

GERMANY'S ELECTORAL SYSTEM  
AT 60: TRENDS AND REFORMS  
FOR THE 21<sup>ST</sup> CENTURY

# AICGS GERMAN-AMERICAN ISSUES

# 11

Karen Donfried  
Olaf Gersemann  
Beate Jochimsen  
Jörg Siegmund



AT JOHNS HOPKINS UNIVERSITY

The American Institute for Contemporary German Studies strengthens the German-American relationship in an evolving Europe and changing world. The Institute produces objective and original analyses of developments and trends in Germany, Europe, and the United States; creates new transatlantic networks; and facilitates dialogue among the business, political, and academic communities to manage differences and define and promote common interests.

©2009 by the American Institute for Contemporary German Studies

ISBN 1-933942-22-3

ADDITIONAL COPIES:

Additional Copies of this Policy Report are available for \$5.00 to cover postage and handling from the American Institute for Contemporary German Studies, 1755 Massachusetts Avenue, NW, Suite 700, Washington, DC 20036. Tel: 202/332-9312, Fax 202/265-9531, E-mail: [info@aicgs.org](mailto:info@aicgs.org) Please consult our website for a list of online publications: <http://www.aicgs.org>

The views expressed in this publication are those of the author(s) alone. They do not necessarily reflect the views of the American Institute for Contemporary German Studies.

## TABLE OF CONTENTS

Foreword	3
About the Authors	5
The Decline of the <i>Volksparteien</i>	7
Economic Challenges for the New German Government	19
The German Fiscal Federal System	27
U.S. Expectations of Germany after the Election	37



## FOREWORD

---

When Germany elected a new government on 27 September 2009, it did so not with an eye to the party, economic, or political successes of the previous sixty years. Rather, the election displayed a startling realignment of the party system. This election, occurring as it did in the middle of a celebration of sixty years of the Federal Republic of Germany, can perhaps be seen as the beginning of a new period of German politics, and its impact on transatlantic relations will continue to be seen. The American Institute for Contemporary German Studies (AICGS) is pleased to provide new analysis not only on an historic milestone, but also on Germany's way forward in the twenty-first century.

The essays in this edited volume look at the political, the economic, and the transatlantic developments and consequences of the 2009 German election. In his essay on "The Decline of the Volksparteien," Jörg Siegmund addresses the significant losses experienced by the SPD and CDU/CSU in 2009, the increasing fragmentation of the party system, and whether the changes seen in 2009 are cause for concern or are examples of the stability of German democracy. Olaf Gersemann looks at the economic situation leading up to the election of a center-right governing coalition, what steps the new government will need to take in its recovery efforts, and whether Angela Merkel can live up to the challenge. Fiscal federalism and reforming the economic system within a complex political system are the topic of Beate Jochimsen's essay on "The German Fiscal Federal System: Status Quo, Imminent Challenges, and Plans of the New Government." Finally, Karen Donfried turns to the transatlantic aspect of the German election, examining the Obama administration's expectations of the new coalition in Berlin.

AICGS is very grateful to the *Transatlantik-Programm der Bundesregierung der Bundesrepublik Deutschland aus Mitteln des European Recovery Program (ERP) des Bundesministeriums für Wirtschaft und Technologie (BMWi)* for its generous support of AICGS' project on "60 Years Federal Republic of Germany: Rebuilt, Reunified, Revitalized?". The project is also supported by the Draeger Foundation and by the AICGS Business & Economics and Foreign & Domestic Policy Programs. Additionally, AICGS would like to thank Kirsten Verclas, Research Associate, and Jessica Riester, Research Program and Publications Coordinator, for their work in implementing the project and editing this publication.



Jackson Janes  
Executive Director  
AICGS



## ABOUT THE AUTHORS

---

**Dr. Karen Donfried** is the Executive Vice President of the German Marshall Fund in the United States. She provides strategic direction to programs centered on transatlantic relations, helps manage GMF's headquarters in Washington and its seven offices throughout Europe, and works closely with the institution's Board of Trustees. From October 2003 to May 2005, Dr. Donfried served in the U.S. Department of State and handled the European portfolio on the Policy Planning Staff of the Office of the Secretary of State. Prior to this position, she served as GMF's director of foreign policy and worked as a European affairs specialist in the Foreign Affairs, Defense, and Trade Division of the Congressional Research Services (CRS). She has written extensively on German foreign and defense policy, European integration, and transatlantic relations. She is a member of the Council on Foreign Relations and the American Council on Germany. Dr. Donfried earned her PhD and MALD from the Fletcher School of Law and Diplomacy at Tufts University and a Magister at the University of Munich in Germany. She also holds a Bachelor's degree in Government and German from Wesleyan University.

**Mr. Olaf Gersemann** is the Deputy Business Editor of *Die Welt*, *Welt am Sonntag*, and *Berliner Morgenpost*. He is mainly responsible for editing the business section of *Welt am Sonntag*, Germany's largest Sunday people. Before joining *Die Welt* group, Mr. Gersemann was International News Editor at *Financial Times Deutschland*. Between 1999 and 2005, he was the Washington correspondent for *Wirtschaftswoche*, Germany's largest business weekly. He is author of "Cowboy Capitalism – European Myths, American Reality" (Cato Institute, 2004).

**Dr. Beate Jochimsen** is an assistant professor for Economics (Public Finance) at the Freie Universität Berlin and the Social Science Research Center. Prior to joining the university, Dr. Jochimsen worked as the Chief of Staff for the State Ministry of Finance. She also worked as a trainee, from 1988-90, at Deutsche Bank Berlin AG. She has written extensively on political economy, fiscal federalism, fiscal equalization, state and regional budgets, debt policy, bureaucracies, and EU finances. Dr. Jochimsen was awarded the Hans-Jürgen-Ewers-Prize for Applied Infrastructure and received a scholarship from the Konrad-Adenauer-Foundation. She earned her PhD in Economics from the Technical University of Berlin and served as a visiting fellow at the European University Institute in Florence, Italy. Prior to receiving her doctorate, Dr. Jochimsen earned an MSc in Economics from the University of Cologne and an MSc in European Studies from the London School of Economics and Political Science in London.

**Mr. Jörg Siegmund** currently teaches at the Geschwister-Scholl-Institute for Political Science at Ludwig-Maximilians University of Munich. In addition, he serves as a research fellow at the Munich-based Center for Applied Policy Research (CAP) and contributed to the 'Sustainable Governance Indicators (SGI),' a comparative survey of thirty OECD member states conducted by the CAP in cooperation with the Bertelsmann Foundation. His research focuses on democracy and governance, comparative government, and German politics with a special interest in East Germany. Mr. Siegmund has written extensively on the compensation of victims of the former German Democratic Republic. He has received scholarships from both the German National Academic Foundation and the German Academic Exchange Service. He studied political science, modern and contemporary history, and public law at the Albert-Ludwigs-University of Freiburg, the University of Glasgow, and the Ludwig-Maximilians-University of Munich.



THE DECLINE OF THE  
VOLKSPARTEIEN

01

# THE DECLINE OF THE VOLKSPARTEIEN: AN ANALYSIS OF THEIR HISTORICAL LOSSES IN THE 2009 ELECTION

JÖRG SIEGMUND

---

## 1. The Role of the Volksparteien in German Politics

Henning Scherf, a former SPD Mayor of Bremen, published an article in the *Süddeutsche Zeitung* on 2 October 2009 in which he expressed his concerns for the German political system in light of the decline of the *Volksparteien* in September's general election.<sup>1</sup> He labeled these once-big parties as a "virtue per se," valuing them as necessary for the functioning and stability of Germany's political system. Scherf demonstrated how deeply he is worried about the current situation, particularly for the SPD, by referring several times in his article to the Weimar Republic and the fate of its party system that had quickly degenerated, thereby contributing to the collapse of Germany's first democracy. The perception that strong and influential catch-all parties are essential for the survival of our political system is indeed very widespread throughout the country. As the *Economist* noticed earlier this year: "If the *Volksparteien* are in trouble, Germans fear democracy may be too."<sup>2</sup>

A *Volkspartei* can be defined as a party that attempts to attract people regardless of their social background, religion, or ideology. Therefore, it is the opposite of any single-issue party or a party addressing exclusively the interests of a certain class or faction within society. In order to be able to attract as many voters as possible, a *Volkspartei* is characterized by a rather non-specific party platform and needs to care for the internal balancing of quite diverse interests of its members. In addition, the term *Volkspartei* is usually reserved for those parties that can actually rely on a broad electorate, meaning that only the bigger parties are labeled as such. Nonetheless, there is no

specific threshold in terms of a certain share of votes that must be won. In Germany, both the CDU/CSU and the SPD are traditionally identified as *Volksparteien*.

In the aftermath of the 2009 election, public attention has primarily focused on the SPD's debacle. However, the CDU and its Bavarian counterpart, the CSU,<sup>3</sup> have also lost much support in the electorate and are, at least in the long run, similarly in jeopardy of losing their status as *Volksparteien*.

This essay will, first, provide some empirical data that clearly highlight the decline of these parties. Although the focal point is the 2009 federal election, some long-term developments in the German party system are also taken into account. These developments should demonstrate that the decay of the formerly dominant parties in fact began several years ago. Second, the article will reflect key reasons for these changes in the party system. And third, some crucial questions will be briefly addressed: What are the expected consequences of the decline of the *Volksparteien* for Germany's political system? Do we have to fear political instability? And does it make any difference at all?

## 2. The Election Results

Table 1 reflects the share of the valid second votes that the different parties won in the 2009 election. The second votes were chosen because they alone determine the share of seats a party gets in the Bundestag (except for the infamous *Überhangmandate*, or surplus seats). In addition, the gains and losses in relation to the previous Bundestag election

held in 2005 are also shown in Table 1.

TABLE 1: FEDERAL RESULT OF THE ELECTION TO THE BUNDESTAG 2009

Party	Second Votes: Percent	Second Votes: Difference from 2005 in percentage points
CDU/CSU	33.8	-1.4
SPD	23.0	-11.2
FDP	14.6	4.7
Left Party	11.9	3.2
Greens	10.7	2.6
Others	6.0	2.1

Source: [www.bundeswahlleiter.de](http://www.bundeswahlleiter.de) (17 November 2009)

These data provide a first impression of the heavy losses suffered by the SPD. On the other hand, the real magnitude of the poor results for both big parties can be determined only if we look at these numbers from a historical perspective. In 2009, it was the first time:

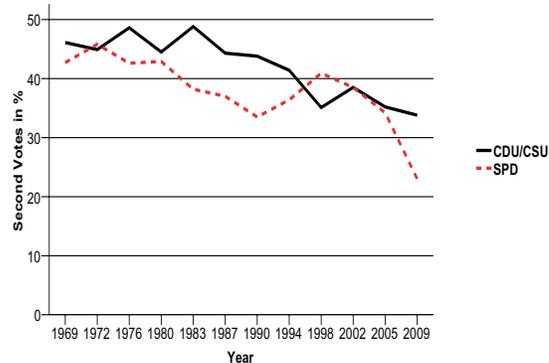
- since 1949 that the strongest party got as low as 33.8 percent of the second vote;
- in any Bundestag election that the second strongest party got less than 25 percent of the second vote; and
- in any Bundestag election that a single party lost more than 10 percentage points compared to the previous election.

In other words, the result for the SPD was its worst performance ever after World War II. Its conservative opponent, the CDU/CSU, did only slightly better—in only one election, in 1949, did it receive a smaller share of votes than it did this year. And it has never happened in postwar Germany that both big parties

have combined for less than 60 percent of the second votes. In fact, in the 1970s these two parties alone attracted so much electorate support that the party system more and more resembled the British or the American one—despite an electoral system of proportional representation, Germany seemed to be on its way to a two-party system. Support for both the SPD and the CDU/CSU reached an all time high in the 1976 election with 91.2 percent of the second votes cast for these two parties. In sharp contrast, the *Volksparteien* received merely 56.8 percent in 2009.

As Figure 1 shows, the decline of the *Volksparteien* is a rather long-term trend. It started right after the aforementioned 1976 election and was particularly accelerated by the appearance of two new parties, i.e., the Greens in the 1980s and *Die Linke* (the Left Party) after German reunification.

FIGURE 1: ELECTION RESULTS, 1969-2009 (SECOND VOTES IN %)

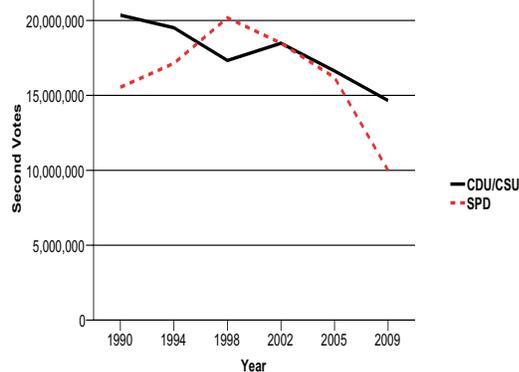


Source: [www.bundeswahlleiter.de](http://www.bundeswahlleiter.de) (17 November 2009)

However, this perspective is somehow misleading as it only takes into account the share of valid second votes and, therefore, depends on the turnout and the performance of the remaining parties as well. Thus, a party's support in society is better represented by the total number of votes it gets in an election. If we look at these figures for both the Social Democrats and the CDU/CSU in every Bundestag election since 1990, the decline of these parties becomes even more apparent. The year 1990 was chosen as a starting point here because the number of those entitled to vote grew significantly due to reunification; it would be

more difficult to draw a comparison to previous elections that took place only in former West Germany. As Figure 2 shows, the SPD has lost more than half of its voters since 1998 when slightly more than 20 million Germans cast their ballots for the center-left party and thereby secured Gerhard Schröder's victory over Helmut Kohl. Similarly, the number of CDU/CSU voters has dropped by more than a quarter since 1990 when these center-right parties also received more than 20 million votes and could, quite to the consternation of the majority of those living in the western parts of the country who favored a replacement of Chancellor Kohl, continue their coalition government with the FDP.

