Brain-Dead Debt Brake

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The debt brake is brain-dead—pull the plug. Germany's financial super-ego fails to protect the democratic self-governance of future generations. Instead, it shackles us and our descendants to a small-c conservative agenda animated by yesterday's economic orthodoxy.

Reflecting the lingering zeitgeist of the late 20th century, Article 109 (3) of the Basic Law mandates that "[t]he budgets of the Federation and the *Länder* shall, in principle, be balanced without revenue from credits." This blend of German economic orthodoxy and almost comical rules-based hubris deems the budgetary limitation "satisfied if revenue from credits does not exceed 0.35 percent in relation to the nominal gross domestic product." To soften the edges, "[t]he Federation and *Länder* may introduce rules intended to take into account, symmetrically in times of upswing and downswing, the effects of market developments that deviate from normal conditions, as well as exceptions for natural disasters or unusual emergency situations beyond governmental control and substantially harmful to the state's financial capacity." Any debt funding beyond these exceptions requires a constitutional amendment—a two-thirds majority in *Bundestag* and *Bundesrat*—as discussed in the context of a special fund for the armed forces.

Allegedly, the debt brake aims to protect financial sustainability and the democratic self-governance of future generations. The logic behind the constitutional limitation is simple. Debt is fiscally irresponsible and morally dubious (*Schuld*!). It comes with a hefty price, and who is supposed to ever pay that back? If the current government, legitimized by today's electorate, runs up public debt, future generations will bear the costs of past pleasures. Principal and interest will suffocate future generations' opportunities. That is unfair—think of the children. Every *Stammtisch* will agree that the state just wastes money. Berlin Brandenburg Airport and California High-Speed Rail, amirite? The "*Schwarze Null*" becomes the sole respectable choice —*alternativlos*, one might say. In polite discourse, the debt brake has allowed upward redistribution and cuts to public investments to posture as the ultimate rules-based triumph over alleged populist desires. *Prost*.

The debt brake builds on a crude understanding of (future) self-governance and debt itself. First, whatever we do, we destine the democratic choice architecture of future generations. Neutrality as to the future generations' opportunities is not an option. Incur debt and realize a marginal investment, say a space program? Both decisions will define our children's opportunities. Don't do either, and we also create path dependencies—just different ones. Assuming that inaction, even when disregarding substituting behaviors, leaves inherently more room for future maneuvering is naïve. It entirely misses dynamic effects. To stick with the example, our children cannot just magically create the satellites that we failed to build and realize the subsequent innovation that would have emerged. Time passes, and missed opportunities are missed for good.

Second, the debt brake does not necessarily reduce risk; rather, it one-dimensionally de-leverages public finances and inevitably shifts risks into other dimensions. Practically speaking, a decision against deficits in today's political economy is one for climate change acceleration, for example. Any foreseeable financial risks from elevated debt levels will pale against the climate risks we implicitly accept. The same is true when infrastructure crumbles due to underinvestment in maintenance.

Third, and following from the first two points, the only relevant policy question can be whether incurring debt *for a specific purpose* is worth it. If an investment promises a return of 10% and we can finance it at 1%, it is financially worth it; if the opposite is true, not so much. The debt brake does not even distinguish between investments and consumption. It focuses on deficits alone. Even if there were a generalizable, optimal or maximally tolerable debt to GDP ratio, the debt brake fails at guaranteeing that. It focuses on the numerator alone and disregards the denominator. Obviously, the assessment of value does not need to be bound to narrowly construed and quantifiable financial considerations. Normative or ethical factors can and should guide the decision as well.

Fourth, predictions about the returns of government investments are inherently prone to errors—even when focusing on the quantifiable economic aspects alone. What is the long-term ROI of building a subway? Of investing in high schools or hospitals? At best, we can work with vague projections based on prior projects. And granted, all too often these estimates are rosier than reality. These type-1 errors, investments that should not have been made, burn themselves into the collective consciousness. At a more abstract level, though, this concern can be condensed to the diagnosis that the future is uncertain and hard to predict. True, indeed—just not very illuminating. Leveraging the concern about uncertainty against public deficits in general, though, remains misguided, as the same uncertainty plagues the decision not to build the subway or invest in high schools or hospitals. There is no evidence for a structural asymmetry between type-1 and type-2 investment errors, erroneously missed investment opportunities; failed public investments are just more visible and better suited for *Stammtisch* *Schenkelklopfer*. In fact, we should be highly concerned if we did not see frequent failures of public investments and projects, as it would strongly suggest a suboptimal investment level. The state is and must be the ultimate investment risk-taker: a 10% success rate in publicly funded research can be a terrific result.

Fifth, the debt brake not only self-disciplines the governing coalition's desires for relentless spending. If successful, it also deprives future generations of the very virtues of democratic self-governance it alleges to protect. To be clear, the constitution generally limits the legislative power of simple majorities from taking certain actions with good reason. In fact, that is the constitution's very purpose. A constitution reflects the fundamental consensus of society: human rights, the institutions of the state, and the division of power. Are we really as convinced of the veracity of the economic policy zeitgeist as we are of human rights, the establishment of state institutions, and democratic divisions of power? Have we now found the ultimate truth? Just within the last decade, we had to throw a fundamental assumption over board, for example, when we learned that the zero lower bound is significantly lower than zero. Imagine if past generations had constitutionally bound us to the details of their economic orthodoxies and required supermajorities to deviate from the gold standard, the Bretton Woods exchange system, or specific tax rates. Heaven forbid, if future generations dared to think climate change, economic inequality, or war posed larger risks to their or their children's democratic self-determination than debt. After all, it seems like fiscal policy and the worthiness of investments is best decided by the people closest to them in space and time and not by constitutional framers for decades to come.

Sixth, if we are indeed concerned about risk and our children's room for maneuver, as we should be, public deficits are a bizarre focus, to say the least—irrespective of the current budgetary situation. The plutonium we produce has a half-life of 24,000 years. Manmade climate change will severely constrain future self-determination, and all German constitutional law provides is a principle-based recognition to be taken into consideration, spelled out in a recent decision by the Federal Constitutional Court and not the text itself. Infrastructure brings enormous path dependencies; urban planning engrains bad policies for generations to come. At least comparatively, the correction costs of public debt appear manageable.

Seventh, the debt brake's benchmark defeats the framework's purpose. Just to recall, the budgetary limitation is "satisfied if revenue from credits does not exceed 0.35 percent in relation to the nominal gross domestic product." The nominal gross domestic product as currently understood reflects an aggregation of preferences and valuations expressed by today's market participants through prices. Yet, it is no secret that the assignment of value dramatically changes over time as societies evolve. Pegging the debt brake's benchmark to today's prices inevitably imposes contemporary preferences and valuations upon future generations—how ironic for a measure that allegedly aims to secure the democratic self-governance of future generations. On top of that, the debt brake imported all concerns about GDP as a measure of wellbeing into the constitution. I doubt that our descendants will necessarily agree with our current accounting of happiness, externalities, informal labor, and government production, for example.

So, what are the optimal debt and deficit levels? What are good investments, and what are bad ones? What expands the next generation's opportunities, and what diminishes them? I don't know, but the debt brake certainly does not provide answers to any of these questions. Public debt is neither good nor bad, neither moral nor immoral. It is a means of funding—an instrument of governance—to be judged by what it achieves.