Applying the “Debt Brake”
The Political Construction of the German Anti-Debt Agenda, 1999-2009

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Since 2010, austerity has been the central response to the financial crisis in the UK, the US and in the Eurozone. The ratio of debt to GDP has become the overriding preoccupation of policy. The promise of austerity in the form touted since 2010 has been not only that it will reduce the new accumulation of debt, but that it will actually raise growth thus improving both sides of the ratio at once. The idea of the “expansionary fiscal contraction”, pushed by the economist Alesina and others, has attracted remarkably widespread support. Mark Blyth has traced the networks through which “austerity politics” enjoyed a new popularity.1 A key role in this was played by international institutions such as the OECD, the IMF and the EU and a cluster of Italian neoliberal economists associated with Bocconi University in Milan.2 In political terms, however, there is little doubt that the main driver of the austerity agenda in Europe has been the German government of Angela Merkel with her dour Finance Minister Wolfgang Schaeuble as the battering-ram.

This association of austerity with Germany, of course, conforms to stereotypes. And true to type, Merkel’s government has doggedly insisted on a rule-bound policy in the style of a revamped ordoliberalism. In thinking about the strong hold of neoliberalism on Germany we tend, for obvious reasons, to stress its “deep history” and its role in the foundation of the Federal Republic, in the era of Konrad Adenauer and Ludwig Erhard.3 The recent surge of interest in the history of neoliberalism has encouraged this backward movement to the 1930s and 1940s. This has only been reinforced by the rediscovery of Foucault’s lectures on neoliberalism from the 1970s. But as important as it no doubt is to appreciate the founding significance of the Freiburg school for the Federal Republic, the resulting histories tend to reify and fix a certain view of what Germany was and what Germany is. Such a simple and static vision of a German Sonderweg in economic policy cannot do justice to the pullulating complexity of Germany’s capitalist democracy.

Historians of the postwar period have labored long and hard to add complexity and nuance to the endlessly repeated story of ordoliberalism’s triumph in the Adenauer period. To attribute Germany’s economic miracle after 1947 to the influence of the Freiburg school increasingly seems like a crass simplification.

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2 The Political Power of Economic Ideas: The Case of ‘Expansionary Fiscal Contractions’ Sebastian Dellepiane-Avellaneda, BJPIR: 2014
Likewise, since the 1970s, the autonomy of the Bundesbank has proven robust, but it has had to be repeatedly asserted and defended, at times imposed with real aggression. Meanwhile, the stout defense of conservative rigor by the Bundesbank has compensated for the far more chequered performance of German fiscal policy. With regard to debt, Germany is a fairly “average” high income country. Under the reforming Social-Liberal coalition of the 1970s and 1980s, the growth in Germany’s public debt was exceptionally rapid. By 1989, before the impact of reunification made itself felt, Germany’s gross public debt at 42% of GDP was higher than that of either France or Britain. In 2007 before the crisis struck, Germany’s debt at 66 percent of GDP was well-nigh identical to that of the Eurozone average. The question that needs to be posed is what the relationship is between this fairly average track record on public debt and Germany's self-proclaimed role as the chief prophet of austerity. Clearly, if we are going to argue for a distinctive German history of fiscal austerity this cannot start from a simple “matter of fact”. It must be a dynamic history of struggle within Germany, in which aspirations as much as realities are at stake and in which there is no settled “German view”, but a series of conflicting points of view in tension with one another. One is reminded of the truism in the history of sexuality that a repressive culture, filled with talk of abstinence and moral sanctions should not be confused with an absence of desire or sex.

The austere line of the Merkel government can be traced back to a program of reform driven by a mounting sense of fiscal panic within Germany itself, which then collided with the financial crisis of 2008-9. The centerpiece of this reform program, in its latest iteration, is the so-called debt brake amendment (Schuldenbremse) to the German constitution passed in June 2009, in the last months of Angela Merkel's first Grand Coalition government. Since 2010, the debt brake has been adopted as the model for fiscal reform in the EU and has been aggressively pushed by Schaeuble. It has been subject to withering criticism by economists both from within Germany and without. And in its resolute refusal of commonplace economic logic, it is tempting to read it as a quintessential expression of an anti-state, anti-debt affect of the right-wing. But as the brief genealogical sketch offered by this paper will reveal, the debt brake in fact originated in a Federal Finance Ministry that for ten years between 1999 and 2009 was under the control not of the CDU, but of the right-wing of the SPD. The prominent involvement of social democrats is not unusual in the recent history of neo-neoliberalism. But the German case does add three additional components. The language of justification for German austerity, is redolent not of old-school conservatism, but of the environmental concern for “sustainability” injected into German politics by the Green Party. Furthermore, because of the dynamic competition on the left of the German political spectrum between the SPD, the Greens and Die Linke, the debt

4 For critiques from within Germany, see P. Bofinger and G. Horn, Appeal: Die Schuldenbremse gefährdet die gesamtwirtschaftliche Stabilität und die Zukunft unserer Kinder 15.5.2009 Heiner Flassbeck, Friederike Spiecker Der Staat als Schuldner – Quadratur des Bösen? Wirtschaftsdienst 2011/7. A. Tooze, Germany’s unsustainable growth, Foreign Affairs Sep/October 2012.
5 A point well made by Hans Kundani, Can Germany’s Social Democrats Offer an Alternative? Dissent Fall 2013.
brake idea was subject from its inception to a powerful left-wing critique. The result is what one might term, a “reflexive” neoliberalism, a neoliberalism that sees its enemies coming, anticipates their arguments and seeks to disarm them at source. Against their opponents on the left, who argued that the debt brake was a depoliticizing, constraining corset for democracy, the right-wing Social Democrats around Peer Steinbrueck argued that the debt brake was both a means of restoring the agency of the state and enforcing the necessity of responsible democratic choice. Furthermore, as a response to the problems of Germany’ complex, multi-party federalism, the debt brake is an essential tool for governing the kind of multi-level, dispersed, “quasi-medieval”, “post-sovereignist” political structures that are characteristic of the contemporary world and of which the EU is the quintessential example.

