

THE GERMAN ELECTION

134

NO VOTE FOR EUROPE?

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- The outcome of the German federal elections on September 22nd will have a significant impact on the management of the on-going eurozone crisis and set the tone for the future course of European integration.
- Although the EU and the euro are largely absent from current electoral debates, significant differences on these issues exist both inside and between German political parties in the run-up to the September polls.
- However, in the absence of significant debate, fundamental decisions over the future of EU integration will be postponed until after the election, when a cross-party compromise appears more feasible.
- Regardless of the election outcome, the next German government is likely to prove more conciliatory on austerity policies in Europe and will boost domestic spending, but will retain some red lines on further EU integration.
- While the rhetoric and the pace of change might differ significantly depending on the shape that the next coalition government takes, German eurozone policies will continue to trade fiscal solidarity for structural reforms.

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Pivotal power¹

Germany is Europe's pivotal power. As France founders and Britain retreats, Germany has inevitably been cast in a central role. This is not only the case in the evolving eurozone drama – which many argue Germany is exacerbating – but increasingly applies to a wide range of other issues. Whether it concerns EU institutional reforms, a common energy market, or Europe's global role, Germany's voice is often decisive. In these and many other areas, Europe's future, it seems, will be made in Germany. But burdened by its history and constrained by its domestic institutions, Germany is loath to lead. When it does, it often seems to focus on defending its own national interests rather than pursuing its European vocation.

Inevitably, this has led to a great deal of friction inside the EU. Public resentment towards what is perceived as “German hegemony” has become widespread. At the same time, numerous commentators have warned that a lack of German leadership is threatening to undermine the European project. According to George Soros, soothsayer of the ERM collapse, Germany's “current policies are leading to a prolonged depression, political and social conflict, and an eventual break-up not only of the euro but also of the European Union”.

While much of the hysteria over a euro collapse is exaggerated, most critics agree that the EU will remain weak without an active and engaged Germany at its core. This is particularly the case in four key policy areas:

First, to avert a deepening of the debt spiral amongst the EU crisis countries and prevent austerity-driven deflation, critics argue that Germany ought to accept some form of debt mutualisation amongst eurozone members. Second, to provide a growth stimulus and even out intra-European current account imbalances, they hold that Germany needs to shift its own economic model away from exports and towards consumption. Third, to strengthen the political legitimacy of the EU and create a full economic union, they maintain that further sovereignty has to be transferred to Brussels. Finally, to

1 The authors are indebted to Jens Närger for his competent help as a research assistant.

reinforce Europe's global role and revive the EU's Common Security and Defence Policy, they demand that Germany needs to shoulder greater international responsibilities.

Over the past four years, Angela Merkel's government has contested the need to act on these issues. But as Germany heads to the polls, what are the chances that Europe will get the Germany it wants and needs?

Absent Europe

Compared with the rest of the EU, the German public remains reflexively pro-European. Although public support for the EU (60%) and economic integration (54%) has declined somewhat, it remains well above the European average (45%/28%).² Moreover, popular support for the euro has visibly increased, with 69% now in favour of the euro while only 27% want to see a return to the *Deutschmark*.³ However, this rather rosy picture hides a growing disenchantment with the idea of an “ever closer Union”. Mistrust in EU institutions has grown (59%) while few Germans support the introduction of Eurobonds (17%) or the transfer of budgetary rights to the EU (36%). A full 74% now oppose the creation of a federal Union on the model of the United States.⁴

Although a sizeable share of the German public also opposed the introduction of the euro and even German re-unification, this sagging public enthusiasm for a federal Europe has created friction inside the German party system. Much of this has been limited to internal debates, as the launch of an openly euro-sceptic party – the Alternative for Germany – failed to rally significant public support.

