The 'German Way' of Curbing Public Debt

The Constitutional Debt Brake and the Fiscal Compact – Why Germany has to Work on its Language Skills

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Public debt: relevance for funding of modern states – Keynesian revolution – Consequences of the financial crisis in Germany – Introduction of the debt brake and Fiscal Compact – The constitutional debt brake: structure and exceptions of the balanced budget rule, four deficiencies of the debt brake – The Fiscal Compact: historical background and structure of the balanced budget rule – Sufficient implementation of the balanced budget rule in Germany? – Constitutionality of the Fiscal Compact? – Austerity as the wrong answer for solving the current economic problems

Introducing public debt

Next to taxes, public debt has always been one of the most important funding sources of modern states.[1] Until the beginning of the 19th century, however, it was mainly used in emergency situations, especially (though not only) for the financing of war. Since then, public borrowing has become more and more a 'regular' way of funding state activities and this growing importance can be explained mainly by two developments. First, the number of state-tasks has constantly expanded, and this has automatically led to growing financial demands on the state.[2] Due to the intentions of the politicians (who want to be re-elected,

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[1] A. Thiele, *Finanzaufsicht* (Mohr Siebeck 2014) p. 302-307; W. Heun, 'Steuerung der Staatsverschuldung durch Verfassungsrecht im Widerstreit', *Zeitschrift für Staats- und Europawissenschaften* (2009) p. 552 at p. 553.

[2] Adolph Wagner called this the 'Law of growing state-tasks', *see* A. Wagner, 'Grundlegung der politischen Ökonomie', in A. Wagner (ed.), *Lehr- und Handbuch der politischen Ökonomie* (C. F. Winter'sche Verlagshandlung 1893) p. 893.

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and therefore spend more money to please the public), as well as the requirements of the social welfare state,[3] these demands could not be fully satisfied by taxes only. Accordingly, public debt has risen continuously in practically all states of the western world, including Germany since 1950 (though it sank slightly, for the first time, in 2013). Secondly, since the middle of the 20th century and due to the works of John Maynard Keynes,[4] public debt is not only seen as a (second and useful) possibility to finance specific tasks, but also as an important instrument to influence and stabilize the national economy. According to Keynes, public debt can help fight recessions, as it, first, prevents expenditure cuts, so that the automatic stabilisers (especially reduced income taxes and welfare spending) can take effect; and, secondly, stimulates macro-economic demand through additional expenditure by the state. This 'Keynesian Revolution'[5] strongly influenced political life in Germany right up to the beginning of the 21st century and thereby added to a growing public deficit as the second part of Keynes' ideas – consolidating public budgets in times of economic upswing – was not taken as seriously as it should have been. Though Keynes' theory has never been undisputed in the economic field, it seems safe to say that it is at least generally accepted (and even more so since the recent financial crisis) that – especially in times of recession – there can be good reasons for a state to revert to public borrowing to make possible or support economic recovery. German politicians, as well as the German public, accepted this view and, as a consequence, public borrowing became a normal (and not particularly disputed) instrument in everyday politics.

However, due to the constantly growing German public deficit, which was also boosted by the immense costs of the unification of Germany,[6] opinion about public borrowing started to change in Germany at the beginning of the 21st century. Public debt was increasingly seen as a problem[7] and those arguing for

[3] *See* K. v. Lewinski, 'Nationale und internationale Staatsverschuldung', in J. Isensee and P. Kirchhof (eds.), *Handbuch des Staatsrechts Band X* (C. F. Müller 2012) p. 461 at p. 463.

[4] *See* especially J. M. Keynes, *The General Theory of Employment, Interest and Money* (Palgrave Macmillan 1936). For 'Keynesians before Keynes', *see* W. Höfling, *Staatsschuldenrecht* (C. F. Müller 1993) p. 125-127.

[5] Höfling, *supra* n. 4, p. 128.

[6] Three periods in German history are characterised by an extremely high new public debt. First, the years between 1970 and 1980 in which – partly due to the oil-crisis – public debt almost quadrupled; secondly, the doubling of public debt due to the unification of West- and East-Germany between 1990 and 2000; and, thirdly, the rise of public debt due to the financial crisis in 2010/2011 – money that was spent for bailing out systemic relevant financial institutions and for economic investment programmes.

[7] However, the (mid-term and long-term) effects of public borrowing are less clear than one might expect. *See*, for a detailed discussion, W. Heun, 'Staatsverschuldung und Grundgesetz', 18 *Die Verwaltung* (1985) p. 1.

sustainable finances and financial austerity gained more and more influence – with the help of one of the leading conservative German newspapers[8] and, as we will see later, even the *Bundesverfassungsgericht* (Constitutional Court).[9] The financial crisis that became apparent in 2008 seemed to confirm the negative consequences of excessive public deficits – the fact that the financial crisis was actually caused by too much *private* debt and that at least Germany's public deficit could hardly be interpreted as being too high at the time,[10] was practically not taken into account. The 'dogma' that public borrowing had to be restricted was therefore soon broadly accepted among almost all German political parties. This consensus finally led to the introduction of the so-called 'debt brake' (*Schuldenbremse*) in 2009.[11] The relevant norms generally demand that the German budget should be balanced, that is, financed without public borrowing. Since then, an excessive public deficit appears to be one of the biggest German economic fears ('German *Angst*'), next to inflation.[12] From this perspective, it seems almost natural that the ensuing Euro crisis and the anxiety of having to 'bail-out' failing Eurozone states led German politicians almost immediately to demand austerity from practically all its Eurozone-partners – even though the crisis of the Euro, except in Greece, was not primarily a problem of excessive public deficits but of structural deficiencies of the Eurozone itself.[13] This demand was finally specified and made more or less legally binding in the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the Fiscal Compact), which was signed on 2 March 2012 and laid the foundation for what has been the (rightly criticised)[14] strict German version of austerity in most of Europe ever since.

[8] Notably the *Frankfurter Allgemeine Zeitung* (FAZ).

[9] *See* BVerfGE 119, 96 (141-143). For an analysis of this decision, *see* H. Neidhardt, *Staatsverschuldung und Verfassung* (Mohr Siebeck 2010) p. 174-203.

[10] *See* Heun, *supra* n. 1, p. 555: '*noch nicht allzu besorgniserregend*'. This was true also for Spain, where the financial problems of the State were a result of the halting of the construction business, *see* V. Ruiz Almendral, 'The Spanish Legal Framework for Curbing the Public Debt and the Deficit', 9 *EuConst* (2013) p. 189 at p. 191.

[11] *See* v. Lewinski, *supra* n. 3, p. 466.

[12] This German fear of inflation in some ways can also be seen as an explanation of the OMT-Programme of the ECB's being viewed so critically in Germany and even leading to the first referral of the Constitutional Court to the ECJ; *see* BVerfG 14 January 2014, 2 BvR 2728/13. For a critical discussion of this decision, *see* A. Thiele, 'Friendly or Unfriendly Act? The "Historic" Referral of the Constitutional Court to the ECJ Regarding the ECB's OMT-Program', 15 *German Law Journal* (2014) p. 241-264 and W. Heun, 'Eine verfassungswidrige Verfassungsgerichtsentscheidung – der Vorlagebeschluss des BVerfG vom 14.1.2014', 69 *Juristenzeitung* (2014) p. 331.

[13] On the reasons for the crisis of the Euro, *see* A. Thiele, *Das Mandat der EZB und die Krise des Euro* (Mohr Siebeck 2013) p. 1-11.

[14] *See* especially M. Blyth, *Austerity* (Oxford University Press 2013). For an analysis of the conditions under which conditions austerity can work *see* N. Batini et al., 'Successful Austerity in the United States, Europe and Japan', IMF Working Paper 12/190 (July 2012). On the effects of

Both the 'debt brake' and the Fiscal Compact therefore are the result of considerable fear of public borrowing amongst the German public and politicians. Against this background, this article takes a closer look at these two 'German instruments' for curbing public debt (including the incorporation of the Fiscal Compact into German law). It concludes that, since they both over-emphasise the negative effects of public deficits and do not take sufficient notice of the positive impacts public borrowing can have, Germany should return to the more relaxed view of public borrowing it had before 2009. To paraphrase a speech of Volker Kauder,[15] maybe it is not Europe that needs to speak German, but Germany that needs to work on its language skills. Otherwise, overcoming the recession within the Eurozone may be a lot harder than is necessary.[16]

The German constitutional debt brake

Debt rules before the debt brake of 2009

Corresponding to the abovementioned importance of public debt for any modern state, the *Grundgesetz* (GG; Basic Law), the German Constitution, has contained specific rules that made public borrowing possible ever since coming into force in 1949. The original version of Article 115 GG, however, allowed public borrowing only in the case of an 'extraordinary need' (*außerordentlicher Bedarf*) and generally only for the purpose of financing infrastructure (*werbende Zwecke*). This – from a formal perspective – restrictive wording did not hinder a growing public deficit, but was the reason for a major reform of Article 115 GG in 1969 that aimed to incorporate the then prevalent economic ideas of the 'Keynesian Revolution' into the Basic Law. The new Article 115 GG[17] therefore made public borrowing much easier, as it no longer demanded an 'extraordinary need' as long as the deficit did

austerity for 'soft' public investment, *see* W. Streeck and D. Mertens, 'Fiscal Austerity and Public Investment: Is the Possible the Enemy of the Necessary?', MPlfG Discussion Paper 11/12 (July 2011).

