**Daniela Schwarzer**

# Germany's European Challenges after the Elections

There is no doubt that Berlin has moved to the centre stage of European policy making since the sovereign debt crisis took a firm grip of the euro area in 2010. And there is little doubt that Germany will stay just there in the years to come. This explains why the recent German elections and coalition negotiations have attracted tremendous media attention in the EU and beyond. The many critics of Germany's initiatives and hesitations were keen to assess one question: Will Germany's European policy substantially change with a new coalition?

The short answer is: unlikely – unless the crisis hits back or German decision makers refine their assessment of the long-term risks of the current developments in the euro area.

The long answer is that the factors which determined Germany's recent policy choices are still very much in place and the coalition treaty confirms their persistent relevancy.[1] The most important of these factors are dominant economic beliefs about how budgetary consolidation and economic recovery can come about, constitutional constraints, financial and economic interests and domestic politics. A change of the CDU's junior coalition partner from FDP to SPD will certainly lead to different nuances, in particular with regards to domestic economic policy. Some of the points which the SPD negotiated into the coalition treaty, such as a minimum wage of 8,50 €, may have moderately positive effects for domestic consumption and hence the rebalancing process of the euro area.

But with regard to the euro area's architecture, the coalition treaty indicates continuity. Both the part on banking union and the absence of suggestions for further integration in the field of fiscal policy demonstrate that a guiding principle of German policy towards the euro area is still firmly in place. This principle is to avoid higher degrees of risk sharing and debt mutualisation – both in the banking sector and in public finances. The interest is to keep transfers low has remained strong and this not only for political and economic reasons. There are also constitutional constraints with regard to the ability of the German government to actually commit further financial support, i.e. German tax payers' money, to helping out European governments and banks.

The commitment to strengthen the rules-based coordination of domestic budgetary and economic policy has meanwhile not weakened. The coalition treaty explicitly refers to the Contractual arrangement which, in the future, should help increase the commitment of governments to structural reforms by making them sign a bilateral agreement, which, if respected, can entitle them to some form of financial aid which yet remains to be defined in detail. Underlying this latest German proposal for the improvement of economic and budgetary governance mechanisms is a growing concern about the slow progress with reforms in a number of crisis and non-crisis Member States such as Greece, Italy or France. The proposal, however, also reflects a certain acknowledgement that the conditions for the implementation of reforms are so grim in some Member States that short-term financial support is needed to enable progress.

### The importance of the 'Community method'

A certain change of recent German EU policy-making practices may be read into a coalition treaty paragraph which emphasises the importance of the 'Community method'. Chancellor Merkel had

[1] This commentary was drafted after the conclusion of the coalition treaty negotiations and before the results of the Social Democratic Party member referendum on the agreement. There is hence a possibility that the coalition does not become effective.

openly questioned this method which strongly relies on supranational EU institutions by underlining the benefits and legitimacy of intergovernmental cooperation which she tagged the ‘Union method’ in late 2010.

Indeed, in particular in crisis management, the Heads of State and Government in the European Council have taken on a key role, and this strongly under Chancellor Merkel’s leadership. With regard to the European Commission, the interesting thing to observe in 2014 will be whether the German leadership will actually strategically back the incoming Commission to let it regain its previously strong and entrepreneurial role as a guardian of the Treaty and an engine of integration. Or, and this may be the more likely scenario, the German government continues to strengthen the European Commission in its surveillance and sanctioning functions with regards to Member States’ economic and budgetary policies. With regards to the European Parliament and the strongly debated lack of democratic legitimacy, in particular of the deepened economic governance in the euro area, one might expect a German proposal for strengthening the EP’s role in democratic policy making in the EU – if Germany was to uphold its traditional approach to reforming the EU system. Over the decades, it was predominantly the German government which supported an extension of the EP’s competencies. Since the crisis hit, Germany, however, has not assumed this traditional role.

A further sentence in the coalition treaty that invites interpretation is one which announces a change of EU primary law to account for governance needs in the euro area. This may merely be a statement which backs the outgoing governments’ concern that the Single Resolution Mechanism of the European Banking Union needs a solid legal base. If interpreted in context with the paragraph emphasising the necessity to improve democratic legitimacy of EU policy making, however, one might sense an appetite for big treaty change. The mood in Berlin, however, does not seem to be such.

