

## One state, one interest?

How a historic shock to the balance of power of the Bundesbank and the German government laid the path for fiscal austerity

*Inga Rademacher*

*King's College London*

*Department of European and International Studies*

Table 1) General government expenditures; average annual growth rates (1974-2014), percentage

	Final consumption expenditure			Social transfers			Gross fixed capital formation		
	1974-1979	1980-1989	1990-2014	1974-1979	1980-1989	1990-2014	1974-1979	1980-1989	1990-2014
Denmark	3.08	1.01	1.71	4.60	1.31	0.16	13.87	4.73	5.37
Finland	4.80	3.69	1.18	5.46	2.50	1.63	16.41	11.42	4.33
Sweden	3.72	1.54	1.10	5.09	0.97	-1.23	9.28	9.43	4.25
Norway	5.24	2.60	2.71	-1.99	3.02	-0.48	12.17	10.67	6.00
Germany	3.74	1.00	1.80	3.31	-0.77	0.11	6.82	1.28	3.59
France	4.58	2.84	1.66	0.15	0.84	0.90	12.07	11.88	2.44
Austria	3.70	1.62	1.83	1.19	0.56	0.39	8.33	2.27	2.99
Netherlands	13.50	3.67	4.77	4.09	0.13	-1.77	9.38	2.41	4.00
Belgium	3.73	1.26	1.50	4.98	-0.73	0.42	11.78	-1.70	4.98
Japan	5.00	3.47	2.17	10.02	-1.92	2.41	14.21	3.76	0.17
Italy	3.57	2.87	0.45	1.93	-0.10	1.29	21.26	18.66	2.16
Spain	5.82	4.76	3.08	na	0.90	0.44	14.08	26.28	2.48
Portugal	8.93	5.37	1.74	na	1.31	2.33	41.44	20.45	4.66
UK	1.92	0.76	2.04	2.80	-0.16	1.14	6.56	9.40	6.30
Canada	3.21	2.14	1.45	1.06	2.13	-0.03	na	na	na
USA	1.49	2.64	1.13	1.90	1.06	1.72	9.79	9.18	3.44
Average	4.75	2.58	1.90	3.18	0.69	0.59	13.83	9.34	3.81

# Austerity

- *Pierson (2002) 'fiscal stress'*
  - fiscal discretion constrained
  - simultaneous pressures of rising needs for spending
  - limited room for finance
  - endogenous pressures: of a post-industrial society stagnating productivity, ageing and unemployment lead to rising expenditure needs (Pierson 1998; 2002)
  - Structural pressures: rising levels of sovereign debt generate; financial markets constantly monitor the 'soundness' of fiscal decisions (Streeck, 2014; Streeck and Mertens, 2011)

# Existing Explanations don't analyse within-state relations

- A) Capital mobility around breakdown of the Bretton Woods system
  - more independent central banks (Schelkle 2012)
  - consolidate budgets in face of tax optimisation (Lierse and Seelkopf 2016)
- *However, state actors often clash over policy goals*
  
- B) Ideational change leads to policy change (Blyth 2002; Hay 2016; Schmidt 2010)
- *However, ideas often considerably differ between state actors*
  
- C) Institutionalism/VoC approach looks at interaction wage bargaining systems and monetary
- *In-depth analysis of how ideas travel from one realm to another*

