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Fresh Faces, Tired Policies?
The German 'Grand Coalition' and the EU

Two months after the national election on 18 September, Germany finally elected its new Chancellor. On 22 November, Angela Merkel was confirmed in her new post and will now lead Germany's new 'Grand Coalition' between the Christian Democrats, the CDU/CSU, and the Social Democrats, the SPD.

Before the election, many expected a victory for Angela Merkel to cause a shift in Germany towards a more liberal approach to economic reform and a more Atlanticist stance on foreign policy. A new centre-right government was seen as having significant effects on the balance of political power within the European Union as well, as a Merkel Chancellorship would change the German position on issues such as the Lisbon Agenda and the Budget. However, when the result of the election forced CDU/CSU to enter into a coalition with the SPD, the expectation of significant changes in German politics was markedly reduced.

Indeed, a more detailed examination of the outcome of the month-long coalition talks shows that there will be little movement in Germany's position in the EU. Plans for domestic economic reform are limited rather than radical, and on the specific issues of the Lisbon Agenda and the EU Budget Germany's stance will remain unchanged. We should also expect broad continuity from the new government on foreign policy and on EU enlargement. It may come as a surprise, however, how strongly the coalition remains committed to the European Constitution.

Background

During their initial coalition negotiations, the partners first agreed on the personnel of the new government. For Germany's EU partners, three posts are key: the Foreign Ministry, which was given to former Chancellor Schröder's former right-hand man, Frank-Walter Steinmeier; the Finance Ministry, handed to the SPD's Peer Steinbrück, noted for his centrist position on economic issues; and the Ministry for Economy, run by the CSU's Michael Glos, who will be responsible for the Lisbon Agenda.

Over several weeks, the parties then discussed in depth which policies should form the basis of their joint term in government. The result of these negotiations is a weighty document entitled 'Together for Germany - with Courage and Humanity'. In its 140 pages (191 with annexes), it sets out in detail what reforms the coalition is planning to tackle and includes several passages on how the new government plans to handle European issues. The document was not welcomed with much enthusiasm by the media and the public, with economic commentators criticising the proposed reforms and opinion polls showing public dissatisfaction with the parties' decisions.

CONTINUED OVERLEAF

EDITOR's NOTE

This is the eighteenth in a series of regular *European Policy Briefs* produced by the Federal Trust. The aim of the series is to describe and analyse major controversies in the current British debate about the European Union.

We would welcome comments on and reactions to this policy brief. Other Policy Briefs are available on the Federal Trust's website **www.fedtrust.co.uk/policybriefs**.

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Domestic Economic Reform

The new German government has pledged wide-ranging changes to economic policy. However, instead of a clear re-orientation of the economic approach taken by Germany, the new policies represent a continuation of the reform efforts undertaken by the SPD since 2002. Moreover, rather than creating new stimulus for economic growth, the new government's first priority seems to be fiscal consolidation.

The most controversial measure introduced in order to reduce the budget gap is a three-point increase in value-added tax. The new government has agreed to raise VAT from 16 to 19 per cent on 1 January 2007. It is hoped that domestic demand will increase towards the end of 2006 as consumers anticipate the forthcoming tax increase. Nevertheless, this increase in VAT seems likely to hamper growth in domestic demand, a point at which the German economy has been particularly weak over the past few years.

The VAT rate increase is off-set slightly by a reduction in non-wage labour costs: while the contribution to unemployment insurance will be lowered by two percentage points, the contribution to pension insurance will rise by 0.4 per cent. Moreover, the new government has planned a 25 million euro spending programme over the next four years. This will feature increased support for families, more money for research and development and higher investment in transport.

However, contrary to pre-election pledges, the new coalition has not proposed concrete cuts to be carried out on subsidies. Instead, apart from the agreed abolishment of the controversial home owner benefit, they have given only a vague indication of how much money should be saved by such cuts. Moreover, the CDU/CSU was not able to persuade the SPD to remove government support for overtime outside of the normal working week.

In a concession to the SPD, the coalition has also surprisingly decided to introduce a new 'tax on the rich'. The level of income tax paid by those earning over 250,000 euro (or 500,000 euro for married couples) will rise from 42 per cent to 45 per cent. This tax increase is mainly of symbolic value, showing that the SPD has not moved too far to the centre in agreeing to form a coalition with the Christian Democrats. The fact that it was included in the coalition contract is a powerful example of the extent to which the SPD's agenda was realised in the outcome of the talks. Overall, fiscal consolidation will thus be financed by tax increases rather than the reduction of expenditure.