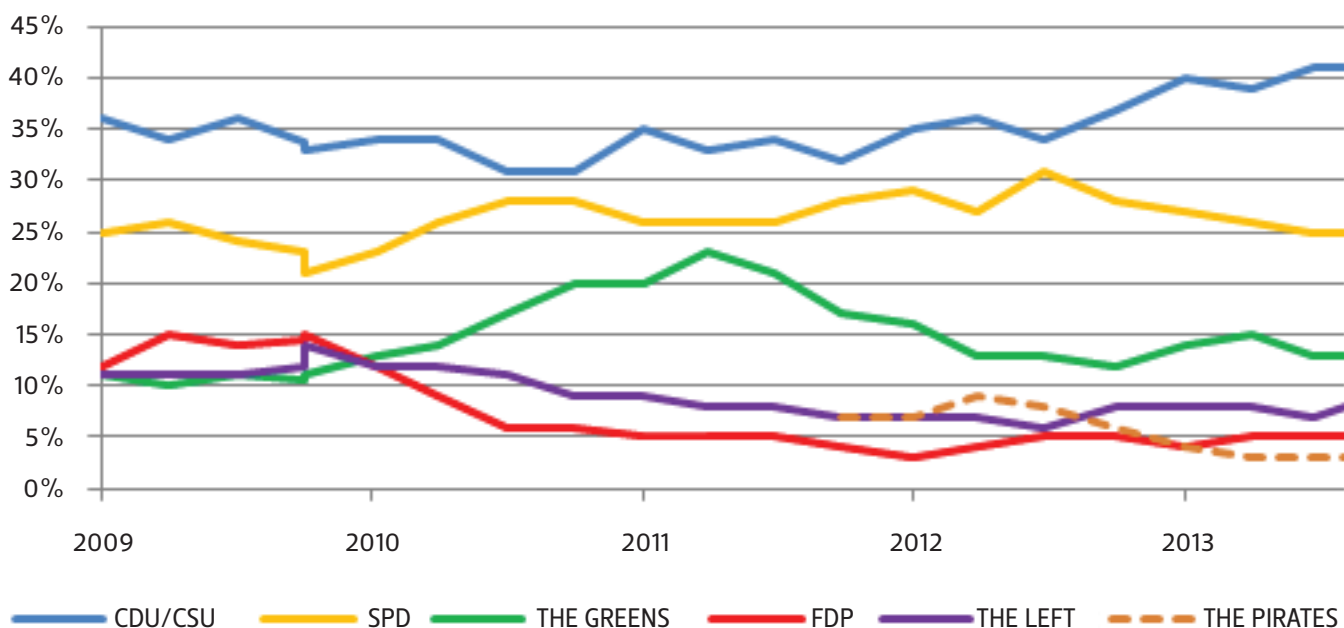
However, there are now deep divisions between pro- and anti-integrationist trends in all of Germany's catch-all parties. This has been visible during the bailout votes in the German Parliament, as well as in the often contradictory statements of old-style Europeans like Wolfgang Schäuble and the more

2 Andrew Kohut, “The Sick Man of Europe: the European Union”, Pew Research Centre, 13 May 2013.

3 *Handelsblatt*, “Deutsche finden den Euro gut”, 9 April 2013.

4 *The Guardian*, “Crisis for Europe as trust hits record low”, 24 April 2013.

Support for political parties in Germany. Source: EMNID.



EU-sceptical Angela Merkel. As a result of these deep divisions and due to the widespread public scepticism, Europe has been largely absent from the electoral debate.

With Germany experiencing a low in unemployment, rising real wages and record consumption, much of the debate has focused instead on innocuous domestic issues and the personality of the candidates. Here Merkel enjoys a big lead over SPD candidate Peer Steinbrueck, whose sharp-tongued oratory and business ties have alienated German voters.

As a result, Merkel's CDU (40-42%) is enjoying a comfortable lead in the polls and has several potential options for forming the next government; with or without the much-reduced FDP (4-5%). The SPD (25%), on the other hand, remains far from its goal of clinching another coalition with the Greens (13-14%). The weakness of the left is further compounded by divisions between the centre-left SPD and the far-left Linkspartei (8-9%), which remains an electoral outcast. This has narrowed much of the election down to coalition arithmetic. However, small changes in electoral outcomes can have a big political impact.

Eurozone crisis

As Europe's largest economy and the eurozone's biggest creditor, Germany has a crucial role in

shaping the EU's response to the current economic crisis and the future of EU economic governance at large. Viewing the crisis largely as a sovereign debt crisis, Germany – together with some of the eurozone's smaller triple-A rated countries – has championed a combination of strict fiscal discipline and improved competitiveness as the only means to reduce budget deficits and cut Europe's burgeoning public debts.

Accordingly, bailout loans to struggling eurozone economies have been provided only in exchange for austerity measures and accompanying structural adjustments. At the same time, the German government has been adamant in its opposition to any form of debt mutualisation. It argues that any such move would reduce the pressure on crisis countries to implement necessary budget cuts and carry out crucial structural reforms, while increasing German liabilities.