[15] *See* the speech by Volker Kauder at a party meeting in November 2011: 'Jetzt auf einmal wird in Europa Deutsch gesprochen, nicht in der Sprache, aber in der Akzeptanz der Instrumente […] Ausgangspunkt der Krise sind nicht die Spekulanten, sondern dass wir uns nicht an Haushaltsdisziplin gehalten haben in Europa.' video on <https://youtu.be/eUeuCIe9vkQ> at 4:52 to 6:10 minutes, visited 26 March 2015. *See* also J.-H. Reestman, 'The Fiscal Compact: Europe's Not Able to Speak German – On the Dutch Implementing Act and the Hazardous Interpretation of the Implementation Duty in Article 3(2) Fiscal Compact', 9 *EuConst* (2013) p. 480 at p. 480.

[16] Apart from the massive political implications this policy can have – for example, at the end of August 2014, lack of support for the austerity-based reform programme of the French President by the French Minister for the Economy led to a complete restructuring of the French Government.

[17] For an overview *see* Heun, *supra* n. 1, p. 563-566.

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not exceed the amount of public investments (the so-called 'golden rule').[18] A higher deficit was, formally, only possible to prevent a disturbance of the overall economic equilibrium (*gesamtwirtschaftliches Gleichgewicht*) – yet, due to the wide discretion of the relevant political authorities,[19] this specific restriction played practically no role and therefore was not able to stop the constant increase of the public deficit.[20] With public opinion becoming more and more sceptical about this development, and even the *Bundesverfassungsgericht* recommending the introduction of a constitutional reform in 2007,[21] the 'Federalism Reform II'[22] presented new debt rules in 2009. By introducing a fairly rigid debt brake, inspired by a similar provision in Switzerland,[23] the new rules thereby changed the previous debt-concept more or less completely.[24]

According to the new Article 109(3) and 115(2) GG, both the federal level authority (the 'Federation') and those at state level (the '*Länder*') in Germany[25] are

[18] See I. Härtel, 'Die Schuldenbremse im föderalen Deutschland – das neue Rechtsregime und seine Umsetzung in Bund und Ländern' in Europäisches Zentrum für Föderalismus-Forschung (ed.), *Jahrbuch Föderalismus 2013* (Nomos 2013) p. 228 at p. 230; P. Bofinger, *Ist der Markt noch zu retten?* (Econ 2009) p. 196; H. Tappe, 'Die neue "Schuldenbremse" im Grundgesetz', 62 *Die Öffentliche Verwaltung* (2009) p. 881 at p. 882; M. Kloepfer, *Finanzverfassungsrecht* (C. H. Beck 2014) p. 272. For the economic rationale behind the 'golden rule' *see* Heun, *supra* n. 1, p. 563-564. *See*, for details of the genesis of this norm, Höfling, *supra* n. 4, p. 140-142.

[19] These are the Government (*Bundesregierung*) and the Parliament (*Bundestag*). *See*, for details of the budgetary cycle in Germany, W. Heun, *Staatshaushalt und Staatsleitung* (Nomos 1989) p. 291-583.

[20] C. Calliess, 'Finanzkrisen als Herausforderung der internationalen, europäischen und nationalen Rechtsetzung', 71 *Veröffentlichungen der Vereinigung der Deutschen Staatsrechtslehrer* (2012) p. 113 at p. 166; Härtel, *supra* n. 18, p. 230. *See also* H. Beck and A. Prinz, *Staatsverschuldung* (C.H. Beck 2011) p. 94. The Constitutional Court tried to make this restriction more effective by inventing special duties of reasoning for the political authorities (*see* especially BVerfGE 79, 311 [343]), but was also unable to reverse the trend towards a constantly rising public deficit. For further problems of the former Art. 115 GG, *see* Tappe, *supra* n. 18, p. 882-885.

[21] BVerfGE 119, 96 (141-143).

[22] *See* for an overview of the results of this reform, M. Koemm, *Eine Bremse für die Staatsverschuldung* (Mohr Siebeck 2011) p. 32-36.

[23] Calliess, *supra* n. 20, p. 167. *See* Heun, *supra* n. 1, p. 567-568 for an overview of the Swiss rules. On the effectiveness of these Swiss rules, *see* L. P. Feld and G. Kirchgässner, 'On the effectiveness of Debt brakes: The Swiss Experience', in R. Neck and J.-E. Sturm (eds.), *Sustainability of Public Debt* (MIT Press 2008) p. 223 at p. 227-246.

[24] W. Heun, 'Art. 115', in H. Dreier (ed.), *Grundgesetz Supplementum Band III* (Mohr Siebeck 2010) p. 209 at p. 221.

[25] Germany is a federal state. Therefore public borrowing can appear on the federal as well as the state level. Whereas the former debt-provisions in the Basic Law applied only to the federal level, the new debt brake also restricts public borrowing for the German *Länder*. Such a restriction does not violate the federal state principle laid down in Art. 20(1) GG: *see* A. Thiele, 'Das Ende der Länder?', 17 *Niedersächsische Verwaltungsblätter* (2010) p. 89 at p. 89-94 and Härtel, *supra* n. 18, p. 232-234. A similar discussion came up with the new Spanish debt rules, which also restricted the financial

generally obliged to balance their budgets without any revenue from credit. It is evident that the new concept intends to make public borrowing much harder than before, even though the rules provide certain exceptions (*infra)*. The state, one might summarise, is generally supposed to finance itself through taxes and nothing else. Before 2009 public borrowing was the rule and a balanced budget the normative exception. It will be exactly the other way round as soon as the debt brake comes into force.[26] And despite the fact that the former constitutional rules were not able to prevent growing debt, the German public generally believes that the debt brake will be able to manage such a system change even in the complex area of public finances. Such a belief may appear strange from a non-German perspective. Indeed, as the current European (and worldwide) debate shows, (constitutional) rules in this particular area are seldom very successful.[27] However, especially because of the strong position of the *Bundesverfassungsgericht* and the thus created constitutionalisation of the whole legal order,[28] faith in the general steering capacity of the Constitution (in combination with the political tracts[29] of the *Bundesverfassungsgericht*)[30] remains strongly rooted in German society nonetheless.[31] The constitutionality of any political action taken therefore plays an important role in practically all political debates[32] and almost any highly disputed question will sooner or later be brought before the *Bundesverfassungsgericht*. The question of compliance with the German debt brake will be no exception – indeed possible non-compliance in the future already forms an important part of the current discussions in Germany.

autonomy of the autonomous communities. However, the Spanish Constitutional Court upheld the constitutionality of the laws: *see* Almendral, *supra* n. 10, p. 193.

[26] According to Art. 143d (1) GG, this will be in 2016 for the Federation and in 2020 for the *Länder*. The Federal Government, however, will probably succeed in having a balanced budget by 2015 – the first balanced budget for 46 years.

[27] *See*, for instance, J. v. Hagen, 'A Note on the Empirical Effectiveness of Formal Fiscal Restraints', 44 *Journal of Public Economics* (1991) p. 199-210; J. Poterba, 'State Responses to Fiscal Crises, The Effects of Budgetary Institutions and Politics', 102 *Journal of Political Economy* (1994) p. 799-821.

[28] *See* W. Heun, *The Constitution of Germany* (Hart Publishing 2011) p. 7.

[29] Heun, *supra* n. 28, p. 7.

[30] This has also led to a dominant position for the *Bundesverfassungsgericht* within German legal scholarship. This effect has rightly been criticised by some scholars: *see*, for instance, B. Schlink, 'Die Entthronung der Staatsrechtswissenschaft durch die Verfassungsgerichtsbarkeit', 28 *Der Staat* (1989) p. 161 at p. 163. *See also* W. Heun, *Die Verfassungsordnung der Bundesrepublik Deutschland* (Mohr Siebeck 2014) p. 8.

