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GRAND COALITION

Germany's Grand Coalition: Will It Make a Difference?

Germany finally has a government. That is the good news. Following about six months of political stagnation, election campaigning and coalition negotiations attention can now be turned away from personnel issues toward the much more important factual ones. This is where the bad news comes in.

The government's programme does not present a consistent economic policy. It is a compromise based on the smallest common denominator, a hotchpotch of different individual measures born of necessity.

The new Federal government will concentrate on bringing the budget back into equilibrium. This is indeed a heroic task, for Germany has long become tangled in the closely woven network of the welfare state. In recent years, and in particular following reunification, demands on the public budget have grown considerably. The growing requirements of structurally weak regions and sectors, as well as the increasing number of pensioners and unemployed, have led to a steady increase in government spending. On the other hand slow economic growth and the falling number of employees who are obliged to pay social security contributions have meant that state revenue has not risen to the extent necessary. The state has therefore increasingly had to resort to borrowing. The debt burden has reached almost €1.5 thousand billion. Net new borrowing will reach a record level in 2006 and Germany will fail to achieve the Maastricht criterion of net new borrowing of a maximum of 3% of GDP for the fifth year running.

The annual spending of the German government is approx. €1000 billion. Seventy billion are spent on interest on past borrowing. More than 600 billion are required in the present for social expenditures and subsidies. Only 30 billion are spent on the future in the form of gross investments. The state is no longer able to act but is forced to react. It does not invest in the future but supports present consumption. It cannot take up the offensive and spend more money on research and development. That the Grand Coalition is giving particular priority to the stabilisation of government finances is therefore certainly correct.

The problem with the new government programme is that the individual cogs do not fit together to form a functioning whole.

On the contrary: individual parts contradict one another. The economy is to be stimulated but at the same time taxes are to be increased. The labour markets are to be made more flexible but at the same time additional activities are to be subject to a minimum wage. Protection against dismissal is to be relaxed but in fact one relaxation is only being replaced by another. Many other examples could be named which show how difficult the Federal government finds it to break out of the vicious circle of the welfare state, to free itself from the shackles of interest groups and to regain room for manoeuvre for economic policy.

There are a few rays of hope, however. Among the strong points of the government's programme are the clear statements that subsidies are to be reduced and that the civil service is not to be exempted from cuts in spending. Among them is also the fact that pension development is to be uncoupled from wage trends for the next few years. The crucial test will be whether the new government goes beyond the coalition agreement and ceases to finance the social insurance systems from contributions based on wages. Today each hour of labour is burdened with a penalty tax of 40% in the form of incidental costs. No wonder that production is automated and expensive workers are replaced by cheaper machines. No wonder that many find black market labour attractive. Incidental wage costs must be reduced to a much greater extent than the new government plans, but this can only be achieved by a fundamental change of system. A Grand Coalition can make such fundamental changes more easily than previous governments, if only it wants to.

The greatest problem of the Grand Coalition will be the fact that it must succeed in making clear to the population of Germany the principles for which it stands.

Is it concerned with justice, freedom, sustainability or the maintenance of common values and norms? Or is it only concerned with staying in power? In Germany there is a dangerous gap between perception and reality. Perception says that the country has changed enough. The population is tired of reforms. And the truth is that Germany has changed remarkably in the last fifteen years. The globalisation of the economy and the Europeanisation of politics have given Germany a new face. Many firms have been extremely successful in utilising the new possibilities and chances offered by open markets.

The "bazaar economy", regarded critically by many, is the best proof of the fact that German companies have succeeded in profiting in an optimal way from the advantages of the international division of labour. The business sector has modernised itself. Now politics has to follow suit.

The factual responsibility of the Federal government has been reduced dramatically, in many cases due to market forces but often also for political reasons. National competences have been lost or were freely surrendered to European institutions or international organisations. The most obvious example is the change from the deutschmark, which to the Germans was much more than simply a currency, to the euro. In addition, no other western country was even remotely so affected by the collapse of the Eastern bloc and the end of the East-West conflict as Germany. The historical good fortune of reunification is one thing but the economic costs are another. Without reunification growth in the Federal Republic would be about the European average and state debt would not be an issue. But above all, the fall of the Iron Curtain has shuffled the deck anew in Europe. Democracy, the rule of law and the market economy had been the decisive trump cards of the West for decades. They made the West vastly superior economically to the East. They created the breeding ground for industriousness, modern technologies and innovations of all kinds. West German workers were better, and therefore usually also cheaper, in almost all areas than their eastern neighbours, who were not really competitors.

But the truth is also that although the changes to date do go far, they do not go far enough. Globalisation and structural change require more and more rapid adaptation. More and more activities can to an increasing degree be carried out independently of location, anywhere and at any time. The countries of eastern Europe and south-east Asia have caught up, and some of them have overtaken Germany. Democracy and the rule of law are now firmly established matters of course in eastern Europe, too.

German workers are facing strong competition, both directly and indirectly. Directly from competing products from low-wage countries. Indirectly from the threat, or the actual carrying out, of the moving of labour-intensive production stages from Germany to eastern Europe, south-east Asia or somewhere else abroad. Workforces are having to make more and more concessions in order to keep their jobs. Thus the balance of power is shifting daily from the trade unions to the employers. The rights which workers struggled for in the course of the last century are now being lost in the space of a few years. Many react with rage and anger. But does that help? Can the wheels of globalisation be stopped by the nonacceptance of reforms, by labour disputes and the threat of strikes? No, that is like trying to change the order of the seasons. It is also true that the social state can only continue to be financed on the basis of the success of the economy. Not accepting reforms will not improve Germany's economic situation. It will only make it worse.

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