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# The *Goldkrieg*: Revaluing the Bundesbank's Reserves and the Politics of EMU

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In May and June 1997, Germany's commitment to Economic and Monetary Union (EMU) underwent its most serious test ever when the Bundesbank and the government of Chancellor Helmut Kohl clashed openly over the government's plans to revalue the country's gold reserves. Faced with a budget short-fall and strong political opposition to either tax increases or spending cuts, Finance Minister Waigel attempted to introduce a modest change in the Bundesbank's bookkeeping procedures to bring them in line with the standard practices at other European central banks. The Bundesbank resisted, arguing that the changes would infringe upon its closely guarded independence. This paper analyzes how the politics of coalition interacted with Germany's political institutions to cause this conflict.

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# The *Goldkrieg*: Revaluing the Bundesbank's Reserves and the Politics of EMU

In May and June 1997, Germany's commitment to Economic and Monetary Union (EMU) underwent its most serious test ever when the Bundesbank and the government of Chancellor Helmut Kohl clashed openly over the government's plans to revalue the country's gold reserves. Faced with a budget short-fall and strong political opposition to either tax increases or spending cuts, the Finance Minister attempted to introduce a modest change in the Bundesbank's bookkeeping procedures to bring them in line with the standard practices at other European central banks. At the core of the proposed change was a plan to revalue the Bundesbank's gold and foreign currency reserves from the lower cost valuation principle (*Niederstwertprinzip*) to a level closer to their real market value. In addition to making Germany's system of foreign reserve accounting comparable to that of its European Union partners, revaluation would also make the government's bleak budget picture look rosier.

However, within the space of a few weeks, what had seemed a minor—and not necessarily controversial—clerical procedure became the center of a political storm that threatened to bring down the Kohl government. The Bundesbank publicly defied the government and asserted that such a move would undermine the central bank's statutory independence. The governing coalition marshaled its parliamentary majority and introduced legislation to alter the Bundesbank Law in order to compel the Bundesbank to comply with the new directives. Ultimately, a showdown between the government and the Bundesbank was averted; with the government backing away from its plan to alter the Bundesbank's accounting procedures for the 1997 fiscal year, thus forgoing the immediate improvements to its troubled budget figures. The Bundesbank for its part, accepted that the run-up to monetary union would require an eventual revaluation of its gold and international reserves.

The origins of this political crisis can be found in the partisan alignments within Germany's governing institutions and the economic crisis that confronted the Kohl government in 1997. A combination of international commitments and domestic political conflicts put the Federal Govern-

ment in an untenable budgetary position early in 1997. Its attempt to escape from this political straitjacket led it into a major confrontation with the Bundesbank. The outcome of the crisis, sometimes interpreted as a humiliating backdown by the Kohl government, was in fact a compromise which gave a short-term public victory to the Bundesbank while preserving the government's ultimate objective of launching EMU on time. The whole affair demonstrates the formidable obstacles that the Kohl government had to overcome on the road to monetary union and the underlying struggle for partisan political advantage that motivated the principal participants.

## THE 1997 BUDGET AND THE MAASTRICHT CRITERIA

During the first half of 1997, the German government faced a series of ominous economic trends. While economic growth had returned to Europe, it was the jobless growth that had characterised the late 1980s. The labour market remained depressed with unemployment surging in the winter of 1996-7 to levels unseen since the Great Depression. Higher demands for unemployment benefits and lower tax revenues added to existing pressures on the public finances stemming from unification, the continuing need to rebuild eastern Germany, and rigid labour markets. The level of public indebtedness continued to climb to record levels (Table 1).

**Table 1. German Economic Figures, 1994-97**

| | 1994 | 1995 | 1996 | 1997 |
|---|---|---|---|---|
| % workforce unemployed | 9.6 | 9.4 | 10.4 | 12.2 (Feb.) |
| budget deficit as % GDP | 2.4 | 3.5 | 4.0 | 3.0* |
| government debt as % GDP | 50.4 | 58.1 | 60.8 | 61.6* |

* -- EU Commission estimates.

Sources: Unemployment -- OECD, *Main Economic Indicators*, (Paris: OECD, April 1997), pp. 124-5.
Debt and Deficit (1994-96) -- EMI, *Annual Report 1996*, (Frankfurt: EMI, 1997), p. 31.
Deficit and Debt (1997) -- EU Commission estimates cited by *Handelsblatt*, 20 May 1997.

Normally during a downturn in the economic cycle, a government can pay unemployment benefits, provide a modest amount of fiscal stimulus to the economy, and hope for an eventual recovery in the labour market. The German government's commitment to EMU under an exacting set

of economic criteria laid out in the Maastricht Treaty made it politically impossible for them to spend their way out of the recession.

The centerpiece of the Treaty of European Union (TEU) was the European Union member-states' pledge to launch a single currency before the end of the decade. EMU, as negotiated at Maastricht in 1990, is part of the evolution of European economic policy institutions in the wake of the Single Market. The particular institutional reforms called for in EMU entail a major shift in monetary policy decision-making authority to the EU level, a removal of that authority from the control of domestic politicians, and (for some countries) the creation of a new set of macroeconomic priorities. Economic and monetary union would create a single currency among the participating states and a common monetary policy. The charter of the planned European Central Bank is modeled closely on that of the German Bundesbank with its emphasis on price stability and institutional independence. The Maastricht Treaty is explicit in its declaration that price stability is the primary objective of the ECB and pursuit of this objective shall take precedence over all other goals.[1]

In the run-up to monetary union, potential participants, including Germany, will have to meet a series of economic criteria, the most important of which are controls on government budgets. Of the five convergence criteria referenced in Article 109j(1) of the Treaty of European Union (TEU) for EMU participants, two deal specifically with the fiscal position of nation governments:[2]

- maintain a total public sector debt of under 60 per cent GDP in the year prior to selection.
- run a public deficit under 3.0 per cent of GDP in the year prior to selection.