[31] Sceptical with respect to the area of public finances, however, is J. Wieland, 'Neuordnung der Finanzverfassung nach Auslaufen des Solidarpakt II und Wirksamwerden der Schuldenbremse', 211 *Speyerer Arbeitsheft* (2013) p. 12-13.

[32] *See* Heun, *supra* n. 28, p. 7: 'Political disputes are therefore quite often discussed in constitutional terms.'

The general structure of the German debt brake

The basic rule of the debt brake is formulated at the beginning of Article 109(3) GG:[33] 'The budgets of the Federation and the *Länder* shall in principle be balanced without revenue from credit.' From a normative perspective, the provision thus makes clear that public borrowing is supposed to be the exception and not the rule. Yet, as a complete ban of any form of credit would not only have been economically completely absurd, but also practically impossible,[34] the basic rule allows for three exceptions, which are also contained in Article 109(3) GG.

1) Article 109(3) GG makes clear that the principle of a balanced budget is deemed to be met for the Federation (but not for the *Länder*!)[35] when credit revenues do not exceed 0.35 per cent in relation to the nominal gross domestic product (GDP); this concerns the so called 'structural deficit'.[36] The relevant GDP is that of the year in which the budget is applicable.[37] The Federation is allowed to have such a structural deficit in all circumstances, independent of the economic situation.[38] Moreover, and in contrast to the previous provision, Article 109(3) GG does not link this amount of borrowing to the amount of public investments – the 'golden rule' has therefore been abolished.[39] As public investments usually exceed 0.35 per cent of GDP, in practice this should not make much of a difference. At least

[33] For an overview, *see also* Kloepfer, *supra* n. 18, p. 269-304. The rule is (unnecessarily) repeated for the Federation in Art. 115(2) GG.

[34] *See* Neidhardt, *supra* n. 9, p. 270.

[35] The debt brake is therefore stricter for the *Länder* than for the Federation. Against Kloepfer, *supra* n. 18, p. 283-285, this is constitutional and does not violate the federal principle laid down in Art. 20(1) GG: *see* H. Siekmann, 'Art. 109', in M. Sachs (ed.), *Grundgesetz* (6th edn., C. H. Beck 2011) p. 2276 at p. 2300.

[36] As the provision states that, even with a certain amount of credit, the budget is supposed to be balanced, it is not an exception to the balanced budget rule in a strict sense. Factually, however, this has the same effect as if it were an exception. *See* S. Korioth, 'Das neue Staatsschuldenrecht – zur zweiten Stufe der Föderalismusreform', 64 *Juristenzeitung* (2009) p. 729 at p. 731.

[37] § 4 Gesetz zur Ausführung von Art. 115 GG (Law for the execution of Article 115 GG), BGBl. I, p. 2702.

[38] M. Heintzen, 'Art. 109', in I. v. Münch and P. Kunig (eds.), *Grundgesetz Band 2* (C. H. Beck 2012) p. 1181 at p. 1196; Kloepfer, *supra* n. 18, p. 280; J. Christ, 'Neue Schuldenregel für den Gesamtstaat: Instrument zur mittelfristigen Konsolidierung der Staatsfinanzen', 28 *Neue Zeitschrift für Verwaltungsrecht* (2009) p. 1333 at p. 1333; Heun, *supra* n. 24, p. 231; Korioth, *supra* n. 36, p. 731. Koemm, *supra* n. 22, p. 206-209, sees the 0.35 per cent clause as a real exception and therefore argues that, in this case also, the political authorities have to give reasons if they want to revert to public borrowing . In this sense, *see also* G. Kirchhof, *Die Allgemeinheit des Gesetzes* (Mohr Siebeck 2009) p. 599.

[39] In this sense, also Koemm, *supra* n. 22, p. 209-211.

theoretically, however, the debt brake allows a public deficit for the Federation even if there are no public investments at all.

2) The second exception applies to both the Federation and the *Länder*. It allows them to depart from the balanced budget rule 'when economic developments deviate from normal conditions'. This is the so-called 'economic exception' or 'economic component', which has also been named a 'breathing limitation' (*atmende Grenze*), because Article 109(3) GG provides that 'the effects on the budget in periods of upswing and downswing must be taken into account symmetrically'.[40] Even though this exception is supposed to ensure that the Keynesian anti-cyclical policy will generally remain possible, it will probably make this more difficult than before for two reasons. First, the *Grundgesetz* now emphasises that the Keynesian theory includes the duty to cut deficits 'symmetrically'[41] in boom-times.[42] To ensure compliance with this obligation, it will be necessary to adopt a corresponding amortisation plan that enables the credit obtained to be reduced within an adequate period of time. In other words, the political authorities have to think about ways to reduce debt effectively at the moment they take the credit. Secondly, this exception is linked to a 'deviation from normal conditions'. How far the debt brake will make anti-cyclical policies possible therefore crucially depends on what kind of economic developments will be assumed to be 'not normal' in this sense and how much public borrowing will be deemed acceptable in such a situation.[43] The wording leaves a lot of room for interpretation[44] and the law concerning the execution of Article 115[45] does not make the situation much clearer.[46] If one goes by the intentions of the drafters of the debt brake, this requirement will have to be interpreted restrictively.[47] In the end, it will be the *Bundesverfassungsgericht* that decides – and one can only assume that it will prefer an interpretation where 'normal' really means 'normal', so that a

[40] Kirchhof, *supra* n. 38, p. 592. Similarly Härtel, *supra* n. 18, p. 23: 'atmender Haushalt' (*breathing budget*).

[41] The norm obviously assumes that booms and busts appear 'symmetrical' (*see* Siekmann, *supra*, n. 29, p. 2378). That, however, is not the case and will cause difficulties when applying the norm. *See also* Heun, *supra* n. 24, p. 233: 'rather escapist view'.

[42] *See* Tappe, *supra* n. 18, p. 888.

[43] R. Wendt, 'Art. 115', in H. v. Mangoldt et al. (eds.), *Grundgesetz Band 3* (6th edn., Franz Vahlen 2010) p. 1647 at p. 1669-1670.

[44] H.-G. Henneke, *Der europäische Fiskalpakt und seine Umsetzung in Deutschland* (Kommunal- und Schul-Verlag 2013) p. 79.

[45] *See supra* n. 37.

[46] Heun, *supra* n. 24, p. 234-235.

[47] However, it seems more or less certain that at least the Constitutional Court will stick with such a restrictive interpretation, as it was the Court that demanded a reform that effectively reduces public debt.

deviation cannot be assumed in cases of regular ups and downs of the economy, but only in times of a real recession (whatever that means). In any case, the deviation from normal conditions will have to be justified in detail by the political authorities and this reasoning will be fully litigable before the Constitutional Court.

3) Finally, Article 109(3) GG allows an exception from the balanced budget rule in the case of natural disasters or unusual emergency situations beyond governmental control and substantially harmful to the state's financial capacity. Whereas there are bound to be no great discussions regarding the interpretation of the term 'natural disasters',[48] it is unclear what is to be considered as an 'unusual emergency situation beyond governmental control.'[49] The wording was obviously taken from Article 122 TFEU[50] and it seems safe to say that at least the financial crisis of 2007/2008 would have been such an emergency.[51] The credit-financed bailing-out of systemically relevant banks and the following economic stimulus programmes of the German Government, therefore, would also have been possible under the debt brake. However, the example of the 'historic'[52] financial crisis also reveals that this exception will probably be of hardly any practical relevance in the near future.

Structural deficits of the debt brake

The introduction of the debt brake was widely embraced in the German political arena as well as in most legal and economic literature.[53] And, indeed, there would be nothing much to say against a debt brake that ensured a sustainable level of debt and did not neglect the economic rationalities that can make public borrowing a sensible measure to be taken in times of economic downfalls. When looking at the German debt brake from this perspective, one notices at least five aspects which present a problem.

[48] For a definition, *see* A. Thiele, 'Katastrophenschutzrecht im deutschen Bundesstaat', in I. Härtel (ed.), *Handbuch Föderalismus Band III* (Springer 2012) p. 69 at p. 72-74.

[49] Heun, *supra* n. 24, p. 237-238. For a detailed analysis *see* Koemm, *supra* n. 22, p. 236-242.

[50] *See* Heintzen, *supra* n. 38, p. 1198.

[51] *See* Koemm, *supra* n. 22, p. 236; Thiele, *supra* n. 25, p. 90; Heintzen, *supra* n. 38, p. 1199. Not every economic down-swing, however, can be interpreted as such an 'unusual event', as these are already covered by the 'economic exception' (see *supra*).

[52] *See* A. Thiele, *supra* n. 1, p. 1-7.

