

Coalition without consensus: Germany in 2015

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Summary

For almost exactly one year the German Grand Coalition government has preserved Angela Merkel in power and handed the centre-left SPD exceptional influence over energy and microeconomic policy. The trade-offs at the heart of the coalition were possible only because apparent German economic strength allowed a ‘consensus’ on simultaneous fiscal discipline, expansive energy spending and a deepening of the German social safety net. 2015 will be the year that this consensus starts to unravel, as Germany comes under increasing economic pressure. Both sides of the coalition are now focused on reasserting their own diagnosis and prescriptions for German growth and Ms Merkel is perched above this fracturing partnership. Can she control it? What choices will it force on her? And given Germany’s centrality to policy choices at the European level, what does this German domestic landscape imply for the rest of Europe?

December 2014 marks the first anniversary of the German Grand Coalition. For a year the coalition has preserved Angela Merkel in power and handed the centre-left SPD exceptional influence over energy and microeconomic policy. The policy trade-offs that resulted were possible only because apparent German economic strength allowed a suspension of any doubt in the idea that Germany could be governed by a coalition committed simultaneously to fiscal austerity at home and in Europe, and to a higher minimum wage, fiscal expansion in infrastructure and renewable energy investment and in a deepening of the German safety net, for pensioners in particular. Merkel, characteristically, has acted as the guarantor of this ‘consensus’ and the government that symbolises it.

2015 will be the year that this consensus starts to unravel. The latest federal budget passed last month is based on growth rates that now look unrealistic. Without those assumptions, reality will start to intrude. With one eye on its own long term exit from coalition and a wave of regional elections in 2016, the SPD are starting to develop their own diagnosis and prescription for German economic malaise and contemplating a move leftwards to secure a governing majority. On the other side of the marriage table, elements of the CDU/CSU clearly see the problem in the ideological compromise forced on them by coalition and are developing their own repositioning strategy. Ms Merkel is perched above this fracturing partnership. Can she control it? What choices will it force on her? And given Germany’s utter centrality to policy choices at the European level,

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Going their own ways

A vital fact about the German coalition's first year has been the extent to which external factors have helped ease the policy strains at its heart. Increasing tax revenues made SPD-driven social measures affordable such as the pension reform to lower the retirement age to 63 and increase pension benefits for mothers, estimated to cost taxpayers € 160bn until 2030. A growing economy meant businesses tolerated the introduction of a minimum wage of € 8.50 per hour and caps on rents. The first coalition achieved a structural balance and a deficit of €6.5bn, only because the ECB decreased interest rates on 5 June, which reduced anticipated debt service expenses and allowed additional spending without hampering fiscal consolidation. The coalition's focus on budget consolidation suggested cross-party commitment to fiscal rigour even as the SPD - with Merkel's support - were driving a more expansive policy and deepening the German safety net. The 2015 budget is more exposed: for the first time since 1969, the budget deficit is envisaged to be zero. However, Schäuble's initial budget plan had been based on 2% GDP growth. He had to revise this projection since (most external projections are for around 1.2% in 2015) but planned expenditures have only been marginal scaled back, leading even the Federal Court of Auditors to criticize the government's decreasing fiscal space. This slowdown has provoked a wave of tactical

	2014 ¹⁾	2014 ²⁾	2015 ¹⁾	2015 ²⁾
GDP growth	1.9	1.3	2.0	1.2
Consumption	0.9	0.5	1.0	0.8
Government	0.2	0.2	0.2	0.2
Investment	0.8	0.6	0.8	0.5
Net exports	0.3	-0.2	0.0	-0.2

1) Spring 2014 forecast 2) Autumn 2014 forecast

Table 1: Revised Contributions to German GDP growth in percentage points

Source: German economic research institutes

and strategic rethinking in both the CDU and the SPD. Germany's conventions of seeing out a parliamentary terms are strong and make early elections unlikely, but neither the CDU nor the SPD will contemplate repeating the coalition in 2017. In both cases the instinct is to reaffirm their separate political identities. The weaker economy and tight budget provisions do not only hinder

the Social Democrats' ability to use active social policies in the future, but the SPD leadership also recognises that power and policy control have not translated into electoral popularity. CDU/CSU poll ratings remain at about 41% while Social democrats languish at around 25%. SPD Chairman Sigmar Gabriel's coalition strategy had been to avoid the eclipse of SPD electoral fortunes that resulted from its first coalition with Merkel before 2009 by putting an indelible SPD stamp on coalition policy. But thus far spending power has not translated into popular approval (Fig 1).

