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The Rise of the European Consolidation State

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Abstract

The rise of the consolidation state follows the displacement of the classical tax state, or *Steuerstaat*, by what I have called the debt state, a process that began in the 1980s in all rich capitalist democracies. Consolidation is the contemporary response to the “fiscal crisis of the state” envisaged as early as the late 1960s, when postwar growth had come to an end. Both the long-term increase in public debt and the current global attempts to bring it under control were intertwined with the “financialization” of advanced capitalism and its complex functions and dysfunctions. The ongoing shift towards a consolidation state involves a deep rebuilding of the political institutions of postwar democratic capitalism and its international order. This is the case in particular in Europe where consolidation coincides with an unprecedented increase in the scale of political rule under European Monetary Union and with the transformation of the latter into an asymmetric fiscal stabilization regime. The paper focuses on the developing structure of the new consolidation regime and its consequences for the relationship between capitalism and democracy.

Zusammenfassung

Der Aufstieg des *Konsolidierungsstaats* in Europa folgt der Ablösung des klassischen *Steuerstaats* durch den *Schuldenstaat*, ein Prozess, der in den 1980er-Jahren in allen reichen kapitalistischen Demokratien einsetzte. Konsolidierung ist die Antwort auf die schon in den späten 1960er-Jahren, als die Epoche des Nachkriegswachstums zu Ende ging, erwartete „Krise des Steuerstaats“. Sowohl der langfristige Anstieg der Staatsverschuldung als auch die gegenwärtigen weltweiten Versuche, ihn rückgängig zu machen, sind mit der „Finanzialisierung“ des entwickelten Kapitalismus und ihren komplexen Funktionen und Dysfunktionen auf das Engste verbunden. Der gegenwärtige Übergang zu einem Konsolidierungsstaat beinhaltet einen tiefgreifenden Umbau der politischen Institutionen des demokratischen Kapitalismus der Nachkriegszeit und seiner internationalen Ordnung. Dies gilt insbesondere für Europa, wo die fiskalische Konsolidierung mit einem beispiellosen Zuwachs in der Reichweite politischer Herrschaft in Gestalt der Europäischen Währungsunion und mit deren Transformation in ein asymmetrisches Regime fiskalischer Stabilisierung zusammenfällt. Das vorliegende Papier untersucht die sich herausbildende Struktur des neuen Konsolidierungsregimes und ihre Auswirkungen auf das Verhältnis von Kapitalismus und Demokratie.

Contents

1	From the fiscal crisis of the state to the Great Recession	1
2	Consolidation in hard times	9
3	The European consolidation state	14
4	A new regime	19
5	The consolidation state and democracy	25
	References	26

The Rise of the European Consolidation State

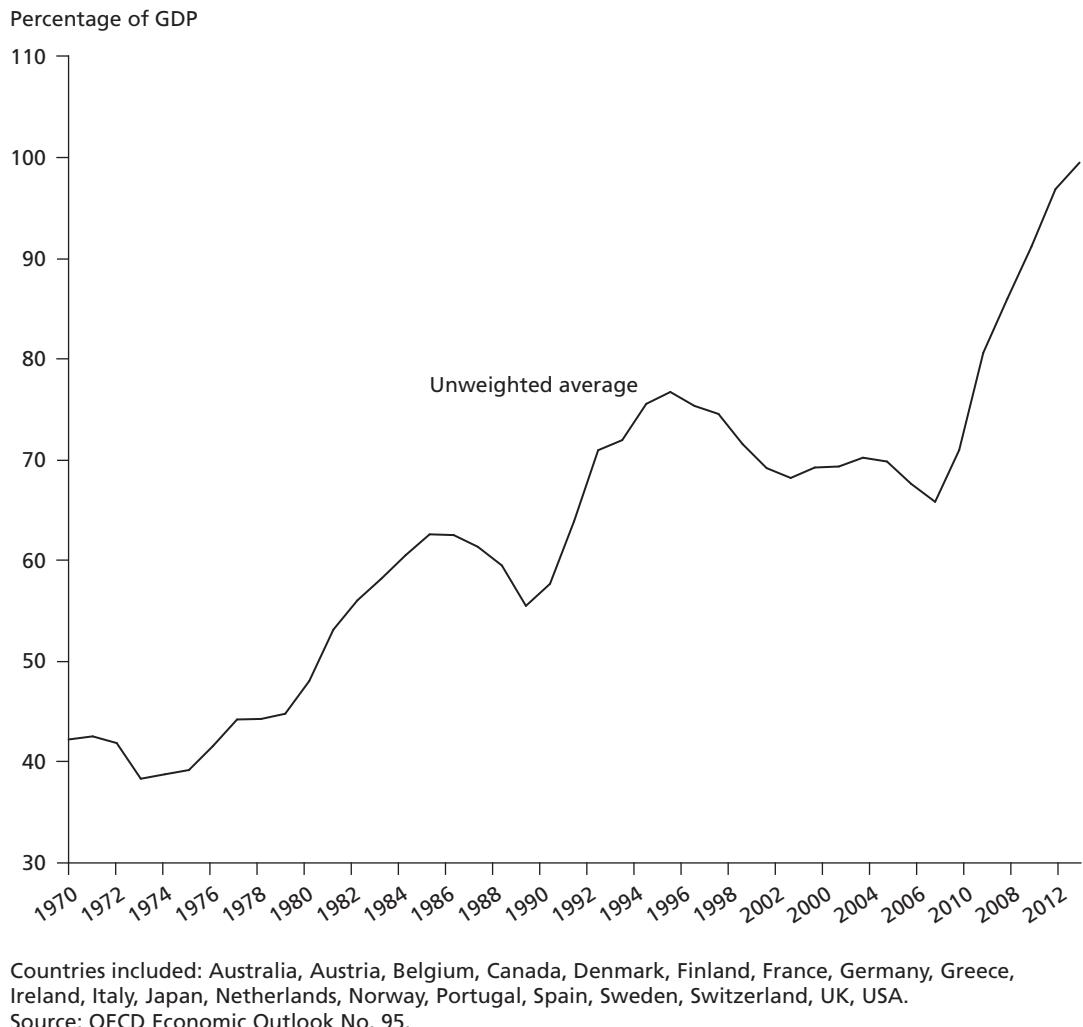
The rise of the *consolidation state* follows the displacement of the classical *tax state*, or *Steuerstaat* (Schumpeter 1991[1918]), by what I have called the *debt state* (Streeck 2014a), a process that began in the 1980s in all rich capitalist democracies. Consolidation is the contemporary response to the “fiscal crisis of the state” envisaged as early as the late 1960s (O’Connor 1970a, 1970b, 1973) when postwar growth had come to an end. Both the long-term increase in public debt and the current global attempts to bring it under control were intertwined with the “financialization” of advanced capitalism and its complex functions and dysfunctions (Magdoff/Sweezy 1987; Strange 1998; Krippner 2005; van der Zwaan 2014). As I will show, the ongoing shift towards a consolidation state involves a deep rebuilding of the political institutions of postwar democratic capitalism and its international order, in particular in Europe where consolidation coincides with an unprecedented increase in the scale of political rule under European Monetary Union (EMU) and the transformation of the latter into an asymmetric fiscal stabilization regime.

In the following chapter I begin by briefly recounting the development that led to current consolidation efforts, with the financial crisis of 2008 as something like a critical juncture. Next I sketch out the domestic and international politics of fiscal consolidation at a time of low growth (or even secular stagnation), a long-term increase in economic inequality, and record-setting overall indebtedness. Following this I will discuss the specifically European dimension of consolidation, in particular the emergence, during the crisis, of an integrated *European consolidation state* as a unique configuration of national states, international relations, and supranational agencies, with fundamental implications for both domestic democracy and the international order. Finally, I look at some of the political-economic consequences of consolidation, especially for the relationship between states, societies, and markets, and for what citizens will be entitled to expect from democratic government and democratic participation in the future.

1 From the fiscal crisis of the state to the Great Recession

By the mid-1970s, the accumulated debt of states in the OECD world began to increase steeply and steadily (Figure 1). Indebtedness rose by and large simultaneously, regardless of country, national economic performance, or the political complexion of the govern-

Figure 1 General government debt as a percentage of GDP, selected OECD countries, 1970–2013



ment of the day. North Sea oil made a difference for Britain, unification for Germany, the rise and fall of defense spending for the United States, but always only temporarily. Indebtedness increased for two decades until the mid-1990s, when debt levels seemed to stabilize. After 2008, however, they rapidly returned to the long-term trend.