[53] *See*, for example, C. Seiler, 'Konsolidierung der Staatsfinanzen mithilfe der neuen Schuldenregel', 64 *Juristenzeitung* (2009) p. 721 at p. 721-728; H. Pünder, 'Gerechte Lastenverteilung zwischen den Generationen', 123 *Deutsches Verwaltungsblatt* (2008) p. 946; L. P. Feld, 'Sinnhaftigkeit und Effektivität der deutschen Schuldenbremse', 11 *Perspektiven der Wirtschaftspolitik* (2010) p. 226 at p. 241: debt brake 'balanced and effective'.

First, a debt brake should limit all sorts of public debt that may have negative consequences ('problematic public debt') to be effective.[54] Otherwise even a balanced budget would not give a correct picture of the actual debt situation of the relevant state. In other words, as the political authorities in such a case would have manifold possibilities for taking up problematic debt without violating the debt brake, the state might go bankrupt despite a formally balanced budget – making the debt brake itself more or less useless.[55]

From this perspective, it does not seem to be a problem that the German debt brake covers neither credit taken from public borrowers[56] nor public guarantees given by the state to companies or – thinking of the crisis of the Euro – to other states.[57] In the first case, the public debt does not seem problematic, as only credit taken from the private capital market can have the effect of 'crowding-out' private investors,[58] which is the main reason that public debt can be characterised as problematic at all. In the second case, guarantees may indeed have an effect on the budget sometime in the future and thereby may require additional public borrowing (which would then be covered by the debt brake). But if, and to what extent, this might be the case cannot be predicted with sufficient certainty when giving the guarantee. It would thus be necessarily unclear as to what percentage such a guarantee should be presumed to be 'credit' in the context of the debt brake. The same is true, therefore, for credit that is not taken but *given* by the Federation or the *Länder*.[59]

However, it appears highly problematic that the debt brake, just as the former Article 115 GG, does not cover any form of debt taken up by autonomous public entities founded by the Federation or the *Länder*.[60] Thus, for example, the debt brake does not concern itself with the debt of the social insurance

[54] Not all sorts of public debt are problematic in this sense, and some sorts are more problematic than others. The public debate does not usually differentiate sufficiently between these different forms – a constitutional debt brake, however, obviously should.

[55] In contrast, the Spanish rules avoid such 'gimmicky fiscal practices', *see* Almendral, *supra* n. 10, p. 196.

[56] *See* § 3 Gesetz zur Ausführung von Art. 115 GG, *supra* n. 31.

[57] *See* Siekmann, *supra* n. 35, p. 2296; Kloepfer, *supra* n. 18, p. 277. Similarly G. Kirchhof, 'Art. 109', in H. v. Mangoldt et al. (eds.), *Grundgesetz Band 3* (6th edn., Franz Vahlen 2010) p. 1433 at p. 1468.

[58] The state taking up credit from the private markets causes interest rates to rise and thus hinders at least some private investors in taking up credit for private investments. This (theoretical) effect of public debt is called 'crowding-out'.

[59] Kloepfer, *supra* n. 18, p. 277; Siekmann, *supra* n. 35, p. 2295.

[60] H. Siekmann, 'Art. 115', in M. Sachs (ed.), *Grundgesetz* (6th edn., C. H. Beck 2011) p. 2366 at p. 2369. This is a major difference from European debt-rules and especially the Fiscal Compact. This discrepancy, however, was no mistake: it was seen and accepted when the debt-brake was introduced, see Heun, *supra* n. 24, p. 180 – 181.

carriers,[61] even though in the end it is the Federation or the *Länder* that stand behind these. That obviously gives the political authorities enormous possibilities of bypassing the debt brake – making it a lot less effective than it could have been.[62] In actual fact, the German Government tried to finance massive (and unnecessary) tax reductions using such a construction – it was only because of the massive political and public pressure that it refrained from doing so in the end. However, what might happen in 'emergency situations' seems more than obvious.[63] Besides, the highly indebted German municipalities (*Kommunen*) are also autonomous entities in this sense.[64] In other words, about 7 per cent of all public debts are not covered by the debt brake,[65] although, in the case of bankruptcy, the relevant *Land* or, depending on the solvency of that *Land*, even the Federation will have to step in.[66] All in all, a 'balanced budget' in the context of the debt brake can be a lot less balanced than one might assume.

Secondly, a debt brake should indeed limit all problematic debt, but make public borrowing at least possible where it seems economically appropriate, necessary or (more or less) harmless. This argument has two aspects. First of all, from the perspective of sustainability in the long run, it is not the amount of public debt itself that appears problematic, but its size in proportion to the GDP.[67] As long as this proportion is stable, public borrowing is at least not harmful[68] when it comes to the question of state-bankruptcy – though it still might lead to the crowding out of private investors (depending on the economic environment).[69]

[61] See Kirchhof, *supra* n. 57, p. 1467.

[62] See also Heun, *supra* n. 28, p. 116: 'The efficiency of these provisions seems extremely doubtful.'

[63] See Heun, *supra* n. 1, p. 571.

[64] Heintzen, *supra* n. 38, p. 1193; Heun, *supra* n. 24, p. 180 – 181. Kirchhof, *supra* n. 57, p. 1468, however, wants to include municipalities in the debt brake. Yet it seems very doubtful that the Constitutional Court would change its former adjudication in this respect.

[65] This, however, is significantly less than in Spain, where the municipalities manage 13.6 per cent of public spending: *see* Almendral, *supra* n. 10, p. 198.

[66] Rightly critical, therefore, Heun, *supra* n. 24, p. 180-181 and H.-G. Henneke, 'Art. 109', in B. Schmidt-Bleibtreu et al. (eds.), *Grundgesetz* (13th edn., Carl Heymanns 2014) p. 2727 at p. 2748. The fact that the indebtedness of local government can become a major problem is visible in the United States.

[67] *See* especially W. Scherf, *Öffentliche Finanzen* (UTB 2009) p. 432-437; W. Heun, 'Balanced Budget Requirements and Debt brakes Feasibility and Enforcement', 15 *German Economic Review* (2013) p. 100 at p. 100-101. *See* also Lars P. Feld and G. Kirchgässner, *supra* n. 23, p. 223 and C. B. Blankart, *Öffentliche Finanzen in der Demokratie* (6th edn., Vahlen 2006) p. 387.

[68] This again is recognised by the Spanish debt rules, *see* Almendral, *supra* n. 10, p. 193-194 and p. 197.

[69] For the 'crowding-out' effect, *see* Scherf, *supra* n. 67, p. 410-411; Heun, *supra* n. 8, p. 10-13. Crowding-out, however, can occur only where the amount of credit is limited, as, otherwise, the

A debt brake could consider this, for instance, by making public borrowing harder as long as the debt-to-GDP-proportion is above a certain level[70] and 'releasing the reins' as soon as it falls below. Yet, the German debt brake does not take this aspect into consideration at all.[71] The only mention of the GDP refers to the total possible amount of debt that the Federation is allowed to incur ('structural deficit', see *supra*) and has nothing to do with the current debt level. In other words, the debt level itself plays no role at all. Therefore, the debt brake 'brakes' just as hard when the debt level stands at 100 per cent of GDP as it does when it stands at 20 per cent, 10 per cent or even 0 per cent. Economically, such a 'uniform braking speed' seems more than questionable and can be endorsed only if one believes that public debt is simply evil in all cases – a view which is hardly maintainable.[72]

Thirdly, according to Keynesian economics, public borrowing should be possible in times of economic downfalls to make use of the automatic stabilisers and to stabilise demand.[73] As mentioned before, the German debt brake allows additional credit in such times, yet it appears doubtful whether it will assure the needed flexibility for an effective anti-cyclical financial policy in this sense. As already pointed out, this will depend on the conditions under which the *Bundesverfassungsgericht* will deem an economic environment to be 'normal' in the sense of the debt brake and how much political action (that is, how much debt) it will allow in 'abnormal' times. Judging from its former decisions, it seems more than probable that the Court will take a very restrictive perspective here. Some legal scholars have already pointed out that they believe that the economic exception restricts both the Federation and the *Länder* to a form of 'passive economic policy', meaning that they would be allowed only to refrain from expenditure cuts[74] but not to enact substantial economic stimulus programmes

interest rate will remain uninfluenced through public borrowing. The problems in Europe at the moment are quite different. Private investors are simply not investing, even though the interest rate is extremely low. Without public investments there would thus be more or less no investment at all. Under such conditions public borrowing can obviously not crowd-out any private investments (as these do not occur even without public borrowing).

