

The consequences of the Constitutional Court's ruling. Ways out of the German fiscal crisis

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In its ruling on 15 November 2023, Germany's Federal Constitutional Court (FCC) has challenged the methods of funding the federal government's expenditure, thus forcing the coalition parties to seek ways out of this difficult situation. Although suspending the 'debt brake' (*Schuldenbremse*) again in 2023 and also 2024 is hardly avoidable, in the long term the government will need to implement systemic solutions. These may include exempting strategic investment projects (such as those carried out in the field of energy transition) from the application of the 'debt brake', or establishing a separate pool of funds for this purpose, modelled on the Bundeswehr fund which is enshrined in the constitution.

The FCC's ruling not only challenged the reallocation of €60 bn in the 2021 budget to the Energy and Climate Fund (KTF; for more see '[Germany: the Constitutional Court deprives the government of €60 bn earmarked for transformation](#)'). It effectively questioned the system of public finances as a whole, which the coalition had agreed upon as part of a compromise between the parties so it could both obtain subsidies and maintain the constitutional 'debt brake'. The ruling has cast doubt on the operation of other federal government resources, in particular the Economic Stabilisation Fund (WSF), which has €200 bn at its disposal and has been used to stabilise prices on the energy market. Doubt has also been cast on the legal basis for the disbursement of several billions of euros from a special fund for the reconstruction of the Ahr river valley which had been damaged by flooding in 2021, as well as Olaf Scholz's 2020 decision (at that time he was the federal minister of finance in the CDU/CSU–SPD government) to earmark €26 bn to combat climate change.

The 'debt brake' is suspended again

In the present legal environment, the government has no other option but to launch a difficult period of adjusting public finances to the FCC's ruling. A crucial element of these actions will be amending the budget law to earmark €37 bn in the federal budget for energy price freeze mechanisms, as well as several other purposes worth a total of €45 bn. This will clearly exceed the spending limits set by the 'debt brake'. Although finance minister Christian Lindner has announced a blockade on new spending and commitments by several specific ministries, this situation will not change, and it will be necessary to retroactively suspend the 'debt brake' for 2023.

The problem is that there is no clear justification for such a step, which will certainly raise doubts among constitutionalists. The energy crisis, which is most often cited as a possible pretext, emerged in 2022 due to the Russian invasion of Ukraine and the turmoil on the gas

and oil markets. While the effects of this crisis are still evident, the justices in Karlsruhe may view the absence of a clear temporal coincidence between these developments as justification for them blocking the government's actions once again. However, it is even more difficult to imagine a scenario in which the justices would be convinced by the references to 'war and destabilisation in the Middle East' or the 'polycrisis', advocated by some politicians of the SPD and the Greens. The minister for economic affairs Robert Habeck has mentioned the 'polycrisis' in interviews. Therefore, the most likely justification for suspending the *Schuldenbremse* would involve the intention to maintain energy security, further backed by the argument that the FCC's ruling has radically altered the terms for funding in this field.

The paths of reform

Solving the problem of next year's budget, which has not yet been approved by the Bundestag, will likely be even more difficult. The government has planned to spend around €20 bn from the WSF and at least a portion of the challenged €60 bn from the KTF. Most likely, these funds will be subject to another suspension of the 'debt brake', although this will require an attempt to find a more robust legal base for government spending. Therefore, a heated debate on the future shape of public finances should be expected.

A seemingly obvious way out of the crisis would involve introducing an austerity policy. However, this would trigger two processes. Firstly, it would aggravate the already painful economic crisis, as smaller government spending equals reduced global demand; another consequence could involve a deterioration of public finances, as in the situation of a recession the proportion of public debt to the GDP could rise, rather than fall. Secondly, the actual scope of these restrictions would most likely be limited. Many spending programmes have already been launched as part of the government's commitments, and withdrawing them would have significant costs. It is also difficult to imagine that the coalition would quickly agree on which areas of public spending should be most affected by cuts: the social welfare policy (including the *Kindergeld* family allowance and the citizen's allowance known as the *Bürgergeld*), investments in climate and energy policy, or the subsidies offered to support the economy. Thirdly, overly extensive cuts would trigger the risk of the anti-system opposition gaining ground. Support for Sahra Wagenknecht's party and the AfD could rise by several percentage points among people affected by spending cuts. As a consequence, these parties would obtain strong political arguments which they could use in future electoral campaigns.

For these reasons, it should be expected that attempts will be made to carry out a comprehensive reform of the constitutional 'debt brake'. One such attempt could involve adding a special clause to the relevant regulations in order to exempt investments of strategic importance to the economy, in particular regarding energy transition, from the restrictions. This would require support from the CDU/CSU, which will most likely set a high political price (such as more restrictive budget cuts) for abandoning its principled approach to the 'debt brake'.