I

Germany’s latest round of fiscal reform has its origin in an earlier iteration of failed fiscal restraint. The spending boom triggered by reunification culminated in the record deficit of 1996 run up by Kohl’s last Finance Minister Teo Waigel. After the brief tenure of the SPD left-winger and future leader of the Linke Oskar Lafontaine, Hans Eichel served as the Finance Minister of the Red-Green coalition between 1999 and 2005. Originally, Eichel had a determined mandate for cuts. After the fudging of the accounts for which Waigel had been notorious Eichel, in the manner of Gordon Brown, offered the new bromide of good government in the 1990s, stability and transparency. MifriFi – Mittelfristige Finanzplanung, medium-term financial planning was the mantra. But what he lacked was the necessary backing from Gerhard Schroeder and the necessary good luck. Eichel was derailed by economic slowdown in the early 2000s. Faced with these headwinds, Schroeder’s tactical calculation seems to have been that it was better not to combine the painful reforms of Agenda 2010 with an austere fiscal policy. When in the budget round for 2002 Eichel faced hard choices, Schroeder cut him loose. In a notorious moment of flippancy an impatient Schroeder told his Finance Minister: “Oh give it up, Hans” (“lass mal gut sein, Hans”). The result in 2004 was one of the largest deficits in postwar history.

What was revealed was not “German discipline”, but a worrying lack of constraints. In alliance with French President Jacques Chirac, the Red-Green coalition in Berlin ruptured the fiscal frame of the Maastricht citeria that was supposed to act as the functional substitute for a fiscal union. Faced with the combination of indiscipline in both France and Germany, Brussels was helpless. At home it was the opposition parties, the CDU and FDP, who took it upon themselves to mobilize the resources of the ordoliberal constitution, by bringing suit in front of the constitutional court, accusing the Federal Government of having breached article 115 of the constitution that required new debts not to exceed the level of investment. Only under exceptional circumstances was this to be breached. By 2004, the government had used its Bundestag majority to declare four economic emergencies in a succession.

http://www.spiegel.de/spiegel/print/d-25718148.html
But as fraught as the situation of the federal government may have been, the more acute symptoms of crisis were felt at the level the Laender, cities and communes. The post-industrial regions of Bremen and the Saar had been hardship cases since the early 1990s. In 1992 having declared themselves as being under a financial state of emergency (“extreme Haushaltsnotlage”) both Laender had taken their case to the Supreme Court and had been allowed financial aid from the Bund, the federal state. What had been intended as temporary assistance had subsequently morphed into a permanent dole. Within ten years Bremen and Saar had drawn 15 billion Euros in subsidy.

In the early 2000s, however, it was not just the peripheral Laender that were in trouble, but the capital city of the reunified Germany. Since reunification Berlin had been running up debts on an enormous scale. But what tipped the scales in 2001-2002 was a haunting foreshadowing of events across Europe and the US 6 years later. In the mid 1990s the Berlin Landesbanken had been merged into publicly owned Bankgesellschaft Berlin. Closely connected to the Berlin establishment and above all the CDU who governed Berlin throughout the 1990s, the Berlin mortgage caixa rapidly established itself as one of the largest and most adventurous lenders across Europe. In 2001 huge imbalances appeared in its accounts. The head of its IT department committed suicide and the bank had to be rescued by an injection of 1.6 billion Euro in new capital by the state government of Berlin, which also took responsibility for 21.6 billion Euro in dubious real estate loans. With the CDU government having been toppled from power, a new SPD-led minority government enjoying the toleration of the PDS took office and promptly invoked the “extreme Haushaltsnotlage” that had triggered aid for Bremen and the Saar ten years earlier. The federal government, however, refused to leap to Berlin’s aid. In September 2003 Berlin therefore brought suit in the Supreme Court in Karlsruhe against the national government to which it plays host, demanding aid on the same basis that Bremen and the Saar had received it. Meanwhile to compound the legal confusion, the constitutional court of the Land Berlin found Berlin’s 2002/3 budget unconstitutional on the grounds of excessive borrowing, leaving the capital city without a functioning budget.

It is no doubt wise to take talk of “urban decay” in Germany’s well-ordered cities with a pinch of salt. Since the 2000s the so-called “ghettos” of Berlin have become hot spots of gentrification, triggering a new chorus of complaints. “Misere auf hohem Niveau” – misery at a high level of comfort – is a specialty of the Federal Republic. But the scale of the debts run up by Germany’s municipalities and the city-states of the North are dramatic by any standard. In 2013, after a decade of budgetary cuts, Berlin’s debts at 21,702 Euros per inhabitant were larger than those of bankrupt Detroit, which came to only 20,574 euros per head. The ancient Hansa city state of Bremen clocked up a remarkable 34,171 per inhabitant, larger than those of even the most heavily indebted and richest cities in the US. Of 427 cities and communes in the Nordrhein-Westfalen, former industrial region, by 2005, 180 had had to introduce special budgetary measures to avoid insolvency.

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8 http://www.theguardian.com/world/2001/may/28/johnhooper
Not surprisingly, given the fiscal incontinence at both the national and state level, by 2005 right-wing business interests were in uproar, demanding action. In 2005 the business forum of the CDU (Wirtschaftsrat) an influential group that is not afraid to criticize even a figure with the authority of Angela Merkel, came out in favor of a so-called “debt brake”. A legal or constitutional remedy should be provided to stem the rising tide of debt.9

But it was not just the right-wing that were concerned. In Berlin, in 2005 the Rosa Luxemburg Foundation, a bastion of the left, launched a major initiative on the control of budgets under conditions of democratic capitalism.10 Senior reformist social scientists, formerly associated with the Schroeder government, including figures such as Wolfgang Streeck, were arriving at similar conclusions.11 In an expertise for the Max Planck Institute Streeck diagnosed a state increasingly caught in a web of inflexible, non-discretionary expenditure, thus deprived of true political autonomy and forced to engage in theatrical rather than substantive politics. This for Streeck was the depressing material reality that informed the disappointing performance of the Schroeder government.