[70] What level is sustainable (60, 70 or 80 per cent of GDP?) in the long run is, however, highly disputed. The 90 per cent rule established by Carmen Reinhart and Kenneth Rogoff, which played an important role on the political level (*see* C. Reinhart and K. Rogoff, 'Growth in a time of debt', 100 *American Economic Review* (2010) p. 573-578) has been put into question; *see* especially T. Herndon et al., 'Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff', PERI Working Paper 322 (April 2013).

[71] Again this is a significant difference from the European rules.

[72] *See again* Scherf, *supra* n. 67, p. 449.

[73] *See especially* J. M. Keynes, *supra* n. 4. *See also* Scherf, *supra* n. 67, p. 406. *See also* Heun, *supra* n. 67, p. 102 and Beck and Prinz, *supra* n. 20, p. 32-38.

[74] In order to activate the automatic stabilisers.

('active economic policy').[75] The latter would therefore only be possible according to the third exception (that is in the case of natural disasters or unusual emergency situations, so, practically, not at all). Though this view is hardly convincing from a 'Keynesian perspective',[76] it surely gives a realistic impression of the current atmosphere in German scholarship and public opinion – and this will almost certainly have an influence on future decisions of the Constitutional Court .[77] In addition, the fact that the political authorities have to try to balance the budget 'symmetrically' in times of upswings might also have too restrictive an effect on public borrowing. Economically, upswings and downswings are simply not symmetrical in the sense the debt brake implies – a downswing is hardly ever followed by a completely corresponding upswing. In order to comply with this rule nonetheless, political authorities thus might feel obliged to borrow less than necessary in the first place, as they otherwise might not be able to reduce the debt within an adequate period of time, as the rule demands. Moreover, the danger of a cyclical financial policy is also increased through the 0.35 per cent rule for the Federation, as it automatically allows more debt in good times and less debt in bad times.[78] From an (anti-cyclical) economic perspective, in order to give the necessary support to the 'economic exception', it should have been exactly the other way round.

Fourthly, a public debt brake should differentiate between different forms of public debt, as some forms of debt are more problematic than others. This attribution mainly depends on the use made of the revenue from public borrowing. From this perspective, the now abandoned former 'golden rule' seemed sensible for several reasons.[79] First of all, it is economically rational to permit the financing of investments through public borrowing, as it allows stretching the costs over a longer period of time. As the costs would otherwise have to be carried immediately, without the possibility of incurring public debt, a huge number of investments would simply not be possible – this is the reason why private investments are also practically always financed with the use of credit. Secondly, sustainable public investments (at least theoretically) lead to economic growth and thus more tax revenues, which then enable the state to pay the interest rates. Thirdly, credit-financed investments make sure that all the generations that profit

[75] *See especially* Koemm, *supra* n. 22, p. 221 with further references. For a different opinion, *see* Heintzen, *supra* n. 32, p. 1197.

[76] Keynes recommended active deficit spending in times of economic downturns.

[77] Judging from its former decisions, it seems more or less clear that the Constitutional Court will take the view of the debt-restrictors. The question, therefore, is not whether the Court will interpret the exceptions of the debt brake restrictively, but how restrictive this interpretation will be.

[78] Because good times mean a higher national gross domestic product, *see* Tappe, *supra* n. 18, p. 890.

[79] *See also* Beck and Prinz, *supra* n. 20, p. 32-38.

from the investment also contribute to the costs of the investment – the 'payasyouuse-principle'.[80] Debt-financed public investments therefore ensure greater fairness between the generations than tax-financed public investments, where one generation pays and future generations use the investment. Finally, because the use of public debt may lead to a crowding out of private investments,[81] as long as public debt is used to invest these public investments are able at least partly to compensate for this effect,[82] so that public debt, in the end, leads to no losses of investment for the economy from an overall perspective. The German debt brake, however, does not take any of these considerations into account and in actual fact even generally allows a certain amount[83] of debt for the Federation to be used for whatever is assumed essential (and therefore not necessarily for economically sensible and sustainable) public investments.[84] In the rare cases, also, where the debt brake allows additional debt – for economic reasons or in cases of natural catastrophes or unusual emergency situations – the public debt is not linked to the necessity to invest in any form. Apart from being economically questionable, the debt brake provides absolutely no incentives for the public authorities to invest at all.[85]

In fact, the consequences are already visible. Despite an obvious and practically not disputed investment backlog in Germany[86] and the fact that the German economy has at least lost some of its power the German Government did not even consider further investments in 2014. Instead, it (finally successfully) tried everything to be able to present the first balanced budget for 46 years already in 2015 – that is one year before the debt brake actually comes into force – as if such an aim was of any economic value just for itself. Furthermore, the German Chancellor, Angela Merkel, has also refrained from specific tax reforms, again solely to reach a balanced budget as soon as possible. This policy also seems more

[80] *See* R. A. Musgrave, *Finanztheorie* (2nd edn., Mohr Siebeck 1969) p. 523; Beck and Prinz, *supra* n. 20, p. 28.

[81] As there are hardly any such private investments in Germany or in the European Union at the moment, public borrowing would not result in such a crowding-out under the current economic conditions.

[82] This obviously depends on whether public and private investments are equally effective, which is highly disputed between economic scholars. However, it seems safe to say, that public investments are not completely ineffective and therefore can at least partly compensate for private investments . See R. Ford and P. Poret, 'Infrastructure and Private Sector Productivity', 17 *OECD Economic Studies* (1991) p. 63-89; W. Kitterer and C.-H. Schlag, 'Sind öffentliche Investitionen produktiv?', 52 *Finanzarchiv* (1995) p. 460-477.

[83] 0.35 per cent of GDP, see *supra*.

[84] *See* Siekmann, *supra* n. 35, p. 2297.

[85] *See* also Heun, *supra* n. 1, p. 569-570.

[86] Especially the road system is in desperate need of public investments. The same is true for a lot of public buildings, such as schools and universities.

than problematic from a European perspective, as Germany is currently practically the only Euro-state with financial resources left to invest. Especially France and Italy are currently struggling to reform their economies without having to breach the European debt rules. German public investments could support these efforts and this at least in the long run would surely also be in the interest of Germany. The most surprising fact, however, is the reaction of the public in Germany, which seems to prefer a balanced budget with no public debt and with the risk of downsizing the economy, bad roads and too few investments over any form of public debt – and the debt brake in its current form not only fails to give the right answers to such irrational expectations, but actually supports them.

Fifthly and finally, a German debt brake has to consider the consequences not only for the national financial markets, but also for the European neighbours and in particular the Eurozone, if the biggest European economy should suddenly drastically reduce public debt and thereby the availability of German government bonds. The Eurocrisis has revealed the importance of more or less safe government bonds that private investors can invest in, and German government bonds from this perspective are – next to American bonds – probably the 'safest' bonds on the market. It can obviously hardly be in the interest of German policy that not only professional but also private national investors are more and more forced to invest in the riskier bonds of other European States. This would not only result in even fewer private national investments – so to speak a 'crowding-out' from the German market through less public debt – and German investors financing the investments of foreign states,[87] but might also lay the foundation for the next financial crisis. What has to be kept in mind is the fact that professional investors in this sense are not only hedge funds or dubious investment companies, but also pension funds, insurance companies and other institutions[88] that play a vital and important role in the functioning of the economy and in practically everybody's daily life. These institutions are already desperately looking for sufficient safe investment possibilities and with fewer German bonds this will become more and more difficult. In the end, this might even affect monetary policy, as commercial banks need safe marketable securities as collateral when contracting with the ECB[89] – without being able to invest in German government bonds, these might be hard to get. From this perspective, German public debt is thus an important factor for stabilising not only the national but the European economy as a whole.

[87] *See* Bofinger, *supra* n. 18, p. 195.

[88] For an overview of the relevant financial institutions, *see* Thiele, *supra* n. 1, p. 125-164.

[89] The ECB was strongly criticised when it reduced its safety requirements during the Eurocrisis in order to be able to continue to accept Greek government bonds as collateral despite its financing problems. *See* Thiele, *supra* n. 13, p. 80-84. But what should the ECB do, if safe German bonds are simply not available anymore? It obviously could not simply stop supplying commercial banks with central bank money they need.

In other words, public debt cannot be judged separately, but has to be seen in a far wider context, taking into account the complex implications of any radical change in this area for other states and for the stability of the Eurozone.