A growing level of public debt is the result of cumulative, non-Keynesian¹ deficits in public budgets: of an enduring inadequacy of government revenue compared to government spending. A popular explanation for this is offered by the “public choice” school of institutional economics, which conceives public finance as a poorly managed “common

1 Non-Keynesian, because Keynesian debt is supposed to be paid off as the economy returns to an adequate level of growth and public budgets generate a surplus of revenues over expenditure. Anti-Keynesian economists, in particular in the United States, tried early on to blur this difference by accusing Keynes of having provided spendthrift governments with a good conscience when they overdraw the public accounts (Buchanan/Wagner 1977, 1978).

pool” from which democratic-electoral majorities and office-seeking politicians may satisfy ever more extravagant collective demands without having to assume responsibility for the costs (Buchanan/Tullock 1962). As I have shown, however (Streeck 2014c), the secular rise of public debt in OECD countries coincided with a general, equally secular decline in the political power of organized labor and social-democratic politics, as indicated by long-term sinking rates of unionization, falling participation in national elections, an almost complete disappearance of strikes, high and steady rates of unemployment, stagnant wages and rising economic inequality (Schäfer/Streeck 2013a).

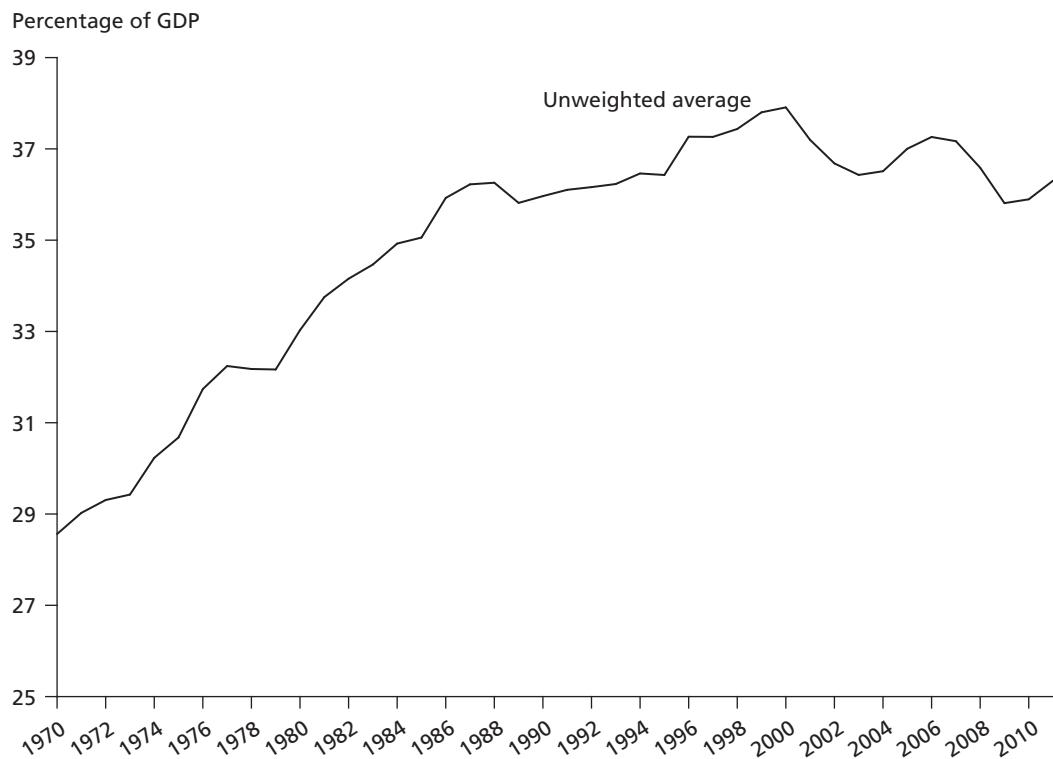
If redistributive democracy didn’t do it, what did? As mentioned above, the Marxist theorist James O’Connor, writing in the tradition of authors such as Schumpeter and Goldscheid (1926, 1976[1917]), predicted already in the late 1960s a widening gap between the fiscal means governments could mobilize under capitalist relations of production and ownership, and the demands on state support made by an advancing capitalist economy. States under capitalism, according to O’Connor, had to provide both the legitimacy and the efficiency of capital accumulation – the former through all sorts of social consumption, the latter through investment in a public infrastructure. O’Connor also expected mounting pressure on state finances by public sector trade unions claiming the same wages and benefits as workers in private industry and thereby exposing the state to the “cost disease” of the service sector (Baumol 1967). It is interesting that Daniel Bell, almost at the opposite end of the political spectrum, found much to endorse in O’Connor’s analysis, although he seems to have placed the emphasis, somewhat like the public choice school, less on functional needs and structural contradictions than on cultural change away from protestant values towards materialistic consumerism, or “bourgeois hedonism” (Bell 1976: 250).

In hindsight, the route from the tax state to the debt state looks less straightforward than one might have expected at its beginning. Empirically, deficits became endemic and debt started to accumulate after the end of inflation in the early 1980s. Before then, high inflation had substituted for real growth by wiping out parts of the public debt, thus slowing down its accumulation. For a while it had also kept up employment.² With monetary stabilization, unemployment became high and chronic, causing social spending to increase until, with a delay of a decade or so, it was again brought under control by neoliberal “reforms.” Up to this point, public debt was basically a matter of the inertia of social security systems functioning as “automatic stabilizers.”³ In addition, however, the end of inflation ended what is called “bracket creep” in the United States: the movement of tax payers into higher income tax rates with rising nominal incomes.

2 On the political functions of inflation and the way they were taken over, in part, by public debt in the 1980s, see Streeck (2011, 2014a).

3 That is, it was *not* a matter of growing demands for public handouts by spoiled citizens. However, unemployment insurance has undoubtedly become essential for the legitimization of the capitalist economic system, and citizen entitlements for support in times of economic stress can be curtailed only at high political risk, at least outside the United States.

Figure 2 Total tax revenue as a percentage of GDP, selected OECD countries, 1970–2011



Countries included: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, UK, USA.
 Source: OECD Revenue Statistics.

Moreover, it reinforced tax resistance in particular among the middle class and lent momentum to calls for “tax reform,” meaning tax cuts that typically most benefited the payers of high taxes – like the Reagan tax cuts of the early 1980s.

Overall, the “fiscal crisis of the state” turned out to be caused less by an increase in citizen entitlements than by a general decline in the taxability of democratic-capitalist societies (Figure 2). While tax revenue had kept pace with public spending by and large until the mid-1970s, by the mid-1980s it began to stagnate until, after a short recovery, it started declining at the end of the century. By 2007, taxation levels were back where they had been twelve years earlier, only to decline further in the course of the financial crisis. A contributing factor was the “globalization” of the capitalist economy, which led to increased tax competition among countries, resulting in tax cuts for corporations and earners of high incomes (Genschel/Schwarz 2013). It also extended the opportunities for owners of capital to evade taxation by moving assets between countries or into international tax havens (OECD 2013). If, in other words, the increasing fiscal problems of the rich capitalist democracies after the 1970s were due a revolution of rising demands, that revolution occurred not among ordinary citizens, but among capital and those in command of it.