One of the reasons why this is so lies in other capitals than Berlin. German policy makers have a hard time figuring out with whom a larger Treaty change could be initiated and successfully handled. The Franco-German relationship currently does not promise a far reaching European initiative. Since the Socialist leadership came into office in 2012, there have been hardly any European policy proposals coming out of Paris, apart from the push together with Rome and Madrid for more measures to foster growth in June 2012. The European debate in Paris hits other walls than the one in Berlin. A major concern is that sovereignty should not be abandoned or further restricted in key areas of policy making, such as national budgets and economic policy. German and French preferences over the future development of the euro area hence seem to be contradictory and too far apart on too many points to make a Franco-German compromise that could drive a substantial Treaty reform a realistic option.

Moreover, any opening of the Treaty is at the moment seen as potentially inviting disintegration. London and The Hague are openly requesting the repatriation of certain competencies. And the shock of the negative votes in the referenda on the Constitutional Treaty in the Netherlands and France has left deep marks. New ratification failures are seen as likely and make policy makers refrain from thinking about big steps.

**Integration dynamics**

However, integration dynamics can still resort from two possible developments. A first one is a sudden re-acceleration of the banking and sovereign debt crisis. In this case, principled beliefs may be pushed aside and measures which do not seem in the realm of the likely today may be adopted. This may even mean that constitutional grey zones are entered to secure the higher good, namely the euro. This can involve measures which de facto strengthen the fiscal solidarity or mutual insurance element in the euro area, which may eventually raise the pressure to reform decision making structures in order to enhance democratic control. However, as long as the ECB, with the silent backing of the German government, continues to successfully calm markets in particular with the OMT promise, this scenario will not materialise.

A second dimension of the crisis may over time cause a policy shift in Germany. The social crisis in a number of EU countries continues to deepen and may actually translate into an undeniable political crisis and a risk for national democracies. In this case it is unlikely that German policy makers do not become more open to pondering temporarily stronger support for the countries in question. Some critics argue this point has long been passed and Germany should have reacted more decidedly to help alleviate the risks much earlier. While this may be true, the concern about the stability of the societies and national democracies in southern Europe seems to have been growing. It is not to be excluded that the incoming government actually takes a more pro-active role in the debate on how much support the crisis countries need to ensure a successful transition. From a German perspective, financial aid would, yet, have to be designed and embedded in such a way that it does not reduce reform efforts. The key concern, namely to avoid moral hazard and free-riding, will not vanish.

If the German government accepted more solidarity with fellow EU Member States, this would be a matter of strong domestic debate. The discussions over euro area developments are likely to become more controversial in the years to come. There are several reasons for this. Firstly, the newly founded euro-sceptic party AfD (*Alternative für Deutschland*) is likely to be elected into the European Parliament in March 2014. The party already scored 4,7% in the general elections in September 2013 and only very closely missed the 5% threshold. Being elected into the European Parliament will give it an important platform. Even if the party continues to be internally divided and will probably end up having limited impact in the EP due to the dividedness of the EU sceptic and populist parties, it may be able to use this electoral success to weigh more heavily in the German euro debate. In any case, already now, the fear that euro-sceptics may have growing influence in the future weighs in heavily on the moderate parties' European policy choices.

Secondly, pressure from right- and left-wing populists may actually encourage euro-critical voices in the two parties forming the coalition. At first sight, a grand coalition suggests stable political conditions and a strong backing for Merkel's future European policy. But vocal EU-critical dissent in the main stream political parties may come at a lower short term price in a grand coalition setting. Dissenting MPs of the coalition parties will not put at risk the governments' strong majority.

Thirdly, the widening discussion on 'less Europe', triggered by the UK's quest for a partial repatriation of competencies and backed by the Netherlands, is starting to gain momentum also in Germany. The 'subsidiarity principle' is much en vogue in the current debate on the future of Europe. So under a different title than 'repatriation', there is also a German debate on reducing EU competencies.

Despite these actual and potential developments, it still cannot be excluded that the new German government attempts to launch a broader initiative for deeper integration of the EU. At its core, there would most likely be an attempt to push for a further strengthening of fiscal and economic policy coordination, i.e. institutional changes that enable stronger control of domestic policies, but with stronger legitimacy. The bottom line of Germany's positions is likely to remain stable: minimise moral hazard, increase control and the credibility of rule-based coordination and enable European interference with national policies if joint rules are not respected. As argued, the interesting question will be whether Germany will eventually rediscover its traditional stance on EU policy making and will drive a serious initiative to strengthen the Community framework and the two core institutions, the European Commission and the European Parliament.

(c) Stiftung Politik und Wissenschaft

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This project has been funded with support from the European Commission. This publication reflects the views only of the author, and the Commission cannot be held responsible for any use which may be made of the information contained therein