The other three conditions deal with membership in the Exchange Rate Mechanism, converging interest rates, and converging inflation rates. The long recession of the early 1990s had hit EU public finances particularly hard, making fulfillment of the treaty requirements problematic for many countries. While the treaty's ambiguous language allows for member states to be 'approaching' the reference values, this liberal interpretation of the Maastricht criteria ran against the German government's literal interpretation of the convergence numbers. While countries such as Italy and France suggested that a more flexible reading of the treaty would make achievement of

EMU easier, the German government could not sell a 'soft' euro to either its skeptical citizens or the Bundesbank. In response to the German public's sentimental attachment to the deutschmark, the Finance Ministry began a massive public relations campaign under the slogan: 'the euro: as strong as the mark'.[3] Even with the support of the state information apparatus, the single currency failed to excite any enthusiasm from the German public. Polls in early 1997 showed that nearly two-thirds of the German population continued to oppose giving up the mark for the euro.[4] Widespread but unmobilised antipathy towards the centerpiece of the German government's European policy existed throughout Germany. Most mainstream opponents of the single currency were reluctant to mount a frontal attack on the European Union; instead, they made their opposition more nuanced, declaring their support for a single currency in principle, but only one where all the member-states met the criteria.

The government's policy was further complicated by the Bundesbank and the Federal constitutional court, which took similar positions on the terms of the Maastricht Treaty. The Bundesbank reserved for itself the right, under its obligation to safeguard the value of the currency, to produce a report in 1998 not only on the German government's success in meeting the criteria, but also on the success of all the other potential members in fulfilling the economic targets. For its part, the Federal constitutional court, in an opinion approving the ratification of the Maastricht Treaty declared that membership in EMU was constitutionally permitted so long as the terms of the criteria that guaranteed price stability were met.[5] With an uncertain public, a skeptical central bank, and a constitutional decision in its way, the German government would have been hard-pressed to pursue any policy other than a strict interpretation of the Maastricht criteria. In Germany, politicians have always seen the convergence criteria as firm targets. The government was relentless in its declaration that all potential members must meet the targets.

The Bonn coalition itself was firmly behind the EMU project. Besides Kohl's loyal CDU contingent, the small FDP had impeccable pro-European credentials and its former chairman had been the Foreign Minister who had first proposed that Germany endorse monetary union. The Christian Social Union (CSU), the CDU's Bavarian sister party and the third member of the coali-

tion, was much less pro-European. However, the CSU's chairman, Theo Waigel, was the Federal Finance Ministry who had been responsible for negotiating the broad outlines of the EMU agreement. His continuing presence in such a key cabinet post seemed to guarantee that the CSU would remain supportive of Kohl's EMU policy.[6]

However, Waigel, who as Finance Minister was responsible for the overall budget position of the federal government, faced additional pressures from within his own party, While Waigel was the nominal leader of the CSU, the Minister-President of Bavaria, Edmund Stoiber, was his chief rival for the position. Stoiber harbored ambitions to lead the CSU and combine the offices of Minister-President of Bavaria with those of the party chairman, the post held by Waigel. Waigel, too, had desired to combine both of these powerful positions in his own hands, but Stoiber had thwarted Waigel's attempt in the early 1990s to return to Munich as Bavaria's Minister-President. The growth of support for right-wing nationalists, the Republikaner Party, in Bavaria threatened the CSU's absolute majority in the Bavarian Landtag and exacerbated the personal rivalry between Stoiber and Waigel.[7]

With his base of support threatened by a nationalist party whose appeal stemmed at least in part from its populist support for the deutschmark, Stoiber moved increasingly to the right to protect the CSU's electoral position from Republikaner encroachment.[8] In addition to hardening his rhetoric on issues such as the German-Czech Reconciliation Proclamation, Stoiber staked out a position of strict compliance with the Maastricht Treaty, arguing that anything short of a strict interpretation of the convergence criteria would lead to a euro weaker than the deutschmark. If Waigel could not hold the line on government spending, he would have opened himself up to harsh criticism from Stoiber that could undermine his position as leader of the CSU. This led Waigel to articulate a particularly hard-line view of the convergence criteria, repeatedly declaring when referring to the deficit criteria that 'three point zero means three point zero'.[9] This position succeeded in holding both Stoiber and the national opposition at bay.

It also contained an international element which strengthened the German government's negotiating position with its EU allies. At the time of the negotiations surrounding the Maastricht

Treaty, the German government had agreed to monetary union with the strict convergence criteria on the assumption that Germany would easily achieve the targets. Since many countries were not expected to meet the criteria, Germany would thus be in a position to select its partners in EMU from those members with solid fiscal and monetary policies similar to Germany's. The debt-ridden, weak currency countries of the Mediterranean could be excluded under a fairly transparent set of selection criteria. However, for this strategy to succeed, Germany itself needed to meet the criteria. Otherwise, not only would domestic opponents of the single currency have an issue to derail EMU in Germany but other EU countries could resist German demands for austerity and budgetary restraint as preconditions for membership. If, for example, Germany had a budget deficit of 3.5 per cent of GDP, it would be difficult for Germany to attempt to exclude Italy or Spain whose budget deficits might be 3.7 per cent of GDP.

It was thus with a great deal of apprehension that the German government watched its finances deteriorate throughout 1996. Slow growth and high unemployment reduced revenues and exacerbated the calls for more social spending. The government quickly exceeded the deficit targets that it had thought it could easily achieve at the beginning of the year. At year's end, a final surge of 500,000 in the jobless rolls pushed unemployment over 4.4 million (12.2 per cent of the workforce), the highest number of Germans without work since the final days of the Weimar Republic. High levels of unemployment increased the burdens on the budget. In the first quarter of 1997, the Federal Labour Office needed 12 per cent more money than it had received during the same period in 1996.[10]

In December 1996, when it passed its budget for 1997, the government had allocated DM439.9 billion in expenditures. The government had predicted that it would raise DM345.9 billion in revenue during 1997.[11] By the middle of 1997, it was very apparent that both these figures were overly optimistic. In fact, government expenses were up and tax receipts were down. By the middle of 1997, it was expecting outlays of DM458.6 billion compared with tax inflows of DM336.7 billion. Although non-tax revenue made up some of the short-fall, the government still needed to borrow DM71.2 billion, well above its original plans.[12] When these budget figures be-

came available at the beginning of May, the federal budget deficit appeared to be headed for a yearly total of 3.4 per cent of GDP, well outside the Maastricht criteria.[13]

## THE POLITICS OF COALITION AND BLOCKADE

The German government found that its room for maneuver in response to its fiscal problems was very restricted. Putting the budget back towards greater balance could be achieved in one of two ways: raising taxes or reducing social spending. The balance of power in Germany's two houses of parliament precluded either of these two options. Since the Union parties (CDU/CSU) ruled in coalition with the small Free Democratic Party (FDP), the policy of the government did not always reflect the preferences of its major partner, the CDU. CDU and CSU members would have preferred an additional tax levy to bolster the sagging public finances. However, the electoral strategy of the FDP would not support this policy.