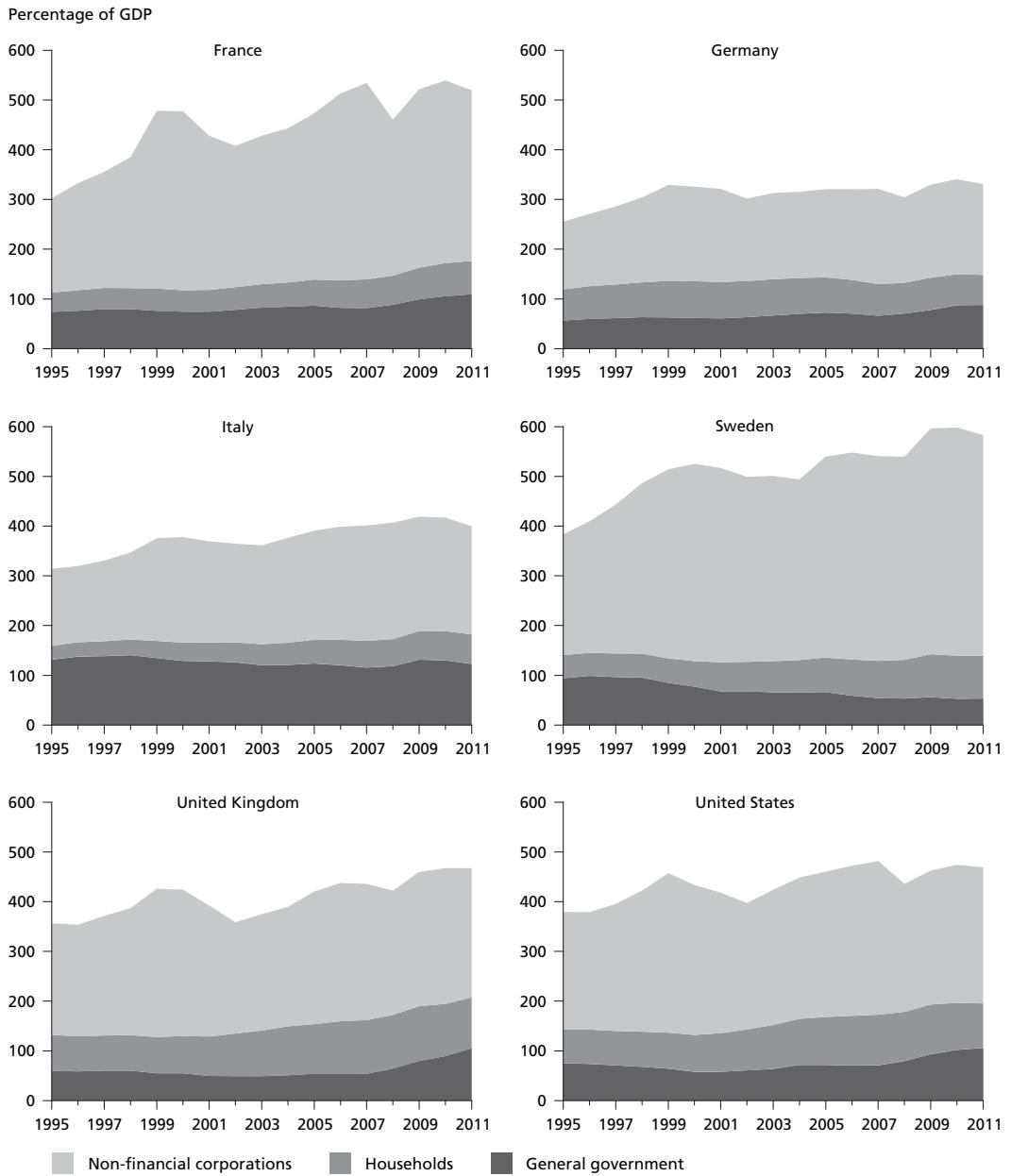
Another respect in which early theories of fiscal crisis had failed to anticipate what was coming was that they underestimated the possibilities of capitalist states to finance deficits for a protracted period of time by borrowing. Actually the rise of public debt in the final third of the twentieth century and beyond was linked to the financialization of the capitalist economy, which in part consisted of an explosive growth of its financial sector and of the amount of credit money it produces. Credit enabled states under capitalism to live with a widening gap between citizen demands and capitalist needs for infrastructural support on the one hand, and the increasingly powerful resistance by taxpayers – individual as well as corporate – to pay the bill on the other. Financialization made it possible for governments to push back the moment when they had to do something about the increasing inadequacy of their fiscal means. Low nominal interest rates, made possible by the return to sound money, helped as they made rising debt levels more manageable; in fact, they soon began luring governments into substituting credit for taxes as the latter became more difficult to collect. There also was an international dimension to the debt state. In particular, the United States began to sell its public debt abroad to sovereign investors, especially to the governments of oil-producing countries looking for opportunities to “recycle” their surpluses and in return gain military protection against regional adversaries and their own peoples.

In subsequent years “financial services” became the most important growth industry by far in both the United States and the United Kingdom (Krippner 2011). After the end of the Bretton Woods monetary regime, with the dollar continuing to be the leading global reserve currency, the United States enjoyed the “exorbitant privilege” (Giscard d’Estaing) of being able to indebt itself internationally in its own currency and repay its debt, if need be, by printing basically unlimited amounts of it. The rich supply of fiat dollars that ensued nourished an expanding financial industry about to turn into the financial sector of capitalism worldwide. Aggressive deregulation of financial institutions allowed for unprecedented “financial innovations” that attracted capital from all over the world and became a major instrument for governments not only looking for new economic growth but also desperately seeking access to credit. Indeed, as the overall credit supply expanded, it was not just states that became increasingly “leveraged” but also corporations and, later, private households. Thus the rise of the debt state became embedded in a movement of advanced capitalism as a whole towards higher and higher indebtedness across the board – with public debt in fact amounting to no more than a small share of overall debt (for six selected countries see Figure 3).⁴

How closely the management of the debt state came to be connected to the leveraging of capitalism in general became particularly visible in the 1990s when the first attempts were made at fiscal consolidation. In the United States, Clinton had won the presidency

4 Figures become even more impressive if the liabilities of the financial sector are added. In the United States, they are today as high as the liabilities of the three other sectors together. Total liabilities, including all sectors, increased from roughly 400 percent of GDP in 1974 to more than 800 percent after 2010.

Figure 3 Liabilities (excluding financial corporations) as a percentage of GDP, by sector, six countries, 1995–2011



Source: OECD National Accounts, non-consolidated data.

in 1992 by promising to do something about “the double deficit” in the federal budget and the balance of trade. The “peace dividend” after 1989 seemed to open a window of opportunity for spending cuts, and that a country like Sweden experienced two successive fiscal crises (1977ff. and 1991ff.) was seen as a general warning signal. Orchestrated by the United States through international organizations like the OECD and the IMF, capitalist democracies made an effort to break the upward trend in their indebtedness by

returning to balanced budgets through spending cuts and reforms of their budgeting institutions (Poterba/von Hagen 1999). Indeed, countries succeeded in the 1990s in bringing down public expenditure to levels that more closely matched their stagnant revenue (see Figure 2). In the United States, this went as far as producing a budget surplus by the end of Clinton's second term. It should be noted, however, that this was due to a large extent to low interest rates made possible by monetary expansion, to savings on defense spending in the wake of 1989 (soon to prove short-lived), to economic growth (especially in the financial sector) inflating the denominator of the debt equation, and to savings on social security (as a result of both low unemployment and cuts in entitlements).⁵

The consolidation attempts of the 1990s responded to, perhaps misinformed, concerns among American voters about high public debt. But one can also assume creditors were concerned about the long-term solvency of sovereign borrowers. In any case, in an era of financial deregulation and expansion, pressures for fiscal consolidation presented an opportunity for cutting back the state in favor of the private sector, by referring citizens to private credit as a substitute for previously free public services. Thus, financialization not only *required* fiscal retrenchment – to ensure the further creditworthiness of sovereign borrowers – it also made it possible, and with it the retrenchment of the state. As households indebted themselves to compensate for cuts in public provision, aided by low interest rates furnished by obliging central banks, they opened the door for the private sector to move into fields that had previously been the domain of government. They also filled the gap in aggregate demand caused by cuts in public spending – an effect referred to as “privatized Keynesianism” (Crouch 2009, 2011).⁶

Far from being unsuccessful, the first wave of consolidation managed to bring down public debt during the decade from the mid-1990s to the eve of the Great Recession (see Figure 1) – helped in Europe by the Maastricht Treaty on European Monetary Union with its debt limits, while hindered in the United States after 2001 by the Bush tax cuts and rapidly rising defense spending. However, all of this was undone when the pyramid of private debt that had grown alongside public debt – all the more so after the increase of the latter had temporarily been halted – collapsed in the financial crisis of 2008. Here again, the close interconnection between the debt state and the financialization of modern capitalism became apparent, as states found themselves forced to absorb the bad debt created by the private sector under financial deregulation. In fact, they had to take up additional debt for stimulus spending to prevent a complete breakdown of their national economies. Ironically, it was the debt that states incurred to protect societies from the fallout of speculative lending and borrowing – encouraged by government policies of deregulation and cheap money – that made “financial markets” suspicious about

5 Between 1993 and 2000, public expenditure in the U.S. declined by four percent of GDP while tax revenue increased by two percent. The 1993 federal deficit of four percent of GDP turned into a surplus of two percent in 2000.

6 See in addition, among others, Prasad (2012), Rajan (2010), and Trumbull (2012).

Figure 4 Long-term interest rates on government bonds, selected OECD countries, 1998–2014



Including Greece would have distorted the scale and made changes in the interest rates for other countries invisible.

Source: OECD Economic Outlook No. 95.

states' capacity to live up to their obligations as debtors. When declining creditor confidence showed itself in rising risk premiums on government bonds from a number of countries (Figure 4), it was time for the *debt state* to be rebuilt into a *consolidation state*.⁷

7 Figure 4 documents that there is no one-to-one relationship between a country's level of indebtedness and the risk premium it has to pay in capital markets – Japan, for example, refinances its huge national debt at record-low interest rates. The figure also shows that sudden jumps in interest rates for just a few countries (one could add Greece, Ireland, Portugal, and others for the post-2009 period) are capable of setting in motion a general effort at regaining market confidence by “reform,” as in the European Union. See the next section.