Streeck thus made explicit one of the basic ironies of the modern debt discussion. Campaigning against debt, restricting the capacity to take up debt, can easily seem like an anti-political effort to restrict the scope for political action. But the inability to balance the books could itself be read as a lack of political capacity. It reflected a failure to match ends and means. Debts were freeing. But they were also an easy way out. By postponing the question of taxes, they were a way of escaping genuine political debate. But once the debts reached certain critical threshold level, they not only retarded further economic growth, the principal concern of economists like Reinhart and Rogoff.12 They also became a massive restraint on political agency and democratic choice. Debt service and credit-ratings would then dominate budgetary discussion. Both anti-debt activists and their opponents in Germany thus found themselves contesting on the same ground – the question of the agency (Handlungsfaehigkeit) of the state.

To add further layers of complexity to the political scene, an essential element in German debt discourse by the early 2000s was the grafting of the old strain of austerity onto the much more up-to-date and fresh seeming topic of sustainability (Nachhaltigkeit). The idea of assessing fiscal policy in terms of sustainability entered the policy debate in the 1990s by way of an early paper by Buiter and Blanchard’s influential work at the OECD. In the Schroeder government, Finance Minister Eichel, had, as Prime Minister of Hesse in the 1990s, been one of the chief protagonists of Red-Green coalitions. In 2001 the scientific advisory cttee of his Ministry took up the issue in a major report.13 Meanwhile, at the sub-national

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9 Deutschland Wirtschaftsrat, Jahresbericht 2005.
10 Petra Brangsch und Lutz Brangsch, Haushalt, Haushaltspolitik und Demokratie (Berlin, Dietz, 2005).
11 MPIfG Discussion Paper 07/7 Endgame? The Fiscal Crisis of the German State Wolfgang Streeck
13 Wissenschaftlicher Beirat BMF 2001 Nachhaltigkeit in der Finanzpolitik Konzepte für eine
level the restructuring of communal and state level government that has been ongoing since the 1990s under the slogan of the “new model of management” or Neues Steuerungsmodell, has similarly melded together concerns for sustainability, inter-generational balance and fiscal reform.14

II

It was this multi-stranded discourse of anti-debt politics that Angela Merkel mobilized when she appeared at Davos as the new chancellor of Germany to give the opening address in January 2006.15 No speech by a CDU Chancellor on economic policy can do without references to Ludwig Erhard, but soziale Marktwirtschaft stays relevant by being continuously reinvented. Merkel’s title was the “creative imperative” and the main thrust of her talk concerned technology and globalization. But creativity was connected to agency and agency to sustainability in a financial as well as an ecological sense: “[To understand the social market economy as a NEW social market economy in the 21st century we must],”6 Merkel intoned, “first of all reorder the priorities of politics towards an understanding of politics that is directed ahead, towards future generations. For us in Germany that means first of all clearing up our financial situation, our budgets. We have a demographic problem. We know that we have too few young people and nevertheless we live at the expense of the future by running up debts. That means that we rob future generations of their room for investment and development and that is immoral."17

The central challenge, as in so much of the fiscal policy debate, was the rediscovery of agency: how to translate good ideas into practice to overcome a “self-imposed paralysis (selbstverschuldete Laehmung) ... “.

In Merkel’s government, Eichel’s place was taken by Peer Steinbrueck, former PM of Nordrhein Westfalen and a protégé of Helmut Schmidt the father-figure of the right-wing of the SPD. In the first years of the Merkel administration, Steinbrueck pushed through a remarkable series of revenue raising measures. VAT was hiked drastically, the largest single tax increase in the history of the Federal Republic. Then tax relief for homeowners was abolished, as were tax breaks for commuters and finally the retirement age was raised to 67. In 2006 Steinbrueck’s...
budget still fell short of the German constitutional requirement that borrowing should not exceed investment. But he credibly promised that by 2007 he would be in line both with article 115 of the German constitution and the Maastricht criteria.

And as the budget swung back towards balance, the full scale of Steinbrueck’s ambition became clear. Once balance was achieved, he announced, the “lid would be put on”. Steinbrueck’s staff at the Ministry, including the influential Joerg Asmussen, had become enthused by the Swiss model of a debt brake. Whereas in Switzerland a popular referendum had imposed a debt brake, the unique political constellation of the Grand Coalition would enable Germany to impose it from above.

Over the next 12 months the pressure for action was raised by two decisions by the Supreme Court. In October 2006 Karlsruhe in an unusually tough judgement rejected outright any claim by Berlin for financial assistance from the Bund. In effect the court denied that there was any collective responsibility on the part of the German federation for the debts of its members. At a stroke, it thus redrew the boundaries of German federalism. Given the scale of Germany’s sub-national debts, financial markets might well have panicked. They held their nerve. But a new definition of Germany’s fiscal constitution was clearly called for. Under Red-Green, the so-called Foederalismuskommission had hosted a largely fruitless debate between Bund and Laender on contentious issues, above all responsibility for education. In March 2007 a new Foederalismuskommmission II was convened. On its agenda was a general rebalancing of the financial relations between Bund, Communes and Laender, a possible reorganization of the Laender themselves and proposals for a debt brake.

Less than a year later the need for action was further reinforced when the constitutional court rendered its judgement on the case brought against the Federal Government’s 2004 budget. The majority of the court agreed that the government had remained within the forms required by the constitution. But a vocal minority expressed the opposite viewpoint and they demanded urgent action to prevent a recurrence of “emergency” finance.

For Steinbrueck and his leading political civil servants, the case for immediate action was driven not only by these external pressures. There was also a compelling political logic operating not across the parties, but from within the SPD itself. The grand coalition of SPD-CDU would provide the necessary majority for a constitutional amendment. But how long would it last? A Grand Coalition was generally regarded as an abnormal configuration that short-circuited real debate within the political system. From the point of view of the CDU and the SPD it exposed them to the serious risks of being outflanked either by the market-liberal FDP, or the opposition parties of the left, the Greens and the PDS-Linke. But what was the alternative? For the SPD the main alternatives since the 1990s have been the Greens or Die Linke. In Eastern Germany Red-Red coalitions, or minority SPD governments tolerated by the former Communists were far from exceptional. A basic question for the future of the national SPD was the extension of the electoral

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18 DB Research 2013, Länder bonds What drives the spreads between federal bonds and Länder bonds?
The logic of Red-Red to the former West Germany. For the left-wing of the SPD this was a test of whether or not the basic political divides of the Cold War had finally been overcome. Would the right-wing of the SPD tolerate a truly left-wing coalition on the western side of the Wall? For party centerists like Steinbrück, the answer was an emphatic No! What he saw on the party’s left-wing was not just a throwback to the futile radicalism that had done so much to unseat his idol, Helmut Schmidt. What was also under threat were the achievements claimed for the Agenda 2010 reforms, which under the Schroeder government had divided the party and caused key members of its left-wing including Oskar Lafontaine to throw their lot in with the former communists of the East. A left-left coalition would jeopardize the market "reforms" that appeared to have re-energized the German economy whilst further alienating centrist voters.