Despite several years of decline following its successes in the first all-German elections in 1990, the FDP had undergone a metamorphosis in the middle 1990s. Differences between economic liberals and social liberals had been effectively resolved in 1995 with the resignation of Sabine Leutheusser-Schnarrenberger from her post as Justice Minister after a ballot of party members endorsed greater use of police surveillance against suspected criminals. Leutheusser-Schnarrenberger's resignation effectively sidelined the civil liberties wing of the party and made way for a greater emphasis on 'law and order' issues coupled with economic liberalism, particularly tax reduction and privatization. Despite criticisms and fears that the party would face electoral defeat, the FDP defied expectations and emerged as the big winners in the March 1996 *Landtag* elections in Schleswig-Holstein, Rhineland-Palatinate and Baden-Württemberg, easily surpassing the five per cent threshold for representation in all three parliaments and forming part of the governing coalition in the latter two Länder.[14]

The FDP's leadership, in particular General Secretary Guido Westerwelle, attributed the party's resurgence to its newfound opposition to excessive government regulations and high levels of taxation. A party conference in Wiesbaden endorsed this strategy as the basis for the FDP's 1998 federal election campaign.[15] For many years, the FDP had had a reputation of a party that

would do anything to stay in power. During the history of the Federal Republic, it had only been out of government during the three years of the Grand Coalition (1966-9) and its abandonment of a coalition with Helmut Schmidt and the Social Democrats paved the way for Helmut Kohl's long reign as chancellor. As a very small party, the FDP was always in danger of falling below five per cent of the vote, the point at which it was allowed representation in the Bundestag. As the only major party in Germany pledged to lower taxes, the leaders of the FDP felt they had latched onto a position that would differentiate them from the other parties and ensure they received enough votes to return to the parliament after the next elections. Rather than abandon what they perceived as an electorally advantageous 'principle', the FDP refused to accept any form of tax increase to resolve the federal government's budget problems. The route of tax increases was blocked.

This still left open the possibility of reductions in government spending to bring the budget deficit under 3.0 per cent of GDP. Spending cuts had always been unpopular and a government attempt to reduce coal subsidies in March 1997 had triggered a massive demonstration of miners in Bonn. The government ultimately backed down and promised additional subsidies to coal miners, but not before the demonstrators had rioted near the Bundestag and stoned Thomas-Dehler-Haus, the FDP's national headquarters. Despite its reinstatement of the coal subsidy, the government remained committed to implementing the rest of its package of budget cuts.

The bicameral nature of the German parliament threw up an obstacle to this strategy. While the government coalition controlled a majority in the Bundestag it lacked a majority in the Bundesrat. Selected by the state governments, the upper house of the German parliament could block or delay many pieces of government legislation. Nearly three-quarters of federal legislation requires the Bundesrat's approval. During the 1970s, when they were out of power, the Christian Democrats used their control of the Bundesrat to delay and modify legislation.[16] During the 1980s split control of the two houses of parliament was not an issue as the CDU and their FDP allies controlled majorities in both chambers. The circumstances of the 1970s were repeated themselves in the 1990s, only this time it was the SPD-led opposition that controlled the Bundesrat (Table 2).

**Table 2. Representation in Bundesrat, Spring 1997**

| | Government | Opposition | Mixed |
|---|---|---|---|
| | 6 Bavaria | 6 North Rhine Westphalia | 4 Rhineland-Palatinate |
| | 6 Baden-Württemberg | 6 Lower Saxony | 4 Thurungia |
| | 4 Saxony | 5 Hesse | 4 Berlin |
| | | 4 Schleswig-Holstein | 3 Mecklenburg-Vorpommern |
| | | 4 Brandenburg | 3 Hamburg |
| | | 4 Saxony-Anhalt | 3 Bremen |
| | | 3 Saarland | |
| TOTALS | 16 | 32 | 21 |

**Source:** Press Offices of *Länder* governments.

By 1997, the governing coalition in Bonn controlled only three of the sixteen Länder delegations, a total of sixteen votes out of the 69 votes in the Bundesrat. Passing legislation through the Bundesrat requires the support of 35 votes. Since Länder with mixed representation in the Bundesrat—that is, Länder whose governing coalition includes members of both the Bonn government and opposition parties—often abstain in the Bundesrat, these votes are effectively 'no' votes as well. On the basis of political party control, the Socialists and their Green allies commanded enough Bundesrat votes to block many government actions in 1997. To override opposition in the Bundesrat required a two-thirds majority (448 out of 632 votes) in the Bundestag and the coalition had only 337 seats.

The SPD, under the leadership of Oskar Lafontaine, conducted a strategy of 'blockade politics', using its strength in the Bundesrat to prevent passage of the government's proposed legislation. The SPD claimed that it was preventing the government from cutting popular social benefits and that its control of the Bundesrat simply reflected popular rejection of the government's policies. Government supporters complained that the SPD was preventing the government from implementing a successful economic program in a cynical attempt to keep the economy in a recession through the federal elections scheduled for 1998. Whatever the reasons, the government's attempts to reform what it saw as a bloated system of social welfare ran afoul of the SPD's control of the upper chamber. While the SPD did acquiesce to modest controls on social spending, primarily

delays in a promised expansion of benefits, it rejected additional government efforts to make the major cutbacks necessary to fulfill the Maastricht criteria. Indeed, the SPD used its majority in the Bundesrat to block passage of the federal budget in February 1997, leaving an unexpected budget shortfall of DM11 billion.[17] The path of spending cuts was blocked as well.

