Originally published March 27th, 2024 in
https://www.wzb.eu/en/article/why-the-debt-brake-is-a-threat-to-democracy-in-germany

Why the debt brake is a threat to democracy in Germany

The austerity mandate is increasing disillusionment with established political parties

By Mark Copelovitch and Daniel Ziblatt

It was a drumbeat: On November 15, 2023, the Federal Constitutional Court declared the second supplementary budget unconstitutional. The federal government had to significantly reschedule the budget, with a sudden shortfall of 60 billion euros. The court based its decision on the debt brake enshrined in the Basic Law. Mark Copelovitch and Daniel Ziblatt reflect in their analysis on the effect of these conditions. For them, the debt brake is not just an obstacle to economic development. Rather, they see it as a threat to democracy in Germany and Europe.

We normally think of democracy as being threatened by demagogues who engage in violent rhetoric. But sometimes seemingly technical and innocuous rules of the political game can make a democracy vulnerable to exactly these sorts of political actors. Rules of public finance—especially an excessive commitment to rules of budgetary austerity—have in the past proven dangerous for democracy. Today, there is reason to be concerned that Germany's "debt brake" may not only be bad economic policy, but also that it may weaken the resilience of democracy in Germany and Europe.

On November 15, the Federal Constitutional Court declared the German government's 2021 second supplementary budget unconstitutional, on the grounds that it violated the Schuldenbremse, or "debt brake," enshrined in the Articles 115 and 109 of the German Basic Law. The debt brake includes both a structural component, which limits the government to new debt of no more than 0.35 percent of gross domestic product (GDP) per year, and a cyclical component, which permits additional debt during economic downturns but requires this to be repaid in better times. The debt brake also includes an "escape clause," under which the Bundestag can, by simple majority, suspend the brake during extraordinary circumstances or an emergency.

The Constitutional Court's ruling blocked the government's plan to redirect unused pandemic funds to finance climate-related investments, leaving the federal budget with a €60 billion gap. Following the Bundestag voted to suspend the brake for 2023 by a vote of 414-242-9. The government justified the suspension on the grounds that the war in Ukraine constituted an emergency. After tense negotiations among the coalition government's parties, the government reached a deal on the 2024 budget, which will reinstate the brake for 2024 and require cuts to the climate transformation fund and other parts of the budget.

The debt brake is highly contested in Germany among both experts and voters. A recent ZDF poll found that 61 percent of Germans were opposed to loosening the brake. But this high level of support masks deep divisions both within and outside of Chancellor Olaf Scholz's fractious Ampel coalition government. In the same poll, 55 percent of SPD voters, and 67 percent of Green party voters said "yes," in response to the question of whether the brake should be loosened. In contrast, only 31 percent of FDP voters said "yes," while only 20 percent of CDU/CSU voters and 14 percent of AfD voters supported loosening the brake. Similarly, in a recent survey of 187 German economics professors by ifo Institute – Leibniz Institute for Economic Research at the University of Munich and Frankfurter Allgemeine Zeitung, half said the brake should be reformed (44 percent) or abolished (6 percent), while roughly the same share (48 percent) said "no" to either option. At the same time, modest majorities (52 percent) both expected negative economic consequences in the short-term (1-2 years) from the Constitutional Court's ruling (52 percent) and expected it to have a negative effect on political stability in the short-term (59 percent).

These sharp divisions over the debt brake highlight why it poses such a deep threat to democracy, not only in Germany but in Europe more broadly. The budget cuts and foregone public investment required by the debt brake are highly unpopular, politically divisive, and will impose significant economic costs on an already struggling German economy. Moreover, given Germany's position as the Eurozone's largest and most important member, the debt brake will have substantial spillover effects at the EU level, posing a serious threat to the long-term stability of the eurozone. Amidst growing concerns about the AfD's surge in the polls at home, and the EU's broader authoritarianism-from-within problem, the debt brake poses yet another obstacle to democratic stability in the years ahead.

The debt brake is bad economic policy

Whenever an economic crisis hits, the frequently instinctive response of politicians and voters is to believe the government—like a household—should tighten its belt and cut back spending to reduce debt and balance the budget. Unfortunately, as we know from a very large literature analyzing data across space and time, fiscal retrenchment of this kind rarely works. In the short term, it is associated with slower economic growth and rising inequality. In the longer run, this "procyclical" approach is associated with increases, rather than decreases, in government debt levels. Even the International Monetary Fund, long an advocate of fiscal austerity during economic crises, has found that fiscal consolidations in advanced economies do not, on average, reduce debt-to-GDP levels. Similarly, there is little, if any evidence, that high debt levels reduce economic growth. In fact, when one compares the policy responses and recoveries from the pandemic economic crisis in the US versus Germany and the Eurozone, one sees again that more aggressive fiscal policy actually seems to be correlated with both stronger economic growth and declining debt/GDP levels.

The debt brake, by restricting the government's ability to pursue countercyclical fiscal policy, runs directly counter to these findings. By limiting borrowing and forcing the government to implement unpopular budget cuts, it hurts the economy in the short term and reduces prospects for economic growth in the medium-to-long term. In Germany, the looming budget cuts in 2024 and beyond will further exacerbate the country's already glaring underinvestment in infrastructure and hamper the ability to spend on climate policy, defense, and other areas of urgent need. This will delay much-needed public investment and further slow growth, even as the German economy already faces stiff headwinds due to rising energy costs, an aging society, the decline of its key export sectors, an increasingly creaky government bureaucracy, and struggles implementing digitalization.