2 Consolidation in hard times

Understanding the politics of the consolidation state requires a look at the political economy of the debt state. The rise of the debt state took place simultaneously with a general increase in economic inequality and was closely linked to it. The declining taxability of capitalist economies in the course of “globalization” produced a rising demand for credit on the part of governments, while tax cuts for the increasingly rich increased the corresponding supply. As a result, the debt state found it convenient to substitute credit for ever more difficult-to-collect taxes, to the extent that citizens remained willing to consider government bonds a safe investment. States going into debt allow citizens with high incomes to keep their money instead of having it confiscated, invest it safely, collect interest on it, and pass it on to their children. Unlike what is sometimes suggested in the literature (Wagschal 1996), the rich in rich democracies are not necessarily opposed to government debt since the alternative may be higher taxes, especially for them. What they must be concerned about, however, is too much debt compromising the capacity of governments to service it.

How much is too much debt cannot be answered generally. States default if they cannot repay old debt by taking up new debt. At what level of indebtedness financial markets will cease to extend credit to states differs, because it depends not on the magnitude of the existing debt as such, but on the confidence of the markets in it being repaid. As debt levels rise, therefore, debt states must intensify their efforts to secure that confidence to avoid rising risk premiums and at some point losing their ability to borrow. Normally states can be expected to do their utmost *not* to default, as this may for a long time exclude them from borrowing. One advantage they have in this respect is that they may use force – on their citizens – to raise the funds they need to pay their creditors.⁸ Governments may also oblige some of their subjects, especially financial firms under prudential supervision, to invest part of their capital in government bonds, on the premise that these are particularly safe. On the other hand,

since a sovereign government, by definition, controls its own affairs, it cannot be obliged to pay back its debt ...^[9] Failure or refusal of the government of a sovereign state to pay back its debt in full ... may be accompanied by a formal declaration ... not to pay (repudiation) or only partially pay its debts ... or [by] the de facto cessation of due payments.¹⁰

8 As has often been noted, the rise of democratic constitutionalism, by making “the people” the sovereign, turned sovereign debt into debt of the people. Unlike a king, a people never dies, and in a democracy government debt can be construed as debt incurred by the people themselves, who can therefore be held morally responsible for it (Fourcade et al. 2013). The probability that public debt would be conscientiously served was highest after the first wave of democratization, when the King in Parliament took the place of the King in person, and the parliament consisted basically of holders of property, including state papers. However, a popular-redistributive democracy may potentially be as predatory in relation to its creditors as a personal ruler.

9 In particular, there is as yet no legal way for creditors to take possession of a defaulting debtor state’s assets. In the past this was sometimes done by war.

10 Wikipedia, “Sovereign Default,” http://en.wikipedia.org/wiki/Sovereign_default, accessed September 24, 2014.

Attempts to establish an international bankruptcy regime for states that would regulate the rights and obligations of debtors and creditors and establish some form of international jurisdiction have been unsuccessful so far.

Fiscal consolidation, then, is essentially a confidence-building measure. Its objective is to make a state attractive for financial investment by making it clear to the financial markets that the state is in a position to service its debt. Consolidation is rarely about states ceasing to borrow altogether. Even after a state's accumulated debt has begun to shrink, there will long remain old debt that has to be refinanced on a revolving basis. Regardless of whether their debt is growing or declining, states thus continue to have a vital interest in low risk premiums on government bonds, since even a minor increase in the average rate of interest they have to pay may wreak havoc on their finances.¹¹

Today's emerging consolidation state is a political-institutional response to financial market demands for a break in the trend towards ever higher public indebtedness, at a time when debt levels were rising dramatically, annihilating all gains from the first wave of consolidation that began in the 1990s. To continue lending, financial markets want to be assured that public debt is under political control, certified by a demonstrated capacity of governments to halt and indeed reverse its long-term growth. Creditors' calls for consolidation reflect the experience of the last four decades that the Keynesian promise of governments deleveraging in good times to be able to incur new debt in bad times had not been kept: that fiscal reflation had a ratchet effect producing ever higher debt levels, in effect continuously expanding public expenditure. Consolidation is to reverse what had increasingly seemed like a one-way street towards insolvency and make governments return once and for all to fiscal solidity and sustainability.

Debt containment or reduction may be achieved by not replacing paid-back debt or, failing that, by "fiscal repression": a combination of low interest rates with higher rates of inflation, or nominal growth, over a longer period of time, by which existing debt is slowly devalued. Lowering or at least stabilizing public debt by fiscal repression may be an acceptable way of restoring financial credibility, as long as the resulting "haircut"¹² remains moderate and big investors are given early enough warning. In practice, consolidation as a confidence-building measure proceeds, almost as a matter of course, *not by raising revenue but by cutting expenditure*. Exceptions may be higher sales taxes, user fees, and social security contributions making tax regimes more regressive. Much-publicized efforts to close tax loopholes and prevent international base shifting, most recently at the G20 level, have yet to produce results; in any case, they would seem capable at most of slowing down the decline of tax revenue, not of ending or reversing it.

11 An increase in the average interest rate on a state's accumulated debt by two percentage points would mean an increase in public spending by five percentage points in a country with a total debt of one hundred percent of GDP and a government share of 40 percent of GDP. Total defense spending for most NATO countries is far below two percent of GDP.

12 A colloquial expression for a sovereign debtor unilaterally changing the terms of a loan in a fiscal crisis at the expense of its creditors.

A budget surplus, including one owed to lower interest rates or unexpected increases in tax revenue, is preferably used to pay off debt or cut taxes, to suppress political temptations to restore previous spending cuts.

An established consolidation state is one that has managed to institutionalize a political commitment and build a political capacity never to default on its debt, projecting an uncompromising determination to place its obligations to its creditors above all other obligations. It features a general configuration of political forces that makes spending increases difficult while making spending cuts, on everything except debt service, easy. Countries with a small state, like the United States and Japan, are more likely to be recognized as consolidation states since a small government share in the economy can be taken to indicate both an entrenched aversion to state spending and the possibility for tax increases as *ultima ratio* in financial emergencies.¹³

A country that comes close to the ideal is the United States, which combines powerful anti-taxation politics with a sacrosanct constitutional commitment never to compromise its “full faith and credit.”¹⁴ In fact, in the United States, as in no other country, it is understood across the political board that properly servicing the public debt must take precedence over everything else, including public pensions. Even the Tea Party movement contributed – unintentionally – to the perception of the United States as a solid debtor when it was defeated in 2011 and 2013 over the national debt ceiling by a coalition between the president and the Republican leadership – who at the time could not agree on anything except that the United States must in all circumstances service its debt, if necessary by incurring more debt.

I have described the debt state elsewhere (Streeck 2014a: 80ff.) as having two constituencies, citizens and creditors – or two peoples, a *Staatsvolk* and a *Marktvolk*. Debt states have to be loyal to both, with the two struggling over who is to be the principal stakeholder and who, in a fiscal crunch, has to give. The consolidation state settles that struggle in favor of its second constituency, its *Marktvolk*, by firmly internalizing the primacy of the state’s commercial-contractual commitments to its lenders over its public-political commitments to its citizenry. In a consolidation state, citizens lose out to investors, rights of citizenship are trumped by claims from commercial contracts, voters range below creditors, the results of elections are less important than those of bond auctions, public opinion matters less than interest rates and citizen loyalties less than investor confidence, and debt service crowds out public services (for an ideal-typical representation of the relations between debt states and their two constituencies see Table 1, taken from Streeck 2014b: 81). One could also speak of two kinds of public debt: *explicit*

13 Thus, Japan could in principle resolve its huge public debt problem by introducing a higher sales tax, and the United States could do the same with a federal gasoline tax, even one remaining clearly below European levels.

14 Article IV, Section 1 of the United States Constitution, which has come to be interpreted as applying to US treasury bonds and similar financial commitments.

in relation to “the markets” and *implicit* in relation to citizens, the latter downgraded in comparison to the former – or of two classes of property rights or entitlements: *capitalist* and *civic*, the former rising above the latter. In short, a consolidation state may be described as one whose *commercial market obligations* take precedence over its *political citizenship obligations*, where citizens lack access to political or ideological resources with which to contest this.

Table 1 The democratic debt state and its two peoples

<i>Staatsvolk</i>	<i>Marktvolk</i>
national	international
citizens	investors
civil rights	contractual claims
voters	creditors
elections (periodic)	auctions (continual)
public opinion	interest rates
loyalty	“confidence”
public services	debt service

Converting a popular democracy into a consolidation state takes time since it requires disempowering democratic-egalitarian politics in favor of solid customership in financial markets. The goal is to resolve the basic *ambivalence of democracy* as a depersonalized and therefore less capricious, longer-lived, and more reliable debtor, on the one hand, and a sovereign agent of wealth allocation and redistribution, on the other. This involves tying the hands of the state by redefining its sovereignty into a guarantee of its ability to repay its debt, for example by making balanced budgets an enforceable constitutional requirement. While a balanced budget or a budget surplus may be presented by governments to citizens as a step on the way to governmental independence from financial investors,¹⁵ the immediate purpose is to reassure lenders that their investment is safe and that they can at any time be paid and repaid. Lower risk premiums may also be achieved by other institutional reforms, to the extent that these credibly prevent future governments from once again mitigating capitalist distributional conflicts by public spending and thereby jeopardizing the state’s reliability as a debtor.

