

GERMANY'S ELECTION: BEHIND CONSENSUS POLITICS LIE CONFLICTING IDEAS OF EUROPE

Annette Bongardt, Lorenzo Codogno and Francisco Torres

- Ahead of the 24 September German federal elections, Angela Merkel and the CDU/CSU are leading by a wide margin, although the number of undecided voters is still high. Contrary to the perception that German elections are 'boring', there is a lot at stake for the future of Europe.
- Although Europe has been relatively absent from the electoral debate, there is a clash between two different visions: further integration by strengthening European institutions, and gradual integration by making the Union even more inter-governmental, with a de-politicised Commission and a transformed European Stability Mechanism.

Annette Bongardt is Visiting Senior Fellow in European Political Economy at LSE. Before joining LSE she was a Visiting Fellow at the Robert Schuman Centre for Advanced Research of the European University Institute, Florence. She is regular Visiting Professor at the National Institute for Public Administration, Lisbon, and Associate Professor at UFP, Porto. She holds a Ph.D. in Economics (1990) from the European University Institute, Florence. She is a Research Associate of CIGP (FCT research centre) and NIFIP (Faculty of Economics, Porto University) in Portugal.

Lorenzo Codogno is Visiting Professor in Practice at the European Institute and founder and chief economist of his own consulting vehicle, LC Macro Advisors Ltd. Prior to joining LSE he was chief economist and director general at the Treasury Department of the Italian Ministry of Economy and Finance (May 2006-February 2015) and head of the Italian delegation at the Economic Policy Committee of the EU, which he chaired from Jan 2010 to Dec 2011, thus attending Ecofin/Eurogroup meetings with Ministers. He joined the Ministry from Bank of America where he was managing director, senior economist and co-head of European Economics based in London. Before that he worked at the research department of Unicredit in Milan.

Francisco Torres is Visiting Senior Fellow in European Political Economy at the LSE. He is also a PEFM Research Associate of the European Studies Centre at St Antony's College, Oxford University, and Visiting Professor at the Católica Lisbon School of Business and Economics. He holds a Ph.D. in European Political Economy (UCP, Lisbon), an MSc in Economics (UNL, Lisbon) and a 'licenciatura' also in Economics (UCP, Lisbon). He also studied Economics at the EUI, in Florence (PhD progr.) and holds an MA in International Affairs from the Johns Hopkins University, SAIS.

Many commentators have pointed to the uneventful campaign and the lack of interest in the 24 September federal elections in Germany, but their outcome could potentially result in important changes for the EU and the Eurozone. Chancellor Angela Merkel and the CDU/CSU are leading in opinion polls by a wide margin, and her fourth mandate as German Chancellor seems a foregone conclusion.

How significant will the change in policy be? There are two primary variables to watch: (1) the coalition that will emerge from the poll and (2) how the junior party (or parties) in the coalition will weigh on the role of the Finance Minister, a position that is key for future policies towards Europe.

Four possible options

Recent opinion polls suggest a 13-17 percentage point lead for Merkel (37-39% for Merkel's CDU/CSU vs 23-24% for the Social Democrats). The FDP is at about 8-9% (they failed to reach the 5% threshold in 2013, and they are currently not in Parliament). The Greens are at about 7-8% and the far-left Die Linke is around 9-10%. Most probably, the far-right AfD will pass the "five percent hurdle" and enter Parliament, but they would be out of any alliance. Six parties are likely to gain access to Parliament as opposed to just four currently.

Considering that some smaller parties are not going to be represented and their votes are to be redistributed, about 48% of the votes may be sufficient to get an outright majority of seats in Parliament, giving four possible options depending on where the decimal points fall and on Merkel's decision.

A re-run of the Grand Coalition between the CDU/CSU and the SPD

A Grand Coalition might well be Merkel's preferred result, not to become hostage to both the CSU and the FDP in European affairs (but also on migration, energy and climate policies). However, if the CDU/CSU manages to have a majority with the FDP it will be very difficult not to dump the SPD, as it would be difficult to convince both the CSU and part of her own party.