Over the winter of 2007- 2008 a major struggle was going on for the soul of the SPD. On the left Andrea Nahles, Niels Annen und Björn Böhning were rallying the troops. In the pivotal West German state of Hesse the left-wing of the SPD was eying up a coalition with Die Linke, the first such coalition to be considered in the former West Germany. Meanwhile, Steinbrück as Finance Minister and Steinmeier as Foreign Minister set themselves to rallying the front that had backed Schroeder’s agenda 2010, crucially the Seeheimer group and the so-called Netzwerk of Schroederite Bundestag members. In this struggle over the basic direction of the party, the debt brake became one of the central objects of contention.

For the left the debt brake was a clear instance of a self-abandonment of political autonomy under the sign of neoliberalism. The right-wing countered this explicitly with their own discourse of autonomy. As Olaf Scholz, Steinbrück’s colleague as Labor Minister and later to be elected as the influential mayor of Hamburg, would say. "The principle of effectively limiting indebtedness is a thoroughly progressive concept because it sets a stop on the insincere tax reduction promises of conservatives. It is left-wing to argue for a properly formulated debt brake." Scholz’s model was not Swiss but American. For him the deficit-reduction measures of the Clinton administration, which had halted the irresponsible tax cuts of the 1980s were a model. Without a hard budget limit, the right-wing was free to engage in populist tax-cutting even though the only way to fund their "supply side economics" was either ballooning debt, or cuts to large "entitlement" programs – pensions, unemployment benefits etc. As Scholz hammered home: "If there was a debt limit, the conservatives would be forced to admit this. It is left-wing to argue for a sensible debt brake."

In the spring of 2008 Klaas Huebner, the chair of the Seeheimer Kreis, and the Netzwerk group of Schroederite modernizers represented by MPs Carsten Schneider and Christian Lange launched a new manifesto. In their paper, Konsolidierung mit Perspektiven - für einen handlungsfähigen Staat (Consolidation

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19 [http://www.spiegel.de/spiegel/vorab/a-535700.html](http://www.spiegel.de/spiegel/vorab/a-535700.html) Länder bonds What drives the spreads between federal bonds and Länder bonds?

20 [http://www.spiegel.de/spiegel/print/d-55854221.html](http://www.spiegel.de/spiegel/print/d-55854221.html) Gäbe es eine Begrenzung der Verschuldung, müssten die Konservativen das auch zugeben. Es ist links, für eine vernünftige Schuldenbremse einzutreten
with long-term perspective – for a state capable of action) they demanded immediate action on Germany’s debt. This paper was characteristic of the thinking of those favoring consolidation in arguing that debts were anti-social. They burdened future generations and reduced current investment. Already in 2008, the interest burden was equivalent to the entire federal budget of education, transport and family. Furthermore, the interest payments went above all to the wealthy, who lent money to the state. Without providing any empirical evidence to back this claim, they asserted that cutting debt was part and parcel with a policy of redistribution.

It is in fact notoriously difficult to obtain precise information about the holders of German public debt. The Finanzagentur GmbH, which manages the debt, issues no special statistics. The majority are held abroad. Within Germany, there can be little doubt that the holding is skewed towards higher income households, who thus receive a disproportionate share of tens of billions of Euros in interest payments. It is likely, of course, that those same higher income households also pay more of the taxes that finance the interest payments. But according to a rough estimate prepared in 2004 the entire revenue from progressive taxes in Germany including income tax, wealth taxes, inheritance tax, capital gains tax and corporation tax was less than the 66.2 billion Euros paid out in interest. It seems likely to be true, therefore, that the net effect of tax-financed interest payments is regressive.

That would be even more the case, Steinbrueck’s supporters continued in their memorandum, if the CDU and the FDP got their way and were allowed to cut top tax rates. The Christian Democrats and Liberals talked of raising spending and investment whilst lowering taxes. But how was that possible without going further into debt? What was at stake, once again, was nothing less than the state itself. “A state that cannot manage money responsibly loses confidence and thus the legitimacy of the political system.” Interestingly, they phrased the question not just as a challenge of inter-generational justice, but as a challenge for the younger generation of German politicians. The task facing a new generation of German politicians was to demonstrate that they would not go down the path of least resistance chosen by the generation who had been responsible for reunification.

In June 2008 Peer Steinbrueck submitted budget plans that promised to realize the long-held ambition of the German fiscal reformers. By 2011 his budget forecast he “schwarze Null” (a black zero), a fully balanced budget. Unlike Eichel, Steinbrueck enjoyed the full backing of his Chancellor. It had been a tough round of negotiations. There had been a generous pay settlement for public workers and ministries had requested 7.5 bn euro in extra spending. In four cases Steinbrueck had had to threaten to deprive ministries of their budgetary autonomy. For 2009 he had limited spending to an increase of 5.2 billion euro raising the total to 288.4 billion. That meant new debt of 10.5 billion euros. This was a modest result but what mattered to Steinbrueck was the long-term perspective, which promised a surplus in 2011 and a truly healthy surplus in 2012.

http://www.zeit.de/2004/21/Verteil_Effekte
Steinbrueck’s willingness to sacrifice Ministerial prerogatives for the higher goal of fiscal stability made him in the words of the *Spiegel* one of the last true adherents of the grand coalition. By the summer of 2008 the two wings of Merkel’s government were bracing themselves for electoral competition. The CDU was openly discussing the possibility of a coalition with the FDP, which since the 1980s had drifted into an embrace of brash pro-market liberalism. Meanwhile, the divisions within the SPD had become so serious that Steinbrueck was barely on speaking terms with figures such as the mayor of “poor but sexy” Berlin, Klaus Wowereit.22

Meanwhile, amidst the increasingly intense partisanship, the prospect of any large-scale reform of the fiscal constitution seemed to be slipping away. The Finance Ministry had presented the Foederalismuskommission with a debt brake proposal that would permit a debt cap of 0.35% of GDP for the Bund and 0.15 for the Laender. But this was hugely unpopular with heavily indebted SPD-led states such as Bremen, Saar and Schleswig-Holstein. It was not until June that the SPD itself had agreed sufficiently for the proposal to be put to the Foederalismuskommission even in a watered down form.23 Meanwhile, the Bavarian CSU blocked any progress by insisting that there must be a complete ban on new Land borrowing plus 28 billion Euro in tax cuts, of which the Laender would have to shoulder 17 bn Euros.

