As Germany's Finance Minister, Wolfgang Schäuble is one of Europe's most influential politicians -- and one of its most hated. Many hold his austerity policies responsible for mass poverty and unemployment in the south. How does he know his decisions are right?

At the Federal Ministry of Finance on Berlin's Wilhelmstrasse, working home to one of the most powerful men of our time, the corridors are up to 700 meters (2,296 feet) long. They lead to 2,100 offices, whose stone doorframes form seemingly endless rows reminiscent of the set of a grim, futuristic film.

The layout of the building, designed by Nazi architects, looks like the drawing of a complex machine part. Those who enter the building inadvertently find themselves whispering, as if to avoid disturbing the power concentrated inside. History is constantly being made, day after day,
in this building. Senior Nazi leader Hermann Göring once strode through its corridors. It was occupied by the Soviet military administrators after World War II, and it was the setting for both the establishment of the German Democratic Republic (East Germany) and, decades later, its liquidation by the Treuhandanstalt, the agency that privatized former East German state-run enterprises.

Wolfgang Schäuble's office is in room 4358, an unadorned corner office on the fifth floor. Many people in cities like Athens and Madrid hold this man responsible for their misery. For them, he is hardly less contemptible than the other men whose offices were once in the same building. They blame him for the plight of retirees reduced to scavenging for food in garbage cans. They claim that the Teutonic furor behind his austerity measures has impoverished Europe and turned it into a place of decay. They believe that no one bears more responsibility for such policies than the man in room 4358 at the German Finance Ministry. Does this man in a gray suit actually know what he is doing?

'Into a Dark Forest'

Schäuble isn't one for small talk. He seems to have no objection to getting right to the point -- to the question of what constitutes the basis of his political decisions, and how academic insights enter into the political process. "As Bismarck said, from one second to the next, you suddenly find yourself walking into a dark forest," he says.

The minister is referring not only to his particular branch of government, but also to the system of finance, global transfers and hypersensitive expectations in an era of chronic crises. Many voters act on little more than the hope that their elected representatives in the parliament and the administration have a pretty good idea of what they are doing. But what exactly serves as the basis for their decisions?

Schäuble points to a man sitting with him at the table: an unobtrusive, alert man whom the minister, with a hint of sarcasm, calls his "chief economist." His name is Ludger Schuknecht, and his head resembles that of a nervous bird. As the Finance Ministry's director general for economic policy, a position referred to as "AL I," Schuknecht serves as the link between the world of economic theory and the world of the feasible, between knowledge and power.

"He is an outstanding academic," says Schäuble, although he is unable to resist adding a "but..." He doesn't complete the sentence, and yet it is clear what Schäuble means to say: Politics is a whole different game. Schuknecht laughs nervously.

Staying One Step Ahead

Schuknecht's job is to provide answers to all technical and specialized questions on the spur of the moment. Schäuble sometimes even calls him at night to resolve questions that are on his mind. Could you explain to me, once again, the "balance sheet crisis" in Spain, he might ask? Or: Which laws govern the shadow banks in the US state of Delaware? Schäuble expects to receive immediate input, material to contemplate.

Schuknecht's economic policy division employs about 140 people, most of them economists, whose job is to provide the state secretaries and the finance minister with the latest figures. They are expected to be consistently well informed about the latest academic debates, or
preferably even a step ahead of them. Schuknecht is convinced that there isn't a single important thought that escapes his team. They represent the concentrated expert knowledge of the powerful.

Each employee in the economic policy division has access to specialized knowledge and contacts at universities, banks and associations, as well as think tanks in Brussels and Washington. Schuknecht's staff members invite professors to write concept papers or, at times, to pay a visit to the minister in room 4358.

One of those academics was Kenneth Rogoff, a Harvard economist and one of the world's foremost economic thinkers. He stopped by Schäuble's office on March 2, 2011, just after having given a talk in the ministry on his latest book, "This Time is Different," a 500-page tome on the financial crises of the last 800 years. The book, a massive collection of figures derived from archives, forgotten books and documents presumed lost, became a global bestseller and required reading for finance ministers and central bankers alike. It helped to explain the anatomy of financial crises.

Schäuble, who had read the book, met with Rogoff for an hour. "It wasn't a narrow advice-giving session," says the minister. "I asked him to explain to me what he said in his talk." As it turned out, Rogoff's views conformed to what Schäuble had always known: Ever since money has existed, there has been debt and there have been crises. And when they expand into sovereign debt crises, and when the entire structure of global finance begins to totter, there are no longer any easy answers. After the meeting, the name Rogoff began popping up in Schäuble's speeches.