## THE LOWER COST VALUATION PRINCIPLE (*NIEDERSTWERTPRINZIP*)

Waigel sought his way out of this political and fiscal crisis through a clever use of the Maastricht Treaty and a reform of the Bundesbank's valuation of its international reserves. His proposed change to the Bundesbank's accounting methods was rooted in the Maastricht Treaty, which stated in one of its protocols that

> The European Central Bank shall contribute to the harmonization, where necessary, of the rules and practices governing the collection, compilation and distribution of statistics in the areas within its fields of competence.[18]

As part of the integration of national central banks to prepare the way for the European Central Bank (ECB), national governments would need to harmonise their disparate methods of accounting so that all the subordinate central banks would be providing comparable information to the ECB and to each other. Many of these changes were minor adjustments and calibrations, but in the area of valuation of foreign reserves the method of accounting made a great deal of difference. The traditional German method of accounting for foreign exchange assets was the *Niederstwert-prinzip*, the lower cost valuation principle. Under this principle, when a company or public entity (such as the Bundesbank) made up its yearly balance sheet, the price of an asset is calculated based upon either the price at the time of the item's acquisition (the historical exchange rate) or the prevailing market price at the date the balance sheet is issued, whichever is *lower*.[19] In addition, unrealised gains are not traditionally claimed on balance sheets; only once an asset has actually been sold and the gain realised can bookkeepers record the profit. In contrast, unrealised losses are recorded immediately as the market price of the asset would then be lower than the acquisition price.[20]

In practice, this method proved an extremely conservative method of valuing assets whose price had appreciated over a long period of time—up to fifty years for some of the Bundesbank's

gold reserves. Gold purchased in the 1960s during the Bretton Woods monetary regime when the price was about $35/ounce (DM125/ounce) remained on the Bundesbank's balance sheet at DM125/ounce in May 1997 when the international price of gold was $344/ounce (DM 588/ounce).[21] In 1997, the market value of the Bundesbank's international and gold reserves amounted to DM55.9 billion, yet the official book value of these reserves was listed as a mere DM13.7 billion. The average price of the gold on the Bundesbank's books was a mere DM144/ounce, less than one-third of its market value.[22]

An international comparison reveals just how conservative Germany's *Niederstwertprinzip* accounting was when applied to international reserves. Of the other members of the EU, only Sweden priced its reserves at a level below that of Germany. Indeed, under Waigel's proposed change, Germany would still be valuing its reserves beneath the level that 11 of its 13 EU partners valued theirs (see Table 3). It was this disparity that Waigel sought to reduce when he requested that the Bundesbank reserves be revalued at 60 per cent of the price they could fetch on international markets.

**Table 3. Book and Market Valuation of National Reserves, December 1996**

| Country | Total Gold Reserves millions of troy ounces | National Valuation $ per troy ounce | Book Value as % Market Value |
|---|---|---|---|
| Belgium | 15.3 million ozs | $385/oz | 112% |
| Italy | 66.7 | 380 | 111 |
| France | 81.9 | 371 | 108 |
| Ireland | 0.4 | 350 | 102 |
| Portugal | 15.5 | 322 | 94 |
| United Kingdom | 18.4 | 298 | 87 |
| Denmark | 2.0 | 295 | 86 |
| Spain | 15.6 | 271 | 79 |
| Finland | 1.6 | 250 | 73 |
| The Netherlands | 34.8 | 248 | 72 |
| Greece | 3.5 | 237 | 69 |
| Waigel's Proposal | 95.2 | 206 | 60 |
| Austria | 10.8 | 167 | 48 |
| Germany | 95.2 | 92 | 27 |
| Sweden | 4.8 | 50 | 15 |
| Luxembourg | 0.3 | n.a | n.a |

**Sources:** IMF. *International Financial Statistics*, Vol. 50, No. 5 (Washington, DC: IMF, May 1997).
Book value as per cent of market value calculated based upon gold trading at $344.05/oz on 30 May 1997.

The European Monetary Institute (EMI), in its yearly report published in April 1997, announced that the ECB would base its asset values on market valuation. Any gains that occurred to due revaluation after the reserves of national central banks were transferred to the European Central Bank would be placed in a revaluation account so as not to list unrealized gains as income. Although the EMI left national central banks free to pursue their own accounting rules for their non-ECB accounts, it would obviously be easier for a national central bank if it simply followed the accounting procedures of the EMI.[23] The implications for Germany and its undervalued reserves were rather serious. If Germany transferred its reserves to the ECB at their undervalued level, then all the gains from the revaluation would be put into the ECB's revaluation account, of which Germany would have a modest share. If, however, Germany changed its bookkeeping methods and claimed a special gain from the revaluation, it could take advantage of the whole amount of the revaluation for strictly domestic purposes. But this could only occur if the government acted before the creation of the ECB in 1999.

Bundesbank President Hans Tietmeyer and his deputy Johann Gaddum brought the possibilities that new definition opened to the German government to the attention of Kohl and Waigel. They envisioned taking advantage of a revaluation to reduce the debts in the federal government's 'Fund for the Redemption of Historic Liabilities', the special fund for unification-related expenses, in 1998 and 1999. Using the national reserves in this fashion before the creation of the ECB enabled the German government to lay claim to the value built up in German reserves over fifty years rather than taking a risk that the ECB might find a different use for them. All were agreed that such a sensitive matter should be handled as delicately as possible with a minimum of public discussion. Under this veil of secrecy, the Finance Ministry began plans in early 1997 to introduce legislation in the fall of 1997 arranging for the revaluation of the national reserves.[24]

Waigel proposed that the gain from the revaluation should be distributed on the government's books in three ways. The first part of the gain, would be used to bolster the Bundesbank's capital reserves from DM290 million to DM5 billion. The 'other assets' on the Bundesbank's books would likewise be raised from DM290 million to DM5 billion. A further DM25 billion

would be allocated to a special reserve fund for exchange rate stabilization. The balance of the gain, DM20 billion, would then be transferred to the 'Fund for the Redemption of Historic Liabilities' In this fund, the additional DM20 billion would be counted as a government surplus and could be used to offset deficits elsewhere in the budget.[25]

Earlier in the year, the European statistical agency, Eurostat, had issued a ruling in response to Dutch and Belgian sales of gold. According to Eurostat, sales of gold could not be used to offset government deficits although they could be used to reduce national debt.[26] Since the government was revaluing its reserves, it would not actually be selling anything and it would thus be using the 'hidden' value of its reserves instead. Under this technical distinction, the government would virtually erase the budget deficit that the government expected in 1997. Instead of an embarrassing breach of the Maastricht criteria, the German finances would look extraordinarily healthy.

