NOT JUST IN TIMES OF CRISIS

TEXT: WOLFGANG MULKE

Leon Wansleben, a sociologist at the Max Planck Institute for the Study of Societies in Cologne, takes an analytical look at the state's economic and financial activities. It appears that, rather than leaving everything to the market, the state has begun playing an active role in economic policy.

ILLUSTRATION: ALESSANDRO GOTTARDO FOR THE MPG

Certain dyed-in-the-wool market economists are currently rubbing their eyes in disbelief. The state is doing everything possible to counter the economic consequences of the Covid-19 crisis. Public authorities are even investing directly in private companies, something that was barely conceivable in recent decades.

"For many years," as Leon Wansleben, a sociologist at the Max Planck Institute for the Study of Societies explains, "governments around the world have been vigorously supporting markets while cutting back on the public sector." Now, he goes on, we are seeing the direct opposite – the state has become very active in fiscal matters. For example, it is counteracting the current crisis by taking on a heavy national debt load. "This process is particularly evident in relation to the Covid-19 crisis," says Wansleben. The 38-year-old researcher has been head of the "Sociology of Public Finances and Debt" research group at the Max Planck Institute in Cologne since 2019. There are still many unanswered questions in this field: what influences state economic policy, and who are the ones taking action? Which rationale are they following, and which interests and concepts are playing a role in the background?

The merging of markets and the state

Among other things, the research group is devoted to examining economic sociology and, according to the group's thesis, the traditional, ideal-typical notions about the market and the state are no longer applicable. Many economists treat them as two separately operating, homogeneous units, yet the market and the state overlap in many areas, such as the energy markets, where municipalities often have to compete with private suppliers. Wansleben wants to ascertain the actual structure of these markets and what role the public sector plays in them. The relevant projects are part of an extensive study into the role of the state as an economic stakeholder. The state's economic interventions take many different forms, ranging from direct investment in private companies that have encountered difficulties as a result of various crises (e.g. Lufthansa and the Commerzbank) to investment funds, or from Germany's state-owned development bank KfW to municipal companies.

Wansleben is looking into why, since the 1980s, parliaments and governments have gradually withdrawn from economic governance and ceded control to the central banks. "The dominance of central banks is characterized by their robust independence, increasing media attention, and the leading role they play in countering financial and economic crises," Wansleben explains. These are indicators of their increasing power over recent decades. The central banks ensure that inflation remains low; they stabilize the economy and help floundering states to stay afloat. There is hardly a newscast in which the name of a central bank is not mentioned.

Central banks as crisis managers

In the past, central banks, such as the German Bundesbank, controlled inflation via the amount of money in circulation. Whenever they raised interest rates, consumers and companies would reduce their spending, preferring instead to invest their money, as a result of which pricing pressures decreased. Reducing interest rates produced the opposite effect. Today, rather than stabilizing economies through the money supply, central banks adjust their interest rate policy to align with price developments within the goods and services markets. However, there is a problem with this approach, as it does not take asset markets, e.g. those for equities and real estate, into account. When they burst, price bubbles in these markets can rapidly lead to economic crises. The 2007 to 2009 financial crisis showed just how quickly this can happen.

While the increasing influence of the Bundesbank, the U.S. Federal Reserve (aka the Fed), and other central banks was initially based on different approaches to the threat of inflation, the inflation problem increasingly receded into the background to be replaced by concerns about weak growth, falling real interest rates and the expansion of the financial sector. The world's cen-

"Covid-19 has wiped the market-dogma off the table."

LEON WANSLEBEN

Dizzying: the European Central Bank (ECB) headquarters building in Frankfurt am Main is one of the tallest buildings in Germany. However, many observers consider the ECB's balance sheet total (which currently accounts for 50 percent of the economic output within the euro zone) to also be extraordinarily high.

PHOTO: CARO / BASTIAN / FOTOFINDER

tral banks became the most important crisis managers when, for example, the dotcom bubble burst at the turn of the millennium or after the terrorist attack on the World Trade Center in 2001.

When describing his research project, Wansleben explains, "What I'm trying to figure out is why central banks were able to be so successful in spite of the financial crisis brewing in the background, and which institutional conditions fostered their increase in power." He had already been exploring this subject prior to relocating to Cologne, when he was still teaching at the London School of Economics and Political Science. One of his findings is that the central bankers are, so to speak, the stabilizing force in an economy dominated by the financial markets. They curb uncertainties within the markets, particularly through a predictable interest rate policy, as well as by converting private loans into sovereign payment instruments – by purchasing bonds, for example. The extent of these stabilization efforts can be seen in the central banks' balance sheet totals. The ECB's balance sheet total already accounts for half of the eurozone's economic output, and that of the Fed accounts for about 30 %. This is where the sociological research approach comes into play. Why is it, Wansleben asks, that national parliaments and governments have for so long neglected to exercise not only their authority, but also their decision-making powers and responsibilities regarding economic policy?