Steinbrueck refused to sugar coat the bitter pill by providing additional Federal funds and Merkel showed little interest.24 Since it was generally admitted that there was no chance of making any progress until after the Bavarian elections in the fall of 2008, the committee’s work was suspended. According to the scathing assessment of the opposition FDP the Commission was “wasting away” (sich daein) and the main aim of the joint chairs of the commission - SPD leader of the house, Peter Struck, and Baden Wuerttemberg PM Günther Oettinger (CDU) - was to save face.2526

III

It was at this moment of deadlock, that the crisis struck. The first response in Berlin, was denial. In early September Steinbrueck famously told the Bundestag that the financial crisis was America’s problem. Two weeks later Berlin was facing the implosion of the German banking system. Hypo Real Estate was days away from collapse. Commerzbank, after having swallowed Dresdner, had to be bailed out. The Bundestag was forced in a matter of days to vote through a gigantic rescue umbrella. And the export-dependent German industrial economy faced a collapse in foreign orders. In a single month, in November 2008, German exports fell by 10.6 percent and industrial orders fell by 22.4 percent. Faced with a slump more severe than anything seen since 1929, the Finance Ministry was forced into a shuddering

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22 http://www.spiegel.de/spiegel/print/d-57781718.html
24 http://www.spiegel.de/spiegel/print/d-57119329.html
revision of its financial predictions. As of the summer, Steinbrueck had planned to take up 10.5 billion euros in 2009 to finance the bund. By November 2008 it seemed that the figure might be closer to 18 billion.\textsuperscript{27}

Given the scale of the recession it was clear that some kind of work-creation measures would be necessary. But there was considerable anxiety about taking up large debts and the presiding chief justice of the constitutional court, Hans-Juergen Papier, a member of the conservative CSU, reminded the politicians not to forget the mandate issued in 2007. Germany must consolidate its finances.\textsuperscript{28} Nor was Steinbrueck minded to make concessions. Whereas the world around him was converting to Keynesianism, with Gordon Brown in the lead, Steinbrueck remained resistant. Since his days in the cabinet office of Helmut Schmidt in the 1970s, he reminded one journalist, he had never seen a Keynesian work-creation program deliver any really meaningful stimulus. But the crisis was clearly severe and none of the major parties fancied running an election in 2009 in the face of mounting unemployment, with nothing to offer to the electorate. Over the winter of 2008-9, the SPD’s prospective candidate Walter Steinmeier put huge personal pressure on Steinbrueck to come up with a work-creation package. In intense telephone conversations the two decided to wrong-foot Merkel with an adventurous SPD program, which included concessions to the left such as an increase in the top tax rate and a partial nationalization of key electricity generators.\textsuperscript{29} Steinbrueck’s price was that Steinmeier help whip the rest of the SPD into line over the debt brake. If he was to authorize a substantial crisis response, he wanted a cast iron commitment to medium-term consolidation.

Merkel was indeed embarrassed in early January. She could hardly resist the SPD calls for a work-creation program. But to concede to them was to insult the right-wing of the CDU, who were up in arms.\textsuperscript{30} The CDU was being “SPD-ized” her critics scoffed. Her Bavarian partners the CSU demanded a credible commitment to tax cuts.\textsuperscript{31} And the FDP, her ideal partners, wanted more of the same. The CDU’s attempt to square the circle was the Erfurt declaration that proposed the creation of a 100 billion euro Deutschlandfond to see german business through crisis.\textsuperscript{32} Though later overshadowed by the Eurocrisis, the scale of the shock to Germany, as to the other major capitalist economies, of the bailouts of 2008-2009 should not be underestimated. In January 2009 Merkel told an audience assembled at an exclusive private bank in Frankfurt: “There is a rumor that states cannot go bankrupt. It is wrong.”\textsuperscript{33} The trillions of dollars that were being mobilized to support the banking system imposed a strain even on a state like Germany. Within the CDU too, the quid pro quo for the bail out was the debt brake. In the last week of January the entire finance team of the CDU Bundestag Fraktion made clear that it would support the

\textsuperscript{27} frankfurter rundschau 19.11.2008 Deutschland steuert wieder auf staatsdefizit zu.
\textsuperscript{28} Spiegel online 24.12.2008 forderung nach haerteren regeln.
\textsuperscript{29} “DIEBISCHE FREUDE”, SPIEGEL 12.1.2009.
\textsuperscript{30} http://www.spiegel.de/spiegel/print/d-63546782.html
\textsuperscript{31} http://www.spiegel.de/politik/deutschland/streit-um-konjunkturpaket-unionspolitiker-werfen-merkel-schlechtes-krisenmanagement-vor-a-598435.html
\textsuperscript{32} http://www.manager-magazin.de/unternehmen/artikel/a-600548.html
stimulus package only on the condition that the deadlock was broken on the debt brake in the Foederalismuskomission.34

Quite suddenly, therefore, in early January 2009, the constitutional change that had seemed dead in the water six months earlier, was back at the top of the agenda. Faced with the worst crisis since World War II, the Grand Coalition government would launch the largest work-creation package since 1949. But it would be flanked by a constitutional amendment that required a debt limitation in the medium-term.35 On Monday 12 January 2009 the CDU and SPD agreed on a second stimulus package of 50 billion, raising the total committed since the onset of the crisis to 80 billion. Altogether its borrowing requirement for 2009 was now estimated to be in excess of 50 billion Euros, more than had ever been borrowed by the Federal Republic. The following day, on Tuesday 13 January the coalition agreed to push for a constitutional amendment that would limit new deficits to 0.5 % of gdp as compared to 3 percent allowed under Maastricht criteria. It was to be voted through within the current parliamentary session, to be in force by 2015.36 In the mean time the debts run up during the crisis would be allocated to a special sinking fund that would be given priority for repayment in better years to come.37

Even the Greens took over the debt agenda. In January 2009 they attacked the CDU and SPD for delaying the introduction of the debt brake until 2015, rather than bringing it into force already in 2010. Their vision would protect investment by permitting borrowing to cover net investment.38 The FDP also fell into line. This left die Linke as the only party committed to opposing the debt brake. Lafontaine commented in parliament that for an economy that was the largest exporter in the world to have the smallest stimulus package at a time of global crisis was absurd.