Preventing the debt state from preying on its lenders may also be done by international means. States have a collective interest to ensure that the reputation of sovereign debtors is not jeopardized by wayward governments using their sovereignty to expropriate their lenders. International institutions like the IMF, the World Bank, and the European Union help potentially insolvent states with loans, on the condition they reform themselves so that they can credibly promise not again to overdraw their accounts. Discipline may also be exercised by hegemonic countries aligned with global financial markets, such as the United States. The latest case here is Argentina. Having borrowed in New York, the country unexpectedly found itself under the jurisdiction of an American court, which declared the restructuring in 2002 of part of its debt to be illegal.¹⁶ As

15 See, for example, the various interview statements by the former Swedish Prime Minister, Göran Persson, reported by Mehrtens (2013).

16 This followed years of inventive attempts by American “vulture funds” to mobilize the civil laws of several countries to make the Argentine state deliver on the original conditions of the loan. Essentially what this was about was substituting national commercial law for the still nonexistent international sovereign bankruptcy law. See *The New York Times*, “Vulture Fund News,”

all major banks have, by necessity, subsidiaries in the United States, any government using the banking system to handle its financial transactions may be exposed to American legal action defending the property rights of investors in public debt, should the current rulings stand.

Turning the debt state of the late twentieth century into a consolidation state is not an easy undertaking, especially as it takes place in hard economic times. With economic inequality growing everywhere, debt-financed social expenditure helped states maintain an appearance of egalitarian even-handedness. Budget-balancing by cutting social benefits and social services risks a democratic backlash unless political institutions are rebuilt to insulate economic policies from popular-electoral pressures, in a Hayekian (Streeck 2014a) or post-democratic (Crouch 2004) way. Moving towards a consolidation state is also made difficult by the fact that it is taking place at a time of low growth, if not secular stagnation,¹⁷ with austerity likely to cause further economic contraction (Blyth 2013). (It is also made more urgent by the additional debt accumulated as a result of the financial crisis of 2008.) To investors in public finance seeking reassurance that their investment is safe, economic growth is as important as balanced budgets; both at the same time are, however, difficult if not impossible to obtain. Politically, institutional reforms and fiscal austerity are hard to impose under conditions of low growth and rising inequality on a society that still has recourse to democratic elections, while economically they may further impair aggregate demand and produce a deflationary downward spiral. Although the reigning neoliberal doctrine promises growth as a future reward for present austerity, for investors waiting to be paid that promise may be too uncertain, and the future too far away, to make them feel better.

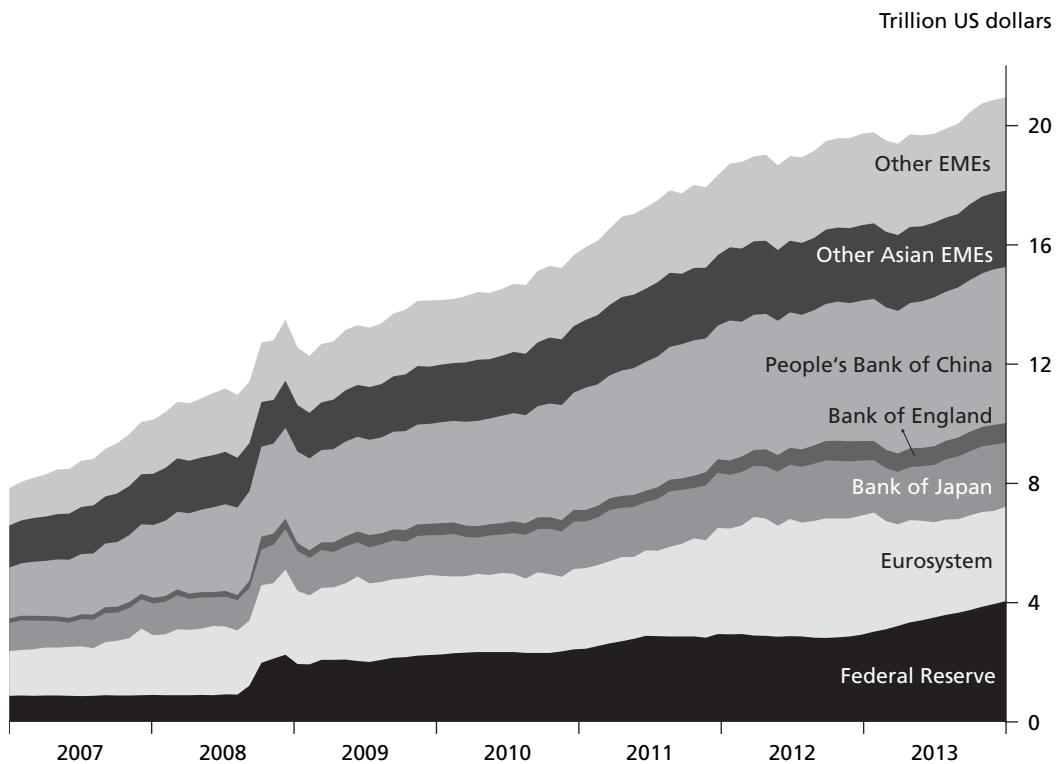
The transformation of the debt state into a consolidation state is under way, but it is far from smooth. While interrelated through global financial markets, its local manifestations differ, although the logic is the same. Some institutional reforms have been implemented, but many are still works in progress. In Europe especially, consolidation is politically contested, in particular in countries like France and Italy. As creditors worry about consolidation subverting economic growth, and governments about austerity undercutting political stability, public debt has further increased in most countries and was still rising in 2014 – even though nobody believes present levels to be sustainable. Currently much of the refinancing of debt states is provided by central banks, in the United States and Japan directly, in Europe indirectly by the European Central Bank lending to national banking systems which, in turn, lend to their national states.¹⁸ But although the

http://topics.nytimes.com/top/reference/timestopics/subjects/v/vulture_funds/index.html, accessed September 24, 2014.

17 As suggested by none other than Lawrence (“Larry”) Summers, in a now legendary presentation at the IMF Economic Forum on November 8, 2013. See also his essay in the *Financial Times* on December 15 of the same year, where he proposes that even before the crisis of 2008, “bubbles and loose credit were only sufficient to drive moderate growth.”

18 The European Central Bank (ECB) is not allowed under the Maastricht Treaty to lend to member countries, which is why it had to devise ways to circumvent the treaty.

Figure 5 Total central bank assets



Source: Bank for International Settlements, 84th Annual Report, p. 86.

balance sheets of the leading central banks have rapidly expanded since 2008 (Figure 5), historically low interest rates and unprecedented infusions of liquidity into the world economy have as yet failed to stimulate economic growth, thereby making market-conforming reforms more palatable and helping states pay their lenders. Like public debt, there is agreement among economic elites that the policy of cheap money cannot be continued forever. What is being debated is how long it can still be relied upon and how it can be ended without causing a new political-economic megacrisis.

3 The European consolidation state

The emerging consolidation state in Europe differs in several respects from the U.S. model. Western European countries do not have command of a hegemonic currency, and redistributive democracy has not yet lost its popular support. Nor is the primacy of states' explicit debt to capital markets over their implicit debt to their citizens as well-established as in the United States, and the same applies to austerity as a principle of domestic state activity, except perhaps in Britain and post-communist Eastern Europe

(which, however, did not have enough time to build up potentially critical amounts of public debt). Also, in the Europe of the European Monetary Union (EMU), consolidation takes on a peculiar form as it proceeds under an international regime governing the fiscal and financial policies of a collection of formally sovereign nation-states, so as to secure their compatibility with a common supranational monetary policy. Unless otherwise indicated, the following discussion will focus only on the Eurozone, or *Euroland*, and its member states.

The construction of the euro monetary regime betrays its origin in the first global consolidation wave in the 1990s. Member states were not allowed to run budget deficits above three percent of Gross Domestic Product, and accumulated debt was not to exceed sixty percent of GDP. The sole mission of the European Central Bank (ECB) was to defend monetary stability, and extending credit to member states was explicitly forbidden. Like the German Bundesbank, the ECB is independent from elected government and insulated from political pressures; in fact it is even more independent as it does not have a unified supranational government as a political counterpart but faces only a council of heads of national governments. Member-state compliance with the rules of Euroland is to be enforced by another nonpolitical supranational authority, the European Commission. This regime, fashioned after the German model, soon proved unable to enforce fiscal discipline even on Germany. It also failed to prevent the post-2008 euro crisis, when public and private debtors in a number of EMU member countries suddenly appeared over-indebted and lost the confidence of their creditors, especially as their national economies became locked into stagnation, with a possibility of debt deflation. As a consequence, risk premiums on public debt in several EMU member countries began to rise; in countries like Italy, Greece, Spain and Ireland they reached an unmanageable level.