FIGURE 2: ABSOLUTE NUMBER OF SECOND VOTES, 1990-2009

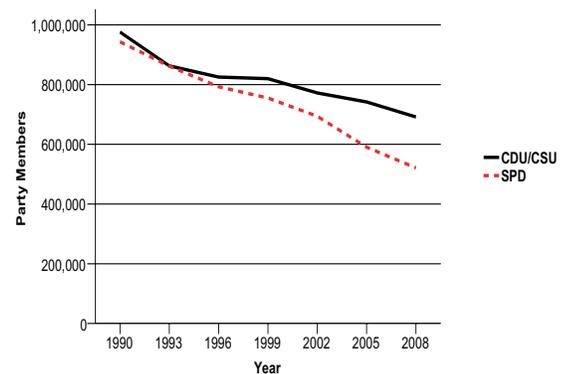


Source: [www.bundeswahlleiter.de](http://www.bundeswahlleiter.de) (17 November 2009)

To add just another perspective on the deteriorating support for the *Volksparteien* in German society, one may look at how their membership levels have fluctuated since reunification. The data provided in Figure 3 emphasize again the parties' weakened positions as the number of party members has decreased dramatically since 1990. As far as the SPD is concerned, its membership has declined almost by half in the last nineteen years, from 943,000 to 521,000 at the end of 2008. The CDU/CSU also had to deal with a continuing slide in numbers, losing roughly 30 percent of its 976,000 members since 1990. For both parties, the consequences of this blood-letting are fairly comprehensive: fewer members not only mean less revenue from membership fees, but also fewer volunteers to assist in future election

campaigns, less activism at the grassroots level of society and, therefore, fewer opportunities to get into direct contact with potential voters. A map depicting the current local branches or committees of the SPD would, for example, contain a lot of white spots in the southern part of Germany where the Social Democrats are no longer present. All in all, this is an unsatisfactory prospect for the parties under review here.

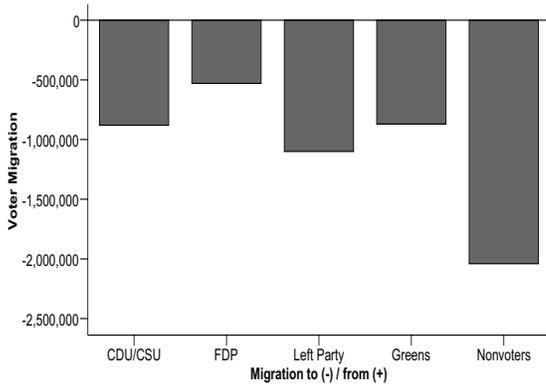
FIGURE 3: NUMBER OF PARTY MEMBERS, 1990-2008



Source: [www.polsoz.fu-berlin.de/polwiss/forschung/systeme/empsocz/schriften/Arbeitshefte/ahosz15.pdf](http://www.polsoz.fu-berlin.de/polwiss/forschung/systeme/empsocz/schriften/Arbeitshefte/ahosz15.pdf) (16 November 2009)

Coming back to the 2009 election and the heavy losses of the SPD and, to a lesser extent, the CDU/CSU, the question arises: Where have all their votes gone? At this point, a clear distinction has to be made between both parties. As Figure 4 indicates, the SPD lost a large amount of voters to every other competitor, no matter if right or left, in the political arena. On the one hand, 1.05 million votes went to the center-right parties, but 1.49 million defectors turned to the Greens and the Left Party. The largest drain of votes occurred, however, to the camp of nonvoters—more than 1.6 million former SPD supporters abstained completely from voting in this year's election.

FIGURE 4: VOTER MIGRATION FOR THE SPD, 2009



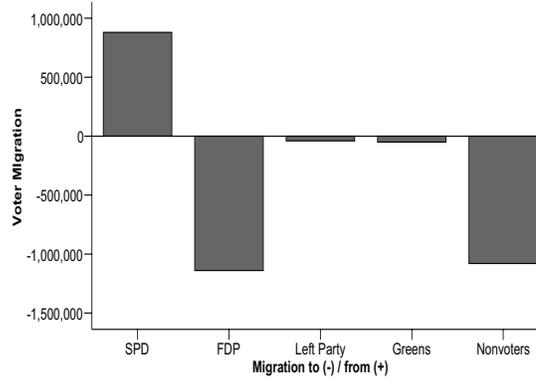
Source: <http://wahlarchiv.tagesschau.de/wahlen/2009-09-27-BT-DE/analyse-wanderung.shtml> (15 November 2009)

The above picture of voter migration emphasizes why it will be very difficult for the Social Democrats to regain their former strength in the electorate or to come at least somewhat close to their performance in past elections. First, this voter migration is hinting at the SPD's positioning in the political center over the last few years and gives an impression of the heterogeneity of the party's supporters. Second, once the appeal of such a party in the center of the political spectrum has deteriorated, it proves extremely difficult to resist the centrifugal forces that very likely will tear apart its electorate. And any adjustment to the party's programmatic profile in order to retrieve lost members will inevitably alienate others even further from the party. Therefore, the SPD will most probably focus on nonvoters. Mobilizing nonvoters in future elections will not necessarily cause SPD voters to defect to other parties at the same time. However, the ability to effectively mobilize support relies either on a strong representation at the grassroots level or the implementation of modern campaign techniques that enable fast, simultaneous, and inexpensive communication with a broad audience even on a non face-to-face basis. On both counts, the SPD does not seem well prepared at the moment.

In comparison to the SPD, the CDU/CSU is in a much more comfortable situation. Although the Conservatives in fact lost some 2.3 million voters, the majority of these cast their ballots for the FDP in 2009, which still provided for a victory for the center-

right camp. Another faction of former CDU/CSU members simply abstained from voting, and only very few defected to the left of the political spectrum (see Figure 5).

FIGURE 5: VOTER MIGRATION FOR THE CDU/CSU, 2009



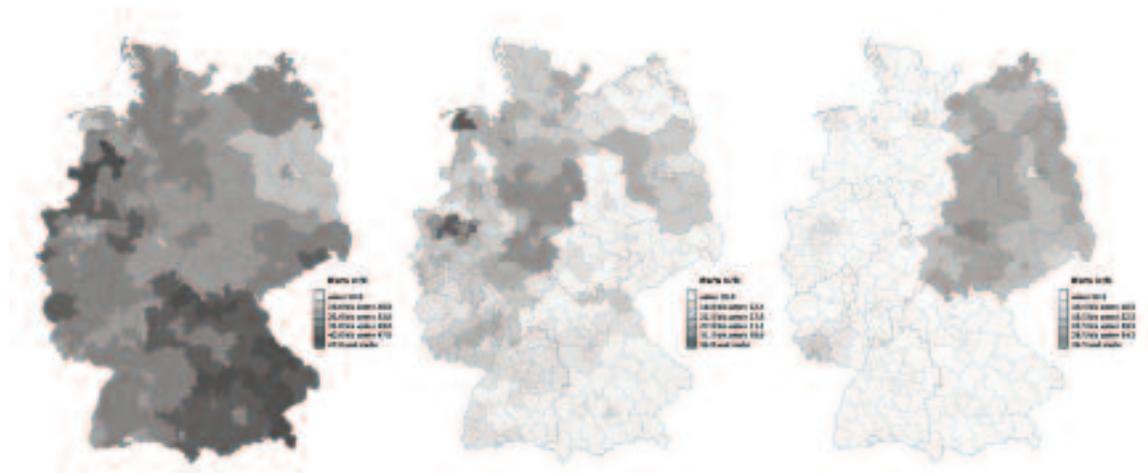
Source: <http://wahlarchiv.tagesschau.de/wahlen/2009-09-27-BT-DE/analyse-wanderung.shtml> (15 November 2009)

From this perspective, it should not be too difficult for the center-right parties to both recover the support of some of the current FDP voters and mobilize those who this time refrained from voting at all. There are good reasons to assume that many who opted for the Free Democrats this time did so because they distinctly disliked the Grand Coalition that had run the country since 2005. Meeting the expectations of these voters for a less social democratic, more liberal—in the economic and civil rights meaning of the word—approach to politics should be a manageable task. Nonetheless, it is difficult to predict what would happen if a markedly conservative party emerged some day at the right end of the political spectrum, being in a way the counterpart of the Left Party. As the last state level election in Bavaria has shown in 2008, more competition in the conservative camp can massively threaten even the position of the long-undisputed CSU. A rather small and organizationally weak political association called *Freie Wähler* (Independent Voters), which had been involved primarily in local politics to date, was able to address the widespread displeasure with both the political decisions taken by the party's leadership and the leaders themselves of the CSU, securing 10.2 percent of the vote for the *Freie Wähler* and

converting it into the third largest parliamentary group in the newly elected Landtag. The *Freie Wähler* present themselves as an association that cares primarily for the “man on the street,” pursuing a rather conservative agenda and focusing on topics like education policy or the promotion of small and medium-sized businesses. For many reasons—namely, the lack of an organizational structure at the national level, a coherent program, sufficient representation in many regions, and, above all, the will of its most influential leaders—the *Freie Wähler* did not stand for election to the Bundestag this time. But there is a chance that they will do so in 2013, imposing additional pressure on the CDU/CSU.

Up to now, this essay's focus was on the national level. However, the 2009 election results differed quite impressively throughout the country in some respect, and therefore it is worthwhile to take a look at the regional outcomes. Figure 6 contains three charts; from left to right they show the share of second votes won by the CDU/CSU, the SPD, and the Left Party in the individual constituencies. The darker the color, the more successful the party was.

FIGURE 6: REGIONAL STRENGTH OF CDU/CSU, SPD, AND LEFT PARTY 2009 (FROM LEFT TO RIGHT; SECOND VOTES IN %)



Source: [www.bundeswahlleiter.de](http://www.bundeswahlleiter.de) (17 November 2009)

Although this essay focuses on the SPD and the CDU/CSU, it does not require much imagination to understand why one must also glance briefly at the Left Party at this point. In the eastern states, this party could in fact claim to be a *Volkspartei*, as they got 28.5 percent on average in the territory of the former GDR and are the second largest party there, only narrowly defeated by the CDU (see Table 2). And in two of these states, Saxony-Anhalt and Brandenburg, the Left Party has outperformed all other parties in the last election, obtaining as much as 32.4 percent and 28.5 percent of the second votes, respectively. In the

western states, the party did not come anywhere near this success. Its best result was in Saarland (21.2 percent of second votes) where the current party's co-chairman Oskar Lafontaine was prime minister for the SPD between 1985 and 1998. On the other hand, the Left Party's worst result occurred in Bavaria where it received only 6.5 percent of second votes.

TABLE 2: RESULT OF THE ELECTION TO THE BUNDESTAG 2009 IN WESTERN AND EASTERN GERMANY

Party	Second Votes: Western States, Percent	Second Votes: Eastern States, Percent
CDU/CSU	34.6	29.8
SPD	24.1	17.9
FDP	15.4	10.6
Left Party	8.3	28.5
Greens	11.5	6.8
Others	6.1	6.4

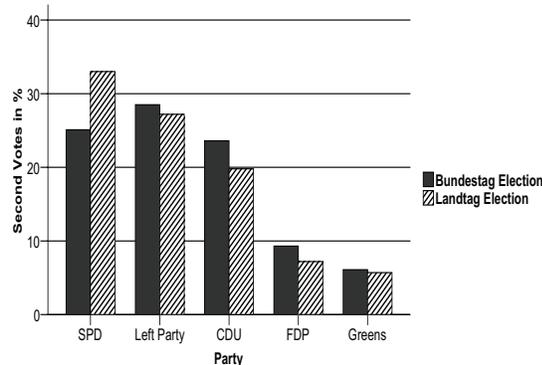
Source: *www.bundeswahlleiter.de*  
(17 November 2009)

Returning to the SPD, one can certainly identify an east-west cleavage in the election results as the average performance in both regions differs notably. It would, however, be more appropriate to state that the party was particularly successful—still at a fairly low level—in the northern or northwestern parts of Germany, whereas its electoral performance in the central and southern regions was disastrous. The SPD has always struggled to gain ground in the predominantly Catholic south that was characterized for a long time by more or less rural areas without much working-class tradition. Although times have changed, the identification with rather conservative ideas and their political representatives has not changed in these regions.

Looking finally at the CDU/CSU, it is difficult to spot regional differences in the results of the 2009 election. One can hardly say that there is an east-west cleavage any longer, and the most striking regional variation of the election outcome occurred in Bavaria, where the CSU received 42.5 percent of the second votes. This success, compared to the CDU's performance throughout the rest of the country, was seen as a catastrophe by many within the CSU, however, as the party was accustomed to much better election results until very recently. In 2005, for instance, they still got 49.2 percent of the second votes in Bavaria, and in 2002 the CSU reached a very remarkable 58.6 percent. Still, despite their historic losses, the CSU helped to secure a somewhat acceptable result for the center-right parties and for Chancellor Merkel.

