0.0324)	(0.0362)	(0.0339)	(0.0141)
ideology	-6.89e-05	-0.000520	0.000162	-1.71e-05
	(0.000381)	(0.000571)	(0.000503)	(0.000226)
ideological distance	5.73e-05	-2.33e-05	2.95e-05	1.13e-05
	(6.62e-05)	(8.66e-05)	(8.13e-05)	(3.29e-05)
alternation	-4.81e-05	-1.27e-05	-1.58e-05	-4.10e-06
	(0.000130)	(0.000135)	(0.000165)	(1.73e-05)
Δ unemployment rate	0.0179***	0.0165**	0.00260	0.000878
	(0.00539)	(0.00656)	(0.00450)	(0.00197)
Δ old-age dependency rate	0.00623	-0.00972	-0.00404	-0.000873
	(0.0155)	(0.0190)	(0.0173)	(0.00824)
decentralisation	0.00502	0.00370	0.00586	0.000643
	(0.00601)	(0.00647)	(0.00604)	(0.00368)
national fiscal rule preferences	-0.00267	-0.000983	-0.0145	0.00434
	(0.0108)	(0.0132)	(0.0107)	(0.00565)
Constant	0.00783	-0.00323	0.00530	-0.00207
	(0.0150)	(0.0176)	(0.0109)	(0.00582)
Observations	267	267	267	267
R-squared	0.116	0.146	0.061	0.073
Number of countries	19	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table A. 14 - Regression results for significant groups continued

	Sickness and disability	Old age	Survivors	Family and children
EDP	-0.0359	-0.0225	-0.0114	-0.0623***
	(0.0231)	(0.0557)	(0.00876)	(0.0190)
crisis	0.118**	0.376***	0.0634***	0.0948*
	(0.0543)	(0.122)	(0.0144)	(0.0493)
EDP#crisis	-0.107*	-0.329***	-0.0561***	-0.101**
	(0.0628)	(0.113)	(0.0187)	(0.0482)
ideology	-0.000422	0.00178	0.000236	0.000276
	(0.000914)	(0.00162)	(0.000294)	(0.000597)
ideological distance	2.33e-05	-6.37e-05	-7.98e-05	-0.000168
	(9.70e-05)	(0.000236)	(5.50e-05)	(0.000134)
alternation	-0.000177	-0.000776*	-0.000161	-1.36e-05
	(0.000167)	(0.000411)	(0.000106)	(0.000184)
Δ unemployment rate	0.0328***	0.160***	0.0211***	0.0312***
	(0.0107)	(0.0206)	(0.00361)	(0.00733)
Δ old-age dependency rate	-0.0486	0.0927	-0.0141	0.00413
	(0.0346)	(0.0715)	(0.0101)	(0.0227)
decentralisation	0.00981	-0.00189	-0.00756*	0.00295
	(0.00925)	(0.0235)	(0.00458)	(0.00717)
national fiscal rule preferences	-0.0111	-0.0835**	-0.00677	0.00478
	(0.0246)	(0.0418)	(0.00781)	(0.0167)
Constant	0.0424	0.136**	0.0147*	0.0285
	(0.0283)	(0.0658)	(0.00852)	(0.0212)
Observations	267	267	267	267
R-squared	0.123	0.324	0.289	0.166
Number of countries	19	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)				
*** p<0.01, ** p<0.05, * p<0.1				

Table A. 15 - Regression results for significant groups continued

	Social exclusion n.e.c.	R&D Social protection	Social protection n.e.c.
EDP	-0.0503**	-0.0245*	-0.00361
	(0.0220)	(0.0146)	(0.0129)
crisis	0.134***	0.0770**	0.0434**
	(0.0429)	(0.0334)	(0.0186)
EDP#crisis	-0.132***	-0.0533	-0.0909***
	(0.0501)	(0.0414)	(0.0258)
ideology	-0.000107	-9.82e-05	-0.000530
	(0.000758)	(0.000659)	(0.000392)
ideological distance	-2.94e-05	1.21e-05	-2.17e-05
	(8.45e-05)	(7.10e-05)	(5.23e-05)
alternation	-0.000130	-6.78e-05	-8.42e-05
	(9.21e-05)	(0.000101)	(0.000111)
Δ unemployment rate	0.107***	0.0120**	0.00211
	(0.00885)	(0.00518)	(0.00444)
Δ old-age dependency rate	0.0546**	-0.00645	-0.00830
	(0.0278)	(0.0157)	(0.0136)
decentralisation	-0.00728	-0.00471	0.00332
	(0.0111)	(0.00692)	(0.00452)
national fiscal rule preferences	0.0219	0.00146	0.00143
	(0.0211)	(0.0125)	(0.0125)
Constant	-0.0140	0.0172	-0.00402
	(0.0227)	(0.0152)	(0.00941)
Observations	267	267	267
R-squared	0.464	0.087	0.057
Number of countries	19	19	19
Linear regression, correlated panels corrected standard errors (PCSEs)			
*** p<0.01, ** p<0.05, * p<0.1			