



MERKEL'S FOURTH TERM

JOHN RYAN



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Following the German elections of 24th September 2017, Chancellor Angela Merkel is set to continue in power for a fourth term. But this historic achievement feels like a heavily qualified victory.

Merkel will not be able to govern alone. An unprecedented seven parties have gained seats in the Bundestag. The four smaller parties – the leftist Die Linke, the liberal Free Democrats (FDP), the Greens and the right wing Alternative for Germany (AfD) – join Merkel's conservative Christian Democrats Union (CDU), her Bavarian allies the Christian Social Union (CSU) party, and the Social Democrat Party (SPD).

Pre-election, the CDU/CSU and their coalition partner the SPD held 80% of the seats in the Bundestag. Before the election the executive was strong and the legislature was weak. The election has reversed this. While mathematically, a continuation of the grand coalition is possible the SPD's worst ever result (20.5%) has pushed it towards opposition.

Expect a three way 'Jamaica' coalition between the CDU/CSU, FDP, and Greens (named for the party's colours matching those of the Caribbean nation's flag). However, the task of tempting Greens, Christian Democrats, out-of-sorts Bavarians and pro-market Free Democrats, into an alliance — let alone keeping them there — looks like an uphill struggle. If it works, the resulting Cabinet tensions will be noticeable. A minority government is another possibility.

This Strategic Update looks at what the start of Merkel's fourth term will mean for German politics, Eurozone reform, and Brexit.

GERMAN POLITICS AFTER THE ELECTION

The election mood in Germany is not going to disappear just yet. With another important state election in Lower Saxony scheduled on 15 October, parties can be expected to keep up their campaigns until the result. Coalition negotiations can be expected to last until January 2018.

Next year's Bavarian regional election will be a primary consideration for the CSU, which was already having very strained relations with Merkel's CDU. The AfD is the party that has benefited most from Merkel's move to the centre of German politics leaving a gap on the right. CSU leader Horst Seehofer will likely move the CSU to the right with the Bavarian state elections in 2018 in mind. Their prospects for a state majority in 2018 are not good: the CSU had scored 49.3% in the 2013 Bavarian state election but won just 38.5% there in 2017, their worst showing since World War II.

Seehofer has already announced that he thinks that "leaving the right flank open" was the main reason for this poor result. This admission may not be enough to keep him in post until the 2018 vote, but there is no doubt that the CSU will try to pull the next German government to the right. And having the AfD in the federal parliament will also push Merkel in the same direction. So far, Seehofer has been able to delay a deeper discussion of his role in the party until a CSU convention scheduled for mid-November 2017. His nearest rival Markus Söder has demanded the introduction of a hard upper-limit on the number of refugees Germany

accepts each year. The problem, though, is that Merkel is against such a limit as are the FDP and Greens.

A coalition would deepen the Greens' identity crisis. They have always been divided between a more fundamentalist left wing, and pragmatists like former vice-chancellor Joschka Fischer who helped to get them into power. But they managed to stay united for political expedience. But now the party is split over which direction to take: become a sort of eco-CDU, following the example of Winfried Kretschmann, the party's most successful leader and only Green state prime minister (in the CDU's heartland, Baden-Württemberg), or maintain its left-wing credentials and remain a green version of the Social Democrats. A coalition with Merkel and the FDP would cement the party's shift in the former direction seen, but alienate many of its left-leaning voters and members. The left wing of the Greens would probably become more vocal in a national Jamaica coalition.

The FDP has resurrected itself in the election at federal level with 10.7% under the guidance of its leader, Christian Lindner. Lindner's call for Greece to exit the Euro appealed to some CDU voters and limited his party's possible losses to the AfD. German industry, which has poured money into the FDP, sees it as worthy of ruling once again in coalition. Lindner made clear on election night that any Eurozone reform that entailed major fiscal transfers as part of a Eurozone budget and cost Germany money would be "a line in the sand". Finance minister Wolfgang Schäuble's exit to become Bundestag speaker could make it more likely that the finance ministry will go to the FDP, which has long had the role in its sights.

EUROZONE REFORM AFTER THE ELECTION

When French President Emmanuel Macron spoke only two days after the German election about deeper Eurozone integration, he was aware that his words would be scrutinised. Macron called for a common Eurozone budget, a European finance minister, and a Eurozone parliament, and he thinks Germany and the EU should boost investment.