Regional differences do still offer hope for the Social Democrats. On the same day the Bundestag election took place, state-level elections to the Landtag were held in Schleswig-Holstein and Brandenburg and the results of the latter one are of particular interest. As voter eligibility regulations for the Bundestag and the Landtag in Brandenburg are fairly similar, almost the same people were entitled to vote in both elections that day. In fact, the number of valid second votes<sup>4</sup> cast for the national and the state parliament differed only very slightly, so one can assume that the same voters took part in these two polls and differences in the election outcomes at either level must be attributed to their individual decision to vote for different parties. As shown in Figure 7, the SPD performed much better in the Landtag than in the Bundestag election, obtaining 33 percent and 25.1 percent respectively. If this was not remarkable enough, the SPD improved its share of votes in the Landtag election by 1.1 percentage points compared to the 2004 election while in Brandenburg alone they lost 10.7 percentage points in the Bundestag election compared to the previous one in 2005.

FIGURE 7: RESULT OF THE BUNDESTAG AND THE LANDTAG ELECTIONS IN BRANDENBURG, 2009 (SECOND VOTES IN %)



Source: [www.bundeswahlleiter.de](http://www.bundeswahlleiter.de) (17 November 2009)

Why did so many people deliberately support the SPD as far as the Landtag is concerned but prefer other parties when electing the Bundestag? How can these differences be explained? Of course, there is no single reason, but a few factors that should be mentioned briefly. First, the candidate: Matthias Platzeck, Minister-President of Brandenburg since 2002 and chairman of the SPD's state committee since 2000, is very popular among his fellow countrymen. In a poll conducted by Infratest dimap only four days prior to the latest election, 82 percent of the respondents stated that they were (very) satisfied with the performance of their minister-president and 91 percent said that they like him personally.<sup>5</sup> His popularity did not diminish even after he resigned the national leadership of the SPD for health reasons in April 2006 after only five months in office, nor did it with his inconclusiveness on with whom to form the next coalition government in Brandenburg. Platzeck left it open until after the election whether he would form a coalition with the CDU or the Left Party, two very contradicting parties in view of their political agendas and the leading actors. Yet people trust him and believe that it is more the minister-president himself than the actual party composition of his government that makes the difference. Second, the competitors: Both the CDU and the Left Party were hoping to join the next coalition led by the SPD, and their respective top candidates, two experienced female politicians, were reluctant to overtly criticize

the minister-president in order to maintain their chances to be part of his government after the election. Third, policy issues: In the poll mentioned above, the reduction of unemployment, education policy, and the economy in general were rated as the most urgent problems. And it was the SPD that people trusted most to solve these problems, valuing particularly this party's agenda in education policy. To sum up, nominating a popular candidate, focusing on the most urgent problems, and a favorable environment at the state level enabled the SPD to win the Landtag election in Brandenburg—and to defy the negative trend that the party was confronted with at the national level. The results in Brandenburg may be a ray of hope for the Social Democrats, indicating that they can win elections against great odds. In the coming years, the SPD will certainly focus on the states to regain political power. The bad news is, however, that there will be elections for only one state legislature in 2010, and this is in North Rhine-Westphalia. At the moment, the circumstances do not look very favorable for the SPD there as Minister-President Jürgen Rüttgers (CDU) has adopted many rather social democratic positions to solve the pending political problems, making it very difficult for the SPD to distinguish itself as the better option for the state government.

### 3. Long-term and Short-term Effects on the Electoral Outcome

To explain the changes in the German party system that have been described so far is a very challenging task. Of course, there are well-established models that provide good explanations for the voting behavior of individual citizens, relying on factors such as the short-term preferences for certain candidates or a specific party platform, the long-term effects of party identification, and so forth. These theoretical approaches are very meaningful and will not be questioned here. Nonetheless, the reasons for the decline of the traditional *Volksparteien* discussed below will not strictly be linked to these models or directly deduced from them; they are rather thought of as an input for further discussion elsewhere and should not be read as a conclusive enumeration of all decisive factors to which the debacle of the SPD and, to a lesser extent, the CDU/CSU, can be attributed.

First, one must recognize the structural changes in German society that have occurred over the last few decades. In fact, there is a wide range of different changes such as the diversification and individualization process that has affected society as a whole. Individualization requires that the parties take into account a much broader spectrum of problems, interests, and demands—that they cannot cope with a one-size-fits-all solution. And certainly the diversification of society makes it much more difficult for the so-called catch-all parties to literally catch them all and to meet the different expectations of potential voters with a single party platform, no matter how unspecific this might be. These are challenges for the *Volksparteien*, and it seems that they have not yet found the right answers to address them properly. In the case of the SPD, this party still advocates primarily the interests of blue and white collar workers, but finds it rather difficult to deal with the demands of the non-working poor, those who depend on social transfers and are often left behind with no chance of social and professional reintegration. The CSU, on the other hand, admits in the meantime that it has not yet adjusted sufficiently to the fact that many young women, the majority well educated, look for a better reconciliation of work and family life. Even though it might be impossible for the *Volksparteien* to completely assimilate to the complexity and diversity of a modern society, the SPD and CDU/CSU can certainly do better than they have up to now.

Second, in addition to the aforementioned structural changes in German society, some aspects of its political culture have altered. Most notably, history and historical experiences seem to be less influential on electoral behavior. Thus, the prospect of being potentially governed by a coalition including the Left Party, an ex-communist party whose members still entertain much sympathy for the GDR, does not provoke any dismay or outrage in society on the whole twenty years after reunification. By and large, Germans have come to terms with this party, which is no longer seen as a threat to democracy. A renewal of the infamous “red socks” campaign—launched by the CDU prior to the 1994 elections in order to attack potential coalitions between the SPD and the PDS, the predecessor of the Left Party—would be a futile effort, maybe even strengthening the latter in a current election. This kind of “normalization” converted the Left

Party into an ordinary competitor for votes at the particular expense of the SPD.

Third, the electoral success of a party simply depends to some extent on how many and what kind of parties stand for election at all. It is certainly easy to understand that for any party it is more difficult to gain the same share of votes in a system with five parties than it would have been with only three of them. And the more these parties resemble each other as far as policy is concerned, the more difficult it will be for them to attract extra votes. In 2009, there were simply too many social democratic parties on the electoral “battleground.” Both the Left Party and, to an even larger extent, the CDU/CSU had adopted some of the concepts proposed originally by the Social Democrats as, for instance, in the case of the *Elterngeld* (parenting benefit), introduced by the Minister of Family Affairs, Ursula von der Leyen (CDU), in 2007. This made it even more difficult for the SPD to argue why people should cast their ballots for them.

Fourth, the strategic options to form a government also affect the electoral success of a party. As far as the SPD is concerned, they had ruled out very early this year any government at the national level including the Left Party, and their favored coalition model composed of them, the Greens, and the FDP, was categorically rejected by the latter party. Therefore, the only realistic option was to continue the Grand Coalition with the CDU/CSU—a government quite disliked by the majority of Germans. The CDU/CSU was in a much more comfortable situation because they advocated a center-right coalition with the FDP that seemed feasible and was welcomed by the parties potentially involved. However, to the surprise of many observers, the CSU primarily attacked its prospective partner, the FDP, during the electoral campaign. This was seen as an attempt of the Bavarian Minister-President Horst Seehofer, who is also the CSU party chairman, to reestablish the former strength of his party in Bavaria. In 2008, it lost its comfortable majority in the Bavarian Landtag and was forced into a coalition with the FDP. Not very surprisingly, voters did not understand why the CSU advocated a coalition model at the national level that they quite overtly disliked at the state level—and, therefore, voters “punished” the CSU by withdrawing

further support and electing the FDP instead, so that the gains of the Liberals in Bavaria even outnumbered their gains at the national level (5.2 percentage points compared to 4.7 percentage points).

Fifth and finally, the internal coherence of a party is a very important factor for its electoral success. In 2009, the SPD could only superficially conceal the internal tensions that were and still are shaking this party. Be it social welfare policy or the privatization of the railroad, be it pension policy or dealing with the massive public debt, there are too many policies where the Social Democrats do not speak with one voice. And they have always been a party struggling with divergent loyalties: On the one hand, there is the party platform adopted by the national party conference, and on the other, there are the many practical constraints that impede and complicate the implementation of several policy proposals contained in the platform mentioned above. Whereas the CDU/CSU deals with this situation in a very pragmatic manner, the Social Democrats find it much more difficult to decide between loyalty to their party platform and loyalty to their Cabinet ministers who usually place emphasis on the constraints and are willing to accept suboptimal solutions rather than none. To the voters, these internal disputes may be somehow entertaining for a while, but in the long run they would like to know which policy will be effectively adopted should the party be in government.

As has been stressed above, the various factors for the decline of the *Volksparteien* and, particularly, that of the SPD in the last elections that have been presented here are by no means comprehensive. No word has been said about the top candidates nor have the many policy proposals been scrutinized—two variables that certainly exert a dominating influence on individual voting behavior. The approach adopted here was rather meant as a stimulus for further discussion, as some aspects presented above tend to be neglected quite often.

#### 4. The Consequences for the Political System

The decline of the *Volksparteien* is a rather long-term process that started back in the 1970s and has certainly not yet come to an end with the 2009 elec-

tion. Both parties involved, the SPD and the CDU/CSU, have tried their best and will continue to do so to resist this trend, to slow it down, or to even reverse it and regain their former strength and dominant positions in the German party system. They may be partially successful if they manage to avoid some of the mistakes committed in the last election, such as confusing the public with protracted internal debates over too many issues at the same time. Nonetheless, quite a few of the factors that caused the decline of these parties cannot be deliberately altered. The very fact that society has changed tremendously during the last few decades cannot be modified or reversed by the parties, nor can it simply be ignored. Therefore, the decline of the *Volksparteien* will not be reversed significantly in any foreseeable future, and Germans will have to get used to a more fragmented and diverse party system.

If so, some questions naturally arise: What are the consequences for our political system? Do Germans have to fear political instability? And is, in the end, even democracy at stake as suggested by Henning Scherf in the article cited at the beginning of this essay?

To give a clear and brief answer: The effects of a more fragmented party system on German politics will be less fundamental than many observers expect at the moment. The decay of the big parties will, of course, impose new challenges for the formation of a workable government. Coalition building is indeed much easier if (only) *Volksparteien* are involved because their programmatic openness facilitates cooperation and a compromise on the government's agenda should not be something too hard to negotiate. By contrast, the more parties, including second-tier ones, that are necessary to form a government, the more difficult it will be for them to reach consensus. And coalition governments comprised of a large number of parties or some parties that differ on many substantive issues are prone to instability.

On the other hand, Germany's postwar democracy has been well-known for its manifold consensual patterns. This means that even in the past it required the cooperation of more parties than just the ones part of the present government at the national level to actually run the country. Many bills can only be

passed, for instance, with the consent of the Bundesrat, which has often been dominated by the minority parties in the Bundestag. And even without the support of the Bundesrat, the opposition parties at the national level have many options at their disposal to influence the federal government. To name but a few, the parliamentary minority can bring the government to the *Bundesverfassungsgericht* (Federal Constitutional Court) on different grounds or they can set up parliamentary investigation committees to which the government has to report. And last but not least, parties found on opposite sides in the Bundestag quite often form a coalition government in some of the *Länder* as, for instance, the CDU and the Greens do in Hamburg at the moment. Thus, any national government until now has been well-advised not to aim for a fundamental conflict with the opposition parties. And the smaller parties have adjusted to the consensual system, too. They know that there is a great chance to influence politics if they cooperate with other parties instead of merely blocking any initiative of the parliamentary majority. Therefore, German parties, at least the ones represented in the Bundestag, are used to compromise, and this is no longer an exclusive feature of the traditional *Volksparteien*.

If the *Volksparteien* are primarily characterized by their willingness to attract as many people as possible regardless of their particular interests, social background, religion, and so forth, one can even say that nowadays there are not only two of them but at least five. The FDP, Greens, and Left Party are no longer single-issue parties addressing only a clearly defined part of the population. Despite some political rhetoric, their supporters stem from all strata of society. Thus, the decline of some *Volksparteien* leads to the rise of others. This is certainly not an appealing perspective for both the SPD and the CDU/CSU, but is not a cause for concern from a democratic point of view.

## NOTES

1 Henning Scherf, "Die Volkspartei, ein Wert an sich," *Süddeutsche Zeitung*, 2 October 2009, 2.

2 "People's parties without the people," *The Economist*, 8 August 2009, 45.

3 If not stated otherwise, CDU and CSU will be referred to as one party (CDU/CSU) below.

4 Similar, but not identical, rules apply to both elections, and the second vote is in any case the decisive one.

5 "Alle lieben Platzek," *Rundfunk Berlin-Brandenburg*, 27 September 2009, <[http://www.rbb-online.de/themen/dossiers/wahl/wahljahr\\_2009/themen\\_und\\_analysen/Umfrage\\_infratest.html](http://www.rbb-online.de/themen/dossiers/wahl/wahljahr_2009/themen_und_analysen/Umfrage_infratest.html)>.