As indicated, there are no general economic limits to public debt, which requires strictly individualized, case-by-case risk assessment on the part of creditors. Under EMU, financial markets had freely lent to weaker member countries at historically low interest rates, apparently on the assumption that, regardless of the Treaty, their debt would somehow be mutualized should they become insolvent. After 2008 this turned out to have been an illusion, probably inspired by integrationist forces in the Commission, and lending to Mediterranean countries became an international counterpart to subprime lending in the U.S. housing market. Since servicing the accumulated debt remained a national responsibility, it became apparent that the decoupling of fiscal and financial policy from national democracy, as demanded by financial markets, had not gone far enough. Democratic resistance to austerity in the South and to a “transfer union” in the North stood in the way of restoring investor confidence in Southern member states. Hopes that growth would return as a result of neoliberal “reform” – of fiscal policies and institutions, as well as of labor markets and social security systems – were either disappointed or remained untested, as reform got stuck in domestic politics. In the resulting stalemate, the ECB bought time for the euro by flooding the markets with money, as ersatz debt mutualization, to keep interest rates low and member states solvent. At the same time, the ECB

insists that this cannot continue forever and that national governments have in return to push through institutional and economic reforms, so as to make European capitalism, as organized in EMU, more “market-conforming” (Angela Merkel).

The rebuilding of the EMU state system into a *European consolidation state* proceeds slowly and fitfully, punctuated by national and European elections that force governments to make themselves appear responsive to citizen concerns, including those they otherwise discredit as “populist.” While the emerging European consolidation state amounts to a novel kind of political-economic regime, it is being developed out of EMU in a gradual, path-dependent institutional reform process. Its outstanding characteristic is a unique amalgam of national, international, and supranational rules and institutions, of constitutions and treaties, and of national politics and international relations. The result is a *state consisting of states*, with domestic politics that combine diverse national politics, foreign relations between nation-states, and supranational authority wielded over them in their collective name by bureaucratic agencies. As a fiscal consolidation regime, the EMU in its evolving form as an international consolidation state may be characterized as follows.

1. In a first approximation, the emerging European consolidation state is a mutual surveillance and control arrangement among what are still formally sovereign nation-states. It is founded on a shared interest in states’ collective reputation in financial markets and on the recognition that the default of one state may have adverse effects on all others, for example in the form of higher interest rates or repercussions on national banking systems. The transformation of the EMU into an international consolidation state on top of a set of national welfare states is to secure an ever tighter coupling of their economic behavior through mutual observation, supervision, and discipline. Institutional development starts from the original structure of the EMU as established in the 1990s, which is being gradually expanded and strengthened in the course and in the aftermath of the post-2008 fiscal crisis, among other things through new regulations, in particular the so-called Six-pack, and new treaties, like the Fiscal Compact passed in late 2011 and early 2012, respectively.¹⁹

19 Details of rules and procedures are, as always in the European Union, extremely complex and fully comprehensible only for experts. In essence, the updated macroeconomic regime of the EMU involves binding obligations on member states to commit themselves constitutionally to balanced budgets. It also institutes comprehensive current surveillance of member states’ fiscal policies by the European Commission. Under the so-called Excessive Deficit Procedure, states may be subject to heavy automatic fines if they fail to keep their public deficits below specified limits. Moreover, under the Excessive Imbalance Procedure, countries may be specifically ordered by the Commission to revise their macroeconomic policies and change relevant institutions, such as their national collective bargaining regimes and their social policies, so as to make them compatible with supranational coordination. Individual policy directives may extend to a wide range of issues not hitherto under European Union jurisdiction. For more see Höpner and Rödl (2012), Scharpf (2013: 134–136) and Streeck (2014a: 107–109).

2. As an international regime not directly exposed to traditional class politics and popular democracy, the European consolidation state is in a better position than a nation-state to impose on unreliable electorates a market-conforming fiscal policy, a policy of austerity, and the primacy of debt service over public services. Disempowering the *Staatsvolk* in favor of the *Marktvolk* (Table 1) by institutionally decoupling popular democracy from the management of the economy²⁰ is more easily done by means of international than by national politics. As the community of states gains power over its members, vested in both horizontal international agreements and vertical supranational institutions, it can even recall elected national governments and install representatives of the international financial industry as national heads of government, as was done by the European Council in Greece and Italy in November 2011.²¹ The objective is to wrest what is left of national sovereignty over economic policy from notoriously difficult national electorates through aggressive institutional reform at international as well as national level.
3. More than in any nation-state, the EMU's central bank, the ECB, can act as an external force in relation to democratic governments. Administering the monetary policy of eighteen nation-states, it is sufficiently far away from the domestic politics of each of them to make monetary policy support for national governments conditional on their cooperation with respect to fiscal policy and institutional reform. Together with other international organizations, in particular the International Monetary Fund and the European Commission, the ECB has deeply intervened into the domestic politics of formally still sovereign member states, among other things prescribing to the Greek government how many civil servants it had to dismiss and when. Since the ECB must be concerned above all about the confidence of financial markets in the currency that it administers, the reforms it demands from member states can only be of a market-conforming kind. In particular, the ECB cannot be supportive of any egalitarian-redistributive ambitions of national governments. The ECB's unprecedented political independence translates into an unprecedented capacity to cater to the interests of financial markets and into unprecedented dependence on these.
4. The international relations embedded in the EMU consolidation state are highly asymmetrical. Economically weak countries, while in the majority, face a small number of economically strong countries in a position effectively to dictate to them, by threatening to withhold financial support. Germany, on account of its regained economic power after 2008 and as the main beneficiary of EMU due to its export strength and to currently low European interest rates,²² de facto governs the EMU as

20 I have described this as the imposition of a Hayekian regime on the European political economy (Streeck 2014a).

21 When the Prime Minister of Greece, Andreas Papandreou, was replaced with the central banker Lukas Papademos, and the Italian Prime Minister Berlusconi had to resign in favor of the former European Commissioner and Goldman Sachs functionary, Mario Monti.

22 This was different in the early 2000s when Euro interest rates, set to combat inflation in the South, were too high for low-inflation Germany (Scharpf 2013).

a German economic empire. In the form of the euro, it imposes a hard currency of the kind Germany has become used to since the war on the rest of Europe, including on countries like France and Italy that have long relied on a soft currency as a means of managing domestic distributional conflict while intermittently relying on devaluation to restore temporarily their international competitiveness.²³ There is no provision in the treaties for turning the EMU into an arrangement for international redistribution, also known as a “transfer union” – quite apart from the fact that even Germany and France together are far too small to provide the weaker countries with more than symbolic economic assistance (Streeck/Elsässer 2014). To the extent that some redistribution from the strong to the weak is required for keeping over-indebted states solvent and monetary union together, it must be accomplished through covert channels, also because of certain voter resistance in the European North. Serving as an invisible conduit for money transfusions is another function today performed by the ECB.

5. The institutional reforms imposed under EMU on its over-indebted member states would, if carried out to their end, result in a deep restructuring of national political economies, especially in the Mediterranean countries. Based on the “German model” as it is understood today,²⁴ such reforms would in particular undo the historical class compromise in countries like Italy and France which accepted high rates of inflation and high public spending, including frequent public deficits, as a price for social peace (Hall 2012 ; Blankart 2013). High inflation made high public debt bearable because it devalued the debt on a current basis; low interest rates and high state subsidies provided for stable employment; and negative effects on external competitiveness were compensated from time to time by devaluation. To the extent that this system supported “rigid” labor markets, short working hours, costly public services, high and early pensions, and high and regular nominal wage increases, it was a thorn in the eye of a growing middle class, as well as of technocratic-nationalist elites bent on “modernizing” their countries. To them, the EMU promised to break institutionally entrenched resistance to capitalist modernization by undoing the various economic fixes on which their national class compromise depended. By having the bitter medicine of austerity and flexibility forced on their countries from the outside, they hoped they would ultimately become able to “stand on their own feet,” get ready for “globalization,” and compete successfully with Germany.

23 There is now a large body of literature on the frictions caused by differently organized national political economies being forced under a common monetary regime. See, for example, Armin-geon and Baccaro (2012), Blankart (2013), Hall (2012), Johnston/Regan (2014), and Feldstein (2011).

24 Some two decades ago, the “German model” was known for relatively low inequality and high social protection under a negotiated social compact between capital and labor. Today, Germany is identified with wage restraint, zero inflation, surplus exports, budget balancing, and “welfare reform.”