Even before the German federal election, Berlin had ruled out Euro bonds – shared borrowing across the Eurozone. The CDU/CSU remain sceptical of France's plans. The party places a premium on adherence to the Eurozone's fiscal rules and opposes proposals that could usher in debt mutualisation, with a coalition pushing it to double down on calls for fiscal discipline. FDP leader Lindner has warned that there should be no "friendly gifts" to Macron that threaten European stability, and maintains a tough position on Greece. The Greens, however, have embraced Macron's proposals, they want an end to austerity and a European 'investment offensive'.

Merkel knows that Germany and France need to work together closely to provide the leadership Europe needs. Her coalition partners will determine whether she has enough leeway to compromise with the French. A Jamaica coalition would make Eurozone reform less likely.

Macron acknowledged these concerns in his speech, saying Eurozone reform was "not about mutualising our past debts or solving the financial problems of one

country". In a defiant response to the FDP's "red lines" warning during the same week, Macron said: "I don't have red lines, I only have horizons." But Macron has nevertheless showed caution in the face of the new political reality. The proposals will move forward in December 2017 with a European Commission paper and summit.

BREXIT AFTER THE ELECTION

The time taken to complete German coalition negotiations will only increase the uncertainty around Brexit negotiations. Many in London are hoping that the negatives of further delay will be offset by the presence of the FDP in a new government.

FDP leader Christian Lindner has warned against punishing the UK. Germany has "an interest in a strong and economically prosperous Great Britain," he said in June 2017, adding that a weakened UK would also leave Europe worse off. Michael Theurer, currently an MEP but poised to move into the German parliament as the FDP's economics chief, even proposed the creation of a special 'Brexit Cabinet' to better safeguard German economic interests with Britain during the Brexit negotiations. Describing his own party as "very British-minded" and "in favour of free trade and market economics", Theurer stressed the need for a strong Britain as a partner for both the EU and NATO.

Having the FDP in the German government would also mean a stronger voice in the Brexit negotiations for German industry, the sector that has most to lose from a punitive

Brexit deal. While the FDP would have to compromise as junior partner in such a coalition, its Brexit-proposals could find favour with the CDU's own business-friendly wing (and particularly the Bavarian CSU).

However, The UK often overestimates its ability to win support from Germany. In recent years, there have been a number of occasions where the UK believed it had German support, but it turned out not to be the case. For example, the UK thought it had the support of Germany in the negotiations on the Fiscal Pact as well as the appointment of Jean-Claude Juncker as Commission President. On both occasions, Germany decided to change its position and leave the UK isolated. Also during the pre-referendum negotiations, Germany was not willing to give the UK government concessions on labour mobility as Cameron sought a 'new EU deal' to present to the public. May remains an optimist on Brexit, is she making the same mistake that sank David Cameron, of thinking all this can ultimately be sorted between politicians?

German elites and the public are on the same page when it comes to the future relationship between the EU and the UK: that the EU should try to maintain a good relationship with the UK but it should not make any compromises on its core principles. There might be a warmer approach to the UK from the FDP but it is unlikely that they will want to spend their bargaining chips in coalition negotiations on Brexit. It was telling that Brexit was not discussed in the election debate between Merkel and her main opponent, the SPD's Martin Schulz.

At the end of the day, the result will not change that much. Merkel understands that the success of the UK and the EU are interlinked, both politically and economically, but that her political interest in keeping the EU-27 together outweighs any interest the German car industry or any other industry has in the British market. Her pragmatism will prevail.

CONCLUSION: GERMANY, BREXIT, & EUROZONE REFORM

Despite the fact that the UK does not use the Euro, Brexit will have important implications for the European Monetary Union's future. The UK's significant financial sector and the loss of its budgetary contributions will lead to numerous EU reforms in the wake of its exit. Germany will lead the EU in taking advantage of this, attempting to use post-Brexit reforms as an opportunity to strengthen the Eurozone and make it more robust against future crises.

A UK exit would mean the weight of the 'market-friendly/liberal' bloc (whose current core members include the UK, the Netherlands, Sweden, Denmark and Estonia) will decline. So although a British withdrawal from the EU would not turn Germany into a hegemon, it could increase the perception of German dominance and with it add pressure to form coalitions to counterbalance its power. Paradoxically, therefore, Germany could actually become weaker – that is, less able to get what it wants – in an EU without the UK, despite higher expectations from other EU member states.

In this way, Merkel may find that both in Germany and in Europe her fourth term may lead to a difficult and unsure path to engage with international and domestic issues over the next few years. The coalition may not survive and new elections may be required before the full term ends, meaning discussions about a possible successor for leader of the CDU and for a new leader for Germany may surface sooner rather than later. ■

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