## ECONOMIC CHALLENGES FOR THE NEW GERMAN GOVERNMENT

02

# ECONOMIC CHALLENGES FOR THE NEW GERMAN GOVERNMENT

OLAF GERSEMANN

---

## 1. Introduction

When Angela Merkel became German chancellor in late 2005, she was confronted by an economy that had just suffered from a seemingly endless period of stagnation. Until then, the economy had never really recovered from the slump that ended the dot-com bubble in 2001. In fact, unemployment rose to over five million people in early 2005—a level not seen in Germany since the early 1930s.

However, led by its export-oriented industries, the corporate sector did finally manage to benefit from the strong upswing of the world economy. Helped by labor market reforms (“Hartz IV”) enacted by the previous government coalition, unemployment came down again quickly, falling below three million people in the fall of 2008. Tax revenues ballooned, enabling Chancellor Merkel, a Christian Democrat, and her finance minister, Peer Steinbrück, a Social Democrat, to bring down annual budget deficits without cutting expenditures.

Thus, in its first years in office, Merkel's first coalition did not face serious economic challenges of the magnitude its predecessors were burdened with. Both internationally and domestically, “Ms. World” herself instead spent many months focusing on promoting (costly) policies to battle global warming. The most talked about reform at home were new welfare-state incentives for young fathers to allow them to take time off work to raise their children.

Only when the financial crisis escalated with the collapse of Lehman Brothers in September 2008 did economic policies take center stage in Germany

again. They are set to remain there for the remainder of Merkel's second term.

As will be discussed in this essay, the new coalition will face three main challenges with regard to economic policies. All three are closely linked. First, the coalition will have to deal with an unusually high degree of uncertainty. Second, it will need to be prepared to act much more quickly than usually and change course drastically, if necessary. And third, it will be forced to cut expenditures dramatically.

## 2. The Economic Situation in Late 2009

In the early years of this decade, Germany repeatedly was labeled the “sick man of Europe.” At a quick glance, this still holds true at the end of the decade. In contrast to countries such as the U.S., the UK, Ireland, Spain, or several eastern European countries, in Germany real estate markets did not veer from the fundamentals (unlike in the U.S. and Spain, for example) in the second half of the decade; German consumers also did not go on a debt-financed spending spree. Nevertheless, Germany in a way suffered even more from the recession than most of its partners on both sides of the Atlantic. Economic output in 2009 will be roughly 5 percent smaller than in 2008, a decline that is larger than in most other western countries, including the United States. The reason for this is that the collapse the world economy experienced in the winter of 2008/09 was mainly driven by sharp declines of international trade. Those declines were largest in markets in which the German manufacturing sector specialized, such as sophisticated machinery and other investment goods.

However, with trade turning around again starting in the spring of 2009, Germany was one of the very few large countries in which economic activity began picking up as early as in the second quarter of this year. While in the past the German economy was a late-comer in business-cycle upswings, this time around it is among the leaders.

What is even more, in the year after Lehman collapsed unemployment barely rose in Germany. On a seasonally adjusted basis, it even declined in every single month between July and October. To be sure, this was also made possible by changes in the way unemployment is calculated. Nevertheless, on the labor market the picture is markedly better than in any other industrialized country.

To sum up, Germany's economy was in a better shape than others before the crisis hit—and so far it seems to come out in better shape, too.

### 3. The Economic Outlook for 2010 through 2013

Germany's economy is set to grow quickly in the second half of 2009 and the first months of 2010. Indicators published so far essentially guarantee growth rates in fall and winter that are much higher than what even optimists had hoped for in late spring. In the third quarter of 2009, industrial production in Germany shot up at an annual rate of roughly 14 percent. Exports rose even stronger, with an annualized growth rate of 22 percent. In the near term, this very positive development is set to continue. New industrial orders climbed by an annualized rate of 35 percent in the third quarter, a rate of growth not seen since the reunification of the country almost twenty years ago. As the economists at Unicredit noted in early November, German "companies virtually made history in recent quarters."

What is far more uncertain, however, is the economic outlook beyond the first quarter of 2010. Essentially all leading economists predict the German economy to continue to grow, albeit at a much slower pace. The upswing is assumed to be sluggish but at the same time supposed to remain intact. Under this scenario, economic output would reach its level of early 2008 at some point in 2012 or 2013.

However, one of the lessons the financial crisis has taught us is not to listen too closely at what economic forecasters tell us. The consensus forecast for economic growth will roughly be correct most of the time in the foreseeable future—but will surely miss the next turning point of the business cycle. To simply extrapolate recent trends of economic development into the future seems to be too big a temptation to resist.

In mid-August of 2008, Germany's leading Sunday paper *Welt am Sonntag* asked a panel of eight well-known German economists to put a number on the likelihood of a recession being imminent. The answer was, on average, 20 percent. Certainly, those economists cannot be blamed for not having foreseen Lehman Brothers collapsing. After all, nobody saw that—and its consequences—coming. However, what was obvious in August of 2008 was that the financial crisis was far from over. In the months before, Bear Stearns, Fannie Mae, and Freddie Mac had to be rescued by the U.S. administration and the Federal Reserve. It looked obvious that more calamities were in the cards. What is more, we do know by now that the German economy was already suffering from a recession for several months by the time *Welt am Sonntag* asked those experts back in August of 2008.

One might counter that there also were the likes of Nouriel Roubini, economists who spent years warning everyone who cared to listen that things would turn nasty. Those pessimists certainly were proven right eventually; however, most people in this group went on missing the not too insignificant fact that economic activity began stabilizing in the spring of 2009. In fact, one well-known commentator kept forecasting a five year depression as late as April of 2009.

Therefore, while it is certainly still important to engage in the business of economic forecasting, the audience should take its results with a grain of salt. It would be better still if forecasters show at least a bit of humility.

Instead, certainly, they are doing business as usual. There has been a lot of debate in recent months about whether the recovery would be V, W, or U-shaped. However, all of these calls require an economist to know what happens in the economy two, four, or even

eight quarters from now. Given that we just learned the economists do not even precisely know what happened during the last quarter, one should deeply mistrust anyone who pretends to be certain which shape the economic development will display.

Actually, there is still a high degree of uncertainty about what might happen in the German, and for that matter, in the world economy for at least a couple of years to come.

#### 4. A W-Shaped Recovery?

There is certainly a considerable upside risk that is not reflected in the current economic consensus forecast. Economists regularly tend to underestimate the dynamic of upswings in capitalist economies. Thus, the possibility that the recovery both in Germany and the world economy as a whole will turn out to be much more resilient than is currently believed is a distinct one.

However, politically much more important is the possibility of a W-shaped recovery. That would mean that the near-collapse of economies and the recent signs of a recovery are followed by a renewed recession before things eventually turn back to normal. To be sure, a W-shaped recovery is the exception, not the rule. For it to become reality, a recovering but still weak economy would have to be hit by an economic shock such as a sudden rise in energy prices. While an oil price shock does not seem to be a very large risk, given the amount of slack in economies worldwide, it still cannot be ruled out.

Another shock could be manufactured by monetary policymakers. Exhibit A for W-shaped recoveries are the back-on-back recessions the United States suffered in 1980 and 1982 when the Federal Reserve, led by Paul Volcker, aborted a recovery by driving interest rates sky-high in order to fight inflation. Policymakers are believed to have learned this lesson. However, after having provided markets with massive and unprecedented amounts of liquidity starting in August 2007 and thus having risked surging inflation rates, central banks might be tempted to withdraw the stimuli too early.

A third downside risk is a renewed escalation of the

financial crisis. Financial markets currently consider the likelihood of that risk to be small. This, however, proves little. After all, no one saw the Lehman collapse coming. Just weeks before Lehman's downfall shocked financial markets, in Germany Deutsche Bank finalized plans for the acquisition of Postbank; Commerzbank decided to buy Dresdner Bank. Both deals surely would not have been closed if top executives at Deutsche and Commerzbank had considered something like the Lehman disaster possible. Financial institutions have proved to be far too nontransparent for making it possible to decide when exactly the likelihood of a renewed escalation of the financial crisis has diminished so much that policymakers can safely neglect it when making decisions.

Fourth, it remains unclear how much of a problem difficulties to receive credit will become in the months to come. Thus far, German banks' credit extension in this crisis seems to have been by and large in line with economic activity. That is to say, credit volumes roughly declined in a way that should be expected in times in which an economic slump has caused corporate investment activity to collapse. On the other hand, it is far less clear whether this will remain the case. There seems to be at least a considerable likelihood that the economic recovery will be hit by a credit crunch that is an aftermath not of the recession but of the financial crisis.

All of these four risks are not specific to Germany: Virtually all industrialized countries face them. Germany, however, is threatened by a fifth danger: the possibility of a dramatic surge of the unemployment rate that is still to come. As mentioned above, the unemployment rate rose only moderately in the first half of 2009 and actually fell in the summer. It is widely believed that German executives fear a shortage of skilled employees so much that they would rather suffer from a bigger than necessary fall of profits to retain skilled workers throughout the crisis.

The federal government in Berlin has assisted companies in avoiding mass lay-offs by extending and expanding a wage-subsidy program called *Kurzarbeit* or short-term work. This program, while costing taxpayers billions of dollars, does not fully compensate those companies that participate in the program, forcing them to pay part of the cost themselves. Thus,

labor unit costs rose drastically; in the early fall they were more than 20 percent higher in the German manufacturing sector than a year before. If the recent surge in new orders continues, this could turn out to be a temporary problem. If, on the other hand, labor unit costs remain at their elevated level, international competitiveness of German companies might suffer badly. In this case, the waves of mass lay-offs and the drastic surge of unemployment rates that many other countries experienced in recent months, would surely also spill over to Germany. By hurting private consumption, this could easily derail the still fragile economic recovery.

In others words: It may very well be that for the recovery to continue at all, in the case of Germany it needs to be a strong recovery. While Germany belongs to the small group of countries that has emerged from the recession first, it might very well be the first, and possibly the only one that falls back into a just another recession. A sustainable recovery might be years off.

It is certainly impossible to attach a probability to the downside risks mentioned above. Unemployment forecasts for instance recently have been even more unreliable than economic growth predictions. As late as March 2009, some economists predicted unemployment to surge to five million people by fall; instead it remained below 3.5 million in October.

What can be taken for granted, however, is that every one of the risks is both serious and not far-fetched. When Chancellor Merkel's second term expires as scheduled in the fall of 2013, the Great Recession might be long behind Germany, having left little more than deteriorated public finances. However, it also may very well be that the second-term will be dominated by just another multi-year period of economic calamities.

## 5. Dealing with Uncertainty

German politicians take pride in staying calm while economic storms gather; they tend to denounce prompt government action that is often seen in the United States as *Aktivismus*. In 2001, Chancellor Gerhard Schröder kept denying that the country has entered a recession until it was obvious to everyone;

it took him two more years to even seriously consider the Hartz IV reform that later proved to be so decisive in bringing unemployment down again.

Similarly, Mr. Steinbrück famously labeled the financial crisis an American problem that would not affect the German economy just days before Lehman collapsed; in July of 2008, he also dismissed the idea of having to prepare for the worst—just in case. And Merkel kept denying that anything more than a meaningless fiscal stimulus was needed as late as November of 2008.

After a significant stimulus was finally decided upon in January 2009, politicians and bureaucrats still did not display any sense of urgency. The *Abwrackprämie*, the German precursor to America's cash-for-clunkers program, proved to be a timely and surprisingly popular success. However, it took many months before the planned public infrastructure initiatives began stimulating demand. Those initiatives are worth €17 billion and are thus more than three times as large as the *Abwrackprämie*. As late as October of 2009, however, they still did not have substantial effects on public construction. In fact, economists reckon that the bulk of the programs will help lift economic activity in the fourth quarter of 2009 at the earliest—two quarters after the recession officially has ended.

This slowness has not prevented Germany from emerging from the recession earlier than others. However, next time around the government will have to be prepared to act much more quickly. A new sudden shock would hit an economy that is much weaker and therefore much more vulnerable than it was in the summer of 2008. Therefore, policymakers will have to watch economic development very closely. It also would be wise for Wolfgang Schäuble, the Christian Democrat now in charge of the finance ministry, to do something that Steinbrück, his predecessor, would not: to develop emergency plans which would be set in place if a renewed recession is considered to be around the corner.

## 6. The Fiscal Straightjacket

Given the uncertainty regarding economic development, it would likely be smart politically if the new

coalition refrains from promises it might not be able to keep. The coalition, however, has inherited one such promise from its predecessor. Earlier this year, the Grand Coalition had decided upon a constitutional amendment called *Schuldenbremse*. This “public-debt brake” will come into force in 2016. By then, the annual budget deficit will have shrunken from €90 billion now to roughly €10 billion.

Being part of the constitution, this mandate cannot and must not simply be ignored. This coalition and the next will at least have to seriously try to reach the target. That in turn means that government expenditures will have to shrink or at least grow significantly slower than revenues. Assuming that governments would attempt to reach the target at a steady pace, the German public sector would subtract roughly .4 percentage points from overall economic growth in each and every year from now until 2016. In other words, the debt brake will also act as a brake for economic growth in years to come.

What is more, the pace will not—and should not—be steady. In order not to derail the still fragile recovery, the government should be careful to not start consolidating public finances too soon. This in all likelihood will mean that the current coalition will leave the bigger and more painful part of the job to the next government.

However, the coalition will still have to begin bringing down the deficit as soon—and as much—as possible. This is one more reason for watching the economy closely and being prepared to act swiftly.