If the CDU/CSU becomes dependent on the SPD to form a governing coalition (that is, it does not reach the numbers to form a coalition with the FDP and/or with the Greens), the SPD may ask for the Ministry of Finance instead of the Foreign Ministry (which they got last time). Martin Schulz, the former president of the European Parliament and current leader of the party, or Sigmar Gabriel, the current Vice Chancellor and Minister for Economic Affairs and Energy and former leader of the party, could become Finance Minister (some people also say that Olaf Scholz, the mayor of Hamburg, could be in the game). It would represent an important shift in policy towards faster and deeper European integration versus the current ones designed by Wolfgang Schäuble. Still, Angela Merkel might resist those demands and convince the SPD to remain with the current portfolios.

Martin Schulz, who is very close to Jean-Claude Juncker, the President of the European Commission, is considered a passionate EU supporter. He would also work very well with Angela Merkel. More importantly, Schulz is committed to strengthening Europe and European institutions. In 2016, he proposed a ten-point plan for reforming the EU. The plan calls for a

streamlining of European institutions and the formation of a strong European government, which would be more tightly controlled by the European Parliament. It would be a significant departure from the policies followed so far by Wolfgang Schäuble, who enjoyed lots of independence even from Angela Merkel and his party. Even without the finance ministry, Schulz would have a strong impact in rebalancing the government towards a more integrationist/federalist stance, especially so with Macron in France.

The so-called Jamaica coalition (CDU/CSU, FDP, and the Greens)

This would be a novelty for Germany. These three parties (actually four, as the CDU and CSU are two different parties) have never been in power together at the national level. They seem sufficiently close, however, regarding policies. Probably the most tricky bit would be combining the somewhat Eurosceptic views of the FDP with the strongly pro-European stance of the Greens. On many other issues (namely on migration, energy and climate policies), the FDP would tend to team up with the CSU and part of the CDU against Merkel and the Greens. This coalition would have a sufficiently vast majority in the Bundestag, although in the Bundesrat, the chamber formed by representatives from the Länder, there may still be some problems.

At the local level, there are grand coalitions and if the SPD does not agree with policies at the national level, the representative of the State would have to abstain in the Bundesrat. The German legislative process often requires the agreement of the Bundesrat on several matters, including those related to Europe. In fact, federal legislation frequently has to be executed by state or local agencies. Parties are used to forming a conciliatory committee to find a compromise when there is disagreement between the Bundestag and the Bundesrat.

No matter how it goes, the consensus way of conducting policies is unlikely to change much in Germany, and this includes policies toward Europe. Still, in many policy areas, there may indeed be change. If tradition holds, which seems likely, as there is always the alternative option of a grand coalition with the SPD – the FDP would stay with the Economics and/or Foreign Affairs ministries. Thus, Wolfgang Schäuble would remain finance minister. The FDP's leader, Christian Lindner (38), would normally opt for the Foreign Ministry (as Guido Westerwelle did in the 2009-2013 political term) or the Economics Ministry.

The Greens are more inclined to ask for ministries that deal with energy, the environment, and family matters. However, if they were to be in government with the CDU/CSU and the FDP, it would be unlikely that the FDP would get both the Economics and Foreign Affairs ministries as the Greens would ask to have Foreign Affairs (like Joschka Fischer in the SPD-Green coalition). In the case of a Jamaica coalition, there would still be a significant chance that Wolfgang Schäuble gets the job again and thus informs policies towards Europe.

CDU/CSU and the FDP (black/yellow)

If the SPD does not perform sufficiently well on 24 September to impede the CDU/CSU and FDP from getting a majority in Parliament, this would lead to a traditional Black-Yellow alliance. On paper, this seems the most cohesive coalition, but many in the CDU/CSU,

especially Angela Merkel, would not like to be so dependent on a small party like the FDP, with which it had important frictions in 2009-2013 and whose stance on Europe, migration and energy/climate issues diverges from the current government and also from Merkel's and at least part of the CDU's.