The coalition's FDP may be another obstacle, as it has openly voiced its concerns about the plan to expand the scope of exceptions and interpretations in the government's financial policy. Indeed, citing the need to protect 'investment', the government could attempt to approve spending plans which are insufficiently linked with Germany's strategic goals. For

example, an increase in social welfare benefits could be justified by the need to protect consumers and companies against high electricity prices. However, opponents of reform to the 'debt brake' should remember that due to the FCC's ruling several German federal states may face a difficult situation. Berlin, Bremen, North Rhine-Westphalia, Schleswig-Holstein and Saarland have used their own methods of circumventing the constitutional rules which were similar to the one applied at the federal level. Strong opposition to the proposed amendments may pose a problem for the Christian Democrats who co-rule some of the states.

The Bundeswehr fund as a model

Due to the complexity of the proposed exemptions from the application of the 'debt brake', the participants in the political dispute may seek another solution to this problem. The proposal involving the establishment of a special investment or energy transition fund, which would be enshrined in the constitution, offers good prospects for reaching a compromise. The Bundeswehr fund worth €100 bn, which was established in spring 2022 through a constitutional amendment, may be viewed as both a precedent and a model for such a solution. The Christian Democrats, whose votes were required for this solution to be implemented, supported it for a number of reasons, including the fact that its operational framework and spending purposes had been defined in great detail.

In this way the mainstream parties, acting in concert, could establish a new 'constitutional fund' with €200 bn available to it over the next five years. The opposition should also be involved in these efforts, and should be able to wield considerable influence on the decisions regarding the specific spending categories. It is likely that the Christian Democrats will be interested in such a solution because funding the energy transition is a long-term problem which future governments will also need to tackle.

The political aftershock

However, even if this reform is carried out on the basis of a surprisingly strong consensus, and can help to find a way out the present situation, it will have further consequences. For example, a debate on how to pursue the climate protection policy is inevitable. Aside from the currently prevailing narrative that this policy requires increased public funding – which will also translate into bigger public debt – the debate will also have to cover issues of supply. These involve the proposal for the transition to be based to a greater degree on the market valuation of CO₂ emissions and on trade in certificates. This may trigger a general impetus to modify German economic policy to make it more liberal and less interventionist. Lars Feld, a former chairman of the German Council of Economic Experts, has suggested that the present coalition should make such a move: the SPD should abandon the implementation of expensive social welfare programmes, the Greens should cancel some energy transition subsidies, and the FDP should give up tax reliefs.

The political crisis over the public finances may also have other less obvious consequences. It cannot be ruled out that criticism of the FCC's operation will mount. This is because in its 15 November ruling it failed to specify methods for combatting the crisis, nor did it define transition periods within which the government must arrive at a legally valid solution. It merely annulled those decisions which it had recognised as being in violation of the Basic Law, with immediate effect. Numerous professional groups, economists in particular, have voiced doubts whether the justices' ruling has taken the state's stability and security into

account, as these issues should be given consideration in the context of the magnitude of the 'cancelled' €60 bn sum. Moreover, in another ruling on 29 April 2021, the FCC highlighted the constitutional importance of climate protection, while in its recent decision it challenged the methods of funding the climate protection policy. This indicates that Germany may soon face an interesting debate on the limits of this body's decision-making power, which may potentially have serious consequences.

Europe's concerns

None of the scenarios for the development of the situation in Germany envisage a halt in the operation of government bodies resulting from the Bundestag being unable to pass the budget law, which would resemble the US government shutdown. Also, the Scholz coalition does have a sufficient majority in the Bundestag to suspend the 'debt brake'. There are also prospects for reaching an agreement with the opposition as regards the new fund, because the Christian Democrats do not have any specific interest in blocking the ways out of the crisis. However, if no agreement is reached, the risk of halting or reducing some budgetary expenses will rise significantly. This also involves foreign policy including financial, military and humanitarian assistance to Ukraine. In recent days this issue has sparked major concern both in Kyiv and in the capitals of EU member states, especially in Central Europe. It is also likely that Germany may soon become a much more difficult partner in talks to increase the EU budget in line with the proposals put forward by the European Commission and the southern EU member states.

The FCC's ruling also equates to a rejection of Berlin's arguments in debates on the reform of EU financial institutions. The plan to convince Germany's EU partners to also implement a 'debt brake' turned out to be an illusion. This 'brake' was viewed as a German 'export commodity' in the field of public finances, and it was based on an idea which should be more firmly rooted in the Stability and Growth Pact. However, Europe may be interested in the concept of 'constitutional funds' as effective tools to fund strategic investment projects and build a broad political consensus around them.