The plan had additional political advantages in that it was something that was solely within the constitutional powers of the governing coalition to implement. All that was necessary was enabling legislation altering the Bundesbank Law, legislation that was necessary in any event to prepare the way for monetary union. The leadership of both CDU-CSU and the FDP were in favor of the change and the advantages it would bring the government in meeting the euro criteria, so the coalition could use its Bundestag majority to pass the new law. Since the suggested accounting changes did not affect the rights of the Länder, the legislation did not require the approval of the SPD-controlled Bundesrat, whose opposition had plagued so many other of the government's plans.

Waigel also anticipated minimal interference from the Bundesbank. Despite the Bundesbank's legendary reputation for independence, the government had been able to ride rough-shod over it during previous conflicts. In 1990, Helmut Kohl had brushed aside the Bundesbank's objections to the extremely generous terms of German economic and monetary union. The German electorate largely sided with Kohl during that episode, which ultimately led to the resignation of Bundesbank President Karl-Otto Pöhl. In 1997, the Bundesbank president was Hans Tietmeyer, a long-time acquaintance of Kohl's who had taken a leave of absence from the Bundesbank to nego-

tiate the terms of the monetary union with East Germany that Pöhl had found so distasteful. The Vice President, Gaddum, had served as Kohl's Finance Minister during the 1970s when Kohl was Minister-President of Rhineland-Palatinate.[27] They had brought the issue of revaluation to Kohl and Waigel's attention and could be counted on to steer the proposal through the Central Bank Council. The most trouble the central bank might cause would be some mild grumbles in the financial press attributed to anonymous Bundesbank sources. Even if the Bundesbank disapproved of the revaluation, it had no formal powers for stopping the government legislation. From this perspective, it appeared that the revaluation plan was an extremely clever solution to the government's budgetary woes.

## THE CONTROVERSY

As Waigel prepared to acknowledge the new reductions in revenue, the increases in spending, and the surge in new public indebtedness he increased his efforts to bring the budget under control. Most of the measures dealing with additional privatizations required approval of the Cabinet, but this approval was forthcoming given the seriousness of the government's financial situation. The Cabinet also approved of the plan to proceed with the gold revaluation; however, what had previously been a well-guarded secret quickly leaked to the press. On 14 May 1997, the leading German business paper, *Handelsblatt*, reported that the government was considering using the gold reserves to reduce the deficit.[28] The next day, to prepare for revaluing the country's gold reserves, Waigel needed to inform the entire Bundesbank Council of his intentions. Taking an unannounced helicopter trip from Bonn to Frankfurt, Waigel attended the Council's meeting on 15 May and briefed them on the Finance Ministry's proposals for consolidating the budget.[29]

The next day, Waigel had the unenviable task of informing the Bundestag of the government's worsening financial situation. He made short work of admitting to the government's problems announcing that the government's tax shortage coupled with the ongoing difficulties in the labour market made it likely that the government would need to spend up to DM20 billion more than had been budgeted. Then he launched into a prolonged criticism of the SPD's blockade of the Bundesrat and the additional expenditures that it had imposed upon the government in foregone

budget cuts. Still, Waigel maintained that the Maastricht criteria would not be endangered, the government would meet its deficit target through additional measures.[30] At this point he quickly outlined his scheme for the nation's gold and foreign currency reserves, declaring that

> These reserves represent the success of the German national economy over the last 50 years. It is a savings which we have amassed from abroad. It was indisputably proper that the Bundesbank valued gold and foreign reserves with extreme caution over the last 50 years. ... The new valuation will proceed with all necessary caution. The financial respectability of the Bundesbank will be guaranteed. Precautions against currency risks and the volume of the gold reserves will remain untouched. Not one ounce will be sold. It follows that not one ounce will finance the budget.... It is both proper and inexpensive to use this 'ancestral credit' to wipe out our historic liabilities.[31]

Not only did Waigel plan to make up for the shortfall with a revaluation of the gold reserves, but he also proposed to accelerate the sale of government shares in Deutsche Telekom its interest in three major airports (Hamburg, Cologne-Bonn, and Frankfurt), to begin the privatization of the postal bank and a series of highway rest stops.[32] None of these measures would have been so controversial had they not been accompanied by the announcement of the DM18 billion hole in the federal budget. As it was, this massive sell-off in the wake of such poor financial revelations—coupled with the suddenness of the Finance Minister's unexpected flight to Frankfurt—gave a look of desperation to the new measures.

The government denied that its was acting in a panic, that revaluing the Bundesbank reserves was all part of a broader plan of re-working the institutional structure of the Bundesbank, one that had the side benefit of bailing the government out of its financial woes. Waigel's helicopter flight to Frankfurt was certainly not the first time that the revaluation issue had been raised publicly. During his testimony before the Bundestag's budget committee on 19 February 1997, Waigel had warned that new regulations regarding the valuation of the Bundesbank's gold and currency reserves would be necessary.[33] One month later, during the Bundesbank President's testimony before the same committee, Tietmeyer was asked about the revaluation plan. His response was more guarded, suggesting that a revaluation was necessary, but that raising the subject for open debate during the sensitive period before monetary union might undermine the credibility of the European Central bank and cause turbulence on the markets.[34] His statement was quite in line with the advice he had given the Chancellor and Finance Minister in January.

There is some evidence in the legislative record however that indicates the government was accelerating its plans for the Bundesbank in response to the worsening budget circumstances. To prepare Germany for membership in the European Central Bank, the government needed to make some changes to the Bundesbank law to bring German law into full compliance with the Statute for the European System of Central Banks. For instance, in extraordinary cases requiring an interim appointment, the Bundesbank Law allowed a member of the Bundesbank Council to serve a two year term of office.[35] The Maastricht Treaty mandated a minimum term of office of five years.[36] The government had been preparing legislation to remove this and several other minor disparities between German national law and the Maastricht Treaty.