However, unlike Merkel's coalition, both the SPD and the Greens are in principle open to some form of debt mutualisation. In their view, the EU is already a union of joint liability (*Haftungsunion*). Accordingly, SPD leaders have proposed setting up a European debt redemption fund which would pool the debts of eurozone member states exceeding 60% of national GDP. Although the SPD insists that each country would continue servicing its own debts and would have to consent to a stringent repayment schedule, the pooled debt would be guaranteed

jointly. The Greens support this suggestion but are ready to go even further. In its election manifesto, the party declares that its long-term goal is the introduction of Eurobonds, although this would require a change to the European treaties and the German Constitution.

Despite the different positions on debt mutualisation, much of the limited electoral debate on the eurozone has focused on the issue of austerity. SPD candidate Peer Steinbrück has repeatedly blamed Merkel's fixation with fiscal consolidation for the European-wide increase in unemployment. In a similar vein, the SPD's election manifesto states that the mutual commitment to balanced budgets – in itself an important goal – “has to be accompanied by a shared understanding of and concrete targets for a European growth strategy”. In order to promote sustainable growth in Europe, the Social Democrats further suggest the establishment of a European investment and restructuring fund, and boosting a recently launched EU fund to combat youth unemployment from €6 billion to €20–25 billion.

The governing coalition has reacted to these attacks by similarly moderating their language on austerity: Merkel recently hosted a high-level EU conference on youth unemployment; Germany's state-owned KfW bank has offered cheap loan packages to small and medium-sized enterprises in Spain and Greece; and several eurozone countries have been granted more time to bring their budgets under control. However, in marked contrast to the opposition, measures to support growth in eurozone countries – like low-interest loans – are of a bilateral and not a supranational nature, suggesting a shift away from further integration.

A significant test case for every future German government will be the sustainability of Greek debt. The IMF recently warned that eurozone governments are likely to face losses on the Greek bailout, as another debt haircut has become inevitable. The German reaction to this has been muted. Merkel publicly insists she sees no need for a further haircut, and on a visit to Athens in July 2013, Finance Minister Schäuble also rejected the scenario. Even Social Democrat Steinbrück says he is “very sceptical” about another debt cut. However, with eurozone officials scheduled to debate further debt relief for Greece in April 2014, few believe that the German opposition to the haircut will survive the election.

In particular, any coalition that includes the SPD or the Greens is likely to take a softer approach on this particular issue.

Economic imbalances

Macroeconomic imbalances inside the eurozone are often considered one of the reasons for the current economic crisis. Liberal Anglo-Saxon commentators in particular have argued that a process of economic rebalancing is required to pull the crisis countries out of their current mess. According to this argument, the large fiscal deficits and declining competitiveness of eurozone crisis countries represent the flipside of a decade of bulging current account surpluses, declining real wages and loose lending in Germany.

To reverse these imbalances and provide a much-needed fiscal stimulus, it is often argued that Germany needs to boost domestic demand by raising wages, lifting public investment and reducing its savings. This argument has irritated the German government, which argues that Europe is facing a sovereign debt crisis and that greater German spending would have a negligible impact on growth in peripheral eurozone member states.

Despite widespread public opposition to an “artificial” rebalancing and a lack of domestic debate about Germany's economic model, electoral campaigns have inadvertently focused on some of the issues behind this debate. Minimum wages have become a key electoral topic following years of wage moderation and the development of an extensive low wage sector. While the SPD and the Greens have campaigned for the introduction of a statutory minimum wage of €8.50 per hour, the CDU and FDP favour a model of sector-wide minimum wages. Both models, if implemented, are likely to raise wages and consumption, which have grown robustly since 2010.

Simultaneously, the two main political parties have made generous electoral promises for an increase in social spending and public investment. Defying the image of the “Swabian housewife”, Angela Merkel's CDU has promised an estimated €21 billion per annum in additional spending to raise pensions, lower taxes and boost child-care benefits, with another €25 billion to go into infrastructure and education.

