

The Dismantling of Angela Merkel

The blow-by-blow of what happened.

BY KLAUS C. ENGELEN

When we last looked at how Germany is responding to the ambitious reform plans of French President Emmanuel Macron and EU President Jean-Claude Juncker to deepen and strengthen the eurozone and the European Union, things appeared very different.

To make room for difficult negotiations on the intended “Jamaica” coalition—named after the colors of the Caribbean nation’s flag—with Christian Democrats and their Bavarian sister party, the Christian Social Union, the liberal Free Democrats (FDP), and the Greens—Wolfgang Schäuble had to give up the finance ministry, which he had occupied for eight turbulent years as the dominant policymaker of the Eurogroup.

Schäuble was moved to the prestigious presidency of the German Bundestag. He left as his legacy as finance minister a “non-paper” for eurozone reform calling for “no bailouts, no transfers, automatic debt restructuring, and more bail-ins.”

In his position paper, Schäuble argued that for any eurozone reform, three principles would be indispensable. First, fiscal responsibilities and control must be kept together, thereby avoiding moral hazard. Second, better instruments are needed to foster the implementation of structural reforms. And third, credible stabilization functions are needed to deal with global or domestic shocks. Finally, any upgrading of the European Stability Mechanism into

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a European Monetary Fund would need to be done on an inter-governmental legal basis to make sure that the fiscal controls of member country parliaments such as the Bundestag would be preserved. Schäuble's warning not to base a future European Monetary Fund on EU Community law was loud and clear.

Since the FDP under their assertive leader Christian Lindner had campaigned on a strong Euroskeptic platform, promising that "with the FDP, a money pipeline out of Germany into other EU states will not happen," there was the prospect that the FDP could get Berlin's finance ministry in a new Jamaica coalition government under Chancellor Merkel, and protect Schäuble's legacy in coming battles on eurozone reform.

BUT THE JAMAICA TALKS COLLAPSED

In November 2017, after a month of exploratory talks, Merkel's CDU, the Bavarian CSU, the pro-business FDP, and the Greens were supposedly close to a historic agreement to form a new coalition government, dubbed "Merkel IV." As was to be expected, the FDP did not get far with radical proposals such as putting an end to the



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The SPD's Martin Schulz: Now a back-bencher in the Bundestag.

government or preparing for new elections. She rejected a minority government because this would expose her to unforeseen instabilities. If it came to new elections, the party could find someone to replace her.

Therefore, forming a third grand coalition, or "GroKo," would be her safest bet. But the Social Democrats, under new leader Martin Schulz, had categorically ruled out the option of entering another coalition under Merkel.

In January 2017, Sigmar Gabriel, then-SPD leader and minister of the economy, had proposed Schulz, the former president of the European Parliament, as the new SPD leader and candidate for the upcoming national elections in September.

In March 2017, in a surge of major opinion polls for Germany's oldest party—founded in May 1863—the SPD delegates to a special party congress supported Schulz with 100 percent of the votes to be Merkel's challenger. Gabriel himself moved to the foreign ministry after the previous foreign minister, Frank-Walter Steinmeier, was elected to the highest office in the land, president of Germany.

In Germany's parliamentary system of government, the president has important powers under Germany's Basic Law. For instance, he can either appoint as chancellor the individual who receives a plurality of votes on the last ballot, or dissolve the Bundestag. And the President can dismiss the chancellor, but only if the Bundestag passes a "constructive vote of no confidence."

Therefore, after the collapse of the Jamaica negotiations, all party leaders were called by the president to sort out how a new government could be formed. There was new pressure on Schulz and the Social Democrats to be part of a "GroKo" to end the political stalemate.

Eventually, before Christmas, the SPD yielded to beginning exploratory talks early in the coming year,

Handelsblatt global chief editor Andreas

Kluth concluded: "Angela Merkel declares victory and surrenders."

European Stability Mechanism as the euro backstop fund, or giving eurozone member states the right to temporarily exit the common currency zone should they run into economic difficulties.

Shortly before midnight, the FDP's Lindner appeared before the press and in a stunning announcement declared that the four partners had not found a common vision for modernization of the country or common trust to resolve differences on migration, taxes, and energy policy. Lindner's Jamaica farewell message left the other partners shattered. "It is better not to govern than to govern badly," Lindner said.

After the collapse of the Jamaica coalition talks, Merkel faced the prospect of forming a minority

arguing that Germany could not afford to miss the window of opportunity to strengthen and deepen European integration, thus responding to the reform proposals of French President Macron and EU President Juncker.

