

Thema

**The Dependence of Financial Markets
regarding to External Sources of
Information**

-

**The Role of the Stability and Growth
Pact and Credit Rating Agencies**

Dissertation

zur Erlangung des akademischen Grades
doctor rerum politicarum (Dr. rer. pol.)

vorgelegt dem
Rat der Wirtschaftswissenschaftlichen Fakultät der
Friedrich-Schiller-Universität Jena

am 27. November 2013

von Diplom Volkswirt Martin Zenker
geboren am 25. Juni 1984 in Jena

Contents

List of Figures	vii
List of Tables	viii
List of Abbreviations	ix
List of Symbols	xi
Deutsche Zusammenfassung	xviii
1 Introduction	1
1.1 The Topic of this Dissertation	1
1.2 The Stability and Growth Pact: Implementation of Multilateral Fiscal Rules within Europe	2
1.2.1 The Formation of the European Monetary Union	2
1.2.2 The Desire for Fiscal Prudence: The Stability and Growth Pact . . .	6
1.2.2.1 The German Domestic Drivers	7
1.2.2.2 Core Intentions of the SGP	8
1.2.2.3 The European Scepticism Regarding the Pact	12
1.2.3 Does a Monetary Union Need Fiscal Rules?	13
1.2.4 The Disregard of Objectives Agreed by Contract	16
1.2.5 Political News and the Sensitivity of the Foreign Exchange Market	18
1.2.6 Fiscal Policy and the Opportunity of Market Discipline	20
1.3 The Connection of Sovereign Debts, Creditworthiness and Credit Rating Agencies	27
1.4 The Credit Rating Industry	30
1.4.1 What are Credit Ratings? A Short Introduction	30
1.4.2 The Historical Development and the Rise of the Credit Rating Industry	31
1.4.3 Business Model - The Advantage of External Credit Ratings	34
1.4.4 Deficiencies of CRAs	37
1.4.4.1 Lack of Competition	37
1.4.4.2 Failures of Integrity	38
1.4.4.3 Failures of Reliability	39
1.4.4.4 Failures in Transparency	39
1.4.5 Overview of the Regulatory Use of Credit Ratings in Europe	40
1.4.6 Game Theoretical and Empirical Analyses of Potential Incentive Problems	42
1.4.6.1 Game Theoretical Analyses	42
1.4.6.2 Empirical Evidence	43
1.4.6.3 Proposed Options for Regulation	44

Contents

1.5	Aim and Approach of this Thesis	45
1.6	The Structure of the Thesis	45
2	Minor Nuisance Around Foreign Exchange Markets	48
2.1	Introduction	48
2.2	Political Events and the Foreign Exchange Expectations Bias	49
2.3	The Theoretical Model and Hypotheses	51
2.4	Empirical Analysis	55
2.4.1	Data	55
2.4.2	The Model to be Estimated	58
2.4.3	Empirical Results	60
2.4.4	Robustness Tests	64
2.5	Implications for EU/EMU Fiscal Governance	65
2.6	Conclusion	66
3	Market Discipline Under A Politicised Multilateral Fiscal Rule	68
3.1	Introduction	68
3.2	Market Discipline in a Monetary Union - A Theoretical Framework	70
3.3	Empirical Analysis	75
3.3.1	Data	75
3.3.2	Model Estimation	78
3.3.3	Empirical Results	82
3.3.4	Robustness Tests	85
3.4	Policy Implications	85
3.5	Conclusion	86
4	The Credit Rating Market's Disincentives	88
4.1	Introduction	88
4.2	Game Theoretical Model with Repeated Interaction	89
4.2.1	The Issuer and its Assets	90
4.2.2	Credit Rating Agencies	91
4.2.3	Two Types of Investors	92
4.2.4	Payoff Structure of the Game	93
4.2.5	Timing	94
4.2.6	Reputation Updates	94
4.3	Analysis of Various Games	97
4.3.1	Monopolistic Scenario with Binding Screening Technology Standards	97
4.3.2	The CRA Market in a Competitive Environment	102
4.4	Conclusion	110
5	The Credit Rating Market - Options for Appropriate Regulation	112
5.1	Introduction	112
5.2	Policy Trends 2013 - The New European Regulation	113
5.3	Game Theoretical Model - Strategic Interaction and Payoffs	115
5.3.1	Status Quo Analysis	116
5.3.2	Random Rating Allocation to one CRA	119
5.3.3	Random Rating Allocation to two CRAs	121
5.3.4	Comparison of the Options for an Appropriate Regulation	125

Contents

5.3.5 Potential Allocation Effects	128
5.4 Policy Implications	129
5.5 Conclusion	131
6 Summary and Final Conclusions	133
6.1 Conclusion on the Lessons of the Stability and Growth Pact Debate	133
6.2 Conclusion on the Potential Regulation of Credit Rating Agencies	136
Bibliography	140
Appendix	159
A The Influence of Negative Peer Pressure	160
A.1 The Development of Negative Peer Pressure Regarding the Political Debate of Softening the SGP	161
A.2 Stabilising versus Destabilising Statements of the ECB and National CBs	168
B Dataset Generation to Measure Political Aversion the Pact	169
C Reasoning of the Cooperative Dataset Elaboration	173
D Appendix to Chapter 2	176
D.1 Overview of Excessive Deficit Procedures	176
D.2 Overview of Destabilising Statements	177
D.3 EUR Exchange Rate Development	178
D.4 Expectation Bias between 2001 and 2005	179
E Appendix to Chapter 4	180
E.1 Proof - Inflation Mark-up	181
E.2 First Difference of Reputation Values	182
Erklärung	183