LETTER FROM

BERLIN

Deutschland Debacle

The court's fiscal boot is on the neck of the ruling coalition.

BY KLAUS C. ENGELEN

Germany's traffic-light coalition of Social Democrats, Greens, and Liberals is unable to escape crisis mode. The coalition's top leaders, Chancellor Olaf Scholz of the Social Democrats, Vice Chancellor and economy and climate minister Robert Habeck of the Greens, and finance minister Christian Lindner of the Free Democratic Party, have been facing one mess after another.

Together, the standing in the current opinion polls of the governing parties is about even with that of the opposition Christian Democrats under parliamentary leader Friedrich Merz, who is becoming more and more powerful.

Using the budget chaos, Merz wants to replace the traffic-light coalition as quickly as possible. He and Christian Social Union leader Markus Söder are pushing for an early election on June 9, 2024, the same time as the European elections, hoping to mobilize a stronger voter turnout and thereby dampen the surging right-wing Alternative für Deutschland.

The AfD looms in second place nationally after the CDU/CSU opposition, but as leading party in the coming East German state elections.

After sixteen years of coalition governments under former Chancellor Angela Merkel, the current traffic-light government has been confronted with monumental breakdowns of the European and global orders. Russian President Vladimir Putin invading the Ukraine and stopping gas deliveries to Germany continues to be a monumental challenge for Berlin policymakers.

DEBT BRAKE VERDICT

On November 15, 2023, Germany's Constitutional Court presented its judgement on the Second Supplementary Budget Act 2021, finding that it was incompatible with the Germany's Basic Law and therefore void.

The act was challenged by 197 members of the Bundestag representing the CDU/CSU party. The act retroactively amended the 2021 federal budget, transferring an authorization to borrow €60 billion for Covid-19 pandemic relief that was not needed in the 2021 fiscal year to the Energy and Climate Fund to be used in subsequent fiscal years. The transfer was carried out retroactively in February 2022.

A press release on the judgement from the court made some key points. First, the government had failed to demonstrate enough of a connection between the emergency which caused the debt brake to be suspended and the measures taken in response.

Second, decoupling the declaration of an emergency from the actual

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Klaus C. Engelen is a contributing editor for both Handelsblatt *and* TIE.

use of the borrowing authorizations was incompatible with the constitutional principles of yearly budgeting. Using emergency borrowing authorizations in subsequent fiscal years without counting them towards the "debt brake" rule for those years, and instead counting them as debt for the 2021 fiscal year, was not permissible.

Third, under German Basic Law, any supplementary budget bill must be introduced by the end of that fiscal year. The adoption of the act after the end of the 2021 violated the principle that the budget must be determined in advance.

In other words, funds borrowed to deal with an emergency must be used for only that emergency and in the same year as the emergency.

According to Bloomberg calculations, this court ruling put €770 billion of off-budget state funding at risk of having to be changed or even dissolved.

THE EUROINTELLIGENCE ASSESSMENT

"It is rare, very rare, that the German constitutional court passes a ruling with the severity it did yesterday. It not only declared a €60 billion budget appropriation for the government's climate transition fund unconstitutional. It declared the budget null and void," according to Eurointelligence, based in Brussels. "The political bottom line is that many coalition disputes reopen as serious budget constraints kick in."

Eurointelligence also points out that "Christian Lindner's credibility is shot. He is the first finance minister in the history of the republic whose budget has been declared unconstitutional."

The Brussels analysts point out that the Court did a lot more than declare the supplemental budget of 2021 illegal on several grounds. "It set out precise guidelines for the use of off-budget finance, as well as the circumstances in which governments can declare an emergency that would freeze the application of the fiscal rules."

The analysts add, "It is now likely that the 2023 and 2024 budgets are both unconstitutional as well."

MERZ EXPLOITS THE DEBACLE

The CDU/CSU opposition party, led by the ambitious Merz, 68, a former rival of Merkel, is exploiting the traffic-light coalition's blunder. As mover and shaker of the strengthening opposition, he made the decision to take the suit challenging the use of special funds outside of the regular budget to Karlsruhe. As the bombshell judgement reveals, Merz was able to get all 152 members of the CDU and all forty-five members of the CSU joining him in the battle over the legality of the traffic-light coalition's emergency funding resources. For him and the CDU/CSU opposition, it is turning into a political windfall of historic dimensions.

By not sticking to the obvious legal framework, the Scholz government caused a "budgetary mess," scolds Friedrich Heinemann of the ZEW research institute. The idea behind the transfer, according to the *Financial Times,* dates back to when Scholz was finance minister under Merkel, but was implemented shortly after he became chancellor.

"The plan was a classic compromise that allowed the partners in Scholz's cumbersome coalition … to paper over their disagreements on fiscal policy and fulfil their campaign pledges. Spending would be increased, but without excessive borrowing. The SPD and Greens secured the funds they needed to make German industry carbon neutral, while the fiscally hawkish FDP won a promise that the 'debt brake' … would be restored in 2023. Now, the whole construct has been declared unconstitutional," noted veteran

"It is now likely that the 2023 and 2024 budgets are both unconstitutional."