The coalition's options are limited. During the economic upswing between 2005 and 2008, many Germans felt left behind. That is largely because disposable income barely rose: The Grand Coalition did not adjust personal income tax brackets to inflation. That meant that pay raises in many cases were eaten up by additional income tax burdens. Moreover, Merkel increased the value added tax by three percentage points in January 2007—the biggest single tax hike in the history of the Bundesrepublik.

This made the promise of tax cuts increasingly popular. Accordingly, the free-market Free Democrats (FDP)—for whom tax cuts have been a central part of

their platform for years—came out of the federal election in September stronger than ever before. The CSU, the Bavarian wing of the Christian Democrats, also promised tax cuts—as did the CDU itself, albeit more vaguely.

What is more, Chancellor Merkel has made a “read-my-lips” statement after her reelection: She has promised not to increase any taxes during her second term, meaning that any tax cuts forced through by the FDP and the CSU probably will not be countered by hikes of others taxes. It does not seem likely that the FDP, the junior partner of the new coalition, will get all that it wants, i.e., a tax cut that would be equivalent to at least 1.5 percent of Germany's gross domestic product (GDP). More realistic would be a tax cut of between .5 and 1 percent of GDP. Part of this tax cut might finance itself through additional economic growth. Assuming that this “Laffer effect” would amount to half of the overall tax cut (a rather optimistic assumption), the additional public deficit would amount to between a quarter and a half percent of GDP.

Taken together, the *Schuldenbremse* and the tax cuts will sooner or later require a cut in public spending in a way unprecedented in recent German history. Again, it would be unwise to start counteracting stimulus measures by cutting public spending too soon. However, as soon as the danger of a double dip subsides, the coalition will have to engage in massive expenditure cuts, thus afflicting hardship on large parts of the electorate and slowing down economic growth. Those cuts will likely make the coalition and its chancellor deeply unpopular. And they will have to be made at a time when the next federal election is already looming.

## 7. Is Angela Merkel Up to It?

For Angela Merkel, the first term was the easy part. She benefited from an economic recovery that was already under way when she came into office in 2005. She also benefited from labor market reforms that her predecessor pushed through, reforms that not only more or less directly led to Mr. Schröder's electoral defeat in 2005 but also deeply alienated the Social Democrat's base from its leadership; the Social Democratic Party is likely to be badly weakened for

years to come.

Now comes the hard part for Merkel—there is no way around it. But is she up to it?

The answer might very well be “no.” Merkel was spared from making difficult, unpopular decisions in her first term; she thus enters the second term being basically untested. Chancellor Merkel in her first four years also displayed a remarkable tendency to avoid any sort of decision that might anger any meaningful chunk of her potential political base. She was many things—but not bold.

This could mean that she will bequeath even bigger challenges to the next coalition in 2013 than she had left to herself now. Much more so than in the past, avoiding hard decisions in the near future will mean leaving even harder decisions for future policymakers.

However, it does not have to be that way. First, it is widely believed that deep in her heart, Merkel is an advocate of lean government; she herself had portrayed herself as such two years before coming into office at the famous party convention in Leipzig. Having changed coalition partners, substituting the free market FDP for the Social Democrats, many pundits consider the chancellor a released prisoner. “Germany’s return to reform politics,” was the title of an op-ed written by Allianz chief economist Michael Heise, published in the *Wall Street Journal* on 1 October 2009.

Second, political analysts often fall prey to a mistake that is widespread among economic forecasters, too: extrapolating trends of the recent past into the future.

When Bill Clinton was inaugurated the first time in early 1993, there was little indication that this president would end up signing the welfare reform and bringing the federal budget back from the red. Similarly, when Schröder came into office in 1998, he started out by disappointing people who have hoped for a new, progressive “Third Way.” Despite the rapid demographic ageing of the German population, his labor minister initially wanted to lower the official retirement age from 65 years to 60. But eventually, during the Grand Coalition’s term, it was one of Schröder’s former chief lieutenants, Franz

Müntefering, who pushed through the decision to actually raise the retirement age to 67. Also, Schröder started out with burdening the German economy with imposing even more labor market regulations on it. Only much later he became the man who risked—and finally lost—his job by enacting those famous Hartz reforms.

Will Chancellor Merkel become a risk-taker, too? Maybe so. However, the *Koalitionsvertrag*, the joint platform she signed up to together with the party leaders of the FDP and the CSU, is widely considered a disappointment. Critics lament that bold reform proposals are missing. What is clearly missing for sure is a strong signal that the new coalition recognizes just how tight its fiscal straightjacket is.

Angela Merkel’s defenders point to the fact that in May of 2010 elections will be held in North Rhine-Westphalia, Germany’s most populous state. The state is currently governed by a coalition of CDU and FDP. Losing this election would also mean that Merkel would lose the majority she now can count on in the upper chamber of the parliament, the Bundesrat. Winning it would mean that Merkel was free to finally become the Iron Lady she promised to be back in 2003 in Leipzig—or so her defenders say. It looks like we will have to wait and see.





## THE GERMAN FISCAL FEDERAL SYSTEM

# THE GERMAN FISCAL FEDERAL SYSTEM: STATUS QUO, IMMINENT CHALLENGES, AND PLANS OF THE NEW GOVERNMENT

BEATE JOCHIMSEN

---

## 1. Introduction

In general, federalism makes people happy and more creative.<sup>1</sup> However, as federalism often goes along with joint decision-making and no clear division of tasks between the different government tiers, there are also dark sides of federalism.<sup>2</sup> In Germany, fiscal relations between the federation and the states resemble a Gordian knot. State politicians face strong incentives to finance public expenditures via debts because they know that, in the end, there will be a fiscal bailout.<sup>3</sup> Incentives for their own activities and effort hardly exist, fostering the rise of large public deficits over the last decades. Existing rules to prevent over-indebtedness of the federation or the states have proved to be nothing but a paper tiger, leaving the absence of fundamental reform of fiscal relations a crucial omission.

Still, the German public is not very aware of these severe problems. In the election campaigns before the federal elections on 27 September 2009 no party discussed this topic seriously. From a political economy point of view this was a reasonable strategy as economic concerns in general did not play an overwhelming role in the election. Although the Western world has been facing the most severe financial and economic crisis for the last decades, only 19 percent of Germans considered the economic situation as one of the most important issues. For 56 percent, unemployment is the central subject. However, this number declined from 85 percent in 2005, the year of the last federal election.<sup>4</sup> At first sight, this comes at a surprise. Despite the worldwide crisis, unemployment sank from 12.3 percent at the beginning of 2005 to 8 percent in

September 2009, the lowest point being in November 2008 with 7.1 percent. A drastic change in unemployment subsidies as well as the good economic situation between 2005 and 2008 caused this decline. Instruments of the social market economy like short-term working (*Kurzarbeit*) cushioned the effects of the current crisis so that unemployment has not risen as much as in other Western democracies.

For public economists this is a dangerous development: there is a worldwide recession that has not changed the economic living conditions of most Germans substantially. On the one hand, this is an excellent result of government policy and the social market economy. On the other hand, it disguises the accompanying problems in public finances. As the federal system includes nontransparent fiscal relations between the federation and the states anyway, some billion euros more in public debt are not really noticed. Over the last five years, two Federal Reform Commissions (I and II) tried to disentangle these (fiscal) relations, making policy decisions more transparent and single politicians or governments more responsible. In the area of fiscal relations the responsible Reform Commission II only partly succeeded in this disentangling. Its most important result are new rules to limit federal and state indebtedness. However, as sanctions only play a negligible role, the success of these new rules heavily depends on public awareness, public control, and public support. Boosting these has to be a major aim of the newly elected government.

This essay is organized as follows: The structure of fiscal federalism in Germany is explained in chapter

two. The third chapter describes and discusses the results of the Federal Reform Commission II (*Föderalismuskommission II*) as well as an alternative strategy to overcome the fiscal problems which would take into account incentives for politicians. Still open economic and fiscal challenges are addressed in chapter four. Furthermore, this chapter offers some possible solutions to the remaining problems. In the fifth section, the (potential) conflict between necessary economic reforms and a tangled political system is debated. Finally, the sixth section concludes and provides an outlook on the economic policy of the new government with special regard to the challenges in fiscal federalism.

## 2. Structure of Fiscal Federalism in Germany

In contrast to the U.S., two-thirds of tax revenue is shared between the federation, the states, and sometimes the local jurisdictions in Germany. The federal level has no restrictions setting their own taxes, but sub-national governments have rather little power when it comes to designing taxes. The local jurisdictions can raise some smaller taxes and can determine the tax rate for real estate tax and for business tax. Thus, the states do not have any tax setting autonomy.<sup>5</sup> By voting in the Bundesrat (Upper Chamber), however, the states do participate in tax legislation. Additionally, the federation and the states negotiate the distribution of tax revenue out of joint taxes. In the end, the revenue system is so complex that citizens do not know which government level is responsible for their tax burden, making it almost impossible for them to control their governments.

Up to now, rules concerning debt issue were far more liberal. So far, the federation and the states face few restrictions regarding debt issue. In the Basic Law (Article 115) as well as in many state constitutions, there is a formal requirement that a government's net borrowing shall not exceed its planned investment expenditures (also called the 'golden rule'). However, this requirement is linked to standard economic conditions, which immediately lessened the strictness of the rule. There are several arguments for politicians to raise debt to a sub-optimal level (e.g., opportunistic or partisan behavior, divided governments).<sup>6</sup> Therefore, the golden rule was not successful in

limiting indebtedness in Germany and, as a consequence, was abolished by the Federal Reform Commission II. With the European Monetary Union, Germany faces additional restrictions for indebtedness. Still, the experience with deficit policies by the EU showed that threatened EU sanctions were never implemented against Germany.

A sophisticated fiscal equalization system obliges financially strong states to provide equalization payments to financially weak states. Because aligning states' revenue is intended to create equal living conditions for the entire population of Germany, it is difficult to insert elements of competition—more decentralization—that might lead to diverging provision of public goods among the states.<sup>7</sup> Furthermore, the federal government pays supplementary federal grants (*Bundesergänzungszuweisungen*) to help financially weak states meet general financial requirements.<sup>8</sup> Finally, co-financing of tasks used to be quite common. Consequently, there is no clear division of political and financial responsibilities between the different layers of government, as would be optimal to control politicians.

The goal of the Federal Reform Commission I was to enhance the ability of both the federation and the states to make decisions and to make the division of political powers clearer. Therefore, in 2006, the first Federal Reform Commission reduced the number of federal laws requiring Bundesrat consent and some rights have been transferred to the states. However, overall the joint decision trap remains. This did not come as a surprise since the Commission introduced no mechanism to overcome the trap. And since financial relations were bracketed out of the first step of the reform, joint decision-making in fiscal policy was hardly reduced at all.

Still, two reform elements have triggered financial consequences. First, co-financing of tasks has been widely abolished and the legislative competence of the states has been increased.<sup>9</sup> For example, the federation and states ended their joint financing of university infrastructure, which is now the sole responsibility of the states. Second, the states can decide on remuneration of their civil servants, and by now all of them deviated from prevailing national pay levels.

The challenge of the Federal Reform Commission II was to overcome the deadlock in the area of fiscal reform. Many actors hesitated to touch this field because the close fiscal links in Germany are to a large extent based on the *Bündische Prinzip* (confederation principle) and the demand for equal living conditions, which have deep historical roots. To maintain this system, failed states like Bremen and Saarland are bailed out rather than forced to balance their budget or to merge with neighboring states. Still, the commission managed at least to address the most pressing problem, namely to stop further public indebtedness.

### 3. Results of the Federal Reform Commission II

In March 2007, the Grand Coalition established a joint Commission on the Modernization of Federation-States Fiscal Relations<sup>10</sup> (Federal Reform Commission II) to strengthen the regional and local authorities and to ensure that they have the financial resources necessary for them to carry out their duties. The reform proposals in Commission II ranged from the prevention and management of budgetary crises, debt management and debt release, and a critical review of tasks and standard-setting, to some tax autonomy for the regions. They also covered the reduction of red tape and the enhancement of efficiency, through, among other things, the redistribution of tasks in the public sector. Finally, the commission was concerned with potential cooperation and requirements for voluntary mergers between states. However, out of all these debated topics only the following results emerged leaving various problems unsolved.

#### RESULT ONE: STABILITY COUNCIL TO PREVENT SEVERE BUDGETARY CRISES

In order to prevent severe budgetary crises the commission agreed to form a stability council (*Stabilitätsrat*). The council consists of representatives of the federation and the states. Its main task is to monitor the budgets of the federation and the states and to execute restructuring measures. If certain budgetary indicators point to an upcoming crisis, the committee can demand budgetary restructuring. However, there exist hardly any sanctions in

case the *Land* ignores these recommendations. Proposals for an automatic income tax increase in the specific *Land* have been dismissed although this would have contributed to the fiscal balance, on the one hand, and might—due to its visibility to the taxpayer and voter—have deterred politicians from producing 'bad' budgetary indicators, on the other hand.

The introduced early-warning system increases transparency because it will be based on widely-used fiscal indicators. When voters can easily understand difficult and technical budgetary problems, they may pay more attention to them. As fiscal sanctions in case of misbehavior in the whole do not exist, the only chance to discipline politicians will be public opinion. However, with the *Finanzplanungsrat* (national fiscal planning committee with representatives of the federation and the states), there already exists a committee that could and should function like an early-warning system. In past decades, its warnings (when made) faded away unheard.