EMU and the international consolidation state growing out of it represent a unique opportunity for the capitalist rationalization of “backward” economies, states, and societies. Nevertheless, because of the danger of democratic obstruction, change towards market-conforming democracy can be administered only slowly. Both national and international politics around fiscal consolidation are complex and convoluted; see the agonies of the Hollande government in France, originally elected to replace *Merkozy*, in the face of German pressures to accede to German-European international consolidation policies. See also the rise in Germany of the anti-euro party, AfD, which expresses and indeed cements German resistance to a “transfer union,” or the growing international tensions between France and Italy on the one hand and Germany on the other. At the end of 2014, the discussion was about a managed devaluation of the common currency as a substitute for national devaluation; about moving the consolidation deadlines of the Fiscal Compact forward; and about “growth programs” for the South and for France, to be funded by new debt, even though debt is already at a historical high and adding to it has not produced growth for more than half a decade now.²⁵ Given the unsustainability of further debt accumulation, these are rear-guard battles on the collective march toward balanced budgets, enforced by pressures from financial markets on the one hand and by German hegemony on the other.

4 A new regime

Rebuilding a debt state into a consolidation state – one in which financial markets can again have confidence, and for longer than just for the moment – is a long-drawn process. At its conclusion stands a new fiscal regime with public austerity as a fundamental principle governing the relationship between state and society: a reformed “configuration of political interests, institutions, and policy arrangements that structure conflicts over taxes and spending … a particular political context of institutions, powerful organizations, public policies, and dominant ideas” (Pierson 2001: 56–57).

Ending the secular build-up of public debt and regaining the confidence of financial markets requires deep changes in political institutions and social structures. Already the gradual cutting down on new debt towards a balanced budget, which tends to take several years, would be unsustainable unless accompanied by a redefinition of the responsibilities of government and the purposes of public policy, in the direction of a smaller state and an expanded market, less public and more private provision, privatization of

25 In fact, at high levels of indebtedness even otherwise auspicious conditions may not make borrowers incur additional debt, for fear of bankruptcy. European growth rhetoric is to pacify voters, Social-Democratic parties, and Southern member states. It also plays on the ambivalence of creditors who want consolidation and growth at the same time. Experience tells them, however, that additional debt, if allowed, will simply be added to existing debt, rather than being used to advance consolidation.

state activities and assets, and a substitution of individual effort for collective solidarity. Ultimately, the construction of a consolidation state embedded in a consolidation regime implies a far-reaching rationalization, or “economization,” of politics and society. In the process states become less like sovereigns and more like firms: instead of overriding markets, they are to be responsive to them. Whereas the politics of democratic capitalism was to protect society from the “vagaries of the market” (Polanyi), the politics of the consolidation state protects financial markets from what are for them the vagaries of democratic politics.

Consolidation is to turn the activist-interventionist state of postwar democratic capitalism into a lean state receptive to market pressures. To be credible and effective, fiscal discipline must be anchored in the political institutions that control the social production of collective demands. In the final analysis, the transformation of the debt state into a consolidation state is to end the tendency, envisaged under both “Wagner’s Law” and the Marxian conjecture of an increasing socialization of production, for a maturing capitalist-industrial society to require ever-rising levels of public support – of infrastructural investment and all sorts of collective repair work and compensation – up to a point where capitalist industrialism would become incompatible with private ownership in the means of production. Imposing public austerity on the debt state of the late twentieth century may be interpreted as an effort to escape this trend, in response to the growing resistance of capitalist society against being taxed for public provision. What results is a large-scale political experiment turning over to private enterprise the tasks of insuring against social risks, providing welfare, education and health, building and maintaining physical infrastructures, and even parts of government itself (warfare, the collection of intelligence). In this way, the establishment of the consolidation state would represent the final stage of the (neo-)liberalization process that began with the end of the “roaring seventies” (Streeck 2014a).

As indicated, the model of a consolidation state is the United States after it imposed an austerity regime on itself in the 1990s (Pierson 1998). An important step along the way was “the end of welfare as we have come to know it” under the Clinton presidency.²⁶ The fact that the reform was pushed through by a Democratic president only reinforced its confidence-building effect. Further contributing to it was that the gradual progress towards a balanced budget, and then towards a budget surplus at the end of Clinton’s second term, was achieved through spending cuts rather than revenue increases. In fact, shrinking the deficit by shrinking public spending was accompanied by substantial tax cuts which, while repeatedly renewing the deficit, created pressures for more spending cuts once “fighting the deficit” had been established as the supreme principle of the new regime (Pierson 2001).

26 This refers to the passage of the Personal Responsibility and Work Opportunity Act in 1996.

Clinton's successor immediately squandered the Clinton surplus on tax cuts, advertised by George W. Bush during his presidential campaign in 2000 as "returning to citizens what is rightfully theirs." Yet neither this nor the wars in Afghanistan and Iraq did anything to diminish the confidence of financial markets. The United States has more than one way to reassure its creditors, including its capacity to produce unlimited amounts of a global reserve currency out of thin air. That the American government nevertheless administered the bitter medicine of domestic austerity to its already anemic welfare state in the 1990s can only have added to financial markets' trust in its "full credit," on top of the culturally established primacy of financial market obligations over citizen entitlements. Moreover, to the extent that the United States runs a deficit to finance its military and its wars, it can ask resource-rich allies to buy treasury bonds in return for protection, making it unnecessary for the latter to maintain military forces of their own. Also, spending on warfare is discretionary and temporary; and like tax cuts and tax expenditures, it may also be used to justify spending cuts in other areas. Even major increases in public deficits, which would make borrowing unaffordable for other countries, cannot therefore detract from the United States' standing in financial markets.

European countries, less privileged than the United States, began a decade later to reinvent themselves as consolidation states. Their efforts at installing an austerity regime as a credible commitment to market conformity had to go further than American efforts, given their competitive disadvantages in capital markets: no global currency, no military capabilities worth paying for, generally higher state shares in their economies, and citizens more insistent on social rights and entitlements. Anchoring national pledges to fiscal austerity in international law – like in the Fiscal Compact – helped, as did the emerging hegemony of a country like Germany, which has historically thrived on export-driven growth and a hard-currency regime.²⁷ Growing debt burdens after 2008 increased the pressure for a second, even more determined round of consolidation efforts, aimed at reducing state shares and freeing up capacities to service the remaining public debt. As elsewhere, consolidation in Europe does not have to be accomplished overnight; phasing in spending cuts over time even seems preferable, as it allows for the gradual settling in of an austerity regime as a permanent feature of political economy.

How austerity may become permanent as a country moves from budget deficits to a stable surplus has recently been shown by Lukas Haffert (2014). Haffert debates what he calls the "symmetry hypothesis," which is that a state, once it has overcome a chronic deficit, may use its regained fiscal capacity to return to political activism and restore the programs it had temporarily cut. In fact, as Haffert shows, this is often the promise made by social-democratic governments when embarking on public austerity. In reality, however, spending patterns after consolidation remain dedicated to austerity, which becomes the central virtue distinguishing a neoliberal consolidation state from its debt-state predecessor. Haffert explains this by the fact that the transition from rising to

27 Or, in Mertens' (2014) term, an export-and-saving regime.

declining debt levels is associated with and can only be accomplished by deep changes in political and institutional routines, in the configuration of vested interests, and in power relations and ideologies that are impossible to reverse on short order.

What are the lasting political-economic consequences of states devoting themselves to fiscal consolidation, in order to reassure financial markets that they will consider their debt obligations sacrosanct and do whatever it takes to remain fit for debt service? Four such consequences have been established by recent research.

1. Budget balancing, if achieved by spending cuts rather than tax increases, and even more so if accompanied by tax cuts, comes at the expense of discretionary as distinguished from mandatory spending (Streeck/Mertens 2010b, 2011). As public budgets approach a balance, a growing share of government expenditure goes to cover comparatively rigid, legally fixed expenditures, such as wages for public sector workers, public pensions, and, of course, debt service. As the latter is sacrosanct in a consolidation state, it is public investment, both in the physical infrastructure and in education, families, active labor market policy and the like – what has been called “soft” (Streeck/Mertens 2011) or “social” (Morel et al. 2012) investment – that must give. Over a longer term, this will produce pressures also on “entitlements” like social security, making them more politically vulnerable and less mandatory in effect. Complaints about old commitments suffocating spending for the future and strangling “fiscal democracy” (Steuerle et al. 1998; Streeck/Mertens 2010a) by denying governments political discretion (Rose 1990) may also result in less generous benefits for subsequent generations, while the benefits of existing claimants are frozen under so-called “grandfather clauses.” This is likely further to de-legitimate social policies.
2. Budget balancing allows no new debt, and this holds all the more for debt reduction by fiscal surplus. Public investment will therefore have to be paid for out of what will very likely be shrinking current revenue. Regaining and retaining the confidence of financial markets may therefore require governments to cut public investment even if real interest rates on government debt approach zero. Resulting deficiencies in physical and social infrastructures must be attended to by private investors assuming what had previously been public responsibilities. One effect is likely to be Public-Private Partnerships (PPPs) of various sorts, with private investment backed by the public, and governments or individual citizens paying user fees to private firms. Indications are that states and citizens will tend to be paying more under such arrangements than they would have paid had the investment remained in public hands. This seems to hold especially for local communities, which often lack the expertise to negotiate as equals with the legal departments of international investors.
3. Cutting discretionary expenditure inevitably involves cuts in social services such as education and especially in universal services benefiting all citizens. As the range and quality of state-provided services consequently deteriorate, the middle class will look for complementary or alternative private provision, and governments will be urged

to allow private firms to compete with public authorities. In the process, the better-to-do will get habituated to more customized provision, which will make them demand (further) tax cuts so they can pay for them – tax cuts that will drive further spending cuts. As the welfare state then loses growing segments of its middle-class constituency, public programs will turn into programs for the poor which, according to an American adage, will make them poor programs.