In order to reform the Bundesbank's accounting system, the government would need to change paragraph 26 of the Bundesbank Law which laid out the lower price valuation principle as the standard method of valuation for the Bundesbank's balance sheet.[37] The government's proposed legislation for changes to the Bundesbank Law was filed with the Bundestag on 20 May 1997, five days *after* Waigel presented his accounting proposal to the Bundesbank Council. Even though the legislation was under the control of the Ministry of Finance, there is no mention of any alterations to paragraph 26 of the Bundesbank Law.[38] Waigel and Tietmeyer's testimony before the Bundestag budget committee reveals that both were aware of, and looked favorably upon, a revaluation of the gold and foreign reserves before the start of monetary union. Indeed, the Finance Ministry, together with the Bundesbank, had been working on the revaluation concept in principle for several months, but had been in no rush to push legislation on the subject. The deterioration in the government's finances was the catalyst that pushed revaluation to the fore.

There were two things that Kohl and Waigel had not counted on. The first was that Tietmeyer could not deliver the Bundesbank's acquiescence. Although many members of the Council were friends of Kohl and Waigel, they did not constitute a majority of the 17 member Bundesbank Council. Six of the 17 were affiliated with the SPD and at least three others, including the bank's chief economist Otmar Issing, were politically-independent monetary hawks. Together, this group of nine formed a blocking majority to the government's revaluation plan which they felt was de-

signed to use the Bundesbank to bail the government out of a fiscal crisis. Tietmeyer managed to reassert his leadership role in drafting the Council's response to the government proposal. With his own supporters, Tietmeyer was able to frame a position that preserved the concept revaluing the national reserves closer to market levels, but one that objected to a special distribution in 1997.[39]

On 28 May, following its Central Bank Council meeting, the Bundesbank issued press release that followed the lines that Tietmeyer had laid out. The statement supported an eventual revaluation of Germany's gold reserves and the allocation of the gains to the Fund for the Redemption of Historic Liabilities; however, it rejected an immediate revaluation for the 1997 fiscal year declaring that

> the detailed special provision for the years 1997 and 1998 envisaged so far in the concept of the Federal Minister of Finance may be regarded as constituting interference in the task of compiling and approving the balance sheet, which falls within the Bundesbank's field of responsibility, and hence as an infringement of the Bundesbank's independence.[40]

In part because of Tietmeyer's cautions about the inflammatory nature of the gold revaluation plan during his testimony in March, Kohl and Waigel had hoped that the Bundesbank Council would shy away from a public conflict with the government over a matter that was mostly about the timing of the revaluation. From the government's point of view, the reserves were going to be revalued in any event, so arranging a time to revalue that was most advantageous for the government was hardly improper. Indeed, it was something that they thought should be within the purview of the legislature. The Bundesbank statement was an enormous setback for the coalition because it made them confront another development for which they were unprepared: the extent to which the Bundesbank's public opposition to the revaluation would inflame popular sentiment against the government. The central bank's resistance enabled the SPD to argue that its opposition was non-partisan, something it would not have been able to claim if the Bundesbank had remained silent on the matter.

Aware that the Bundesbank's rejection of gold revaluation created problems for their fiscal plans, the coalition responded rapidly in a massive show of party unity. The Chancellor backed by Finance Minister Waigel, Economics Minister Wolfgang Gerhardt (FDP), and other leading mem-

bers of the coalition parties reaffirmed their commitment to revaluing the gold reserves and their intent to introduce legislation to compel the Bundesbank to do so during the 1997 fiscal year.[41] This did nothing to staunch the collapse in public support for the government's position. The nation's national newspapers sided with the Bundesbank and refused to support the government's action. Both *Handelsblatt* and *Frankfurter Allgemeine Zeitung* carried leading editorials at the end of May denouncing the government's attempts to revalue gold. Neither saw the revaluation itself as particularly problematic, rather they believed that such financial moves would encourage other countries to flout the Maastricht criteria. Furthermore, open conflict between the government and the Bundesbank undermined international confidence in the German economy. Other major newspapers viewed the situation in much the same way.[42]

The schism between the government and central bank troubled international financial markets, too. Speculators, who had begun to reconcile themselves to the launching of the euro, became less certain that the single currency would begin on schedule. As had often occurred in the previous five years, money began to move from the weaker European currencies into the deutschmark. The mark fluctuated sharply in trading at the end of May. A postponement in EMU raised the specter of a vastly appreciated deutschmark and the subsequent undermining of German exports on international markets. On the one hand, a desire to 'cap' the deutschmark and stabilise its export markets had contributed to the German government's agreement to monetary union back in 1991.[43] On the other hand, if the government could successfully override the resistance of the Bundesbank there was the possibility that other nations would follow the German example and come up with ever grander bookkeeping tricks to bring their budgets into balance. This would make the euro an even softer currency than had been expected and thus might trigger a flight out of the deutschmark. The speculators were uncertain about which direction to speculate. The financial unrest resulting from the ongoing argument with the Bundesbank endangered the exchange rate stability the government was attempting to ultimately cement with EMU. Normally loyal business leaders also expressed concern about the open disagreement between the Bundesbank and the government. Hans-Olaf Henkel, President of the Federation of German Industry (BDI), expressed

bewilderment at the government's plan and urged the two sides to reconcile their differences as quickly as possible. The leader of the Federation of German Banks also criticised the government and echoed Henkel's call for compromise.[44] For the government, this financial turmoil both reinforced the necessity of EMU and heightened their awareness of the risks they were running in their public feud with the Bundesbank.

The already intense conflict intensified further at the start of June, when Tietmeyer suggested to Waigel the possibility of postponing EMU. A technical achievement of the Maastricht criteria at the cost of a risky and unpopular battle with the Bundesbank would not bolster confidence in the single currency. *Der Spiegel* reported that Tietmeyer had told friends in banking circles: 'we need to have a plan to delay monetary union'.[45] A Bundesbank spokesman heatedly denied that Tietmeyer had advocated a delay in monetary union stressing that the disagreement between the Bundesbank and the government was restricted to the issue of revaluing the nation's gold and foreign reserves.[46] Tietmeyer himself issued a statement denying press reports that he favored a delay in monetary union. Again he stressed the limited nature of the disagreement with the government and indicated that the distribution of an extraordinary unrealised gain in 1997 was the only major point of contention between the Bundesbank Council and the government.[47] When Tietmeyer's statements were taken alongside the *Der Spiegel* article, there was a clear message for Kohl and Waigel: abandon plans to revalue the gold reserves or the Bundesbank would oppose EMU. Tietmeyer was in an awkward position, attempting to support his old colleagues in the government but also having to obtain the agreement of the Bundesbank Council for whatever agreement he reached with them.[48] Tietmeyer's interview and statement did contain an indication of where he could make a compromise—so long as the government lived up to its rhetoric regarding the sanctity of the convergence criteria and the avoidance of financial 'tricks', the Bundesbank would not stand in the way of monetary union.