#### RESULT TWO: DEBT BRAKE FOR FEDERATION AND STATES

The most important result of the Federal Reform Commission II is the elimination of the 'golden rule' in Article 115 of the Basic Law. Now, public deficits and public investments are no longer linked to each other. Following mostly the proposal of the Council of Economic Advisers, the reform commission agreed to introduce a debt brake similar to the Swiss model for the federation and the states. In Switzerland, debt brakes exist on a federal and cantonal level. Over the business cycle, the federal level and most cantons are obliged to balance their budgets and to reduce accumulated debt. Expenditures have to be adjusted to revenue that is smoothed over the business cycle. 'Normal' surpluses and deficits are booked in a separate account and have to be balanced over several years. Extraordinary revenue has to be used to pay back debt. Extraordinary expenditures can only be incurred if large political majorities in the parliaments support them.<sup>11</sup> In the style of the Swiss model, the German debt brake is made of four components:

*Component One: Limitation of Structural Deficits*

From the year 2016 onward the federal level is only allowed to raise debt up to an amount of 0.35 percent of nominal GDP (gross domestic product). The states may not raise any structural debt at all from 2020 onward.

*Component Two: Deficits Alongside the Business Cycle*

Deficits are allowed to stabilize the business cycle. If the business cycle is low, the federation and the states may raise debt above the just mentioned limits. In good times there must be a surplus in order to delete the accumulated debts.

*Component Three: Exceptions in Case of Catastrophes*

In case of a natural catastrophe or an extraordinary emergency that lies beyond the control of the state, additional debt may be raised to overcome the situation. However, this has to be connected with a plan to repay the debt.

*Component Four: Check Account*

A check account will control to what extent the real deficit differs from the one that has been calculated based on the business cycle. If the real one exceeds the allowed one, the limits for a structural deficit (component one) will be tighter.

As with the stability council, basically no sanctions in the case that rules are disregarded have been passed. Only component four includes the automatism that the limit to raise structural debt is lowered if the check account is severely unbalanced. Thus, as only the federation is allowed to raise structural debt anyway, there is no sanction mechanism for the states at all. However, sanctions would be necessary because the emergence of high debt levels over the past decades shows that rules to limit indebtedness do not work without sanctions in Germany. The Council of Economic Advisers<sup>12</sup> recommended that the concerned jurisdiction has to raise income tax if the clearing account is not balanced.

Unfortunately, this proposal has not been accepted by the Reform Commission.

In Switzerland, the debt brake functions without having sanctions in case of violation of the rules as a consequence of its high political and public support. So increasing public awareness and public support for a balanced budget might be a way to help the German debt brake succeed.

**RESULT THREE: DEBT AID FOR HIGHLY INDEBTED STATES**

Closely linked to the prevention of budgetary crises is the question of debt release for the states already facing tight budget situations. The debt brake for the states can only work if their budget share for debt service is not too high. Therefore, five states (Berlin, Bremen, Saarland, Saxony-Anhalt, and Schleswig-Holstein) are eligible for consolidation aid from 2011 to 2019. In this period, they are obliged to balance their budgets. In contrast to result one and two, there are sanctions if the states do not follow the budgetary restructuring paths. Then, consolidation aid will be canceled for the relevant year.

However, looking at the amounts of this debt aid it is doubtful if the debt levels can be reduced in the concerned states. Furthermore, debt aid is not paid in the form of matching grants, where, for example, a debt relief of €1 would have been granted if the *Land* had paid off €1 of debt itself. Then states' politicians would have had higher incentives to balance budgets.

**RESULT FOUR: MORE EFFICIENCY IN TAX COLLECTING**

So far, mainly the states collect taxes. However, in many cases tax revenue either goes to the federal level or is divided between federation and states. Thus, the states face incentives for not collecting taxes properly. In order to lower this inefficiency some competences in the field of tax collection have been shifted to the federation. However, the Commission refused to fully centralize tax collection.

#### AN ALTERNATIVE SOLUTION: INSOLVENCY RIGHT FOR THE STATES

In the debate in and around the Federal Reform Commission II many economists put forward a proposal to limit indebtedness that would have been market oriented instead of rule based. They proposed an insolvency right for the states closely linked to municipality bankruptcy codified in chapter 9 of the U.S. bankruptcy code. At the moment, the states cannot go bankrupt. When they cannot afford to serve their debt, they are bailed out by the federal government. If such a bailout was ruled out, the states would be responsible for paying back their debt on their own. This would not prevent politicians from raising debt. However, capital providers would be more cautious about lending money to the states because they would know that they risk losing parts of their capital should the states be unable to meet the debt. If the budgetary situation of a *Land* deteriorated, the capital market would demand higher interest rates until, ultimately, the market would entirely restrict indebtedness.<sup>13</sup> If the market failed and indebtedness of one *Land* became too high, i.e., debt service could not be afforded any more, the *Land* would have the right to go bankrupt. As a consequence, lenders would have to forego some of their money, thereby contributing to budget restructuring.

The United States, Canada, Switzerland, and the Czech Republic are just a few examples of Western democracies where there is no bailout of the lower level(s) of government and where, consequently, financial markets limit debt issue quite successfully. In the United States, for example, the U.S. bankruptcy code has been in power for more than seventy years. In case of a market failure (when despite the interest mechanism, too much money has been lent to the municipality) it allows municipality bankruptcy following very strict rules. This procedure mainly protects the citizens and puts parts of the financial burden on the creditors. Its biggest success is the fact that chapter 9 of the U.S. bankruptcy code has hardly ever been used. Financial markets have been successful in restricting indebtedness before a budgetary situation arose where debt could no longer be served.<sup>14</sup>

From an economic point of view, ending the potential

for federal bailouts and introducing an insolvency right for the states would be optimal. Incentives for politicians (who always want to raise debt) and creditors (who want their money back) would be taken into account and instead of complicated and error-prone rules, financial markets would restrict debt issue. However, as this proposal would have caused the most fundamental reforms of the fiscal system, the Commission could not agree on it.

#### 4. Remaining Fiscal Challenges

Although the Federal Reform Commission II succeeded in codifying new rules to limit indebtedness and to prevent budgetary crises, many reform necessities are still on the agenda. This chapter concentrates on the open questions in the field of fiscal federalism. However, reforms in other economic fields are pressing, too. Very challenging for the federal structure of Germany, for example, is the demographic development that not only puts great pressure on social security systems but also produces very sparsely inhabited areas, particularly in eastern Germany. The latter might be well known to Americans, thus, Germans are used to having a lot of public infrastructure nearby which will not be possible in these parts of the country.

Now, let me present the most important fiscal challenges that have to be addressed in the near future.

##### CHALLENGE ONE: POOR INCENTIVES IN THE CURRENT FISCAL EQUALIZATION SYSTEM

The aim of the fiscal equalization scheme is to equalize the financial capacities per inhabitant among the states. One result is a weak correlation between state economic performance and per capita state revenues after equalization has taken place. From an additional €1 tax revenue, the *Land* may only keep around €0.10. Consequently, the states have few incentives to raise their growth rate and/or collect more taxes.<sup>15</sup> As income tax revenue is shared between the federation and the states, the states' behavior generates a fiscal externality. If the states do not put adequate effort into raising economic growth rates or collecting taxes, not only their own but also the tax revenue of the federal level will be lower than it could be. This negative externality is not taken into

account by the states. So, the fiscal equalization scheme requires fundamental reforms to stop generating this poor economic incentive.

#### CHALLENGE TWO: LACKING FISCAL FLEXIBILITY ON THE REVENUE SIDE OF THE STATES

So far, fiscal autonomy of German states has meant autonomy on the spending side and on debt issue, but not on taxes. Now, after the debt brake has been introduced, the states cannot react to sudden spending needs with new debts. Consequently, they have to get either more flexibility on the spending side (e.g., diverge from spending obligations) or certain tax autonomy. Thus, the latter may have unclear results. Theories of tax competition tell us that vertical tax competition produces tax rates that are inefficiently high. Here, vertical tax competition means that federation and states tax the same tax base, as is common with several taxes in the United States. In contrast, horizontal tax competition between states results in a tax rate that is inefficiently low.<sup>16</sup> Empirical results on which effect dominates differ.

With tax autonomy regional jurisdictions can better meet the preferences for public goods of the local population. Responsibility for fiscal decisions would be more transparent and, therefore, fiscal policy could be more easily controlled by the electorate.<sup>17</sup> Moreover, tax autonomy increases the incentives for politicians to pursue a solid fiscal policy, as they would have to justify an unpopular tax increase to balance the budget.

Otherwise, regional tax autonomy is contradictory to the aim of tax harmonization at the European level. Furthermore, additional states' revenue from autonomous tax setting has to be integrated into the fiscal equalization scheme. Thus, during its validity period until 2019, introducing tax autonomy for the states will be extremely difficult. Finally, the starting revenue positions between the eastern and the western German states vary widely. Therefore, tax autonomy could result in diverging provision of public goods contradicting the aim of having 'equal living conditions' throughout Germany.<sup>18</sup>

Major changes in the present system—with basically no tax autonomy for the states—are unlikely because

the idea of 'solidarity' between the states is highly developed in Germany. Therefore, the only instrument of tax competition seriously discussed is a regional supplemental rate on national income taxes. This instrument only allows small differences in overall tax burdens. Hence, it seems to be suitable for strengthening the fiscal autonomy of the states without causing significant differences in the provision of public goods among them. However, only if additional revenue was not skimmed-off in the equalization scheme might politicians have an incentive to raise additional taxes to finance state-specific projects.

#### CHALLENGE THREE: INFLEXIBLE EXPENDITURES OF THE STATES

Apart from more tax autonomy, the limit on states' indebtedness should be accompanied by more autonomy on the spending side. One option to enhance fiscal flexibility on the spending side would be to permit deviating from federal standards. A widespread argument is that a large majority of states' expenditures are in one way or the other predetermined by federal laws. Although often mentioned in the political debate, no empirical study has ever proven this argument. Indeed, a recent detailed study reaches an opposite result. Seitz analyses the different expenditure categories of the states with regard to their fixing through federal law and the influence of EU legislation.<sup>19</sup> He shows that even if the influence of EU legislation and mixed programs of the federation and the states are considered, no more than 21 percent of states' expenditures are predetermined.

This budget share is not as high as many people in the public debate claim. It could be further reduced by either transferring tasks from the federation to the states (as has been partly done in the Fiscal Reform Commission I) or by making standards more flexible. The latter could, for example, include varying social benefit payments.

#### CHALLENGE FOUR: TOO MANY STATES

From a fiscal point of view, there are too many states, especially small ones. The small states receive additional grants to maintain their independence. Fiscally speaking, this is a waste of taxpayers' money.

Additionally, the more states there are, the more the interregional spillovers limit political decision-making. In order to make a merger between a city-state and another state (Berlin and Brandenburg, for example) attractive, there has to be a fiscal compensation for these two states because a merged state would receive fewer transfers from the equalization scheme than two separate ones.

Moreover, small states are overrepresented in the Bundesrat. This overrepresentation has to be abolished before and despite the mergers taking place in order to avoid a loss in political influence due to a merger. Finally, one could also envision a 'wedding gift' to celebrate the 'marriage' of the two states, in which the federation rewards the merging states with additional money to be used to reduce debt. In the economic community, the necessity to merge and the inevitable requirements are undisputed. Thus, a merger between states is a highly political subject and, therefore, this topic has vanished from the original agenda of the Federal Reform Commission II.

### 5. The Conflict between Economic Necessities and Political Institutions

Most economic reforms, but definitely all in the field of fiscal federalism, require a broad political consent in both chambers. Thus, the political actors vary widely in their interests. The recent discussion in the Federal Reform Commission II provides a good example of the complicated institutional setting in German federalism. There were no clear party lines. In some debates, the federation argued against the states, in others eastern states fought against western ones or rich against poor ones. In the states, CDU positions differed only to a lesser extent from SPD ones, but both of them might have well differed from the federal positions of these parties.<sup>20</sup>

The most pressing fiscal problem was the prevention of severe budgetary crises, which came along with a limitation of debt issue. As the federation and the rich states would have to contribute to a bailout if one *Land* faces a severe budgetary crisis, they had a much stronger incentive to change fiscal rules. Consequently, they used all their bargaining power to push limitation of debt issue. Meanwhile, the poor states only had a weak interest in agreeing to a debt

limit at state level. However, they had nothing against limiting debt issue for the federal level. Most of them still need to issue further debt to pay off the old ones and are not sure if they can draw up a balanced budget before 2020. Their politicians do not want to significantly lower per capita public spending instead because they fear being voted out. Moreover, they know that they will be bailed out in case of over-indebtedness.

Since for most reforms a two-thirds majority in both federal chambers is needed, the rich states depended on the votes of at least some poor states, and these votes did not come free. Their price consisted of two parts. The most obvious way to buy those votes was giving financial aid for budget consolidation to the poor states and, thus, aligning starting conditions within the new rules. A less obvious part of the price was that the approved debt limitations are rather weak. It is way open if and how the new rules will be implemented in the states and if indebtedness of public budgets can be successfully limited in the future.

Diverging interests between rich and poor states continue to exist on tax autonomy and—to a lesser extent—on flexible standards. The rich states as well as the CDU-governed states favor more tax autonomy as a natural consequence from debt limits causing budget restrictions. However, as the poor states fear losing in this tax competition, tax autonomy can—if at all—only be introduced on a very small level. The same arguments hold for flexible standard setting.