There is also little sense that the Grand Coalition will significantly increase labour market flexibility. They did agree to allow much looser contracts for the first 24 months of employment, with these employees receiving far less protection from dismissal. However, this reduction on employee protection was much less far-reaching than that demanded by the CDU/CSU in their election campaign. All in all, the Christian Democrats did not manage to push the SPD into agreeing to broad reforms of the labour market. For example, they were not able to achieve a significant weakening of the system of central wage bargaining in Germany.

The coalition agreement includes a large number of changes, and the parties have been willing to take obviously unpopular decisions, such as raising VAT. However, these reforms do not amount to a significant re-orientation of economic policy. Moreover, they may harm domestic demand in Germany, a key current weakness of the economy. The new coalition has not decided on wide-ranging changes that may be necessary to give Germany the desired impulse in achieving higher growth and lower unemployment, such as increased labour market flexibility.

As a result, Germany seems set to continue its role as an economically underperforming member of the EU. Although fiscal consolidation may help it keep to the rules of the Stability and Growth Pact by 2007, it does not seem that the German economy can in the near future become a stronger motor for the growth of its European partners, especially within the Eurozone. This will also have implications for Germany's role in supporting the Lisbon Agenda, the European-level strategy for reform.

European economic reform

On a European level, the new government is likely to take a centrist position on social and economic policy. The coalition agreement thus includes a commitment to the protection of the European social model as well as to the reform efforts of the Lisbon Agenda. The latter is described as giving Europe 'a suitable framework for economic and social renewal', and the coalition emphasises the need to regulate better and regulate less at the European level.

On social policy, the government pledges that it will try to balance out the needs for national flexibility with the demands of employers and employees. The new coalition also agreed to work towards a uniform corporate tax base and the convergence of minimum corporate tax rates within the EU, but does not go beyond these minimal commitments.

Similarly, the coalition's commitment to prevent 'social dumping' is underlined, but the only practical consequence of this commitment is that the freedom of movement from the ten new member states and Bulgaria and Romania will be restricted for a total of seven years, the longest possible time period. This is no change from previous policy and was not contested by the CDU/CSU in the campaign.

No reference is made to the idea of a 'Social Europe', and it does not seem that the new coalition would welcome any moves to increase European integration in this area. Indeed, the coalition agreement strives to explicitly seek out a compromise position on economic and social issues in the EU, with equal attention given to the need for economic growth and social sustainability. This is no great departure from the position of the previous coalition.

Angela Merkel may well have sympathies with a more free-market approach to European economic reform, and she will try to use her freedom of movement as Chancellor to encourage more liberal policies. Her leadership style is also markedly different from Gerhard Schröder's, as she favours an understated and consensual approach and is wary of protectionist rhetoric. On important decisions she will have to make sure she is supported by her more cautious partners, both in the SPD and within her own party. As a result, the more economically liberal states of the EU will not find a strong new ally in the Merkel government.

EU Budget negotiations

The EU Budget caused major disagreements at the European Council in June, already soured by the failure of the European Constitution. In particular, Britain resented that Germany had tied itself to France on the question of reform of the Common Agricultural Policy, and it seemed that

perhaps a change in government might aid the British cause.

However, the new government will apparently pursue the same goals that the SPD/Green coalition favoured. The coalition agreement includes a pledge to aim for an EU Budget of 1 per cent of European GDP. This new financial framework would also include a 'corrective mechanism' to compensate for disproportionate national contribution so that the German net payment would be kept to a minimum. Furthermore, the coalition explicitly states that it would not touch the compromise on the financing of CAP agreed in October 2002. Reform of CAP must be pursued, but on the path already undertaken.

There is no reason to believe that this is mere rhetoric that could be abandoned under pressure, not least because the Bavarian CSU is itself very eager to protect its farmers from far-reaching CAP reform. At her first visit to the UK two days after her election as Chancellor, Mrs Merkel stressed that Germany would continue to make sure its own interests were protected. When negotiations on the Budget continue, the new negotiators from Germany will take up just as tough a position as their predecessors.

Enlargement

Before the election, much was said on the CDU's opposition to Turkish accession in favour of a 'privileged partnership'. Here, the two main parties seemed to have a real disagreement on a substantive issue, as the SPD was staunchly in favour of Turkey's eventual membership of the EU. The simple dichotomy was perhaps always overdone, as the CDU had said even before the election that it would respect the decision made by the EU on 3 October.