In such a scenario, most probably Wolfgang Schäuble would remain finance minister. If a Black-Yellow coalition were technically feasible, it would be difficult for the two parties not to go for that, given the long tradition and the relatively close political positions between these two political forces. Still, today's FDP is not the same as Genscher's or Lambsdorff's and its positions on Europe, migration, the automobile industry or energy and climate change have headed towards a less open and liberal and a more protectionist and Eurosceptic stance. It is also much less programmatic (principle-based) and it has run the campaign to re-enter Parliament as a one-man show, which makes it less predictable.

A black/green coalition?

This seems not a very likely scenario, although still a possible one if the Greens enjoy a better result than the FDP. The FDP and not the Greens are by tradition the first choice of the CDU/CSU and possibly the CSU would object to the Greens as the only coalition partner (they are much closer to Merkel's choices and ambitions for her most likely last mandate). Therefore, a Jamaica coalition seems more likely than this option.

Will German fiscal policy become more expansionary?

In Germany, strict adherence to the internal debt-brake rule, i.e. the so-called "black-zero", limits the room for expansionary policies and for a stance that takes into account the rest of the Eurozone. With Mr Schäuble remaining at the head of the Finance Ministry, very little would change.

How would it change with other Ministers or other coalitions? The short answer is not much. The national debt-brake rule enjoys a close-to-80% support rate among voters, and as a result, European rules are also held in high regard to the point that no future German government would dare to propose any change. At the national level, it would take a two-thirds majority in Parliament to change the fiscal rules, which is a close-to-impossible outcome.

Germany has resisted calls for a more expansionary economic policy to rebalance its external accounts (about 8.5% of GDP). The in-depth review of the Commission conducted in February 2017 led it to conclude that Germany is experiencing macroeconomic imbalances.

The assessment of the need for public investment, especially in light of the close-to-zero financing cost, is changing and there is now some recognition that a higher level of public investment would make sense but not at the expense of fiscal discipline. There is already some increase in spending on infrastructure, but coming from years of cuts.

There is also a broad call for more public spending at the local level. Schäuble keeps saying that states are not even able to spend the funds already available and Merkel has argued that

the biggest obstacle to spending on infrastructure is not lack of proper funding but bottlenecks in planning and institutional capacity to handle big projects. The CDU/CSU has promised to reduce red tape, ease planning restrictions and introduce a fast track for major priority investment projects. Merkel has also promised some small ‘treats’ in the form of tax cuts for households, on top of more spending on defence. There is no commitment on liberalising services. Schulz has promised some redistribution of the personal income burden.

However, despite these plans, a significant change in attitude towards the external primary surplus or a more convincing stimulus to domestic demand seems unlikely no matter which coalition and Minister emerges from the polls. A short-term stimulus to demand would not do much to address the underlying current account imbalances – i.e. the imbalances between domestic savings and domestic investments – but there seems to be no plan to deal with the issue from the structural side either.

Would the new German government re-launch the European project?

There are high expectations of a new drive towards European integration in the aftermath of the German elections, and EU governance is probably the area where the SPD, especially an SPD led by Schulz, would tilt the balance in favour of further European integration. President Macron in France is proposing a fresh new season for the European project. However, the roadmap presented by the Four and then the Five Presidents has been met with a lukewarm reception, if not outright opposition, in Germany.

Germany has opposed any mutualisation of fiscal policies or fiscal transfers, let alone any Eurobonds or mutualisation of government liabilities and any step towards completing the banking union with a European deposit insurance. There has been strong opposition towards any European unemployment insurance as well. Finally, there has been increasing criticism of European institutions. Is all this going to change?

Recently, Angela Merkel and Wolfgang Schäuble indicated cautious support for Macron’s ideas and made some substantial overtures for an expanded role of the European Stability Mechanism (ESM). The ESM would effectively become a sort of European Monetary Fund (EMF), allowing countries to call on the fund for countercyclical investment and the costs of natural disasters, and with some capacity to issue debt. In the traditional annual meeting with the press, Schäuble announced a proposal that will be unveiled after the elections.