International events also conspired to add pressure to the Kohl government. In France, Jacques Chirac's gamble that the right would win a snap election, thus ensuring that they could pass the tough austerity measures needed to meet the Maastricht criteria, backfired badly. The So-

cialists together with the Communists and Greens emerged with a narrow parliamentary majority after the second round of elections on 1 June. This raised additional concerns in Germany that France would pursue a reflationary strategy. Any German budgets that looked like they contained bookkeeping tricks might be used as precedents for further spending and borrowing in France. Several leading Socialists, including the incoming prime minister, Lionel Jospin, had indicated they intended to pursue precisely this strategy once in office.[49] This threatened the international dimension of Germany's EMU strategy and promised to make the task of selling the euro to the German public even more difficult.

On 3 June, the SPD and Greens tabled a motion in the Bundestag to debate the revaluation of the gold reserves and for a vote of no confidence in Finance Minister Waigel.[50] There were rumblings on the government backbenches as well and in the opening days of June it was not entirely clear that the coalition would be able to win such a vote. The CDU's Minister-President of Saxony, Kurt Biedenkopf, told a television audience he thought the Bundesbank's position was entirely justified.[51] At least one CDU backbencher, Jürgen Augustinowitz, had announced that he would oppose the gold revaluation in the Bundestag.[52] A group of several dozen members of the CDU's delegation from North Rhine-Westphalia met at the end of May to discuss the controversy. They passed no formal motions, but the general sentiment of the participants was that the government should not antagonise the Bundesbank. The coalition's floor leaders were not certain that their usually effective disciplinary measures could keep enough members from casting a protest vote against the government. Losing a vote of no confidence in the Finance Minister would have been an unmitigated disaster for Kohl's government.[53]

On June 3, Chancellor Kohl returned from the International Monetary Conference at Interlaken, Switzerland, where he had defended the government's revaluation plans before the international banking community.[54] Early that morning he had a meeting with the leaders of the coalition parties where they had to review the budget and the impending collapse of the government's international and domestic strategies. While agreement on the outstanding differences between the FDP and the CDU over taxes remained unresolved, the participants quickly agreed that they needed to

take a new approach with the Bundesbank since further conflict with the central bank had become the source of their other political difficulties. The public disagreement had damaged the position of the government and endangered its hold on office. Instead of confrontation, the coalition's leaders decided to seek a compromise, which in practice became acceptance of the Bundesbank's position. The budget committee of the CDU suggested that the proposed revaluation of the Bundesbank's reserves should occur in 1997 as the Finance Minister had suggested but that the first distribution of any gains should not take place until 1998. The government would not be able to use the gains to offset deficits elsewhere in the budget during the crucial year of 1997. Waigel met Tietmeyer at the Finance Ministry to propose the compromise. While the two men reached no firm agreement, the outlines of a compromise agreement were clear enough for them to make a statement to the press. Waigel was able to return to a meeting of the coalition parties with the news that the government intended to accommodate the Bundesbank's concerns.[55]

The government still had to defeat the planned vote of no confidence scheduled for 4 June. The truce with the Bundesbank, the day before the no confidence debate, removed much of the sense of crisis that had been growing around the debate. Waigel began the debate by pointing to the government's new understanding with the Bundesbank and his ongoing discussions with Tietmeyer that would allow the gold reserves to be revalued but with the first distribution to occur in 1998 rather than 1997. Then he revisited the political difficulties that the government faced: the cost of unification, the opposition's blockade of the Bundesrat and the demands of monetary union. The government's long-stalled tax reform would resolve many of the revenue problems, Waigel argued, but the cynical blockade of the SPD prevented it from going into effect. Still, the government would remain committed to its goals and even without the gold revaluation could balance its books through a variety of privatization measures and a budget freeze. Furthermore, for the rest of 1997, Waigel announced, every expenditure above DM1 million would require his express approval. He intended to do whatever was necessary to meet the terms of the Maastricht Treaty and introduce the single currency.[56]

The opposition's case against Waigel and the overall economic performance of the government was harsh. The SPD's Rudolf Scharping had the first response to Waigel's statement. Brandishing a pile of newspaper clippings, Scharping went through the denunciations of Waigel's stewardship of the economy with relish. Reaching the issue of the gold reserves, Scharping bemoaned the damage that the government's actions had done to the international credibility of German financial policies and to the reputation of the Bundesbank. Other opposition speakers followed, each criticizing the government's apparent powerlessness in combating the rising tide of unemployment and the danger of financial instability that would result from raiding the country's foreign currency and gold reserves.

After several acrimonious hours of debate, Helmut Kohl spoke in support of his colleague. Declaring that 'Waigel remains. That is that', Kohl reiterated Waigel's account of the government's compromise with Tietmeyer. From there his speech bore little resemblance to the speeches that had proceeded him. The other speakers had generally been filled with an analysis of the budget, national economic statistics and other convenient or damning facts. In contrast, Kohl addressed the broadly political issues raised in the debate. His comments were at times lofty platitudes without substance, as when he dwelled on the general preparations for the single European currency and his view that European integration provided the basis for peace and freedom in the new Europe. At other times, they addressed the tough political issues facing the German government and the various parties, as when he dismissed Scharping's call for new elections by pointing out the long list of upcoming elections and the SPD's intention to name a Chancellor-candidate only after the March 1998 elections in Lower Saxony. Of the previous speakers, only Joseph Fischer of the Green Party, whose analysis of how the personality struggles within the CSU and contradictions between the CDU and the 'tax-cutting Ayatollahs' of the FDP created a 'self-blockaded' coalition, had provided as broad-based a view of the German political situation as Kohl. Of course, where Kohl believed the government was on the right track, Fischer concluded that it was finished.[57]