But though there was a broad base of agreement in national politics, it was far from obvious, even as the final meeting of the Foderalismuskommission II in early February approached, that a deal on a comprehensive debt brake could be done. Resistance continued both from the poorer SPD-lead Laender and the rich contributors in the South West such as Bavaria and Baden-Wuerttemberg. Klaus Wowereit for Berlin commented that a debt brake at a time of crisis was “abstruse”.

Schleswig-Holstein one of the weakest states rejected the proposals as involving an unacceptable intrusion into sovereign decision-making by the Laender.

As the Laender squabbled over the measure that would block any further increase at some point in the future, the news on the debt front continually worsened. By the first days of February 2009 the Finance Ministry was predicting that by 2012, when Steinbrueck had once hoped to be in the second year of surpluses, debt would increase by 275 billion Euro. The holy grail of stabilization was once more slipping away. This opened the door for savage criticism from the FDP and the CDU right-wing. And it forced Merkel into action. To restore her party’s

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34 Konjunkturpaket II Spiegel 27.1.2009.
37 Schuldentilgung, Spiegel 15.1.2009.
38 Gruene draengen auf nationale Schuldenbremse Handelsblatt 30.1.2009.
damaged image for fiscal rectitude the Chancellor could not longer remain aloof from difficult business of the fiscal constitution. On Monday 2 February Merkel called a meeting with all the CDU Land Prime Ministers at party headquarters. Crucially, this meeting involved both the representatives of the richest Laender, and the Saar, one of the poorest. The party political divide in Germany does not map onto the gradient of rich to poor. The CDU-led government of the Saar indicated its willingness to accept a debt brake so long as a substantial annual support fund was created and some solution was found for the reduction of existing debt, which in the case of the Saar involved interest payments of 460 million euros on a total debt burden of 10 billion Euros, as compared to a regular budget of 3.4 billion. The open question, given this agreement within the CDU, was whether the Bavarian CSU and its PM, Horst Seehofer, would go along.

Finance Minister Peer Steinbrueck it seems, had by early February 2009 become extremely skeptical of any deal with the Laender. In the absence of that, he planned to position the Bund at the head of the consolidation race, by promising to reduce new debt to 8 bilion Euro by 2015 and by advocating a rather elaborate stabilization plan devised in his ministry. The normal level of deficit would be 0.5 percent of GDP, which could be increased during cyclical downturns and repaid on the upswing. He was willing to accord 0.15 % of this credit limit to the Laender. The balance would be monitored by way of a control account, which if it exceeded 1.5 percent of GDP would require automatic repayment. Steinbrueck’s rule gave no special status to investment, but it was akin to the kind of “balanced budget” rule that was standard in macroeconomic debate since the 1990s.

Then, at what was billed as the final meeting of the Foederalismuskommission II on Thursday 5 February 2009, at a Spartan Bundeswehr barracks minutes from Tegel airport, the unexpected happened. A deal was done and a deal with a more draconian character than Steinbrueck had ever imagined. Under pressure from Bavaria, the Laender turned down the offer of a 0.15 percent of GDP borrowing limit. By 2020, following the Bavarian model, all furthering borrowing by the Laender would cease. Until 2019, the weaker states would receive support from an 800 million Euro fund. Reluctantly, Steinbrueck agreed to contribute 400 million Euros to this fund, the rest coming proportionally from the states themselves. The recipients would be Bremen (300 m), Saarland (260 million), Berlin, Sachsen-Anhalt and Schleswig-Holstein would receive 80 million each. In exchange they would submit to external review of their fiscal policy by a Stabilitaetsrat. Laender that refused to respond to its criticism would be stripped of their support. The boot now was on the other foot. With Bavaria leading the way, it was not the Bund but the Laender that were forcing the pace. Seeking to turn the tables completely, Seehofer now demanded that the Bund follow suit and agree to end borrowing altogether. For Steinbrueck that was unacceptable. There had to be some element of fiscal policy flexibility, some room for investment and some degree of realism about the consolidation that the Bund could achieve. By threatening to blow up the meeting, Steinbrueck forced a compromise. From 2016 the Bund would

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40  Streit um Schuldengrenzen 5.2.2009.
restrict itself to borrowing no more than 0.35 percent of GDP, except in exceptional circumstances. The elaborate control account concept was dropped.\textsuperscript{41}

The agreement of 5 February mapped the outlines of a compromise. But it was a long road from there to a constitutional amendment. Two-thirds majorities were needed in both the Bundestag and the Federal council, with its kaleidoscope of coalitions ranging from Eastern shades of pink, to the darkest conservatism of Bavaria. In the Föderalismuskommission, Schleswig-Holstein abstained in the final vote. Berlin was more vocal in its protests. Mecklenburg-Vorpommern would have liked to form a “neutral group” of five East German states, which had achieved budget balance, but which would be exempt from contributing to the support fund for the 5 aid recipients. This was overruled by a majority. Many doubted whether the necessary two thirds majority for a constitutional change could be achieved in the federal council (Bundesrat), or whether such large majorities could then be replicated at the state level to implement countrywide constitutional change.\textsuperscript{42} But the leading spokesmen of the Grand Coalition were confident that they could push it through. Prime Minister Seehofer was jubilant. Bavaria had helped to bring about a “Wetterwende”, a change in the fiscal policy climate. Merkel, who was rumored to have thrown her weight into the argument at a crucial moment on Thursday night, spoke of a Weichenstellung (a change in the setting of the points). It was a powerful demonstration of the functional effectiveness of federalism. After the failure of the effort to craft a comprehensive code of environmental law, due to Bavarian opposition, after years of arguing over the funding of education and childcare, and more than a decade of disgruntlement about the solidarity tax for the East, the debt brake was a demonstration that German federalism worked.\textsuperscript{43} As Merkel commented, reprising the sustainability theme, “Our children and grand-children will not ask, whether the Euro debt was owed by the Bund or whether the Euro was owed by the Laender. This is all one common task.”\textsuperscript{44}