**The Real World**

"Academics are important," says Schäuble, "because one has to constantly make an effort to understand things." And yet there is still a wide gap between all the models and theories, and actual political decisions. The world doesn't submit to theories, and history does not offer quick lessons for the future. Suddenly what the experts believe is the right thing to do diverges from the reality of what is feasible -- a reality characterized by political compromises in Brussels, unrest in Lisbon and the power struggles within the steering committee of a coalition party in Athens.

Greece is only one example, but a good one nonetheless. Schäuble often mentions Greece, and when he does he breathes heavily and pauses frequently, rubs his eyes and clasps his hands together in front of his face as if he were praying. Should the country have withdrawn from the euro zone in 2010? The possibility was discussed in the Finance Ministry, even though these discussions were never mentioned publicly. The numbers were clear, and they made a mockery of the Maastricht criteria.

"But then I get a call from (former US Treasury Secretary) Timothy Geithner," says Schäuble, "and he says, 'You do know that we wouldn't have made the decision to allow Lehman Brothers to go bankrupt if we had been asked 24 hours later, don't you?'" Schäuble shrugs his shoulders and falls silent. He cradles his head in his hands and narrows his eyes, using body language to ask: Well, what do you do in that situation? What's the right thing to do? What isn't? What's going to blow up in your face tomorrow?
"Or take the debate in 2011 over the debt haircut for Greece," Schäuble continues. He shrugs his shoulders once again. What would be the consequences of debt forgiveness? What would it mean for Portugal? And for Ireland? And how much of a haircut should private creditors be forced to accept? 20 percent? 22? 30? Or at least 50, as Schäuble had proposed from the very beginning?

'That Terrible Feeling'

It wasn't because he was sure about the number, but almost on the basis of a gut feeling derived from year after year of dealing with the feasible. In those situations, someone like Schuknecht is no longer helpful. In those situations, politicians get together late at night, drink wine and talk -- not about the specific details and not about methodology, but about all the things they have already experienced, and about what works and what doesn't.

Schäuble talks about how Jean-Claude Trichet, the then-head of the European Central Bank (ECB), warned him that by rigidly calling for a 50-percent debt haircut he was risking the worst crisis since the Great Depression. "Thank God he wasn't right," says Schäuble. "It ended up at 53 percent. In the end, you can't reach a decision like that based on scientific methods. Nevertheless, you have to make the decision as difficult as possible, weighing all the options with the help of experts. Then you reach your decision and assume it's the right one and hope, just a little, that you're not wrong."

Schäuble exhales loudly and shrugs his shoulders. He is honest enough to admit that he wasn't envious of his predecessor, Peer Steinbrück, when Lehman failed in 2008 and the global financial crisis erupted, nor did he envy Steinbrück for "that terrible feeling you get when you realize that this could turn into a panic."

A generation of economists has studied the trauma of the 1929 panic that led to the Great Depression. It dominates their theories and pervades their models. The lessons of that great crisis led to the emergence of two schools of thought that remain hostile to each other to this day, and that can quickly transform discussions of fiscal and economic policy into an ideological minefield.

During the crisis and as a result of its dissection by academics, London currency speculator John Maynard Keynes and Friedrich August von Hayek, the son of a Viennese doctor, became the champions of the two camps. Keynes assigned responsibility to the government, while Hayek, despite everything, continued to argue that markets should be as unregulated as possible.

To this day, controversies in economic theory can still be interpreted as variants of the contradictions between Keynes and Hayek, even if today's debates are conducted with the sophisticated mathematical models of econometrics. For Keynesians, the market is an animal that requires taming. Students of Hayek, on the other hand, prefer to see the state as a night watchman, establishing a loose framework and allowing the markets to run their course. Instead of battling a crisis, the best approach is to weather it like a storm. "These categories are too simplistic for my taste," says Schäuble. "I have a disdain for them shaped by experience. I'm beyond that."

The Flexible Approach
Perhaps that is why he and his advisors end up periodically changing their positions. In the endless corridors of the Finance Ministry, the dispute between the two schools of economic thought has broken down into a question of the right timing, with "Keynes" sufficing for the short term and "Hayek" for the longer and long term. Their goal is to maintain a balance between the rapid stimulation of a tired economy and the long-term achievement of a reasonable level of debt. They call it the "flexible approach to regulatory policy," which the rest of the world tends to describe, and deride, as the "German ideology."

Even when Schäuble sounds like former Chancellor Gerhard Schröder, who once casually decreed that there is no left-wing or right-wing economic policy, but merely a modern and an outmoded economic policy, he still imposes a policy on Germany's European neighbors that their governments see as conservative, at the very least, and substantially inspired by Hayek.