However, the CDU/CSU is still much more sceptical towards Turkish accession than its partner in the coalition, and this is clearly visible in the wording of the coalition agreement. Besides welcoming enlargement as an important contribution to peace and stability in Europe, the document also states that the negotiations with Turkey will be open-ended: accession is not set in stone, argues the coalition agreement. Moreover, due to the economic, cultural and demographic challenges of Turkish membership, the EU must make sure – as it has promised – to consider whether it is capable of letting Turkey join the Union. If membership is deemed unacceptable, the agreement states, alternative means of giving Turkey 'privileged' ties to the Union must be found.

It seems that, in this point, the CDU/CSU's viewpoint has come out strongest in the coalition agreement, as there is obvious scepticism towards Turkish membership and the implication that a 'privileged partnership' may indeed be preferable. The position of the new government – at least as it is stated in the coalition agreement – is strikingly close to that of the Austrians, who had made sure that the process always be termed 'open-ended' and conditional on the EU's capability to accept the EU as a member.

Nevertheless, it is unlikely that Turkish accession will become an important debate in the lifetime of the new coalition government. The most divisive question – whether to open negotiations at all – has now been taken off the table, and actual accession is at least a decade off. After a meeting with the Turkish Prime Minister Recep Tayyip Erdogan on 27 November, Mrs Merkel herself confirmed that the EU's commitment to negotiations would be kept. Luckily for the coalition, Turkey's EU membership is one controversial topic that will probably not have to be handled by this government. It is perhaps because of this that the SPD did not insist on a more open-armed welcome of the opening of accession negotiations with Turkey.

In the other areas of enlargement, the desire for continuity is clear. Thus, the opening of talks with Croatia is welcomed; Romania and Bulgaria will be admitted, with no clear commitment to 2007 or 2008; and migrants from the new member states that joined last year will not be given full freedom of movement, it is hoped, until the full seven-year transition period has passed.

Foreign Policy

Gerhard Schröder won the 2002 parliamentary election partly because he promised not to support the USA in a war on Iraq. His opponent that year, Edmund Stoiber, did not rule out German participation under his Chancellorship, and this contributed to the surprise swing in the polls in the weeks before the election. Angela Merkel has not hidden that she would have give more support to the USA in the war than did her predecessor, although this would probably not have extended to sending combat troops into the area. She may well seek as Chancellor to pursue a more Atlanticist line than that of Mr Schröder.

However, the Foreign Ministry will now be in the hands of the SPD, as Mr Schröder's former adviser Frank-Walter Steinmeier has been named to the post. Moreover, the SPD/Green's opposition to US policies was always exaggerated: after all, this was the government that led Germany into the interventions in Kosovo and Afghanistan. More recently, the government had been trying to rebuild bridges with Washington with some success.

Thus, continuity is the watchword of the day in foreign policy as well as in other areas. Substantively, this can be seen in the continued commitment to a German permanent seat on the UN Security Council, a policy often criticised by the CDU. The new government restates German support for EU negotiations with Iran on its nuclear programme. Interestingly, Iraq itself is not mentioned in the document, a sign that the government is not planning any stronger involvement in its re-building.

Continuity is also assured in the personnel of German foreign policy. Mr Steinmeier has accompanied Mr Schröder on many of his trips abroad and is well-known and well-respected in international circles. Angela Merkel's new foreign policy advisor is Christoph Heusgen, until now the Director of the Policy Planning Unit of the Council in Brussels and Javier Solana's right-hand man. He is a man well-versed in foreign affairs and well-connected through his prominent role in the EU. He will be replaced at the Council Secretariat by one of Joschka Fischer's most senior advisors, Helga Schmid. The new team leading German foreign policy is experienced and represents an effort to promote stability over change. Unless an issue of major national political disagreement – as Iraq was – comes onto the agenda, it seems that this government will manage its foreign affairs in much the same way as its predecessor.

However, there may be a slight change in the position taken by Germany within Europe. Within the freedom accorded to her by her coalition partners, Angela Merkel is likely to promote a more open style of foreign policy and more understated relationships with her fellow leaders. Although Mrs Merkel made a point of visiting France on the first day after her election as Chancellor, she is expected to favour less exclusive ties with Germany's closest partner. Christoph Heusgen has

apparently already encouraged Mrs Merkel to deepen Germany's relationship with Poland, and her visit to London during the election campaign was well-received. She is also less likely to see Vladimir Putin as a main partner in her foreign policy. Nevertheless, the predominant current signal from Berlin is that it will provide continuity with past policy.