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This voluntary self-disempowerment is evident in tax policy, which has been used less and less for redistribution purposes in recent decades. Nor, to a large extent, have these powers been used to address political challenges such as climate change. Wansleben, however, foresees the next change on the horizon. He says, "There are many signs that central banks are currently reaching the limits of legitimacy and effectiveness with their concepts for economic governance, as well as their specific interventions."

A lack of transparency in municipal enterprises

Central bank policies have long been seen as controversial. They spend vast amounts of money on buying up government and corporate bonds to revive the economy and want to increase lending to the economy through a zero-interest policy. However, neither of these measures is having the desired effect. Critics in Europe, for example, fear that the ECB is indirectly communitizing the national debt of southern European states by buying more and more of their state bonds. Achieving the inflation target of two percent is also a long way off. Wansleben asserts that democratic institutions now need to develop new approaches and instruments of economic governance.

His other two projects at the Max Planck Institute in Cologne are still in the early stages, yet hopes for exciting results are high. One of Wansleben's research projects concerns the state's municipal institutions. Using Cologne as an example, he is investigating the economic activities of the public authorities, whereby the focus is on public services – a term which, as he notes, is not precisely defined but "formulated in a deliberately vague manner." The state may take action if there is a public interest in doing so, a precondition, which the city of Cologne interprets rather loosely. It acts, for example, as a telecommunications network operator through the municipal company Netcologne, and has acquired a shipping company that is active throughout Europe. According to Wansleben, the question of what the state is permitted to do and what it is economically sensible to do is "really fascinating."

But a glance into the engine room of the state ought to also reveal who is influencing the actions of its institutions. In this context, Wansleben has identified a lack of transparency in the decision-making process, especially in municipal enterprises. Therefore, politicians are loathe to engage in democratic discourse about the business orientation of municipal companies, apparently due to exaggerated concerns about scandals that could arise from their decisions. Instead, the public debate over municipal policies tends to focus on marginal issues.

In another project, Wansleben and his research group are also investigating the public sector investments being made by municipal authorities in Germany. In general, cities and municipalities reduced their investment budgets at the start of this century. "That was followed by a process of divergence," says the sociologist. The communities' development went in different directions. Some communities, particularly in the wealthy southern German states, started reinvesting more in their infrastructure, while treasurers in other regions continued to cut costs. The consequences quickly became evident to local residents. The infrastructure deteriorated, many schools became dilapidated and were insufficiently maintained, or the construction of new housing was neglected. Wansleben suspects that, "Faced with cost-cutting pressures following the reunification of Germany, the federal system began exerting fiscal pressure on the municipalities." High fixed expenditures for such things as social services have deprived poorer cities and municipalities of the funds needed for investments. Their income from trade taxes is also very low.

"This whole subject has a certain explosiveness these days," as the researcher knows. Population growth in the cities has been greater than expected. They simply must develop their infrastructures. Then there are also the investments necessary for climate protection, such as improvements in public transport services. The Covid-19 crisis is currently providing clear evidence of the more active role the state is again playing. The federal government is providing the municipalities with substantial financial support; after all, the most important tasks in the practical management of the pandemic must be undertaken by the cities and municipalities. One recent example of this is the announcement by the federal government that it is expanding the public health authorities. The federal and state governments want to create 5000 new jobs, as well as implement a digital upgrade within the departments.

SUMMARY

Many years after the state had withdrawn from its economic activities and control of economic policies, the trend is now reversing.