Someone who seeks to enshrine debt limits in the constitution, thereby strapping a chastity belt of fiscal policy onto the government, who advocates stability pacts and for whom a low debt level is more important than high unemployment figure, is staking out an ideological position.

This is the view critics, from France's Socialists to US President Barack Obama to Left Party politician Sahra Wagenknecht, hold of the new "German ideology." Schäuble finds such criticism "ridiculous" and believes that the dispute over "austerity" boils down to a "misstatement of the issues." Anyone who seriously considers the problems of countries, he says, can only conclude: "In many cases the economic foundations have become fragile, and this doesn't work in the long run. That's why simply injecting more money doesn't do any good, and why improving the underlying economic conditions is so important."

Establishing a Threshold

It is a very German and very Protestant view, which, until 2010, could easily have been dismissed as moral nonsense because it lacked strong scientific evidence. But during the course of 2010, that evidence was supplied just in time for the Greek crisis, when economists the world over were able to prove that high levels of government debt stifle growth.

In a short, elegant paper, Harvard Professors Rogoff and Carmen Reinhart even established a number, a "threshold," or magical limit: They wrote that growth suffers when government debt exceeds more than 90 percent of a country's gross domestic product. It was the kind of knowledge that could be used to shape policy.

It also helps to explain the interplay between policy and science. Since their 2010 bestseller "This Time is Different," the names of the two authors, Rogoff and Reinhart, have become a quality seal of sorts. The 90-percent mark quickly became a welcome tool for all those politicians who had always believed austerity was better than borrowing.

Throughout 2011, European Commissioner for Economic and Monetary Affairs Olli Rehn used the expressions "90-percent rule" and "90-percent threshold." They were now being quoted whenever the time came to cut budgets, admonish habitual debtors and intervene in the policies of other countries. Olivier Blanchard, chief economist of the International Monetary Fund (IMF), called the 90-percent threshold "a good reference point." And as soon as the Rogoff-Reinhart paper was published, officials at the German Finance Ministry recognized its potential value in furthering their agenda.
All Hail the Cash Injection

From all corners of Europe, there were growing calls to finally inject more money into the heart of the economy and to put an end to austerity -- with its side effects of the elderly begging for money, young people being deprived of opportunity and burning barricades in Athens and Madrid -- and to finally stop taking debt more seriously than the destruction of the European project.

At the time, the economic policy division supplied Schäuble with ammunition to fend off this attack. It argued that confidence in a sound government has historically carried more weight in Europe than in the United States. It also argued that high debt levels impose a far greater burden on Europe than on the United States, home to the world’s currency, and where the government also has the option of simply printing more money. During the various conferences of the period, Schäuble argued that taking on even more debt was not the way to fight existing debt, as Rogoff and Reinhart had stated in their paper.

The Harvard professor was summoned as a crown witness of sorts against the kingdom of the dollar, on the one hand, and against the tendencies on Europe's periphery to ease off austerity, on the other. In a speech to the German parliament on Jan. 17, 2013, Schäuble mentioned Rogoff directly, saying: "We now know -- as even the former chief economist of the International Monetary Fund, Mr. Rogoff, has demonstrated -- that at a certain level of government debt, a further increase in debt no longer stimulates growth, but in fact hinders it in the medium term. This is precisely why we don't do that."

The Keynesians Strike Back

Last April, three years after the publication of the Reinhart-Rogoff paper, a student at the University of Massachusetts Amherst made headlines when he claimed to have refuted the Harvard professors' numbers. Thomas Herndon, a 28-year-old graduate student in economics, concluded that the 90-percent study was filled with embarrassing typos, was based on incorrect data and compared apples with oranges. According to Herndon, key figures in the study were wrong and essentially worthless. Before long, Herndon's conclusions had been reported in every newspaper, blog and tweet from Alaska to Tierra del Fuego, and from London to Tokyo.

Rogoff suddenly found himself confronted with a digital mob instead of the civil academic community. Rogoff, a scholar who has been a chess grandmaster since the age of 25, talks about the incident in his office at Harvard University. He has withdrawn from the public eye and has stopped giving interviews, fearing that anything he says will only be used against him. He agreed to an interview with SPIEGEL in an effort to defend his credibility.

Rogoff says that at times he was receiving up to 10 emails every five minutes, that he was called a filthy pig and a murderer, and that some people even suggested he should die. He says that he will never forget some of the attempts to assassinate his character on television. Some of his colleagues, he says, have called him the victim of an outrageous and even fascist campaign. He insists that he isn't telling us these things so that we will publish them, but instead to help us understand him.