EXPLORATORY TALKS WITH "EUROPE FIRST"

After about a week of exploratory talks in early January 2018, the CDU/CSU and SPD negotiators presented the results of their talks in a 28-page document, and one thing became clear: How much Schulz as super-salesman of more and faster European integration had succeeded in committing a future Merkel IV coalition government to a policy of "Europe First." The SPD leader proclaimed that Schäuble's austerity "Diktat" imposed on Greece and other troubled eurozone member states would end for good.

When Schulz boasted that he was in close contact with French President Macron and EU President Juncker by telephone while writing the chapter on Europe that appeared at the beginning of the exploratory paper, he put Germany's Euroskeptics and taxpayers on high alert.

A U-TURN IN BERLIN'S EUROPE POLICY

It was revealing how the Brussels editors of the Eurointelligence daily briefing reacted to the exploratory GroKo agreement: "CDU panicking about Europe chapter in coalition deal; Angela Merkel has come under pressure from her own MPs over the coalition agreement chapter on the Eurozone; MPs fear a revolt by party activists, who are getting nervous about the proposed changes to the ESM and the acceptance, in principle, of a fiscal union; the FDP is tabling two legislative motions to safeguard the Bundestag's rights over all aspects of fiscal policy." The Eurointelligence briefing went on: "When we read the preliminary grand coalition agreement between CDU/CSU and SPD, we were struck by the sheer degree of the U-turn on European politics. Germany would accept anchoring the European Stability Mechanism into EU law, and it would accept the principle of an EU budget to be used, in part, for macroeconomic stabilization."

Did a severely weakened Merkel sell out vital German interests in order to secure her power? The CDU Economic Council Germany (*Wirtschaftsrat der CDU*), a major German business association representing the interests of around 12,000 firms, expressed dismay at what the SPD was able to put into the European chapter. "As to the European strategy, the Union (of CDU and CSU) is leaving the field in a frightening way to the SPD

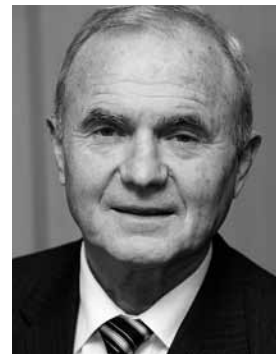
which understands under 'Pan European' only redistribution into 'crisis countries,'" protested an angry Wolfgang Steiger, general secretary of the Economic Council. "The Europe program opens the door wider for more debt. If a common European deposit insurance is introduced, German savers will pay for Athens and Rome's debt not only through zero interest rates but their savings will also be threatened, as if by fire."



Jürgen Stark: Warned of "EU top-down centralization."

STARK AND ISSING SOUND ALARM

Also, two highly respected former chief economists of the European Central Bank and the Bundesbank, Jürgen Stark and Otmar Issing, sounded the alarm with respect to the concession to change the European Stability Mechanism from an inter-governmental to a supranational institution, based on EU law and controlled by the European Parliament.



Otmar Issing: Offered somber warning.

Under the headline "Europa Zuerst!" ["Europe First"], Stark argued in the *Frankfurter Allgemeine Zeitung* in January 2018 that the International Monetary Fund is also constructed as an inter-governmental institution and that more EU top-down centralization would counter the need for more subsidiarity and closeness to the citizens in Europe. And in a *Frankfurter Allgemeine Zeitung* article later that month, Issing issued a sombre warning: "The results of the exploratory talks have to be taken as a farewell to a European Union that is directed to providing stability. This is how the promises that were given citizens in Germany at the introduction of the euro are broken."

Issing also makes the point that Germany is seen as a spoil-sport, somebody with no concept of how Europe should develop, especially in the intra-German debate. Behind this, he thinks, "is the demise of ordo-liberal thinking in Germany, which makes Germany vulnerable to the visions and ideas of a French president." Issing, a veteran of both the European Central Bank and the

Bundesbank, warns that “we are obsessed with asymmetric shocks, but most shocks we have experienced, such as the financial crisis or the oil price movements, were symmetric. Show me the member state [in the eurozone] that innocently gets into trouble.” And Issing continues: “In a few situations, the European Stability Mechanism provides a sufficient mechanism. But to turn the ESM from an inter-governmental to a supranational institution, run by the European Commission, would be a mistake. After all, the Commission has undermined confidence in the Stability Pact. It will also undermine confidence in the rules behind the ESM.”

Issing makes another point: “Those in favor of a fiscal union are not really in support of a genuine political federation. They inject a smokescreen to undermine the

rules of the monetary union and the principles of national economic sovereignty. The biggest tragedy is this: excessive and misdirected political ambitions threaten economic development in Europe, and deepen the schisms between the member states and within member states. All this will undermine European citizens’ identification with this unique project.”