The debt brake is also bad for the stability of the euro. As a monetary union without political or fiscal union, the Eurozone has wrestled since its creation with the problem of large structural imbalances between member-states with large budget and current account surpluses and relatively low levels of government debt (such as Germany and the Netherlands) and those with large deficits and high debt levels (such as Italy and Greece). Although fears of the Eurozone's breakup have waned since the "Grexit" debate of 2015, the core imbalances and institutional weaknesses remain and continue to pose long-term threats to the Eurozone. National policies such as Germany's debt brake pose serious problems for the Eurozone, because they exacerbate the procyclical nature of German fiscal policy, and they prevent any meaningful shift toward reducing the country's extremely large current account surpluses. In the absence of exchange rate movements, this, in turn, makes it nearly impossible for Southern deficit countries to enhance their competitiveness, and it imposes expectations of large-scale, one-sided macroeconomic adjustment on countries such as Italy and Greece, which have already endured years (or, in Italy's case, decades) of painful and politically unpopular austerity. Moreover, German commitment to fiscal retrenchment at home and in Europe has reinforced the unhelpful, moralizing narrative of "Northern Saints" and "Southern Sinners" that has undermined meaningful European-level cooperation and threatened political solidarity within the Eurozone.

The debt brake is bad for democracy

Yet while the debt brake is bad economic policy, the even greater concern is that it may also be very bad for German democracy. There is now overwhelming evidence that fiscal austerity not only has negative effects on the economy, but also is associated with deeply concerning political outcomes. Recent research by Thiemo Fetzer (2019) has shown that exposure to the negative effects of austerity in the UK were strongly correlated with individuals' support for Brexit in the 2016 referendum. Likewise, a team of researchers around Simone Cremaschi has shown that a reduction in public services at the local level in Italy led voters to be more fearful of immigration. Similar historical work by Gregori Galofré-Vilà et. al. shows that the areas in Germany that were more adversely affected by austerity policies in 1930-1933, were more likely to vote for the NSDAP.

This problem appears to be a more general one. Analyzing 166 elections since 1980 in Western democracies, Evelyne Huebscher et. al. find that austerity measures increase both electoral abstention and votes for non-mainstream parties, thereby boosting party system polarization. Moreover, in survey experiments in Germany, the UK, and Portugal, the same authors find that the effects of austerity are particularly pronounced when the mainstream right and left parties both stand for fiscal restraint. Finally, in work that analyzes regional voting data in over 200 European elections, Ricardo Duque Gabriel et. al. show that fiscal consolidation leads to significant increases in vote shares of extreme parties, lower voter turnout, and a rise in political fragmentation.

By restricting the government's ability to respond to economic emergencies and forcing it to adopt widely unpopular spending cuts, the debt brake substantially increases the likelihood that we will see these very patterns play out once again in Germany in the years ahead. This would aggravate increasingly widespread views that the Ampel coalition government is unresponsive and ineffective and increase voter disillusionment with the mainstream political parties in German politics. With the AfD already running second in the polls, previously unimaginable scenarios exist in which the far right gains political power not only at the local and state level, but also comes to be seen as a viable governing party. Perhaps the Brandmauer will hold. But we have seen these patterns before in history, not only in Germany but more recently across multiple EU member-states, including Hungary and Poland.

To be sure, history is not destiny, and support for far right and populist parties is not only about economic crises or material suffering. Indeed, we also know that identity and ideas matter in explaining why voters support extreme parties. But research does show that voters exposed to the material impact of economic shocks and financial crises are more likely to support the far right, and we know from the aforementioned literature that austerity in response to these crises further aggravates the problem. In this context, a hard, mandatory constitutional requirement like the debt brake, one that forces mainstream political parties and governing coalitions to adopt mandatory austerity policies in the face of these challenges, is not only bad economics, it is also bad politics. Instead, to address Germany's serious economic challenges and bolster democracy against the increasingly serious threat posed by the far right and polarization, German policymakers should introduce more flexible fiscal rules. The debt brake may be well-intentioned, but the democratic and economic stakes are simply too high to value fiscal stringency above all other goals.

Literature

Ahlquist, John/Copelovitch, Mark/Walter, Stefanie: „The Political Consequences of Economic Shocks: Evidence From Poland." In: American Journal of Political Science, 2020, Jg. 64, H. 4, S. 904-920.

Copelovitch, Mark/Frieden, Jeffry/Walter, Stefanie: „The Political Economy of the Euro Crisis." In: Comparative Political Studies, 2016, Jg. 49, H. 7, S. 811-840.

Cremaschi, Simone/Rettl, Paula/Cappelluti, Marco/De Vries, Catherine E.: „Geographies of Discontent: Public Service Deprivation and the Rise of the Far Right in Italy." In: Harvard Business School Working Paper, 2023, No. 24-024.

Fetzer, Thiemo: „Did Austerity Cause Brexit?" In: American Economic Review, 2019, Jg. 109, H. 11, S. 3849-3886.

Galofré-Vilà, Gregori/Meissner, Christopher M./McKee, Martin/Stuckler, David: „Austerity and the Rise of the Nazi Party." In: Journal of Economic History, 2021, Jg. 81, H. 1, S. 81-113.

Huebscher, Evelyne/Sattler, Thomas/Wagner, Markus: „Does Austerity Cause Polarization?" In: British Journal of Political Science, 2023, Jg. 53, H. 4, S. 1170-1188.

Kelemen, R. Daniel: „The European Union's Authoritarian Equililbrium." In: Journal of European Public Policy, 2020, Jg. 27, H. 3, S. 481-499.

--

27/3/2024

This text is licensed under the Creative Commons Attribution 4.0 International License
(CC BY 4.0: https://creativecommons.org/licenses/by/4.0/).