The SPD has further upped the ante by promising €80 billion per annum of public investments with the aim of raising the investment quota from 17% of GDP to 20% of GDP. While the SPD proposal includes plans for an increase in the top income tax rate and a reintroduction of the wealth tax, at least part of this investment is meant to be financed by the private sector. The Greens have similarly argued for a large tax-financed increase in spending. The CDU and FDP, on the other hand, oppose any increase in taxation and argue that extra spending cannot be financed through debt.

Although electoral promises of high spending have to be read with some caution, wages and public investments are bound to expand under the next German government. But will this be enough to provide the desired fiscal stimulus for the eurozone and rebalance European economies? Here the evidence is less clear. Germany's current account surplus already halved vis-à-vis the eurozone in 2007–2012. Moreover, an extensive Commission study from December 2012 found that the feed-through effect of any increase in German domestic demand to the crisis countries would be minute – as little as 0.02% of GDP for Spain, Italy and Portugal for every 1% increase in German domestic demand. While Germany's election might inadvertently aid eurozone rebalancing, it is therefore unlikely to generate enough growth to end Europe's recession.

Institutional reforms

The euro crisis has revealed some serious deficiencies in the current design of the EMU, leading to calls for deeper economic and political integration. At the same time, there is widespread agreement in Europe that such steps need to be coupled with reforms that improve the democratic legitimacy of EU governance. While these issues have drawn little attention in the German electoral debate, they are mentioned in the election manifestos of the major political parties.

One of the key aspects of the redesigned EMU will be the Banking Union. The current German government has actively shaped the emerging Banking Union. Most notably, Germany elbowed through its demand that only large, systematically important banks should be placed under the authority of the newly established Single Supervisory Mechanism.

This stance owes much to the fact that small savings banks and cooperative banks form the backbone of Germany's own financial sector. The SPD and the Greens support the government's line on this issue. The Social Democrats, however, argue that the powers to supervise small and medium-sized banks should be delegated to the ECB in crisis situations. In a similar vein, the Greens and the FDP suggest that the European supervisor should have the right to control smaller banks in case national authorities fail to do so.

The most controversial aspects of the European Banking Union are related to banking resolution and deposit insurance schemes. The current German government recently rejected Commission proposals to establish a European resolution fund and to grant the Commission the authority to take ailing banks into resolution. In the German government's view, the power to wind up banks should remain in the member states, as the current treaties would not even allow for the Commission to assume such power. The common resolution fund, on the other hand, is viewed by the government as another potential bailout mechanism. The SPD, however, has a radically different position. In its election manifesto, the party demands both the establishment of a European resolution agency and the setting up of a European restructuring fund that would be financed through nationally collected banking levies. The Greens also support these proposals.

When it comes to deposit insurance schemes, there are no big differences between the parties. Both the CDU and the FDP explicitly reject the idea of constructing a European deposit insurance system, as it would make German savers liable for the failures of foreign banks. However, the CDU favours the harmonisation of minimum standards for deposit guarantee schemes in different European countries. A similar framework is suggested by the Greens as well, whereas the SPD's manifesto remains silent on this issue.

To strengthen the democratic legitimacy of the EU, the German parties look towards the European Parliament and the European Commission. The SPD, Greens and FDP favour empowering the EP by granting it the right of legislative initiative. The Greens also demand that the EP should be entitled to have a say in the management of the euro crisis and in economic governance in general. The SPD and FDP

both envision the future EU as a two-chamber system in which the European Parliament would form the first, transnational chamber and the Council the second, responsible for representing the interests of the member states.

However, opinions on the status of the Commission differ. The FDP suggests no changes to the Commission's role, but proposes reducing the size of the Commission to increase its efficiency. The SPD, by contrast, would like to see the Commission develop into a full-blown European government that would be elected by and accountable to the European Parliament. The Social Democrats and the Greens also speak in favour of using the EP election for selecting the President of the Commission. The SPD has already announced that EP President Martin Schulz is the party's favourite to lead the European socialists' campaign in next year's EP election and to compete for the Commission's top post.

The CDU's election manifesto does not include any proposals regarding the institutional design of the EU. Although an earlier CDU resolution endorses the direct election of the Commission President, Merkel has distanced herself from this suggestion. This reflects a wider rift within the party between those supporting the further federalisation of the EU and those in favour of Chancellor Merkel's 'union method', which entails that the member states continue to play a decisive part in the development of the Union alongside the EU institutions.