In conclusion, one might say that the German debt brake is too lax and too strict at the same time. On the one hand, it does not include all sorts of problematic debt and can therefore be bypassed by political authorities too easily and thus may fail in trying to provide the necessary financial soundness. On the other, it restricts economically sensible debt too rigorously, risking not only serious harm to the German economy but – in the worst case – the destabilisation of large areas of the Eurozone and its financial markets – and it will, almost certainly, make any form of recovery for the 'PIIGS-States'[90] a lot more difficult. To summarise, the introduction of the German debt brake can hardly be called a well-considered reform.[91]

The Fiscal Compact

Historical background and structure of the Fiscal Compact

The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union – the Fiscal Compact – was negotiated and signed within just a few months between December 2011 and March 2012 – that is, at a time when the Eurocrisis was approaching its climax.[92] For the German public, the culprit of this crisis had immediately been easy to name: too much public debt. The member states with problems – starting with Greece, but also Spain, Portugal, Italy, Ireland – had simply spent too much, and were now facing problems that would have been avoidable. This oversimplified view of the Eurocrisis (which is, if at all, true only for Greece) has determined the public debate in Germany ever since. That German politicians would therefore connect any form of financial aid with the demand for 'structural reforms' (meaning massive debt reduction) seems hardly surprising. It is surprising, however, that the German Government managed to convince nearly all the member states of the EU so quickly that collective austerity was the only way to go and to implement this idea in a legally binding contract, despite the fact that the concept of austerity is neither specially new nor particularly convincing.[93] The member states that would need financial

[90] Portugal, Italy, Ireland, Greece and Spain.

[91] *See also* Heun, *supra* n. 1, p. 571: 'Die jüngste, auch aus Populismus geborene deutsche Verfassungsreform ist deshalb in seltenem Maß formal und inhaltlich mißglückt und fehlgeleitet.'

[92] *See* F. Schorkopf, 'Europas politische Verfasstheit im Lichte des Fiskalvertrages', 10 *Zeitschrift für Staats- und Europawissenschaften* (2012) p. 1 at p. 2. Yet the rules themselves, especially the balanced budget rule, did 'not come out of the blue', *see* Reestman, *supra* n. 15, p. 481.

[93] *See*, for a detailed critique of this idea, Blyth, *supra* n. 14.

help in the near future might have had no other choice but to sign,[94] but this is obviously not true for member states such as France, Austria, Belgium, Denmark and many others. In the end, it was only because of the United Kingdom and the Czech Republic[95] that the Fiscal Compact has not (yet)[96] been formally included in primary European law[97] – but this can hardly be seen as a serious setback for the German Government.[98]

According to Article 1, the Fiscal Compact intends to 'foster budgetary discipline' and its basic rule in Article 3(1) therefore demands the budgetary position of the general government of a contracting party to be balanced. Similar to the German debt brake, this rule according to Article 3(1)(b) 'shall be deemed to be respected if the annual structural balance of the general government is at its country-specific medium-term objective, as defined in the revised Stability and Growth Pact, with a lower limit of a structural deficit of 0.5 per cent of the gross domestic product at market prices.'[99] The contracting parties shall ensure rapid convergence towards this medium-term objective with the European Commission proposing a time-frame for such a convergence. This lower limit doubles to 1 per cent when the ratio of the general government debt to GDP at market prices is significantly below 60 per cent – yet, due to the current ratio of about 80 per cent in Germany, this provision will probably be of no relevance in the near future.

[94] According to the 25th recital to the Fiscal Compact, financial aids through the European Stability Mechanism (ESM) require that the applying member state has correctly incorporated a balanced budget rule and the correction mechanism (in the sense of the Fiscal Compact) into its binding legislation: *see* Reestman, *supra* n. 15, p. 490; C. Calliess and C. Schoenfleisch, 'Auf dem Weg in die europäische "Fiskalunion"?', 67 *Juristenzeitung* (2012) p. 477 at p. 485.

[95] v. Lewinski, *supra* n. 3, p. 474; Schorkopf, *supra* n. 92, p. 17; Henneke, *supra* n. 44, p. 7. As Croatia joined the EU after the Fiscal Compact was signed, it is also not a contracting-partner.

[96] According to Art. 16 of the Fiscal Compact, the necessary steps shall be taken with the aim of incorporation of the substance of the Fiscal Compact into the legal framework of the European Union. *See also* M. Gordon, 'The United Kingdom and the Fiscal Compact: Past and Future', 10 *EuConst* (2014) p. 28 at p. 34.

[97] The Fiscal Compact, therefore, is a 'normal' international treaty between 25 contracting-parties: *see* Calliess and Schoenfleisch, *supra* n. 94, p. 481; H. Hofmann and C. Konow, 'Die neue Stabilitätsarchitektur der Europäischen Union', *Zeitschrift für Gesetzgebung* (2012) p. 138 at p. 150. For a detailed analysis of the consequences for the German ratification process, *see* R. A. Lorz and H. Sauer, 'Ersatzunionsrecht und Grundgesetz', *Die Öffentliche Verwaltung* (2012) p. 573 – 582.

[98] For a different opinion, *see* Schorkopf, *supra* n. 92, p. 3.

[99] As the relevant EU legislation required a member state to set its medium-term objective for its annual budget deficit to be between 0 and 1 per cent, the balanced budget rule of the Fiscal Compact is more demanding. *See* Gordon, *supra* n. 96, p. 31; Reestman, *supra* n. 15, p. 482 and S. Peers, 'The Stability Treaty: Permanent Austerity or Gesture Politics?' 8 *EuConst* (2012), p. 404 at p. 412. Reestman, *supra* n. 15, p. 483, believes that the 0.5 per cent of GDP rule will not again be tightened up in the future.

The same is true for the 'exceptional circumstances'[100] that allow the contracting parties to deviate temporarily from their respective medium-term objective or the adjustment path thereto.[101] Nevertheless, with a possible structural deficit of 0.5 per cent, the Fiscal Compact seems to allow for a slightly higher structural deficit than does the German debt brake. However, for two reasons this is probably not the case.

First of all, the maximum structural deficit of the Fiscal Compact includes the structural-deficits of the Federation *and* the *Länder*. Yet, due to the transition period of the German debt brake, the *Länder* will be allowed to obtain credit until 2020 according to their existing debt-rules. As the German debt brake allows a structural deficit of 0.35 per cent of GDP for the Federation alone, the combined structural deficit of all the 16 *Länder* according to the Fiscal Compact is not allowed to exceed 0.15 per cent[102]. At least until 2020, Germany might therefore have more problems than expected in fulfilling its obligations under the Fiscal Compact[103] – especially due to the fact that the European Commission has made clear that Germany will have to fulfil the 0.5 per cent rule, beginning with 2014.[104] These problems are even intensified taking into account that the 0.5 per cent rule of the Fiscal Compact – again different from the German debt brake – also includes the debt of autonomous public entities such as social insurance carriers and local communities. To comply with this balanced budget rule of the Fiscal Compact, the different layers of the German Federation will therefore have to coordinate their financial policies a lot more than before – even after 2020.

According to Article 3(2) of the Fiscal Compact, the balanced budget rule was to be implemented into national law at the latest one year after the entry into force

[100] According to Art. 3(3) of the Fiscal Compact, 'exceptional circumstances' are either unusual events outside the control of the contracting party concerned which have a major impact on the financial position of the general government or periods of severe economic downturn as set out in the revised Stability and Growth Pact, provided that the temporary deviation of the contracting party concerned does not endanger fiscal sustainability in the medium-term. This more or less corresponds to the abovementioned exception provided for in the German debt brake.

[101] The Fiscal Compact includes no 'economic exception' in the sense of the German debt brake. However, as the Fiscal Compact refers only to the structural deficit, deficits for economic reasons do not fall under the 0.5 per cent margin. An 'economic exception' would therefore have made no sense within the Fiscal Compact. *See also* Reestman, *supra* n. 15, p. 482.

[102] In 2013, the structural deficit of the Federation alone was 0.34 per cent of GDP.

[103] See also Hofmann and Konow, *supra* n. 97, p. 149, who remark that, at least from a legal perspective, compliance with the Fiscal Compact until then is not legally guaranteed.