The Constitutional 'Crisis'

In the UK, it sometimes seems that even the existence of a Constitutional Treaty has already been erased from the memory of political leaders. It is widely accepted that the document is dead, with no prospect of resuscitation or resurrection. In other EU countries, the Constitution has not been given up so easily, and the German coalition has committed itself to it with surprising strength.

In their coalition agreement, the CDU/CSU and SPD reiterate their fundamental support for the European Constitution and underline that, in their view, it makes the EU more democratic, efficient and transparent. They want to press for a continuation of the ratification process after the one-year 'period of reflection' called at the European Council in June 2005. Indeed, they say that they will try and give a new impetus to the process during the German EU Presidency in the first half of 2007. Meanwhile, during the period of reflection, the coalition says that it will engage in a broad debate with citizens, social partners, churches and other civil society groups.

Beyond pursuing ratification, the German coalition wants to introduce one element of the Constitution as soon as possible: the 'early warning system' for national parliaments. This would givenational parliaments a formal, yet limited role in the oversight of EU policy-making.[1] Introducing the 'early warning system' would not require treaty amendment and could be agreed by EU member states at any time. This system may be introduced soon and will in any case not depend on German endorsement, but the inclusion of this point in the coalition document shows that Germany is willing to implement specific parts of the Constitution it deems helpful and uncontroversial.

The 'early warning system' may well be implemented long before the German Presidency of the EU in 2007. On 17 November, at a meeting of COSAC, the Conference of Community and European Affairs Committees of Parliaments of the European Union, parliamentarians from across the EU agreed to implement the provision informally from 2006.

Although the coalition agreement does not mention other provisions of the Constitution, it seems that the new government is not opposed in principle to the introduction of those parts that do not require treaty amendment and clearly further the cause of democracy and legitimacy of the EU. In this, the German political leadership takes a much more flexible stance than, for example, the British government.

The coalition agreement also sheds light on how the current constitutional 'crisis' is perceived in Germany. The governing parties share the widespread perception that there are serious problems faced by the Union, in particular where its economic success and its relations with its citizens are concerned.

In the document, it is argued that the current crisis in the EU is an opportunity to re-orient the European project to respond the contemporary challenges. In order to recapture the trust of European citizens, the EU has to concentrate on the essentials of what it does, an argument also put forward by Prime Minister Tony Blair in his speech to the EP on 22 June. This point of agreement between the British and German governments is not new, as even the Schröder government for example endorsed the agenda of reduced and improved regulation in Europe. The coalition document also states that the EU must follow the principle of subsidiarity as strictly as possible, increase co-ordination of national reform efforts and improve the way it communicates with its citizens.

The agreement also stresses that better regulation and reduced bureaucracy at EU level is an absolute necessity in order to get the European project back on track. The coalition thus supports the Lisbon Agenda, meant to increase jobs and growth in Europe, and commits itself to improving the competitiveness of the EU. However, on a national level, there seems to be little prospect that the German economy will work its way back to full health soon, and this will surely feed into the new German government's overall approach to the general question of economic reform within the EU.

Conclusion

The new German government is unlikely to present its partners in the EU and the world with surprises. In foreign affairs, Germany will continue to strive to balance its European and transatlantic commitments, while on enlargement the current course is supported. On the continuing Budget negotiations, the coalition will take the same line as the past government. On the Constitution, Germany may try to push forward the agenda during its Presidency in 2007, and it is interesting that 'cherry-picking' is apparently seen by the coalition partners as a legitimate move to advance the constitutional debate.

However, for its neighbours and allies the most positive development in Germany would be a return to economic strength with high domestic demand and lower unemployment. Neither of these seems to be in the offing at the moment, and the coalition agreement does little to improve the situation. At best, it may improve the situation very slightly, but at worst, the measures approved by the coalition may actually worsen Germany's economic situation. Angela Merkel has set as her first priority the reduction of unemployment, yet it is far from clear whether she will be able to achieve this on the basis of her coalition programme.

Germany's new government, then, has not changed substantially the balance of political ideologies in Europe. There will be no basic reformulation of economic, foreign or EU policy, and any shift in emphasis will be measured in degrees. Despite the sprinkling of fresh faces now leading Germany, the new coalition should be seen as likely to offer striking continuity rather than substantive change.

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[1] See Federal Trust European Policy Brief 3, 'The Role of National Parliaments in the European Union', available at www.fedtrust.co.uk/policybriefs.