CHAOS ON THE FINAL STRETCH

Negotiating the final coalition terms, Merkel was in a weak position from the start. One reason: She had to take into account that by March 4, 2018, almost 500,000 SPD members would be called upon to accept or reject the new GroKo agreement. And to make things more complicated, the SPD youth organization had embarked on a

Will Germany’s Weidmann Succeed Draghi?

The eurozone’s next battle.

Heading the European Central Bank could be the most powerful position in the European Union. Since November 2011, former Bank of Italy governor Mario Draghi has reigned at the ECB helm. Draghi’s term will end in October 2019.

When the finance ministers of the Eurogroup confirmed Spanish economic minister Luis de Guindos to succeed Vítor Constâncio as next ECB vice president when Constâncio retires in June of this year, the speculation over who will succeed Draghi next year began.

Philip Lane, governor of the Central Bank of Ireland, retracted his bid for the vice president job, but indicated interest for other ECB positions in the future.

A Spanish vice president would be the preferred option for those who support Jens Weidmann as the next ECB president. Weidmann and de Guindos together could move the balance toward a more conservative stance on monetary policy. So far in his term, Draghi has been able to mobilize the “southern majority” in the governing council in favor of a zero-interest rate policy and quantitative easing through huge securities purchases. Germany’s Bundesbank vote was marginalized. This left savers in northern countries such as Germany and the Netherlands seeing the value of their savings decline year after year.

The new German coalition government under Angela Merkel already is under pressure to prepare for the coming

succession battles at the ECB. The news leaked during negotiations that her Social Democratic coalition partner put on record that the SPD also would back the candidacy of Weidmann to succeed Draghi.

When pushing for Weidmann, Berlin will face opposition from Italy and the smaller euro area member countries. Weidmann voted against Draghi’s policy of flooding the eurozone with easy money and zero interest rates to keep southern banks and member states afloat. There also will be objections from those pointing out that major institutions are already headed by Germans, including Klaus Regling at the European Stability Mechanism, Werner Hoyer at the European Investment Bank, and Elke König at the new Single Resolution Board.

—K. Engelen



Luis de Guindos



Jens Weidmann

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GABY GERSTER

nationwide anti-GroKo campaign under its charismatic leader Kevin Kühnert, thereby recruiting thousands of new SPD party members.

At last, on February 7, 2018, 136 days after the September elections and after an all-night final haggling on the 177-page long coalition agreement and a fierce struggle over the distribution of ministries, the three party leaders presented policy and spending revisions mostly in favor of the Social Democrats' demands. Merkel's CDU party followers were shocked, because despite emerging from the elections as the largest party, the CDU ended up leaving the powerful Finance Ministry, the Foreign Ministry, and the Ministry of Labour and Social Affairs to the SPD.

The next day, the tabloid *Bild* came out with the headline, "Merkel at any price: Merkel gives the government to the SPD." And the day after, "After GroKo Debacle: Insurgency against Merkel." *Handelsblatt* global chief editor Andreas Kluth concluded: "Angela Merkel declares victory and surrenders." Similarly, Thomas Sigmund, head of *Handelsblatt*'s Berlin office, wrote, "Merkel's coalition giveaways will be her downfall."

There were outcries from former top conservative politicians. Friedrich Merz, a former Merkel rival, who heads the Atlantik-Brücke, warned, "If the CDU takes this humiliation, it gives itself up." For Carsten Linnemann, a rising star in the CDU who speaks up for Germany's small- and medium-sized businesses, Merkel's coalition agreement looks like "the beginning of the end of the CDU as a big-tent party." The chairman of the Bundestag's foreign relations committee, Norbert Röttgen, laments: "In the next government, CDU would be structurally weakened and have less influence on government in the future."

One stunning aspect of the SPD leader's success in the GroKo negotiations was that Schulz turned out to be the big loser in what is called by some the "GroKo chaos week." He had quietly agreed to step aside as SPD leader in reaction to the steeply falling polls for his party. With only 20.5 percent of the vote in last September's elections, the party under his leadership suffered the

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in the polls fell.*

worst results in post-war German history, compared with 32.9 percent for Merkel's CDU.

What proved disastrous for Schulz was that by mid-February, a major poll saw the SPD at 16 percent—only 2 percent above the far-right Alternative für Deutschland. The CDU stayed at 33 percent, an approval level about twice as high. Under such pressure, the former president of the EU Parliament arranged a backroom deal with floor leader Andrea Nahles that she should take the SPD chair in exchange for helping to get him into the foreign ministry in the new government.