[104] German politicians, especially the representatives of the *Länder*, seem to have been surprised by the fact that Germany might be among the countries that have difficulties in fulfilling their duties under the Fiscal Compact. Germany's not being able to stick to the new debt rules would obviously be a fatal political signal.

of the Treaty (that is by 1 January 2014), through provisions of binding force and permanent character, preferably constitutional, or otherwise guaranteed to be fully respected and adhered to throughout the national budgetary process. In addition, by this time national law also had to provide for a correction mechanism to be triggered automatically in the event of significant observed deviations from the medium-term objective or the adjustment path towards it, with an independent institution being responsible at national level for monitoring compliance with the balanced budget rule of Article 3(1) of the Fiscal Compact. However, at the same time, the Fiscal Compact states that the correction mechanism 'shall fully respect the prerogatives of national Parliaments', obviously to avoid too harsh a restriction of the democratic process within the member states, since the national parliaments are decisively involved in the budgetary process in all of them.[105] Yet, it remains more or less unclear what consequences would follow if a national correction mechanism should therefore generally give the relevant parliament the last word regarding necessary corrections. Such a constellation can hardly be interpreted as a breach of the Fiscal Compact if the Fiscal Compact itself emphasises the parliamentary prerogative in such a way. So despite the fact that, according to Article 8 of the Fiscal Compact, it is possible (or even necessary)[106] to take legal action in the form of a special infringement procedure outside the treaties[107] before the European Court of Justice in the case of a contracting party failing to comply with Article 3(2), such a lawsuit would be bound to be unsuccessful in these cases. Moreover, it should even be possible for a national parliament actually to refuse to comply with the national correction mechanism, expressly referring to its 'prerogatives'. The disputed question[108] whether the ECJ is actually competent to supervise either the correct implementation of the balanced budget rule and the correction mechanism or whether a contracting party actually complies with the balanced budget rule during a certain fiscal period would thus lose much of its relevance.

The German implementation of Article 3(2) of the Fiscal Compact

It was obvious that the correction mechanism as well as the institutional requirements of Article 3(2) of the Fiscal Compact would have to be formally incorporated into German law. Yet, such an incorporation would not have been

[105] *See also* Heun, *supra* n. 24, p. 222: necessity of a legal authorisation for any form of credit being the 'core right of the Parliament' within the budgetary process.

[106] *See* Reestman, *supra* n. 15, p. 489; Peers, *supra* n. 99, p. 419; Calliess and Schoenfleisch, *supra* n. 94, p. 484.

[107] Calliess and Schoenfleisch, *supra* n. 94, p. 484; Hofmann and Konow, *supra* n. 97, p. 147. For an overview of the 'normal' infringement procedure according to Article 258 TFEU, *see* A. Thiele, *Europäisches Prozessrecht* (2nd edn., C. H. Beck 2014), p. 68-96.

[108] *See* Schorkopf, *supra* n. 92, p. 12-13; Hofmann and Konow, *supra* n. 97, p. 147.

necessary for the balanced budget rule itself if the existing German version had been at least as strict as that of the Fiscal Compact. This, however, as we have seen, is not the case,[109] which is the reason that Article 3(2) of the Fiscal Compact needed to be implemented by the German legislature completely. Due to the fact that the budget is passed by the German Parliament in the form of a statute and the Parliament, according to Article 20(2) GG, is bound only by the Constitution when legislating, an implementation of 'binding force' 'guaranteed to be fully respected and adhered to throughout the national budgetary process', at least for the Federation would generally have been possible only by amending the Constitution (the *Grundgesetz*) itself.[110] The German legislature, however, refrained from doing so, and decided to incorporate the balanced budget rule into the new § 51(2) of the so called '*Haushaltsgrundsätzegesetz*' (HGrG).[111] This (parliamentary) statute, which is based on Article 109(4) GG, contains budgetary principles that are meant to be binding for the Federation *and* the *Länder*, but still is a 'normal' federal statute. Therefore, there is no doubt about its binding force for the *Länder*[112] but, according to the *lex posterior*-rule, the Federation is allowed to repeal or amend its own statutes – including the *Haushaltsgrundsätzegesetz*.[113] From this perspective, Germany at least has not fully complied with the requirements of Article 3(2) TSCG; and this is indeed the conclusion which quite a few German scholars would probably draw. However, due to the fact that the *Haushaltsgrundsätzegesetz* is intended to be binding also for the Federation some, and maybe even a majority of, scholars have tried to argue that the *lex-posterior* rule can generally not apply in this case.[114] According to this opinion, the *Haushaltsgrundsätzegesetz* within the hierarchy of norms thus stands below the Constitution, but above 'normal' statutes;[115] in other words, a Federal budget that

[109] *See also* v. Lewinski, *supra* n. 3, p. 477.

[110] *See* Henneke, *supra* n. 66, p. 2743; Henneke, *supra* n. 44, p. 83; Hofmann and Konow, *supra* n. 97, p. 148. This, however, depends on how one interprets the implementation duty in Art. 3 (2) TSCG. I here follow the view of the European Commission. For a discussion of the different interpretations possible, *see* Reestman, *supra* n. 15, p. 490-499.

[111] Haushaltsgrundsätzegesetz vom 19. August 1969, BGBl. I., p. 1273, zuletzt geändert durch Artikel 1des Gesetzes vom 15. Juli 2013, BGBl. I, p. 2398 – Act on budgetary principles for the federal government and federal states.

[112] According to Article 31 GG, state-law (including the budget-law) has to comply with any (constitutional) Federal law.

[113] *See*, for the similar problem with respect to the binding force of the implementation of the Fiscal Compact in the Netherlands, Reestman, *supra* n. 15, p. 484 – 485.

[114] *See especially* W. Heun, *Staatshaushalt und Staatsleitung* (Nomos 1989) p. 165-174; Heun, *supra* n. 24, p. 189; Heintzen, *supra* n. 38, p. 1202; C. Gröpl, 'Einleitung', in C. Gröpl (ed.), *BHO/LHO* (C. H. Beck 2011) p. 1 at p. 11. For a different opinion, *see* Siekmann, *supra* n. 35, p. 2304; Kirchhof, *supra* n. 57, p. 1482-1483.

[115] Explicitly in this sense Heintzen, *supra* n. 38, p. 1202.

violates the Act would have to be declared void. The Constitutional Court has not yet had to decide on this question, but with regard to another statute it has accepted a similar construction.[116] Yet, all in all, the issue is more or less open. Against this background, however, it seems more than doubtful whether the ECJ, within Article 8 proceedings, would accept this form of implementation.[117] At least with regard to EU directives, it has made clear that the binding force of the incorporating law cannot be subject to doubt within the national legal system[118] – and this is hardly the case with respect to the *Haushaltsgrundsätzegesetz*. From this perspective, the contracting parties may refer the matter to the ECJ under Article 8(2) of the Fiscal Compact, or could even be obliged to do so under Art. 8(1) if the Commission should find Germany to be in breach of its duty to implement[119] – whether they would indeed do so, however, is more than questionable, taking the political implications into account.[120]

Apart from this, the new § 51(2) *Haushaltsgrundsätzegesetz* implements the balanced budget rule with regard to content, as demanded by the Fiscal Compact. It especially states that this specific balanced budget rule covers the structural deficit not only of the Federation but also of the *Länder*, the municipalities and the social insurance carriers.[121] Yet, as the different budgets addressed by the Fiscal Compact are set up independently in the relevant budget-procedures, § 51(2) will entail increased consulting requirements between the different federal levels. § 51(1) therefore requires the Stability Council (*Stabilitätsrat*) to coordinate the financial and budgetary planning of the Federation, the *Länder* and the

[116] *See* BVerfGE 101, 158 (214-238), where the Constitutional Court held that the so-called '*Maßstäbegesetz*' ('scale-statute'), in which the legislature is obliged to define principles for the assignment of the tax revenues to the Federation and the *Länder*, stands above 'normal' statutes. Within the legal literature, the Constitutional Court was mainly criticised for this surprising judgement, *see* H. Siekmann, 'Vor Art. 104a', in M. Sachs, *Grundgesetz* (6th edn., C. H. Beck 2011) p. 2099 at p. 2118 with further references.

[117] This again depends on how the ECJ would interpret the implementation duty, *see* Reestman, *supra* n. 15, p. 498: 'The interpretation of the implementation duty in Article 3(2), finally, is anybody's guess.'.

[118] *See*, for example, ECJ 20 March 1997, Case C-96/95, *EC Commission* v *Germany*. For further details, *see* M. Ruffert, 'Art. 288 AEUV', in C. Calliess and M. Ruffert (eds.), *EUV/AEUV* (4th edn., C. H. Beck 2011) p. 2441 at p. 2452-2457.

[119] Art. 8(1) TSCG 'invites' the European Commission to report whether contracting parties have complied with the implementation requirements of Art. 3(2). If this is not the case, 'the matter will be brought to the Court of Justice by one of the Contracting States'; *see also* Reestman, *supra* n. 15, p. 489; Peers, *supra* n. 99, p. 419.

[120] As the judgment of the ECJ is binding, Germany would have to amend its Constitution with respect to its budgetary rules. Whether the Constitutional Court would accept this seems doubtful. In this sense also Reestman, *supra* n. 15, p. 498 and p. 500.

[121] In order to obtain full compliance with the further requirements, § 51(2) HGrG then directly refers to Art. 3(2) TSCG as well as to the relevant legislation of the European Union.

municipalities. This provision was already introduced before the Fiscal Compact was signed, in order to meet the already existing European debt requirements.[122] But, with reference to the Fiscal Compact, the Stability Council now also has to take the estimated revenues and expenses of the institutions mentioned in § 52 *Haushaltsgrundsätzegesetz*[123] into account.