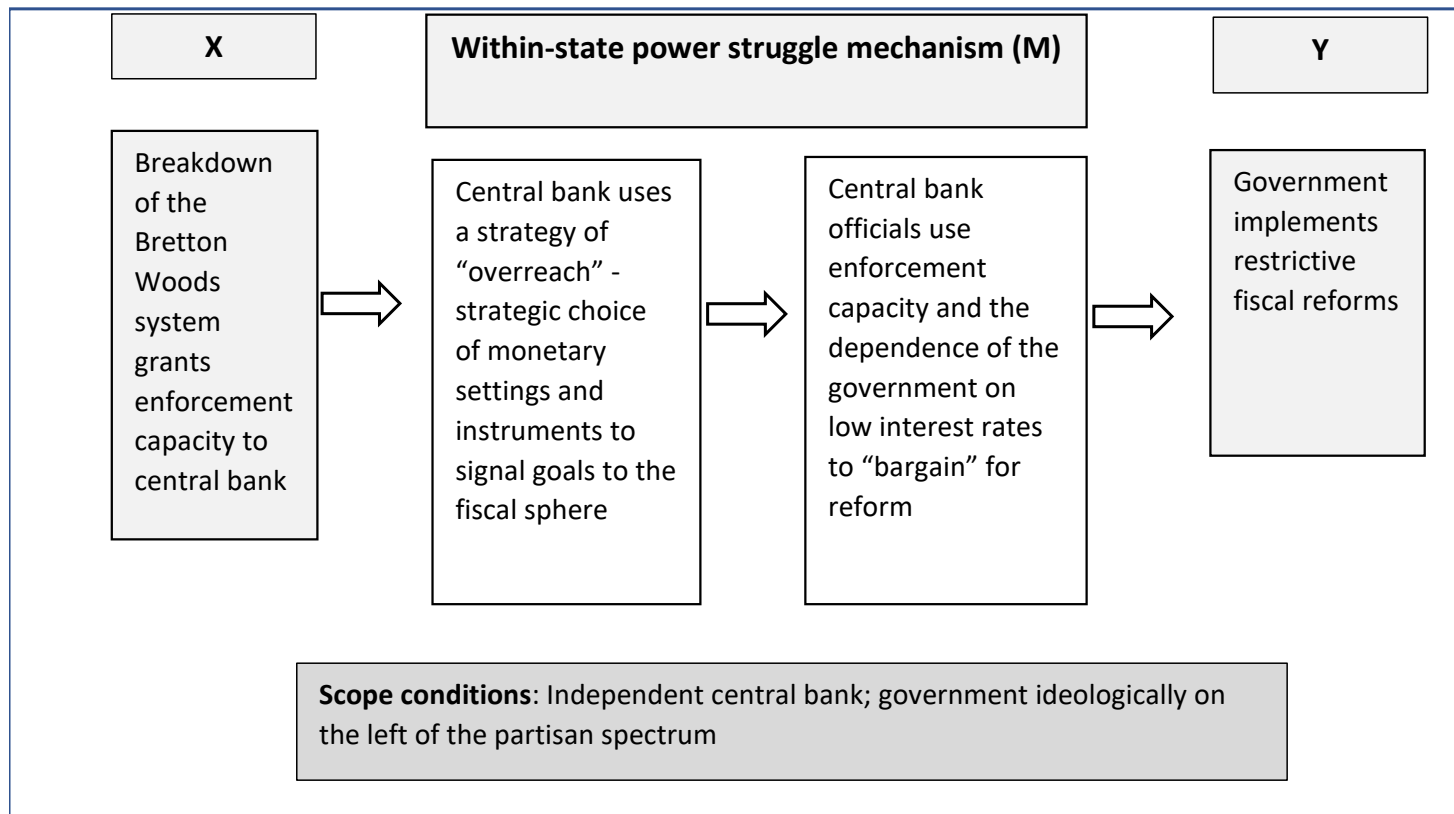
# Data and Methods

- Theory-testing process-tracing technique (Beach and Pedersen 2013)
- Develop a causal mechanism of power struggles between the central bank and the government following the breakdown of the Bretton Woods system
- Test it on the most-likely case Germany (1960-1981)
- Bundesarchiv Koblenz & the Historical Archive of the German Bundesbank

# Theory

- Critical junctures (historical institutionalism) & central bank literature
- CJ moments in institutional development in which an event or a series of events generates a phase of uncertainty among policy actors, which opens up an extended range of policy options after ‘structural (economic, cultural, ideological and organisational) influences on political action are relaxed’ (Capoccia 2015)
- Powerful actors use institutional power to steer outcomes (Capoccia and Kelemen 2007)
- **Applied:**
- Float freed the Bundesbank from the obligation to defend the parity of the DM and allowed it to use interest rates to bring down excess liquidity
- **Overreach:** selectively introduce new monetary instruments to strategically signal to fiscal sphere
- **Bargaining:** use institutional power (interest rates) and the political and economic circumstances to intervene into fiscal sphere

Figure 1) The within-state power struggle mechanism and its scope conditions



# The Process

- **Step 1)** 1970s, Eurodollar markets ‘hot money crises’ limits capacity of Bundesbank
- Float: free of the exchange rate obligation; enforce more restrictive course of monetary policy
  
- **Step 2)** Debates: dirigisme vs monetarism
- ‘dirigiste’ approach: selective credit controls
  - support (president of the Bundesbank, Karl Klasen)
  - ‘the Bundesbank’s power position would be diminished’ because the government could use credit ceilings to implement quotas or enforce the supply of central bank money or credit to the federal government. These types of obligations ‘weakened the power position of the central bank’ (HA BBk, 18.01.1973, B330/6701/2).
- The target was supposed to give an ‘orientation to the economy as a whole’, but to ‘the social partners and the state in particular’ (HA BBk, 1974, B330/7499/1).
  
- **Step 3)** tightening policy (institutional power) and used economic and political conditions (1979 second oil crisis and Schmidt’s interest to implement a stimulus package ‘locomotive’)
- Government set up a debt lid



# Conclusion

- Institutional power structurally distributed the enforcement capacity of central banks
- **Future research:** test whether other central banks used the technique of *overreach* – if they possess freedoms of implementation – and *bargaining* – if they can weigh their own powers against those of the government depending on the political and economic context.
- **Growth-model literature:**
  - focus on capital mobility (Stockhammer 2016)
  - demand-side view of the economy (Baccaro and Pontusson 2016)
- Add a institutional layer of power to this research