These recent reform debates have raised the question of whether it will be necessary to reopen the EU treaties in the near future. Although Angela Merkel back-pedalled on her suggestion of a full-blown treaty revision earlier this year, Wolfgang Schäuble has insisted that limited treaty revisions are a necessary condition for creating a truly European Banking Union. The SPD, in contrast, has argued that the current provisions are sufficient for the time being. In case the need for more substantial treaty revision arises, all German parties favour the convention method.

Global power Europe

German foreign policy has long been characterised by restraint. During the Cold War, Germany was a semi-sovereign country with limited control over

its own armed forces, a deeply pacifist outlook on international affairs, and a foreign policy that was defined by reflexive multilateralism. Germany, in the hackneyed adage of this era, was an "economic giant and a political dwarf". Much has changed since then. But despite having become more assertive in international affairs, most commentators argue that Germany still does not think and act strategically. Instead of shouldering its "fair share of the burden" in international crisis management, German foreign policy seems to have become a function of its trade interests. This "strategic immaturity" is often seen as a crucial problem for the ambitions of a global power Europe.

Indeed, not only does Germany appear less interested in a more integrated European foreign policy towards key countries such as China, but it also seems increasingly at odds with Europe's two strategic leaders – Britain and France. On important strategic issues, such as Libya and Syria, Europe has appeared disunited as a result. The ensuing strategic dissonance between Europe's major powers has put a spanner in the works of global power Europe and encouraged greater Franco-British bilateralism.

Arguably, the German elections are unlikely to deliver a mandate for a more robust and strategically-oriented German foreign policy. Change in strategic culture and defence will always remain incremental. Nevertheless, some subtle differences remain in the outlook of the two major parties, both in the area of foreign and defence policy.

In defence matters, the issue of armed drones has emerged as a dividing line. While current defence minister Thomas de Maizière plans on acquiring armed drones after the election, the SPD has categorically ruled out this type of drone, latching on to the public's traditional opposition to the use of force.

A similar division has emerged over the introduction of so-called advanced decisions (*Vorratsbeschluss*) for the provision of German military capabilities to crisis management missions. This would allow Germany to provide military assets to participate in joint missions without previously having to resort to the lengthy Parliamentary consultations (*Parlamentsvorbehalt*) that are constitutionally required and which have often been criticised by Germany's allies. While the CDU favours advanced

decisions in some areas (e.g. transport aircraft, logistics), the SPD remains unequivocally opposed. Although technical, both issues are central to the future development of the CSDP, as they will impact current EU plans for the joint development of armed drones and for greater pooling and sharing.

In foreign policy, differences remain more muddled, but seem bound to crystallise around two particular issues. One of these is Russia. After a period of particularly close ties between Russia and Germany in the early 2000s – colloquially referred to as “Schroederization” after the former German chancellor – relations have cooled somewhat under Merkel.

More recently, German policy has become highly critical of human rights abuses and autocratic practices by the Kremlin. In fact, there are no longer any mentions of the prospects of a “modernisation partnership” between Germany and Russia, instilling democratic values. It is therefore striking that SPD chancellor candidate Peer Steinbrück has raised “constructive engagement” with Russia as one of the main goals in his first major foreign policy speech. Enthralled by its long tradition of “Ostpolitik”, the SPD’s soft position on Russia might complicate EU attempts to adopt a more unified approach, while Merkel’s tougher line appears more in sync with the emerging European sentiment towards Putin’s Russia.

Another crucial issue is Germany’s wider foreign policy orientation. While the SPD has promised that it would revitalise Germany’s engagement in Europe and its neighbourhood, Merkel’s foreign policy gaze has been cast wider. In what appears to be a flag-follows-trade move, Merkel has increasingly sought closer ties with emerging powers. In some cases this has proven controversial. In particular, a close German-Chinese partnership – characterised as a “dream couple” by Chinese Prime Minister Li Keqiang – is seen as undermining European cooperation, as demonstrated by the recent controversy over EU sanctions on Chinese solar panels. Whether any future German government is willing to disengage from China and other emerging global players remains doubtful. However, from the perspective of a Global Power Europe, it is critical that Germany abstains from too much unilateralism in its ties with emerging powers and maintains its European outlook and vocation.

Coalition arithmetic

Based on current opinion polls indicating a comfortable lead for Angela Merkel and her conservative CDU, and considering the coalition intentions signalled by the various political parties, only three coalition options appear feasible after election day: a renewal of the conservative-liberal government between the CDU and FDP; a new grand coalition government comprising the CDU and the SPD; and an as yet untried coalition between the CDU and the Greens.