There was no doubt that the promise of a future fiscal balance was comforting in 2009. But skeptical economists pushed the obvious next question. If both the Bund and Laender barred themselves from borrowing, how was the public sector to fund investment? The question was put by Peter Bofinger, the maverick Keynesian member of the Wirtschaftswiesen, the official expert advisory committee who issue an annual report on German economic policy. Where, in future, were German savers to invest the 120 billion Euros which they sought to put aside every year? The German corporate sector was self-financing. If the funds were not put into German public debt, their savings would flow into investments abroad.\textsuperscript{45} German savers would finance American public investment. How did it contribute to inter-generational equity if a state, which could borrow at rates of 3 percent or lower was not permitted to invest in education that was thought to yield

\textsuperscript{41} Goldener Zuegel, Spiegel 9.2.2009.
\textsuperscript{42} Finanzreform Spiegel 12.2.2009.
\textsuperscript{43} “Einigung zur Schuldenbremse”, Spiegel 6.2.2009.
\textsuperscript{44} Finanzhilfen fuer armer Lander, Der Spiegel 13.2.2009. Unsere Kinder und Enkel fragen zum Schluss nicht, ob es ein Euro Schulden aus dem Bund war oder ob es ein Euro Schulden von den Lndern war, sagte Merkel im Kanzleramt. ”Das alles ist eine gemeinschaftliche Aufgabe
\textsuperscript{45} Fuehrende Oekonomen verteufern die Schuldenbremse, Handelsblatt 13.2.2009.
a 10 percent return? No one would reward the CEO of a company that refused to take advantage of such opportunities. What would one think of a household on an average German income of 60,000 Euros per year, which limited itself to borrowing as little as 210 Euros per year, whilst its home decayed or its kids went short of a computer for homework? This was a politics of the belly not the head. Steinbrueck and Co were following the impulses of an anti-political affect that had been refuted by their own energetic efforts to rescue Germany from the crisis. Why, the leaders of the SPD-left asked, should the state restrict its freedom of action in this way. And Andrea Nahles formulated a new version of the inter-generational equity principle. Why should the current generation of politicians arrogate to themselves the right to impose on their successors a fiscal policy restriction that they themselves would never have accepted. If the idea of the debt brake was to put a stop to irresponsible tax cuts, why not pass a constitutional amendment barring tax cuts until the debt level fell below 50 % of gdp.48

On 27 March 2009 Steinbrueck made a typically vigorous defense of the compromise in front of the Bundestag. A system of discipline was necessary. The existing system of rules that limited borrowing to the level of investment except in emergency cases had been too easily subverted. He did not approve of the absolute ban on Laender borrowing but that was a masochistic proposal that had come from the Laender themselves. The Bund would retain sufficient flexibility to respond to emergencies. Since the 1970s the federal government had been acting without due concern for the future. As a result the federal budget was losing all flexibility. Weighted down with debt service and non-discretionary spending, which consumed 85 percent of federal spending, the budget was “petrified and devoid of life” (“versteinert und verkarstet”). The FDP signaled its support, and the government was optimistic since with only the Greens and the Linke in opposition its two-thirds majority should be assured.49

In fact the parliamentary opposition against the measure was unexpectedly fierce. The FDP though it approved the measure in principle decided to abstain in the Bundestag because it wanted to ensure that it had the maximum leverage in the Federal Council to ensure that no last-minute concessions were made to the Laender. The Greens and Left voted against en bloc as did 19 members of the SPD-left. The Linke denounced the measured as “assisted suicide” for the weaker Laender. The Greens worried about the impact on cities and communes whose funding by the Laender would now be drastically cut back.50 Their protests were backed up by a public appeal issued by Bofinger and the Trade Union economist Gustav Horn as well as 150 academics of various stripes.51 Spokesmen of the German trade union movement were vociferous.52 Schleswig-Holstein let it be

47 SPD-Linke kritisiert Plaene fuer die Schuldenbremse, Tagesspiegel 7.2.2009.
49 Foederalismusreform Spiegel 27.3.2009.
50 Grundgesetzaenderung Spiegel 29.5.2009.
51 Bofinger and Horn appeal 25.5.2009.
known that it would sue if the proposal passed without providing any fiscal flexibility for the Laender.\textsuperscript{53} Brandenburg and Berlin demanded that the 0.15 in borrowing limits for the Laender be put back. The most distinguished opponent of the amendment was the president of the Bundestag himself Norbert Lammert of the CDU who considered the amendment which ran to several pages and which included specific dates and Euro amounts unworthy of inclusion in the constitution. All together the debt brake required modifications to 7 clauses of the constitution (Artikel 91 c, 91d, 104b, 109, 109a, 115, 143d). If this was a model of the constitutional future, it was a gloomy day for any notion of the universality of legal principle. German constitutional lawyers shared the doubts of the politicians. Joachim Wieland questioned whether it was legitimate for a government which enjoyed a transient two-thirds majority to inscribe its agenda into the constitution thus binding all subsequent governments that were able to muster a mere majority. To do so legitimately, a government would need to be able to invoke “timeless, consensual values (zeitlos konsensfähige Wertungen)”. But whether this applied to a policy of zero debts was far from obvious.\textsuperscript{54} Though debt service payments did constitute a restraint on future citizens and politicians, it was not clear that this was any different from any other decision with long-term consequences. How narrow the government’s majority was became clear on 29 May 2009 in the decisive vote in the Bundestag. The Debt Brake amendment was passed by the Bundestag but with an unexpectedly narrow, 68.6 percent majority, a wafer-thin margin above the two-thirds majority required. On 12 June 2009 against the votes of two of the most indebted states, Berlin and Schleswig-Holstein and Mecklenburg-Vorpommern, which resented making contributions to the support fund, the debt brake passed the Federal Council and entered into force.