Kohl's speech, perhaps befitting a Chancellor, had been vague on specifics and he had not explained how a government so committed to EMU could come so close to derailing it. Whatever

meager chance the opposition parties might have had to convince their fellow representatives in the governing parties to desert the coalition in the no-confidence vote was eliminated by the appearance of Oskar Lafontaine. Lafontaine, Minister-President of the coal mining-region of Saarland, had addressed the protesters during the coal demonstrations the previous month and had denounced the members of the Bundestag for attempting to sellout the livelihood of the miners. Whatever the effects of his speech on showing solidarity between the SPD and the miners, it had contributed to the violent atmosphere surrounding the protests and had infuriated members of the governing parties. When Lafontaine rose to speak in the Bundestag debate, he quickly became engaged in an acrimonious and bitter exchange with the CDU-CSU floor leader, Wolfgang Schäuble, over the propriety of his earlier remarks to the coal miners where Lafontaine had called parliamentarians '*Pfeifen und Flaschen*'. Schäuble demanded that Lafontaine apologise for his 'outrageous' attack on Parliament, comparing Lafontaine's attacks on Parliament in front of street demonstrators with those of the Communists and Nazis in the 1930s. Lafontaine made a half-hearted apology to the members of the Bundestag who had supported the miners—notably not including the members of the government—which only served to throw further fuel on the partisan fire and caused several dozen government members to walk out in protest. The Bundestag was in an uproar and the President of the Bundestag had to call Schäuble and his agitated colleagues to order so that Lafontaine could finish speaking.[58]

In the end, Kohl's prediction that Waigel would remain in office proved correct. Although opposition speakers savaged the Finance Minister's economic policies, his timely capitulation to the Bundesbank had reassured the coalition's Bundestag delegation and robbed the opposition of the issue they needed to break the grip of the party discipline. Strictly along party-lines, the Bundestag rejected the opposition's no confidence motion by a vote of 328-311.[59]

The coalition resumed its internal negotiations over how the budget could best be brought into balance and the SPD continued its blockade of the Bundesrat. Negotiations between the Finance Ministry and the Bundesbank were concluded within two weeks. The outcome was along precisely the lines that Waigel spelt out to Tietmeyer on June 3. Everything the Finance Minister

had proposed in May 1997 was agreed to except the timing of the distribution. The Bundesbank's working capital was increased and a currency volatility fund to handle the repercussions of the revaluation was created. The Bundesbank, in line with the government's request, agreed to revalue it gold and foreign reserves in 1997, with distributions to the Fund for the Redemption of Historic Liabilities taking place in 1998. No special distribution took place in 1997.[60]

## CONCLUSION

The government's desire for monetary union and a strict interpretation of the Maastricht criteria led it to attempt a maneuver that eventually triggered the crisis which came very close to derailing the whole EMU project. While the German political class was largely in favor of EMU, this did not prevent them from using the constraints it imposed on the government to their own partisan advantage. The ability of political parties to pressure their opponents, coalition allies and even fellow party leaders can be seen in the different strengths of different groups and individuals within Germany's political institutions. The story of the gold revaluation crisis is largely a story of how these institutions were used to further the potential electoral prospects of various political actors.

The SPD, in the minority in the Bundestag, controlled a majority of the Bundesrat. The leaders of the SPD have been able to use the Bundesrat's consultative and amendment powers to protect the interests of SPD constituents and block the governing coalition's attempts to reform various parts of the welfare state. The opposition's orchestrated campaign of obstruction prevented the government from implementing many of the programs it claimed were necessary for streamlining the German economy and made fulfillment of the Maastricht criteria more difficult.

Within the coalition, the FDP has used its opposition to tax increases as an issue to define its own image in a way distinct from the other major political parties. The unique nature of the CSU, as a member of the coalition and as a governing party with its own power-base in Bavaria, provided further partisan stresses within the coalition. While the CSU was partially coopted by Theo Waigel's responsibility for the Finance Ministry, the party has its attention concentrated on events in Munich at least as much as it does on those in Bonn. With right-wing nationalists threatening the CSU's absolute majority in the Bavarian Landtag, Edmund Stoiber and his associates in

the Bavarian government had some very compelling incentives to deviate from the Bonn coalition's announced policies and take a hard-line position on fulfilling the Maastricht criteria.

Even the Bundesbank itself was not immune from partisan political tendencies. For while the central bank is independent of government instructions, Lander governments and the Chancellor appoint its members, many of whom have long-standing ties with the parties that have appointed them. The combined opposition of both the SPD and non-political members of the Bundesbank Council was necessary to block Bundesbank approval of the gold revaluation; however, Kohl and Waigel's expectation that Tietmeyer could deliver a majority of the votes on the Council in support of their plan precipitated their attempt to take advantage of upcoming changes to the Bundesbank's accounting procedures.

When the risks they were taking became clear, the government backed down rather than risk the whole EMU enterprise in one high-stakes showdown with the Bundesbank. Ironically, the adverse budget figures which had precipitated the Finance Ministry's panicked response evaporated by the end of 1997. Not only did Germany comfortably meet the deficit criteria with a deficit to GDP ratio of 2.9 per cent, but Italy met the targets as well at 2.7 per cent.[61] As the dawn of the euro era approached, the Kohl government weathered a difficult economic and political climate and succeeded in its international strategy of assuring its EU partners' compliance with the strict terms of the convergence criteria. This success disarmed Kohl and Waigel's domestic opponents and opened the path to German membership in EMU. However, success did not always come on the terms they desired. When it came to meeting the convergence criteria, they both became prisoners of their own rhetoric which forced them into accepting terms acceptable to the majority of the Bundesbank Council.

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[61] 'Deutsche Euro-Teilnahme gesichert', *Frankfurter Allgemeine Zeitung*, 28 February 1998, p. 1. While the Italians finally slipped beneath the 3.0 per cent hurdle courtesy of a one-time refundable 'euro tax' and several dubious bookkeeping maneuvers, their success was in large measure due to their extraordinary efforts at fiscal consolidation that had pared the national budget deficit from more than 10 per cent of GDP to around 3 per cent in just five years.

## The Minda de Gunzburg Center for European Studies

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