4. Privatization of investment in physical and social infrastructures gives rise to a growing private industry operating in what used to be the public sector. While typically subject to regulation, private providers are likely soon to become powerful players in the political arena where they will ally with the upwardly mobile middle class and its liberal-conservative political parties. The evolving connections of the new firms with the government, often taking the form of a revolving-door exchange of personnel, and their campaign contributions will further cement the shift from a redistributive towards a neoliberal state that abandons to civil society and the market its responsibility to provide for social equity and social cohesion.

The most advanced case of a consolidation state with a firmly established austerity regime is, surprisingly, the former model country of Social Democracy, Sweden (on the following see Haffert/Mehrtens 2013; Mehrtens 2014). Here the departure from the post-1970s debt state was much more thorough and went much farther than in the United States, where consolidation was and is made less compulsory by the competitive advantages the country enjoys in global capital markets. It is also interesting to note that Sweden is not a member of the EMU and still has its national currency, meaning that it was not forced to consolidate by international treaties. Sweden is, however, deeply traumatized by the experience of its two fiscal and financial crises in 1977 and 1991, crises far more severe than in most European countries after 2008.²⁸ The lesson learned at the time across the entire Swedish political spectrum was that international financial markets would not hesitate to punish the country mercilessly if they were to lose confidence in it, and that restoring and preserving that confidence had to be the foremost objective of national economic policy.

Sweden's consolidation state operates an austerity regime based on two fundamental principles: an ironclad commitment to a fiscal surplus generated and continuously renewed by spending cuts, to bring down the accumulated debt; and regular tax cuts to renew the pressure for spending cuts and enable the middle classes to replace public benefits and services by self-provision in free markets. Combining a surplus policy with

28 Between 1977 and 1983, Swedish total public debt more than doubled, from 30 percent of GDP to 70 percent, with a peak deficit of seven percent of GDP in 1982. After four years of a budget surplus around four percent, public debt increased again, from 48 to 84 percent between 1990 and 1995, with a peak deficit of 11 percent in 1993. Beginning in 1998, it was gradually reduced to 50 percent in 2007, the year before the global financial crisis (Mehrtens 2013: 70). From 1998 to 2008, the Swedish state ran a budget surplus; with cyclical adjustment the surplus has continued up to the present (Haffert/Mehrtens 2013: 24).

lower taxes makes for a shrinking state share in the national economy, producing a leaner state increasingly in line with neoliberal prescriptions of a non-activist public policy. Obviously, Swedish neoliberal reform was and is facilitated by the fact that it started at a very high level of government activity, so that a national austerity regime has a lot of state activity to feed upon for a protracted time. While the Swedish landing path can therefore be a particularly long one, however, the country's consolidation regime has become so deeply engrained over time that it is hard to imagine how it could be displaced in any foreseeable future.

By the end of 2014, roughly two decades of neoliberal reform had, incrementally but all the more effectively, changed the Swedish political economy almost beyond recognition (Haffert/Mehrtens 2013; Mehrtens 2014). Since the peak of the second crisis in 1993, total government expenditure was brought down from 70 to 50 percent of GDP, and total revenue from 60 to 50 percent (2012). This process is expected to continue, assisted by deep changes in political-economic institutions which, for example, prevent the central bank from accommodating an expansionary fiscal policy:

The medium-term financial forecast of the Swedish government for the years 2013–2015 projected surpluses of up to three percent of GDP ... The estimated annual surplus is up to three percent of GDP. The improvement of the budget balance would be achieved solely by expenditure cuts and not by revenue increases. (Haffert/Mehrtens 2013: 21)

The economic downturn after 2011 did not cause a rethinking of fiscal priorities. Transition from high to low taxing and spending was accomplished, among other things, by a pension reform (1994/1998) that has made the pension system "completely independent financially from the budget. There is no longer any cross-subsidization from the public purse to the pension funds" (ibid.: 17). In spite of the fiscal surplus, pensions were cut in 2010 and will be further cut in future, in line with expected shortfalls in revenue due to demographic change. There also was what was called the "tax reform of the century" in 1990 and 1991, which contributed to the fiscal crisis of the early 1990s and helped justify the subsequent cuts in public expenditure. Taxes were further lowered in 2006 and 2008, as well as in several subsequent years. The reform made the tax system more regressive as capital incomes were taxed much lower than incomes from labor, property taxes were abolished, and the value-added tax remained one of the highest in the world.

Fiscal consolidation, in Sweden no less than elsewhere, was associated with a steep decline in both "soft" and "hard" public investment (Streeck/Mertens 2011). Among other things, spending on active labor market policy was more than halved. Simultaneously, unemployment stabilized at around eight percent, a radically new normal in the Swedish labor market that would have been completely unimaginable before the first fiscal crisis and the monetarist turn under the Social-Democratic Carlsson government. Consolidation was also accompanied by a steep increase in income inequality, steeper than in almost all other advanced capitalist societies. Moreover, from 1998 to 2010, the share of students in private schools below the university level increased from two to twelve

percent, exceeding the respective ratio in the United States (Mehrtens 2013: 220).²⁹ Privatization is rapidly proceeding also in the large Swedish healthcare and childcare sectors. Further adherence to the policy of combining tax cuts with debt repayment, thereby shrinking the state, seems assured as the new consolidation regime has become firmly entrenched in the Swedish political economy in the past two decades.

5 The consolidation state and democracy

The regime of the consolidation state involves a deep transformation of democracy as we know it, away from traditional institutions of popular political participation designed to stand up for social equity against the laws of the market (Streeck 2014a: 58ff.). Where there are fewer public goods due to privatization, there is less to decide politically, and the economic democracy of capitalism – one dollar, one vote – begins to replace political democracy. With markets becoming the principal mechanisms of collective decision-making – by aggregation instead of deliberation – there is even less “fiscal democracy” left than in the rigidified debt state of old. This is also because, at the macro level, public finances are increasingly constrained by constitutionally enshrined debt limits and balanced-budget rules. In the European case, there are also international agreements on fiscal austerity from which countries can break away only at high political and economic cost.

Institutional restructuring towards a consolidation state abandons democratic principles in several other respects as well. Public-private partnerships are often based on complex commercial contracts, large parts of which have to remain confidential to protect trade secrets. As independent central banks rise to become the principal agents of economic policy, political decisions with far-reaching social consequences move out of the purview of parliaments and elected governments. Central banks are run by small bodies deliberating in secrecy, and given the significance of their decisions for the rational expectations of economic agents this cannot be otherwise. Also, whether or not economic policies conform to the needs of the markets cannot be decided by political debate but only by the markets themselves, and whether economic policies are “right” is for the technocratic experts to determine who are charged with applying the rules by which policies are to be bound. All of this requires and advances a decoupling of the management of the economy from democratic politics – backed ideologically by newly fashionable elitist theories claiming democracy to be irrational, incapable of dealing with complex problems, too slow to respond to changing conditions in a global economy, and too vulnerable to popular pressures for economically inefficient intervention in free markets (Bell 2006).

29 At the secondary school level, the ratio was already at 50 percent in 2010, with roughly 90 percent of private school operators being profit-oriented corporations (Mehrtens 2014: 223).

Turning the economy over to a combination of free markets and technocracy makes political participation run dry (Schäfer/Streeck 2013b). Where national democratic institutions are neutralized by international “governance,” as under European Monetary Union, their de-politicized empty spaces are likely to be filled with new content, which may be public entertainment of the “post-democracy” kind (Crouch 2004) or some politically regressive sort of nationalism. Under the auspices of the emerging consolidation state, politicization is migrating to the right side of the political spectrum where anti-establishment parties are getting better and better at organizing discontented citizens dependent upon public services and insisting on political protection from international markets.

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