"Our 90-percent thesis doesn't mean that everything is fine up to 89 percent and that everything becomes catastrophic starting at 91 percent," says Rogoff. "But something happens at this threshold. Perhaps we haven't understood it fully yet, but no one can seriously believe that it
isn't a problem that some countries are reporting their highest ever national debt levels in times of peace." So is Rogoff truly the premier advocate of rigid austerity, as his critics and enemies claim? Rogoff laughs out loud -- bitterly and almost despairingly -- at the question.

Dragged Through the Mud

He can present entire binders of newspaper clippings that demonstrate how perfectly balanced the arguments he and Reinhart presented publicly have been; how they warned against radical austerity; how they advocated adjusting government budgets in a sustainable and reasonable manner, and with a sense of proportion; how they even advocated Keynesian ideas so as not to stifle growth; and how he, Rogoff, campaigned for a little less stability in Europe and a little more inflation in order to find a gentle path of transition. But none of it did very much good.

"How much unemployment did Reinhart and Rogoff's arithmetic mistake cause?" asked the British newspaper The Guardian. Rogoff is appalled by such reductive arguments. He, who prides himself on being nonpartisan and describes himself as a "centrist," whose works were cheerfully appropriated by all sides in the US presidential election campaign and quoted as proof of the validity of their opposing programs, feels like a victim of collateral damage in the old war of ideologies. "What can an academic do when politicians pepper their speeches with his name? Should I have issued a denial each time? To whom?"

In the Keynesian camp, the no less renowned New York Times columnist and Nobel laureate Paul Krugman wrote about the "Rogoff-Reinhart saga," depicting the economists in a highly unflattering light. Soon the two economists were appearing in cartoons as a pair of bunglers who, out of sheer stupidity, had the prosperity of entire nations on their conscience. As recently as this June, a major article in the German newspaper Die Zeit erroneously claimed that the 90-percent mark had been disproven and that austerity policy was wrong.

Even before they were attacked in April of this year, Reinhart and Rogoff had followed up on their 2010 working paper, which was indeed erroneous, with more exhaustive studies that further substantiated an empirical relationship between high debt levels and weak growth. Their conclusions were underpinned by independent, no less profound studies by the ECB, the IMF and the Bank for International Settlements, based in Basel, Switzerland.

Finance Minister Schäuble, a political pragmatist who used Rogoff as much anyone else, defends the economist when he says: "It really doesn't matter whether the threshold lies exactly at 90, 100 or 110 percent. That isn't really the issue at all. But one thing is clear: At some point borrowing goes too far, which no one can seriously dispute."

Nevertheless, have there been situations in his last three years as finance minister when Schäuble feared that he was barking up the wrong tree? "It would certainly be strange," he says, "if you hadn't wondered at some point during the euro crisis: My God, are we on the right path?"

Of course, says Schäuble, there were times when he and others wondered whether the European Union would survive or the grand project would indeed fail. "What would have happened if a revolution had erupted in one of the countries?" Schäuble says. "That's when the economist has no answers, which brings us back to the art of the possible."

It is an erratic art form, resulting in a constant political back and forth, almost like a pendulum swinging between Keynes and Hayek. A radical shift occurred in the summer of 2010, a
departure from debt-financed economic programs and a commitment by most industrialized nations to austerity in their budgets. But why? Because a professor said the right thing in a conversation in room 4358 at the German Finance Ministry? Because a study had been published at Harvard? Or because more and more new studies appeared that substantiated the correlations Rogoff had made?

The likely answer to these questions is no. It may come as a blow to the vanity of some experts, but their expertise, though employed as a tool to support political arguments, is never implemented, and certainly not directly. Their conclusions are chopped up and combined into a stew, and policymakers are not interested in the individual components.

**Experience Breeds Humility**

Economic insight is primarily a means to an end, a piece of background information, but not a navigation system. It's a process, says Schäuble. "You can't turn over political decisions to academics," he says. "But it's just as wrong for politicians to believe that they are always right. As a politician, you need a certain amount of humility."

Many of the players involved lack such humility, especially the experts who appear on talk shows, and are always completely convinced of their opinions and are quick to accuse lawmakers of being incapable of comprehending simple truths. But the reality is that politics, compared with the pure theories of academia, is a dirty business, and in this case it's a good thing.

Wolfgang Schäuble knows the business better than almost anyone else. The 2013 German parliamentary election was his twelfth. He has been a member of the Bundestag for 41 years. Over that course of time the Berlin Wall was toppled, he survived an assassination attempt, a world once divided into east and west had to reconstitute itself, planes were flown into skyscrapers, Wall Street crashed, and the euro shook. So many unpredictable things have happened that the minister has had plenty of time to learn how to be humble.

*Translated from the German by Christopher Sultan*