### 6. Conclusion, Outlook, and Plans of the New Government

Since the Second World War, German federalism with its checks and balances guaranteed stable governments and relative equal living conditions throughout the country. This might not be the only reason why federalism makes people happy. Thus, although federal structures in Germany are far from being welfare maximizing, this should be kept in mind when criticizing the system.

Despite its indisputable merits, German federalism has been increasingly caught in a joint decision trap over the past decades. This triggered many

dangerous incentives for politicians and, as a consequence, caused large public deficits. In 2006 the first Federal Reform Commission had made some cautious steps toward disentangling political responsibilities and marginally strengthening budgetary autonomy of the states. Three years later, the Federal Reform Commission II addressed the topic of fiscal federalism in more detail and passed a law codifying the introduction of a stability council to prevent severe budgetary crises, new debt limits, and consolidation aid for highly indebted states as well as proposals to raise efficiency in tax collection. However, it abstained from addressing other pressing issues. The core part of the reform is the debt brake which is similar to the Swiss one. The brake does not eliminate the incentives for politicians to raise debt. Thus, the Swiss population highly supports their new rules and even puts pressure on politicians to extend them. So far, the German population is not aware of the danger of potential over indebtedness of jurisdictions. Furthermore, the German *Länder* have not implemented the new rules in state laws, leaving open how strict the rules will look like and how easily they can be circumvented. Therefore, it is completely open whether the debt brake will be successful.

Additionally, the Federal Reform Commission II left many problems unaddressed so that several fiscal challenges remain. After the reform, states' debt issue is limited but states' budgets do not have the necessary flexibility to react to regional needs. This flexibility can be introduced by either a tax setting autonomy or more flexibility on the expenditure side including deviations from national spending standards. A first step in this direction was already taken by the first Commission: the remuneration of civil servants, but that is not enough. As long as each additional euro of revenue is almost totally skimmed-off via the equalization system the incentive not to raise taxes will not be reduced. Furthermore, territorial reorganization of the states has not been addressed at all by the Federal Reform Commission II. Thus, provisions that ease voluntary mergers between states are still due to come. The important and necessary discussion of these themes has been postponed because political actors had too diverging interests.

Unfortunately, the new government neither mentions the subject of federalism at all nor addresses one of

the above mentioned remaining fiscal challenges in its coalition agreement. Throughout the legislative period, current incentives within the fiscal equalization system will cause further pressure on federal arrangements.

Finally, even if the federal and the state governments agree to strictly interpret the new debt rules, these rules might not work perfectly from the word 'go.' Particularly the allowed deficits alongside the business cycle are not easy to calculate. The Swiss debt brake, for example, also had to be adjusted soon after its implementation. Thus, debt rules, fiscal equalization, and fiscal federal arrangements will remain on the agenda for sure, even if the new government has not yet realized this.

## NOTES

- 1 Bruno Frey and Alois Stutzer, "Happiness, Economy and Institutions," *The Economic Journal* 110 (2000): 918-938; Charles Blankart, *Föderalismus in Deutschland und in Europa* (Nomos: Baden-Baden, 2007).
- 2 Sebastian Kessing, Kai A. Konrad, and Christos Kotsogiannis, "FDI and the dark side of decentralisation," *Economic Policy* 49 (2007): 5-70.
- 3 Jonathan Rodden, *And the Last Shall Be First: Federalism and Soft Budget Constraints in Germany* (Department of Political Science, MIT: Cambridge, 2006), mimeo.
- 4 Forschungsgruppe Wahlen, "Bundestagswahl 27. September 2009 – Kurzanalyse" (2009)  
<[http://www.forschungsgruppe.de/Umfragen\\_und\\_Publikationen/Wahlen/Wahlanalysen/](http://www.forschungsgruppe.de/Umfragen_und_Publikationen/Wahlen/Wahlanalysen/)> (21 October 2009). With the exception that the rate of the property acquisition tax can be determined by the states as a result of the Federal Reform Commission I.
- 5 Beate Jochimsen and Robert Nuscheler, "The Political Economy of the German Länder Deficits: Weak governments meet strong finance ministers," *Applied Economics*, forthcoming.
- 6 Charles Tiebout, "A Pure Theory of Local Expenditure," *Journal of Political Economy* 64 (1956), 416-424.
- 7 See for a more detailed explanation of the German fiscal equalization system Bundesministerium der Finanzen, *The Federal Financial Equalization System in Germany*, <[http://www.bundesfinanzministerium.de/nr\\_4480/DE/BMF\\_\\_Startseite/Service/Downloads/Abt\\_\\_V/The\\_20Federal\\_20Finacial\\_20Equalisation\\_20System\\_20in\\_20Germany.t\\_mplatedl=raw,property=publicationFile.pdf](http://www.bundesfinanzministerium.de/nr_4480/DE/BMF__Startseite/Service/Downloads/Abt__V/The_20Federal_20Finacial_20Equalisation_20System_20in_20Germany.t_mplatedl=raw,property=publicationFile.pdf)> (3 April 2008).
- 8 See in more detail Katrin Auel, "Still no Exit from the Joint Decision Trap: The German Federal Reform(s)," *German Politics* 17, (2008): 424-439.
- 9 Kommission zur Modernisierung der Bund-Länder-Finanzbeziehungen.
- 10 Lars Feld and Gebhard Kirchgässner, "On the Effectiveness of Debt Brakes: The Swiss Experience," in *Sustainability of Public Debt*, ed. Reinhard Neck and Jan-Egbert Sturm (Cambridge, USA, MIT Press: 2008): 223-255
- 11 Sachverständigenrat zur Begutachtung der Gesamtwirtschaftlichen Entwicklung, "Staatsverschuldung wirksam begrenzen, Expertise im Auftrag des Bundesministers für Wirtschaft und Technologie," Statistisches Bundesamt, (Wiesbaden 2007).
- 12 See for a more detailed analysis of this proposal Beate Jochimsen and Kai A. Konrad, "Anreize statt Haushaltsnotlagen," in *Finanzkrise im Bundesstaat*, ed. Kai A. Konrad and Beate Jochimsen (Frankfurt et al: Peter Lang: 2007), 2nd edition, 11-27.
- 13 See for more detail Beate Jochimsen, "Staatsschulden ohne Haftung" – Eine Option für deutsche Bundesländer?" *Wirtschaftsdienst* 87/8 (2007): 518-524.
- 14 Christian Baretti, Bernd Huber, and Karl Lichtblau, "A tax on tax revenue: The incentive Effects of Equalizing Transfers: Evidence from Germany," *International Tax and Public Finance* 9 (2002): 631-649; and Timm Bönke, Beate Jochimsen, and Carsten Schröder, "Incentive Effects of Fiscal Equalization on Tax Collection," (2009), mimeo.
- 15 E.g. David E. Wildasin, "Nash Equilibria in Models of Fiscal Competition," *Journal of Public Economics* 35 (1988), 229-240; Andreas Haufler, *Taxation in a Global Economy* (Cambridge University Press: 2001).
- 16 Clemens Fuest, "Steuerwettbewerb unter den Bundesländern – wären die finanzschwachen Länder die Verlierer?" in *Föderalismuskommission II: Neuordnung von Autonomie und Verantwortung*, ed. Kai A. Konrad and Beate Jochimsen, (Peter Lang Verlag: Frankfurt et al.: 2008), 119-133.
- 17 Helmut Seitz, "Föderalismusreform zwischen Anspruch und Wirklichkeit," in *Föderalismuskommission II: Neuordnung von Autonomie und Verantwortung*, ed. Kai A. Konrad and Beate Jochimsen, (Peter Lang Verlag: Frankfurt et al.: 2008), 135-155.
- 18 Helmut Seitz, "Die Bundesbestimmtheit der Länderausgaben," (Dresden, 2008), mimeo.
- 19 See for a more detailed analysis Beate Jochimsen, "Fiscal Federalism in Germany: Problems, Proposals and Chances for Fundamental Reforms," *German Politics* 17, (2008): 541-558.



# U.S. EXPECTATIONS OF GERMANY AFTER THE ELECTION

04

# U.S. EXPECTATIONS OF GERMANY AFTER THE ELECTION

## A HIGHWAY TO HELL OR A STAIRWAY TO HEAVEN?

KAREN DONFRIED

The date was 25 September 2009. The place was Pariser Platz in the heart of Berlin. The final campaign rally of the Social Democrats was well underway. The SPD's chancellor candidate, then foreign minister Frank-Walter Steinmeier, was expected to arrive at any moment. Pulsating rock music filled the square. The tune sounded so familiar and then I recognized it: the tried-and-true American rock classic, AC/DC's *Highway to Hell*. As I then processed the lyrics I was humming along to, I had to laugh and wonder what advance person had settled on that selection. The tune, it turned out, proved to be prophetic, as the SPD suffered a bitter defeat at the polls two days later. Angela Merkel was not only reelected as chancellor, but she became the first chancellor to head a different governing coalition in her second term—the coalition of CDU/CSU/FDP, her preferred coalition, which German voters had denied her four years earlier.

The implications of Germany's election outcome for the United States are the subject of this essay. The outcome presents real opportunity for the German-American relationship, but that opportunity will be bounded by the harsh realities of the challenges both countries face in 2009 and beyond.

### 1. Opportunity Knocks: The Promise of the Obama/Merkel Duo

Germans love Barack Obama. This was evident even before his election, when 200,000 gathered in Berlin to experience Candidate Obama in person. Obama's tremendous popularity was captured by the annual *Transatlantic Trends* survey.<sup>1</sup> Each year Germans are asked whether they approve or disapprove of the

way the President of the United States is handling international policies. In 2008, when they were asked about George W. Bush, 12 percent of German respondents said they approved. This year, 92 percent of Germans registered their approval for Barack Obama's handling of international policies. This phenomenal 80 percentage point change demonstrated the German public's great confidence in President Obama.

This warm European embrace has been reciprocated by President Obama. One example is his multiple trips to Europe in his first months in office. His first overseas trip in early April was to Europe and included stops in the United Kingdom, France, Germany, and the Czech Republic. In June, President Obama returned to Germany to visit the Buchenwald concentration camp. Following Merkel's reelection, Nancy Pelosi, the Speaker of the House of Representatives, invited her to address a Joint Session of Congress, an honor extended only to an exclusive group of leaders, on 3 November 2009.

Chancellor Merkel's new coalition partner, the Free Democrats, have called for a more active role in transatlantic relations. The FDP's Guido Westerwelle is now foreign minister, though his views on foreign policy are little known. That said, the weekend following the election, Werner Hoyer and Margerita Mathiopoulos, two of the FDP's leading foreign policy thinkers, published an article in *Spiegel Online* saying that Germany needs to finally accept the offers of President Obama for more dialogue and stronger cooperation:

*Therefore it is important to make up for what the old*

*government failed to do, namely in close solidarity with our transatlantic partners to think together globally and, when possible, to act together. The political change in the United States offers us this possibly unique opportunity. It is a question of political leadership, whether we use it.*<sup>2</sup>

Hoyer was named as one of two State Ministers in the Foreign Ministry and most Germans view him as the equivalent of Deputy Secretary of State. His expertise and grasp of the issues will likely lead the new foreign minister to rely heavily on him, thus giving the views Hoyer expressed in *Spiegel Online* particular weight.

The CDU and CSU are, of course, also parties that have always sought to cooperate closely with the United States. For example, one of the incoming key players, the new defense minister, is the CSU's Karl-Theodor zu Guttenberg, who had served as economics minister in the final months of the Grand Coalition, is a committed transatlanticist. A Member of the German Parliament since 2002, he focused on foreign and defense issues and, by all accounts, he very much wanted the post of defense minister, which is not typically sought after in Germany. Throughout his political career, he has put impressive effort, including regular visits to Washington, into building strong relationships with his counterparts in the United States.

It remains to be seen to what extent foreign and security policy will change under this new coalition. The moment of opportunity, however, is clearly present for a deepening of the German-American partnership.

## 2. Challenges Loom: The Reality of Afghanistan

This moment of opportunity for Berlin and Washington will be tested by the many global challenges demanding immediate attention. At the top of the list is Afghanistan. In September 2009, Germany had close to 4,500 troops deployed in Afghanistan as part of NATO's International Security Assistance Force (ISAF). On the one hand, this substantial troop commitment—Germany is the third largest contributor to ISAF after the United States and the United Kingdom—is applauded and welcomed within the

Alliance. On the other hand, Germany has faced criticism because its troops deploy with significant caveats and limitations and are based in the relatively more stable north where they have been shielded from heavy fighting.

German policymakers, for their part, are proud of this deployment. It was only in March 1999 that German troops participated in their first combat mission since the end of World War II. This debut of sorts came when German pilots flew four Tornado jets in the first sortie of NATO aircraft bombing Serbia in response to the crisis in Kosovo. The decision to deploy troops to Afghanistan in the fall of 2001 represented the German Parliament's approval for the first deployment of German troops beyond Europe in a combat role since 1945. This was a big step indeed.