IV

Within days of the passage of the debt brake amendment, the full implications of the financial crisis for Germany’s public finances made themselves felt. In the last week of June 2009, Peer Steinbrueck, the Finance Minster who had come within grasping distance of a budget balance, presented his colleagues with the financial plans for the period 2010-2013. These involved new debt amounting to 310 billion Euros of which 47.6 billion would be taken up in 2009, more than four times what had been expected and 86.1 billion in 2010. A year earlier the forecast for 2010 had been a deficit of 6 billion Euros. As the debt brake was applied, Germany was ramping up debts as never before. And when the Bundestag election of September 2009 yielded a devastating setback for the SPD with the largest loss in German electoral history, the contradictions multiplied. The first demand of the FDP as Merkel’s new coalition partners was for substantial tax cuts. The result was the Wachstumsbeschleunigung (growth acceleration) package of November/December 2009, a carefully targeted combination of 8.5 billion Euros in family- and business-friendly tax relief, the very antithesis of what the social democratic austerians had had in mind.

The cynics had always argued that the debt brake was the best alibi for

\textsuperscript{53} kreditlimits fuer bundeslaender Spiegel 26.5.2009.
\textsuperscript{54} Ende der Laender Spiegel 4.5.2009.
politicians who were hopelessly addicted to debt and a useful cover for profligacy at a time of bond market anxiety. And the drive for tax cuts amidst talk of austerity in 2009 seemed amply to bear them out. But the debt brake agenda has proven to be anything but a lame duck.

For one, it has become a major element in Germany’s foreign economic policy. After the model of the independent central bank, the Schuldenbremse has become Germany’s latest instrument of economic governance for export. Even before the constitutional amendment had been approved at home, Merkel’s advisor for international economic affairs Bernd Pfaffenbach was arguing for its extension on an international basis. In light of the huge explosion of debts worldwide, a restrictive rule was essential. In March 2009 as the measure was before the Bundestag, Merkel headed to the G20 meeting in London, at the high point of the Keynesian second-coming, to proselytize for the new German system. “We are going to have to try to transfer this to the whole world” she told an audience at the German chamber of commerce in the spring of 2009. As it turned out, it would not be the world, but Europe that became the object of Germany’s reforming energy.

During the critical debates in Germany in 2008/2009 the possibility of a sovereign debt crisis of other Eurozone debtors has been nothing more than a dark cloud on the horizon. Steinbrueck’s response to jitters about Greece and Ireland had been to calm the markets with decisive promises of intervention. When the scale of the Greek problem began to become clear, however, the attitude of the new government in Berlin was very different. Schaeuble made clear that he no more expected Germany to bail out Greece, than the Bund had been ready to bail out bankrupt Berlin six years earlier. This new hard line, culminating in November in the infamous Deauville haircut agreement between Merkel and Sarkozy, contributed powerfully to an escalating loss of confidence that took Greece, Ireland and Portugal over the edge into full-blown crisis. The answer to this panic from Berlin, both in the crisis-stricken cases and with regard to the architecture of Europe as a whole was the same. The lessons of federal fiscal governance learned by Germany the hard way at home, should be applied to Europe. The substance of the agreement on European financial governance, hammered out in December 2011, was the introduction of debt brakes all around.

Of course, this would not have had much credibility, if Germany had continued as it was going in 2009. In fact, however, Schaeuble has proven the cynics wrong. The German public budget has turned around. After first Eichel’s and then Steinbrueck’s disappointment, it is Schaeuble who has reached the promise land. After targeting a surplus for 2015, Schaeuble actually stumbled into a surplus a year early, in 2014. Not surprisingly the CDU likes to celebrate this as a vindication of economy and tight budgetary control. For the first time since 1969 the Federal Republic is in the black. And it is true that spending has not increased substantially.

56 Gipfel am Abgrund Spiegel 30.3.2009 "Das müssen wir versuchen, auf die Welt zu übertragen"
But above all the surplus results from surging tax revenues and relief to the tune of 45 billion Euros per annum brought to the German brought by much lower interest rates. Whether or not the debt brake is truly effective as a mechanism for self-binding, will only become apparent when Germany faces the kind of severe downturn in tax revenues it was hit by in 2009.

And should one wish for its success? On the one hand the making of the debt brake was an impressive exercise in democratic politics. A long-term problem was subject to in-depth and multi-sided analysis. A large majority was found to support a decision that defies any short-term calculation of individual self-interest. A real debate was triggered about fiscal priorities and a debate that continues under the pressure of a hardened budget constraint. All of this deserves to be stressed before we arrive at the palpable absurdity of the outcome actually achieved. Despite its outward appearance of good order and governance, Germany is undeniably in need of substantial public investment. The Bund can, thanks to its competent governments and the global glut of liquidity, borrow at extraordinarily low rates. And yet to maintain the discipline of the debt brake, finance Minister Schaeuble and the Merkel government have made themselves into apostles of expensive and risky public-private partnerships. The only thing they have to recommend them is that they avoid the accumulation of new debts. Meanwhile, Germany’s austerity push combined with its trade surplus of 6.6 percent of GDP in 2014, to deliver a deflationary impulse of 7.2 percent of GDP to the world economy, principally to its Eurozone neighbors.

The central legitimizing mantra of West Germany’s liberalism is the idea of a Lernprozess, a learning process. There is no doubt that the political system of the Federal Republic learns. On issues from economic policy, to the politics of migration, the politics of the Nazi past, reunification, ecology, gender politics or the politics of the family and sexuality it has proven itself to be a highly sophisticated, multi-layered system that is capable of adaptation and assimilation of new ideas, to a remarkable degree. Learning, in general, is clearly a good thing. But, sometimes, learning processes can go wrong. Indeed, as that great ironist of the Federal Republic, Alexander Kluge has remarked, there are learning processes that have deadly outcomes.58 The politics of debt sustainability in the Federal Republic may be one such process.

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