According to Article 109a GG, the Stability Council is an institution that supervises the budgetary management of the Federation and the *Länder* continuously – it was established in 2009 in order to make the debt brake more effective. The *Stabilitätsratsgesetz,* the statute for the Stability Council, includes conditions and procedures for ascertaining the threat of a budgetary emergency and the principles for the establishment and the administration of programmes for taking care of budgetary emergencies. From this perspective, it seems logical that the Stability Council is now also the institution that is responsible for the supervision of compliance with the Fiscal Compact balanced budget rule in § 52(2) *Haushaltsgrundsätzegesetz* (see Article 3(2) of the Fiscal Compact). According to § 6 of the *Stabilitätsratsgesetz*,[124] the Stability Council reviews twice a year whether the balanced budget rule will be met in the ongoing year and the next four years. If it should come to the conclusion that this is not the case, it has to advise how it might be possible to comply with the requirements of the Fiscal Compact. This advice has to take into account the recommendations made by the Council of the European Union according to Regulation No. 1466/97 and is communicated to the governments of the Federation and the *Länder* in order to pass them on to the respective parliaments. These suggestions are not binding for the parliaments – however, as pointed out before, Article 3(2) of the Fiscal Compact explicitly states that the 'prerogatives of national Parliaments' have to be respected, so that this non-binding arrangement of the correction mechanism should be in compliance with the requirements of the Fiscal Compact – whether it will be specially efficient is another question.[125]

When analysing compliance with the balanced budget rule the Stability Council is supported by an independent advisory board (see § 7 *Stabilitätsratsgesetz*), which consists of representatives of the German Central Bank (*Bundesbank*), the German Council of Economic Experts, academic research institutes and the municipalities. As the Stability Council itself consists of politicians only,[126] the advisory board is

[122] This special form of coordination was laid down in an administrative agreement between the Federation and the *Länder* of 1968, before it was implemented into the HGrG in 2010: *see* R. Wernsmann, '§ 31 Anh.', in C. Gröpl (ed.), *BHO/LHO* (C. H. Beck 2011) p. 308 at p. 316.

[123] That is the Federation, the *Länder*, the municipalities and the social insurance carriers.

[124] Stabilitätsratsgesetz vom 10 August 2009, BGBl. I, p. 2702, zuletzt geändert durch Artikel 2 des Gesetzes vom 15. Juli 2013, BGBl. I, p. 2398 – 'Statute on the Stability Council'.

[125] *See also* v. Lewinski, *supra* n. 3, p. 477.

[126] They are the Federal Finance Minister, the Federal Minister for the Economy and the Finance Minsters of the *Länder*.

obviously supposed to guarantee a more objective analysis of the financial situation. The advisory board therefore gives its opinion regarding the fulfilment of the balanced budget rule and – just as does the Stability Board – gives advice how to get rid of possible excessive financial requirements. These suggestions are again not binding – neither for the Stability Council nor for any of the involved parliaments, but have to be published, so the public can and will take notice of them.

Constitutionality of the Fiscal Compact?

Though it certainly contains a 'German spirit', the balanced budget rule of the Fiscal Compact is not an exact reflection of the German debt brake – which is hardly surprising taking the international consensus-finding process into account. Yet, while the Fiscal Compact in certain parts is even stricter than the German debt brake, this also raises the question of the constitutionality of the Fiscal Compact itself. In other words, is it possible that Germany binds itself to stricter budget rules internationally than in its own constitution? Due to the supremacy of European Law,[127] this question did not come up before, even though the European Treaties include similar (though not quite as strict) rules, as the European Treaties do not have to comply with all the provisions of the Basic Law but, according to Article 23(1) GG, only with the provisions mentioned in Article 79(3) GG – the so called eternity clause.[128] Yet, as the Fiscal Compact was not formally inserted into the European Treaties, but presents itself as a 'normal' international treaty, it has to be compatible with all existing provisions of the Basic Law – and thus also the existing debt brake. In its decision on the ESM Treaty and the Fiscal Compact, the *Bundesverfassungsgericht* has already had to deal with this question: it held that the Fiscal Compact raises no constitutional concerns.[129] Though it appears hardly convincing when the Court, in doing so, states that the Fiscal Compact mainly includes rules that are very similar to those already existing on the European and constitutional level, given that they are still at least partly stricter,[130] the two other reasons given in this decision seem convincing.[131] First of all, the Fiscal Compact fully respects the prerogatives of the German Parliament and therefore gives the European institutions no possibilities of interfering with the overall responsibility of the

[127] *See*, for an overview, A. Thiele, *Europarecht* (12th edn., Niederle Media 2015) p. 131-142.

[128] Therefore the European debt provisions within the treaties do not have to comply with the existing debt brake, but are constitutional as long as these provisions could (theoretically) have been introduced into the GG by the German legislator.

[129] BVerfGE 132, 195 (278-287).

[130] BVerfGE 132, 195 (278-284).

[131] *See also* v. Lewinski, *supra* n. 3, p. 476-477.

Parliament concerning the budget[132] – though this argument again obviously raises doubts about the efficiency of the Fiscal Compact itself. And secondly, the Fiscal Compact can at least theoretically be cancelled according to the general rules of international law[133] and therefore does not constitute an irreversible commitment of the German authorities to a certain form of budgetary policy.[134]

Deficiencies of the Fiscal Compact and concluding remarks

The Fiscal Compact avoids a few of the structural deficiencies of the German debt brake. It includes all sorts of problematic debt, so the national authorities will not be able to circumvent the balanced budget rule as easily as with regard to the German debt brake. It includes aspects of economic sustainability, by adapting the 'braking-force' at least partly to the proportion of debt to the GDP (the structural deficit maybe up to 1 per cent if the debt is below 60 per cent). Yet it again fails to give the right incentives for any form of public investment, as it includes no form of the 'golden rule' – although, as the Fiscal Compact refers only to the structural deficit, this is not quite as problematic as with regard to the German debt brake. However, the most dangerous aspect of the Fiscal Compact is the fact that it forces practically the whole of Europe to be austere at the same time. As Mark Blyth has pointed out convincingly, it is not only questionable whether the concept of austerity can work at all, but also practically certain that 'we cannot all cut our way to growth at the same time'.[135] At least someone has to be there to spend if everyone else is trying to save. Looking around within the Eurozone, this someone can hardly be anyone other than Germany – although it is probably the last state that will be willing to do so under Chancellor Angela Merkel.

The debt brake and the Fiscal Compact thus offer austerity as the answer to the current European problems. This answer is not only too simple, but in combination these two 'German' instruments might also effectively hinder the recovery of the European economy.[136] While the effects on the German economy will probably be limited, there may well be drastic consequences for those of its European neighbours when the biggest economy refrains from investments financed through public debt. With the Fiscal Compact making austerity the way

[132] BVerfGE 132, 195 (284-285).

[133] *See* Schorkopf, *supra* n. 92, p. 24.

[134] BVerfGE 132, 195 (285-287).

[135] Blyth, *supra* n. 14, p. 8.

[136] In fact, the solution would be to boost public spending, *see especially* P. Krugman, 'How to end this depression', <www.nybooks.com/articles/archives/2012/may/24/how-end-depression/?page=1>, visited 29 August 2014: 'The truth is that recovery would be almost ridiculously easy to achieve: all we need is to reverse the austerity policies of the past couple of years and temporarily boost spending.'

to go also for the rest of Europe, economic recovery seems more or less impossible in the short run. If one wants to stick to the aim of a balanced budget nonetheless, it is at least to be welcomed that even German politicians are now thinking of allowing a little more time for the economic reforms that are without doubt necessary in some of the states of the Eurozone. But, apart from this, the reforming countries themselves should not forget the second way of balancing a budget in times of recession: tax increases.[137] In its recommendations for the PIIGS-States, the Troika has almost only reverted to expenditure cuts,[138] despite the fact that a fairly new study by the IMF has found that 'only a balanced composition of cuts to expenditure and tax increases boosts the chances that the consolidation will successfully (and rapidly) translate into lower debt-to-GDP ratios.'[139] However, it will be hard (or even impossible) to teach German politicians to speak these foreign economic languages in the near future.

[137] *See* P. Bofinger, *Zurück zur D-Mark?* (Droemer 2012) p. 98-99 and Blyth, *supra* n. 14, p. 241:'So we are talking taxes, which no one likes.'

[138] Greece again being the exception.

[139] Batini et al., *supra* n. 14, p. 32.