Germans have not been shy about criticizing U.S. military engagement in Afghanistan. In particular, they have argued that far more attention needs to be paid to limiting civilian casualties. In an ironic and tragic twist of fate, the Germans proved to be the ones—in the run-up to their own election—that brought about civilian deaths. On 4 September, a German Colonel, Georg Klein, called in airstrikes to hit two hijacked fuel tankers that had become stuck in a muddy riverbed in northern Afghanistan. Unbeknownst to Colonel Klein, civilians were busy siphoning fuel from the tankers when the airstrikes hit and caused a huge explosion. In late October, a confidential NATO report reportedly exonerated Colonel Klein, but stated that it was impossible to verify if any Afghan civilians had been killed; local leaders were quoted in the report as putting the number of dead civilians at between thirty and forty.<sup>3</sup>

The immediate fall-out in Germany of the 4 September events was an increase of four percentage points for Die Linke, the only party in the German political landscape that had been campaigning on a platform of immediate withdrawal (*Raus aus Afghanistan*). But, despite this, no substantial backlash against the war materialized. Chancellor Merkel and her rival in the election, then foreign minister Steinmeier, gave full-throated defenses of the Afghanistan mission in the Bundestag, and the issue quickly faded from the public debate. Strikingly, this was the first time that

the chancellor had offered such a public defense of and rationale for the Afghanistan mission. She underscored that it was not the right moment to withdraw and rather that Germany's focus needed to be on training Afghan forces—army and police—to take over the job of providing security and stability for their own country.<sup>4</sup>

Much suggests that the new government of CDU/CSU/FDP will represent foreign policy continuity. All the parties in the governing coalition support the Afghanistan deployment. On the one hand, polls show a majority of the public want to exit Afghanistan. For example, *Transatlantic Trends* included a question that read as follows: "As you may know, Germany currently has troops stationed in Afghanistan. In your view, should Germany increase the number of troops in Afghanistan, keep its troops at its current level, reduce the number of its troops or should it withdraw all troops from Afghanistan?" A majority of 57 percent wanted to reduce or withdraw troops. On the other hand, the issue is not a high priority. In an ARD-Deutschland TREND survey, conducted by infratest dimap on 8-9 September 2009 following the airstrikes debacle, Germans were asked what role the Bundeswehr deployment in Afghanistan would play in their election decision; 58 percent responded that it was not an important topic, 36 percent said it was an important topic, and 4 percent maintained it was the decisive topic.<sup>5</sup> That reality likely gives the government a certain amount of latitude to either continue current policy or potentially to do modestly more.

Shortly after the election, a report was circulating that Germany was considering increasing the troop level to 7,000.<sup>6</sup> The mandate under which the German army (*Bundeswehr*) operates in Afghanistan is annual and must be renewed in December 2009. On that occasion, the German Parliament, according to recent reports, is most likely to do a straight continuation of the mission at current levels (including a 4,500 troop ceiling). The German government would then revisit and potentially increase its commitment after the international conference on Afghanistan that Chancellor Merkel, together with British Prime Minister Gordon Brown and French President Nicolas Sarkozy, proposed in early September. That conference is likely to take place early in 2010 and is aimed

at setting targets for transferring security responsibilities to the Afghan army and police.<sup>7</sup>

If Germany were to increase its commitment to Afghanistan, it is not at all clear that that would mean sending additional combat troops. Germans were asked in the *Transatlantic Trends* survey about whether they were open to stepping up their civilian or military contribution: "As you may know, President Barack Obama has asked European countries to increase their contribution in the effort to stabilize Afghanistan. Would you approve or disapprove of the following: Increasing Germany's civilian contribution to support Afghanistan's economic reconstruction or increasing combat troops in Afghanistan?" In response, 55 percent of Germans supported a larger contribution for economic reconstruction; only 13 percent approved of sending more combat troops.

It is, of course, difficult to judge whether and in what way Germany could or would seek to increase its engagement in Afghanistan. There are good arguments in favor of foreign policy continuity and even a stepped-up German effort in Afghanistan. That said, it is worth considering what has changed in the post-election landscape that could lead to a different outcome.

Most important to consider is the fact that the Social Democrats suffered such a bitter loss. The SPD has been in government for the last eleven years. In the German context, Afghanistan is Gerhard Schröder's war. Then Chancellor Schröder, at the head of a red-green (SPD/Green) coalition, was the one who led the country into Afghanistan in the wake of the attacks of 9/11. The SPD with Frank-Walter Steinmeier as foreign minister and as the smaller coalition partner to the CDU continued to support the mission during the Grand Coalition. But the SPD is now in opposition. An SPD in opposition could lead to a different foreign policy constellation.

The election was a disaster for the SPD. There was no silver lining. The Social Democrats lost 11.2 percentage points, dropping to 23 percent from the 34.2 percent they received in 2005. The SPD has not suffered a worse result since 1949. Moreover, since 1998, support for the Social Democratic Party has been cut in half.<sup>8</sup> Just over two million SPD voters

stayed home and over 1.1 million voted for the Die Linke.<sup>9</sup>

Die Linke gained 3.2 percentage points to garner 11.9 percent of the vote, more than the Greens, as Die Linke had done for the first time in 2005. These data points lead one to speculate that the SPD will likely move to the left to try to bring voters it has lost to Die Linke back into the fold and put an end to the splintering of the Left that began with the establishment of the Greens in the 1980s.

For the present, Frank-Walter Steinmeier is the guarantor of continuity. He was elected head of the party group (*Fraktion*) in the Bundestag with 98 percent of the vote, but that seemingly strong consensus within the SPD belies real disagreements within the party about how it should position itself in the current political landscape. The former environment minister, Sigmar Gabriel, is expected to be elected party leader in November. Two other key figures in the party leadership are Andrea Nahles and Klaus Wowereit, seen as exemplars of the party's left wing.

When the Afghanistan mandate comes up for renewal in December and at least until the election in the most populous German state of North Rhine-Westphalia next May, Steinmeier will likely ensure foreign policy continuity. Given his past role, Steinmeier is expected to be a strong and critical voice calling for the SPD to stay united behind the Afghanistan mission. SPD support will be important to the governing coalition not for practical reasons—the CDU/CSU/FDP governing coalition has a comfortable majority in the Bundestag—but because the government will want a broad, cross-party consensus in support of a policy which the public has not embraced.

As an architect of Afghanistan policy, Steinmeier cannot change his long-standing position now. Any reversal on his part would give his political opponents yet another example of what they see as SPD “flip-flopping” on key issues. However, the SPD may well, over the coming year, migrate to a different position on Afghanistan that would allow it to play the peace card. Positioning itself differently on this question of war and peace may be a key step in re-securing its left wing.

There are multiple reasons that explain why Germans, for the most part, do not support the Afghanistan mission. Many question the rationale for Germany's engagement. The former defense minister in Gerhard Schröder's cabinet, Peter Struck, used to say that Germany's defense begins at the Hindu Kush, but the harsh reality is that very few Germans believed him. Many Germans saw their involvement as an act of solidarity toward the United States following the attacks of 9/11. And further, Germans, like most of us, want to support a mission only if they think it can succeed. On Afghanistan, pessimism prevails. According to the *Transatlantic Trends* survey, only 23 percent of Germans are optimistic about stabilizing the situation in Afghanistan, as compared to 56 percent of Americans. The challenge for the new governing team will be to convince Germans that the Afghanistan mission is indeed in Germany's national interest. Unless the new team can accomplish that, it is difficult to see how this engagement can be sustained over time.

### 3. German-American Relations: The Nature of Change

The deep unpopularity of George W. Bush in Europe led many to see the upset in transatlantic relations as the result of a particular leader sitting in the White House at a particular time. Germany and Europe seemed to just be waiting out his time in office. When Barack Obama challenged John McCain to be Bush's successor and won, Germans went from bemoaning the tenure of a U.S. president who simply could not connect to Europe to heralding a president who was seen almost as an honorary European. The analysis of the transatlantic relationship during these years put most of the problems in the relationship at the feet of George Bush. Whether the issue was Guantanamo or the Iraq War, George Bush was deemed ultimately responsible for policies the Europeans despised. The feeling was that this was a cyclical change in transatlantic relations. When George Bush left the White House, relations between Europe and the United States would return to warmth and close partnership.

Initially, this expectation was fulfilled. Europeans were over the moon about the new U.S. president. And Barack Obama returned the embrace. But what has become clear in these first several months is that the

tensions across the Atlantic have not wholly dissipated. George W. Bush was not the only problem in transatlantic relations. There are also fundamental structural changes that resulted from the end of the Cold War and the attacks of 9/11 and those events have had differing effects on how Americans and Germans see the world.

The shared focus and priority of the German-American relationship during the Cold War was the defense of Europe from the Soviet Union. Europe was at the core of U.S. foreign policy and Germany was at the core of Europe.

In 2009, Europe is largely whole, free, and at peace, with the Balkans and wider Europe as exceptions. The challenge for the transatlantic relationship is whether Europe and the United States can work effectively beyond Europe. The reality is that, during the Cold War, Americans and Europeans never agreed on how to engage rising powers like China and India, or how to achieve Middle East peace, but those issues were not at the center of our relationship. Today they are.

Obama's style, his preference for multilateralism, his belief in engagement rather than isolation, are all good in European eyes, but they do not solve or at least have not yet solved the underlying, tough issues, whether Afghanistan, Iran, climate, or Guantanamo. And Obama needs Germans not just to like him, but to help him with concrete policy initiatives. Nothing is higher on President Obama's list of foreign policy priorities than Afghanistan.

9 November 2009 marks the twentieth anniversary of the fall of the Berlin Wall. The resulting unification of Germany was a triumph of transatlantic cooperation and commitment. Germany was then governed by a CDU/CSU/FDP coalition. If we remember that time and what we, Americans and Germans, achieved together, it bodes well for what we can accomplish together today. That said, we should not underestimate the structural changes in the German-American relationship over the last twenty years and the global challenges both countries now face and which each country views through its own unique lens, a lens shaped by history, geography, economics, experience, and politics. On 31 October 2009, Chancellor

Merkel made a short video discussing her upcoming trip to the United States. She concluded by saying how much she was looking forward to the trip, because even though it would be short, it was a trip to see "true friends."<sup>10</sup> That is certainly a solid and encouraging basis for the relationship. Let's hope the theme song for today's German-American relationship is Led Zeppelin's *Stairway to Heaven*.

## NOTES

1 *Transatlantic Trends* is a comprehensive annual survey of American and European public opinion. Polling was conducted between 9 June 2009 and 1 July 2009 in the United States and twelve European countries: Bulgaria, France, Germany, Italy, the Netherlands, Poland, Portugal, Romania, Slovakia, Spain, Turkey, and the United Kingdom. The survey is a project of the German Marshall Fund of the United States and the Compagnia di San Paolo, with additional support from the Fundação Luso-Americana, Fundación BBVA, and the Tipping Point Foundation.

2 Margerita Mathiopoulos and Werner Hoyer, "Gastbeitrag: Ein Programm Für Westerstelle," *Spiegel Online*, 3 October, 2009. The original text reads: "Deshalb ist es wichtig, das nachzuholen, was die alte Bundesregierung versäumt hat, nämlich im engen Schulterschluss mit unseren transatlantischen Partnern 'global mitzudenken' and wo möglich mit zu gestalten. Der Politikwechsel in den USA bietet uns eine vielleicht einzigartige Chance. Es ist eine Frage der politischen Führung, ob wir diese nutzen."

3 "Afghanistan is Not a Computer Simulation," *Spiegel Online*, 30 October 2009.

4 Regierungserklärung von Bundeskanzlerin Angela Merkel im Bundestag zu den aktuellen Ereignissen in Afghanistan, 8 September 2009; "Merkel Defends German Involvement in Afghanistan," *Deutsche Welle*, 8 September 2009.

5 According to infratest dimap, the four most pressing problems in Germany are: unemployment (49%), the economy (41%), education (24%), and social inequality (16%). The ARD-Deutschland TREND survey can be found at the following website: [www.infratest-dimap.de](http://www.infratest-dimap.de).

6 "Germany mulling more troops for Afghanistan," *Agence France-Presse*, Berlin, 1 October 2009.

7 "Germany may review Afghan troop levels in 2010," *Reuters*, 23 October 2009.

8 According to infratest dimap, 20.2 million Germans voted for the SPD in the 1998 general election; in 2009, the SPD garnered only 10 million votes. The CDU has also experienced diminishing support, though the drop has not been nearly as dramatic as for the SPD. The shrinking percentages for these two parties suggest a fundamental change in the German party system and may ultimately mark the end of the dominance of the two traditionally big *Volksparteien*.

9 Another 870,000 voted for the CDU/CSU; 860,000 for the Greens, and 520,000 for the FDP. All data is from infratest dimap.

10 The video can be found at the Chancellor's website ([www.bundeskanzlerin.de](http://www.bundeskanzlerin.de)).

































AICGS

1755 Massachusetts Ave., NW  
Suite 700  
Washington, D.C. 20036 – USA  
T: (+1-202) 332-9312  
F: (+1-202) 265-9531  
E: [info@aicgs.org](mailto:info@aicgs.org)  
[www.aicgs.org](http://www.aicgs.org)

AMERICAN INSTITUTE  
FOR CONTEMPORARY  
GERMAN STUDIES

THE JOHNS HOPKINS UNIVERSITY

Located in Washington, D.C., the American Institute for Contemporary German Studies is an independent, non-profit public policy organization that works in Germany and the United States to address current and emerging policy challenges. Founded in 1983, the Institute is affiliated with The Johns Hopkins University. The Institute is governed by its own Board of Trustees, which includes prominent German and American leaders from the business, policy, and academic communities.

*Building Knowledge, Insights, and Networks for German-American Relations*