A renewal of the conservative-liberal coalition, long seen as a remote possibility, once again appears plausible, due to the FDP’s recovery at the polls. While such a coalition might guarantee the greatest measure of continuity, it will be distinctly different from the last coalition. Given the FDP’s current weakness, its influence in the next coalition will be circumscribed. Any future CDU-FDP government would also face a solid blocking majority in the second chamber, forcing it to seek cross-party compromises.⁵ This suggests that such a government may represent a different beast altogether. While eurozone policies would still be defined by continuity, a new CDU-FDP coalition can be expected to be more pliable and will likely temper its support for austerity. Under pressure, it might even concede to a new debt haircut for Greece. But it will continue to fight debt mutualisation tooth and nail and prioritise a balanced budget.

A new grand coalition government between the CDU and SPD is likely to strike a different note on several issues. Having been badly burned by the last grand coalition, the SPD will only concede to such an alliance if it can secure important concessions on policies and representation, suggesting lengthy coalition talks. Compromise appears likely on issues such as the minimum wage, public investment and social spending, possibly even taxes. In EU affairs an easing of austerity and a boosting of the EU growth pact seem plausible. There is also a chance that Merkel might use the cover of the grand coalition to make more wide-ranging concessions; possibly due to the large majority such a government

5 At the time of writing, the opposition holds 36 out of 69 votes in the Bundesrat. The CDU and FDP together hold 15 votes, with another 18 votes held by the “neutral” Länder (jointly CDU-SPD governed).

would hold in both Houses. In foreign policy, the drone programmes, arms exports and a revision of the *Parlamentensvorbehalt* are likely casualties of a grand coalition government, further lengthening Germany's strategic chrysalis.

The formation of a coalition government between the CDU and the Greens, arithmetically a possibility, would be a gamble that could have significant repercussions for Germany's party political landscape. Even though Merkel's U-turn on nuclear power has made such a coalition possible, the overlap between the two sides remains low. One significant focus of a black-green coalition would be to drive forward Germany's energy transition (*Energiewende*) and to revive German leadership on climate change. In EU matters its policies will be similar to a grand coalition, given the Greens' integration enthusiasm. Other issues will be more contentious. Green views on taxation, redistribution, immigration and social policies are almost the polar opposite of the CDU's. And while the Greens' support for the responsibility to protect (R2P) suggests a more expansive global role, its pacifism and proposal to cut defence spending by 10% will temper this drive.

Regardless of the outcome, any future coalition government will have to contend with two structural constraints. The constitutionally enforced debt brake (*Schuldenbremse*), limiting the federal deficit to 0.35% of GDP after 2016, and the Federal Constitutional Court ruling that further transfers sovereignty to Brussels will require changes to the German Constitution. These are likely to prevent any radical change of direction.

Two steps forward, one step back

Germany's much-anticipated election will not write the final dénouement of the eurozone crisis. However, it may well hasten Europe's progress towards a solution. While the next German government is likely to be more conciliatory in its eurozone policies, its role in Europe will remain contentious. Regardless of the governing coalition, there are certain red lines that Germany is unlikely to cross in the short run. Eurobonds and the eurozone bank deposit insurance will, for now, remain off the agenda. Germany will also tread cautiously on transferring additional sovereignty to the EU or investing significant new resources in international

crisis management. But it is likely to soften its tone on austerity and support further rebalancing in Europe through domestic measures on public spending and investment. Although the pace of change on some of these issues will differ depending on the coalition, the likely rhythm will continue to be two steps forward, one step back.

The only reason for Germany to pick up the pace would be a clear and present danger to the survival of the eurozone. This would likely elicit a strong response, perhaps extending to the acceptance of some common liabilities and debt forgiveness, as every future German government will continue to consider the survival of the euro as a core national interest. The brewing crisis over Greek debt, slated to come to a head in spring 2014, might provide just that cathartic moment. In the absence of such a crisis, Germany will continue to move cautiously, lulled by its current economic calm and conscious of the depth of public resistance. Despite this modest outlook, Germany's election will widen the margin for compromise and assuage European fears of the German juggernaut. In the absence of a crisis, this just might nudge Europe towards a solution.

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