The FDP is not keen to speed up integration either. The current FDP leader, Christian Lindner, resigned from the position of secretary general of the party in December 2011. A group of Eurosceptic FDP parliamentarians forced his resignation on the future course of the ESM. Therefore, any plan to go towards a strengthening of the ESM and its transformation into an EMF may find some opposition in the FDP and probably in part of the CDU/CSU as well. In the past, Germany was in favour of a semi-automatic mechanism for sovereign debt restructuring in the Eurozone, designed to prevent any form of risk sharing among its countries, as well as tools to reduce risk, and it is unclear whether this would be part of the ticket that makes the proposal more palatable for some sceptic voices.

What are Schäuble's plans?

Although there are no details, it is not difficult to imagine the direction of travel of Germany under the guidance of Mr Schäuble. The idea is clearly to proceed towards European integration with a more intergovernmental approach by weakening European institutions such as the Commission and, by doing so, also the European Parliament. It would imply the shift of responsibility for surveillance of public finances from the Commission to the EMF. The EMF would take power away from the Commission, which is not seen as an impartial arbiter, and from the IMF, which is too distant and not controlled by Europeans.

The EMF would take on board a greater role in supervising fiscal policy of the Member States and a greater say in debt restructuring. The objective is to “make the rules more credible”, i.e. if the Commission is not willing to act as an independent institution but as a political player (as the Junker Commission has vowed to do, and as it is perceived to have done with respect to the management of the Greek crisis), then Germany would go for another independent institution, i.e. the ESM/EMF. Whether this is entirely compatible with the Treaties is unclear, but it may well be.

Effectively, the financial endowment of the fund would come in exchange for stronger incentives for fiscal discipline. It could be done by simply modifying the ESM Treaty, which is an intergovernmental treaty and thus much easier to change. The new ESM (or EMF) would also have the role of intervening in support of countries in difficulty such as Greece. The governance of the ESM requires unanimity (mutual consent) on many issues (decisions to provide stability support to an ESM Member, the choice of instruments, and conditions and terms of such support). In some other areas, the Board of Governors of the ESM takes decisions by a qualified majority defined in the ESM Treaty as 80% of the votes cast, with voting rights equal to the number of shares allocated to each country. The German Parliament and the German Constitutional Court would have a de-facto veto power over the most important decisions, which is currently not guaranteed by the collegial and political approach of the Commission.

Of course, this German view must be made compatible with the opinion of France. Germany knows that Macron needs to be supported and granted some important concessions if he is to successfully reform his country. One such concession would be to have a European finance minister, who could respond to the European Parliament. Also the Eurogroup could eventually be turned into a Council configuration. Such institutional changes (which will be easier to enact without the UK in the EU) would enhance the involvement of the European Parliament and the democratic accountability for the decisions taken for or on behalf of the euro area as suggested by the Commission's reflection paper on EMU.

Therefore, this German view can be shaped to the needs of France (while all other countries seem out of this game, although eventually, they would have to agree as well). Incidentally, the Italian suggestion to have the seats of British MEPs occupied by pan-European lists has just received the support of France. Moreover, both Merkel and Schäuble will want to leave their mark on the European integration process and therefore might use their last mandate not

only to safeguard Germany's national (and short term) interests but finally to advance it, with much less electoral pressure, in the common and German long term interest.

Bottom line: The 2017 German elections are an important event for both Germany and Europe

For Europe, there is much more than meets the eye in German elections. It will determine the course of European integration, with a clash between two different visions: further integration by strengthening European institutions (Schulz) and gradual integration by making the Union even more inter-governmental, with a de-politicised Commission and a transformation of the ESM (Merkel-Schäuble) with more responsibility on fiscal surveillance. However, Merkel/Schäuble have made some openings toward a possible Eurozone Finance Minister and some fiscal capacity.

If everything goes smoothly, Germany will likely have a new government by the end of October, but it will take a few more weeks to get everything up-and-running in the various ministries. Therefore, the expectation that Germany will be ready to discuss the future of Europe with France and other countries at the summit scheduled for October are probably over-optimistic. More likely, a comprehensive negotiation on the future of Europe will start early next year and will probably produce some outcomes by the summer of 2018. The final approval may not happen before the European Parliament elections in the spring of 2019.

Negotiations will encompass all open issues, probably including also the banking union and the appointment of the president of the ECB. Therefore, the picture that will emerge from the polls on 24 September will be far from a still life painting.