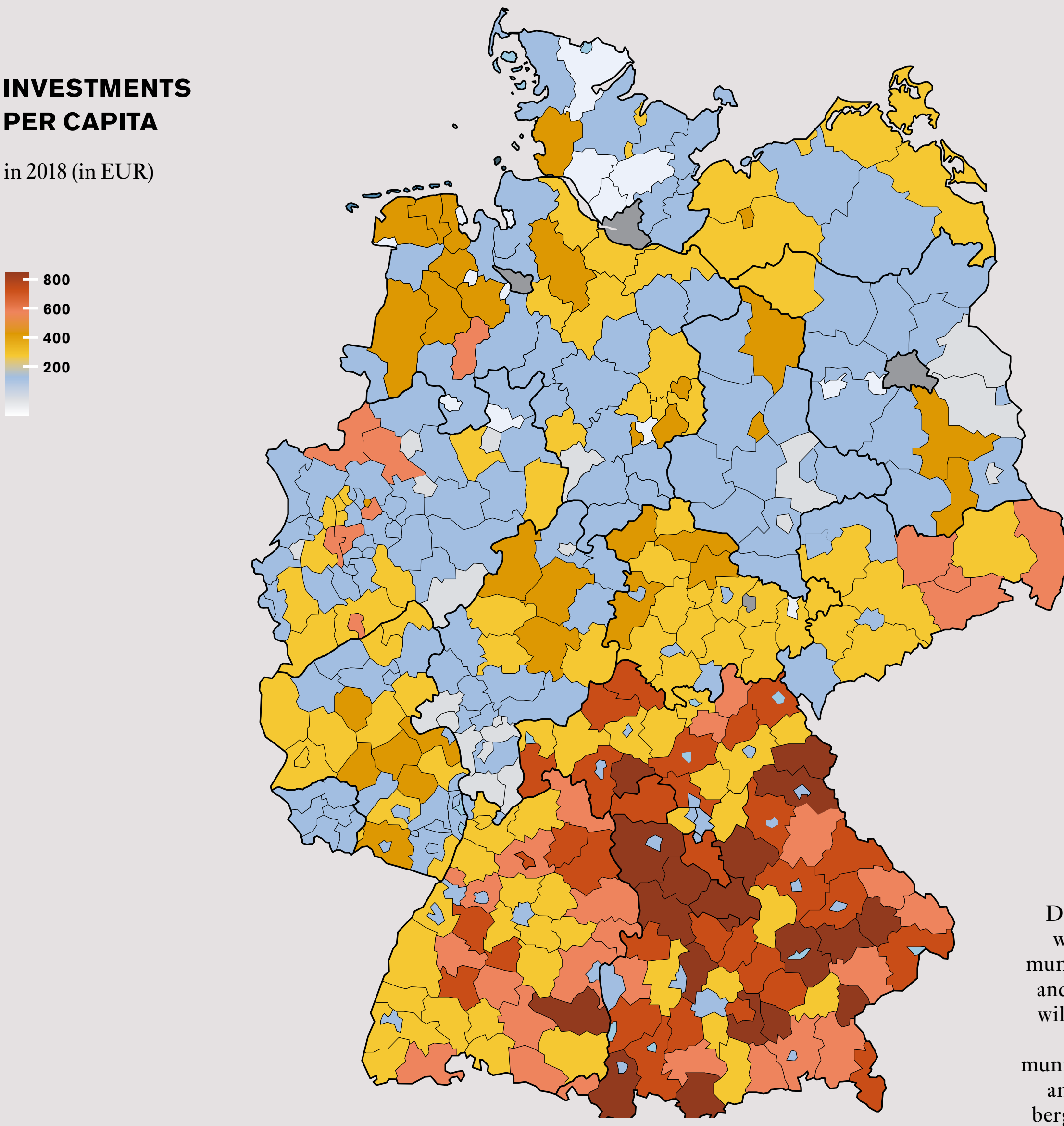
The central banks' ability to avert economic crises is in doubt and a greater political commitment is required.

Municipal enterprises play an important role in the provision of public services.

More state investment in infrastructure is also required.

INVESTMENTS PER CAPITA

in 2018 (in EUR)



GRAPHIC: GCO BASED ON RESEARCH BY LEON WANSLEBEN / MPI FOR THE STUDY OF SOCIETIES

Dissimilar conditions: while many cities and municipalities in central and northern Germany will have to continue to save money, most municipalities in Bavaria and Baden-Wuerttemberg can afford to invest generously.

However, Wansleben identifies a requirement for action on one central issue. He is calling for at least partial debt relief for over-indebted municipalities, because without it they will be unable to solve their structural problems. He asserts that debt repayments and restrictions on municipal supervision have left no room for investment, which in turn has a negative impact on the development of these municipalities. In other words, over-indebtedness triggers a downward spiral. Although acting Finance Minister Olaf Scholz came up with a debt relief plan, it was not accepted by the governing coalition due to long-standing reservations. According to its critics, the plan would reward poorly managed cities and communities. Conversely, the researcher's evaluation of the state's response to the pandemic is positive. "The market dogma has been wiped off the table," Wansleben says and sees the aid packages as a reasonable mix between economic stimulus and investment. "This has now revealed a major disadvantage of the U.S. system," he concludes. There, the federal government is refusing to provide financial support to the individual states. This means, Wansleben explains, that the U.S. states are having to bear the costs of the Covid-19 crisis, while losing revenue at the same time. The German model, in contrast, is based on cooperative federalism in which the federal, state and local governments redistribute funds among themselves and between levels, i.e. they act in solidarity, especially in times of crisis.

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