The SPD is therefore cautiously competing more

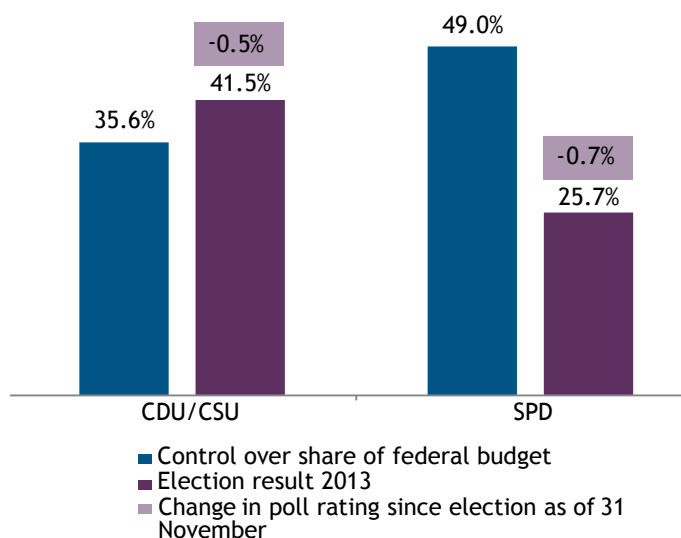


Figure 1: Political and budget power

Source: Deutscher Bundestag & TNS Emnid

directly with Merkel and Schäuble both on their diagnosis of Germany's own problems and on the European economic agenda, carving out a distinct position on the question of investment. Gabriel has taken some cautious steps to soften German positions at European level, leveraging recent IMF thinking about the risks of cutting capital spending and emphasizing the necessity of investments. He is conspicuously cultivating his relationship with French centre-left counterpart Emmanuel Macron, floating the idea of 'Economic Schengen' and the co-ordination of joint investment. Crucially, the SPD has broken its taboo on co-operation with the former Communist party Die Linke, agreeing its first red-red-green coalition in Thuringia this month and endorsing a Die Linke Ministerpräsident (first minister) at the head of the state government. If this experiment proves successful, the calculus for federal politics - that the only way back to left-wing majority government for the SPD is to move off the centre ground - is important.

For Merkel the economics pose a more direct

challenge, because the CDU and Merkel have traded heavily on their robust handling of the Eurozone crisis and economic management in Germany. Merkel's implicit promise to immunise Germany to the Eurozone slowdown is looking vulnerable. Leading Christian Democrats have begun to openly question the SPD's perceived 'anti-business' agenda and the extent to which coalition has pulled the CDU off its own ideological ground. The CDU have moved to flank the SPD's 'growth' message with new spending for infrastructure and the Energiewende, but the general sense that coalition has muddled the CDU prescription of fiscal discipline, supply side reform, tax cutting and pro-business policy is strong and growing.

Tax policy is set to become a battleground for positioning in 2015. Proponents of the new 'Magdeburger Plattform' within the SPD have demanded a wealth tax as similar to that included into the 2013 campaign manifesto. Christian Democrats, however, have ruled out increasing taxes until 2017. Tax hawks inside the party are lobbying for rules that adjust tax brackets in line with inflation, and thus stop individuals moving into higher tax brackets simply because of inflation-linked pay rises, before the end of the term. On this and other issues the coalition dynamic is likely to become more tense in 2015, and Merkel will increasingly find herself more actively opposing the SPD, or alienating elements of her own party.

Berlin in Brussels

Stronger competition within the coalition will leave its mark on the European level during the coming year, but will play out differently within the EU institutions. Although the coalition agreement insists on maintaining coherence within the coalition on European affairs, domestic division will inevitably play out at the European level. On the detail of the European Commission's structural reform agenda in markets for energy, digital services and capital, SPD ministers - not least Gabriel himself - will often be occupying the seat in Brussels. His collaboration with Macron suggests that Gabriel has no reluctance for trying to reshape German policy through the vehicle of European policy. However the real impact of this intra-coalition competition is unlikely to be the game-changer that Matteo Renzi in Italy and Manuel Valls in France are hoping for on fiscal policy, or progress on the strategic imperatives of increasing EU competitiveness that are essential for the UK and for the Commission.

The defining mark of the latter years of the previous Grand Coalition was competition in Berlin

feeding through into dithering and indecision in Brussels, as officials lacked clear instructions and resorted to blocking progress for the Council as a whole. Ironically Gabriel's new assertiveness may therefore serve only to entrench the status quo and unhelpful German positions on service liberalisation to preserve historical protections in banking, professional business services and energy.

On the other hand, Merkel will retain a tight grip on the overall direction of European and especially Eurozone policy. Even though the economic situation at home will nuance her stance on increased investment, Merkel will only change course as far as she perceives domestic politics to allow. While she will aim to outflank the SPD where possible, much more important will be keeping a grip on her own base and worrying about the effect of a perceived softening of German European policy on austerity on defections from the CDU to the insurgent Alternative für Deutschland (AfD) Eurosceptic party. This will be the logic that governs the kinds of signals that Merkel sends to Mario Draghi on ECB asset purchases and state guarantees for riskier ABS tranches. It will also be the calculus that determines any further help for Greece, potentially trumping even the need to strengthen pro-EU forces in an election. If Greece's place in the Eurozone again becomes an open question, we will inevitably be looking to Berlin for a sign of what is politically possible for Germany and thus the wider EU. Merkel remains a dominant figure in a commanding position, but her weakening coalition does not look like the most stable of platforms for German European leadership or even action in 2015.

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