INGA KJER

Olaf Scholz

FREDDIE EVERETT

Robert Habeck

FEDERAL MINISTRY OF FINANCE / PHOTOTHEK

Christian Lindner

Flashing Caution

The top leaders of Germany's traffic-light coalition, Chancellor Olaf Scholz of the Social Democrats, Vice Chancellor and economy and climate minister Robert Habeck of the Greens, and finance minister Christian Lindner of the Free Democratic Party, have been facing one mess after another.

—K. Engelen

THE INTERNATIONAL ECONOMY
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220 I Street, N.E., Suite 200
Washington, D.C. 20002
Phone: 202-861-0791 • Fax: 202-861-0790
www.international-economy.com
editor@international-economy.com

Financial Times Berlin correspondent Guy Chazan.

To the horror of some in the governing coalition, Chazan documented in shocking detail the key role Scholz played in the unprecedented emergency spending programs both as finance minister under Merkel during the Covid-19 pandemic and as chancellor.

The court "set out precise guidelines for the use of off-budget finance."

The chancellor risks, according to Chazan, entering the annals of German postwar history as an accounting trickster now that the German top court has struck down his budget maneuvers.

Carsten Linnemann, general secretary of the opposition Christian Democrats, commented, "It may have been invented by Scholz's officials, but ultimately he's responsible. He's the chancellor." Chazan's November 28, 2023, *Financial Times* story titled "'A house of cards': court ruling leaves Olaf Scholz's legacy in tatters" is also very useful for the CDU/CSU opposition.

STABILITY ANCHOR OR INVESTMENT BLOCKER?

One of the legacies of the fiscally conservative Merkel era was the enshrining of a *Schuldenbremse* (debt brake) in the country's constitution in 2009 by a large majority in the German Bundestag.

Michael Hüther, director of the German Economic Institute, and Jens Südekum, professor of international economics at Heinrich Heine University in Düsseldorf, teamed up in 2019 to write a joint article under the heading "The German debt brake needs a reform." They argued that at the time, "Germany was under the acute shock of the financial crisis" and that "the massive stimulus packages needed to support the economy had pushed the debt ratio up from 63 percent to 81 percent of GDP in just a few years." In their view, the purpose of the debt brake was to reverse this trend.

The debt rule stipulated that budget deficits at the federal level were restricted to 0.35 percent of GDP by 2020, and that the state budgets must be balanced in normal times. Hüther and Südekum point out that Germany's ratio in 2019 was at the 60 percent of GDP mark required by the Maastricht treaty, moving towards 50 percent.

But they admit that at this level, "serious deficiencies in public goods have opened up … crumbling schools, roads, and bridges; a dramatically underfunded education sector; slow and unreliable internet connections across the country; an army in a deplorable state."

They come to the conclusion: "Those deficits have become the major brake on private investment in Germany."

As the forty-fifth Ifo and FAZ Economists Panel demonstrated, the debt brake issue splits the German economist profession into two almost equally large camps on the hotly debated issue of whether the debt brake is more an anchor of stability or a blocker of investments. Of the 187 economics professors surveyed, 44 percent were in favor of reform and 6 percent of abolishing the present debt brake. They mainly argue "this is the only way to meet the high need for investment in infrastructure and the ecological transformation in Germany," and contend that the current debt brake fails to distinguishing between investment and consumption expenditures. Forty-eight percent of participants wanted to keep the debt brake as an incentive to political budgetary discipline.

TWO MORE YEARS WITH AUSTERITY

By not sticking to the obvious legal framework, the Scholz government caused a self-inflicted "budgetary mess," scolds Heinemann. The bombshell debt brake court judgment set out precise guidelines for the use of off-budget finance, as well as the circumstances in which governments can declare an emergency that would freeze the application of the fiscal rules. Economy minister Robert Habeck, echoing this impediment to implementing the coalitions plans, produced the warning on television: "What is now at stake is not only the impact on the climate transition, but the future of German industry." It took weeks of haggling within the traffic-light government before Scholz was able to announce the 2024 budget plan with €17 billion of savings from next year's core budget and €45 billion in cuts from the climate fund through 2027 in response to the court ruling.

Scholz stressed the coalition's determination to "stick to its climate action and industry transformation ambitions," according to *Clean Energy Wire*. Germany would also continue to assist Ukraine. As more and more details of the 2024 traffic-light budget deal became known, the stronger became the protests. German farmers are especially angry because under the austerity plan, they would lose the tax breaks for agricultural diesel and their exemption for farm vehicles from the car tax. They have already protested by blocking the streets around the Brandenburg Gate in Berlin with their tractors.

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How well the traffic-light coalition under the severely damaged leadership of Scholz, Habeck, and Lindner will be able to serve out their remaining two years after the Karlsruhe judges took away part of the coalition's financial basis remains an open question. ◆