But since Schulz had declared categorically many times that he never would serve in a cabinet under Merkel, there was fierce opposition in the SPD party ranks, especially from those who backed Foreign Affairs Minister Sigmar Gabriel to stay in his job as the most popular SPD politician in the country. Realizing the mounting opposition in the party, Schulz announced that he would give up his plan to enter the new government as foreign minister. The sudden positioning of Nahles as SPD leader was fiercely contested within the party. The SPD leadership retracted their move and nominated her as SPD leader to be confirmed by a party conference. The mayor of Hamburg, Olaf Scholz, was put in as caretaker SPD leader. As it turned out, importing a former top figure from the European stage into Germany's political battlefield turned out to be an unmitigated disaster, leaving a severely damaged Schulz as a back-bencher in the Bundestag.



Former Hamburg mayor **Olaf Scholz** as finance minister and vice chancellor will assume a key role when working together with French President Emmanuel Macron on deepening and strengthening the European Union and the eurozone.

—K. Engelen

WHERE DOES THIS LEAVE EUROPEAN REFORMS?

Despite being the big winners of the GroKo negotiations, the Social Democrat leadership—because of their backroom deals, their infighting and contradictory decisions—lost much credibility with their party members and voters. Paradoxically, the more concessions they got from Merkel’s conservatives, the lower their rating in the polls fell.

What resulted from the “SPD chaos week” was that apart from the designated new party leader Andrea Nahles, Hamburg Mayor Olaf Scholz—with his long government experience, his caretaker party role, and now as designated finance minister and vice chancellor—emerged as a heavyweight in a Merkel IV coalition government.

On February 8, Deutsche Bank Research published a report, “GroKo coalition treaty—more spending than strategy.” Its authors, Barbara Böttcher, Dieter Bräuninger, and Stefan Schneider, remind their readers that the European focus will not make the GroKo agreement an easier sell to the party base because “Europe is no vote winner in Germany.” Most Germans do not share the view that the euro is still in a vulnerable situation and the euro area requires further stabilization measures, especially given their concern that they will end up footing the bill.

The report also points out that in the regular monthly ZDF Politbarometer survey on the most pressing politi-

SPD leader Martin Schulz turned out to be the big loser.

cal issues for Germans, the topic of reforming the euro area does not register.

The Deutsche Bank researchers argue that “the coalition agreement clarifies that the rights of the parliament remain unaffected by the envisaged transformation of the European Stability Mechanism.”

After all, the highest German court ruled on the ESM in 2014 that the Bundestag cannot approve a guarantee or a transfer automatism on which it has no control anymore. Merkel faced critical questions by her party fellows in this regard and stated that a future European Monetary Fund will not become “an agency” of the Commission and that control rights of the Bundestag “will not be touched.”

We were struck by the sheer degree of the U-turn on European politics.

They agree that a new SPD finance minister will get a critical position in the new cabinet, because all the relevant projects have to pass his office. And as member of the Eurogroup and the ECOFIN which prepare and partly decide on euro area and EU reforms, the new SPD finance minister can markedly shape Germany’s stance on European policy.

But the researchers caution: “Albeit these are important competences, it should not be overlooked, however, that according to the German basic law, it is the Chancellor’s power to set all policy guidelines. Especially with regard to European policy, traditionally and even more in Merkel’s past terms, the Chancellery has been the center of power.”

There was a sigh of relief on March 4—more than five months after the national elections—when the SPD leadership announced that a majority of 66.02 percent of 463,723 eligible SPD members voted in favor of joining the coalition under Chancellor Merkel, clearing the way to her fourth term beginning March 14, 2018.

There is no doubt that Olaf Scholz as finance minister and vice chancellor will wield serious power in the new government. He will assume a key role—as did his predecessor Wolfgang Schäuble—on the European stage, especially when working together with French President Macron on deepening and strengthening the European Union and the eurozone.

This will not be easy, since the Netherlands has formed an alliance of eight small- to medium-sized EU member states to oppose the Franco-German drive for stronger eurozone integration. This group includes Ireland and the Nordic and Baltic states. They argue that because Germany is no longer guided by the principles that Schäuble put down in his “non-paper” on eurozone reform, they need to stand together since they will not accept French-German compromises. They demand prior risk reduction in the eurozone banking system and—as to new loans through a converted European Stability Mechanism—prior government debt restructuring. Also, a new European Monetary Fund should remain inter-governmental, with its actions subject to approval by the member states and not by the European Commission or the European Parliament. ◆