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Cross-Asset- and Strategy-Research

Crunch time in Berlin

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The German coalition negotiations are in their decisive phase

The coalition talks in Germany have kicked off at an impressive pace, at least when it came to amending the constitution to ease the fiscal debt brake to permit more defense spending and enable a EUR 500 billion special fund for public investment. Admittedly, this rushed approach was forced upon the political actors due to the looming reconstitution of the new parliament, in which the political center lacks the required two-thirds majority. But now, the painstaking task of negotiating a coalition agreement is proving to be much more sluggish. The policy working groups of the only two possible coalition partners, the conservative CDU/CSU and the social-democratic SPD, have concluded their tasks: Now, party leaders need to overcome the often diametrically opposed positions that emerged from those groups. Originally, Chancellor-designate Friedrich Merz (CDU) aimed to have the agreement and government in place by Easter, in two weeks. But the negotiators are still searching for compromises like my children once hunted for well-hidden Easter eggs.

The last mile is always the hardest

It is by no means certain that the coalition talks will succeed. The conservative CDU/CSU need to secure a few big wins after falling out of favor with parts of their electorate due to the abrupt about-face on loosening the fiscal debt brake. On the other hand, the Social Democrats must steer the draft agreement unscathed through a membership vote. Hence, they cannot afford to concede too much either. Squaring that circle requires trust and empathy. Now, they are paying the price for an often abrasive election campaign. Both camps credibly affirm that they are aware of their responsibilities. No one wants to risk new elections. But that understanding on its own is no guarantee of reaching agreement.

Struggling for Compromises

Both Partners Under Pressure

German voters were somewhat mischievous in putting these two parties in bed together. This is not a marriage made in heaven...

However, a robust coalition agreement is urgently needed. Otherwise, there is the risk of another self-imposed blockade akin to the previous "traffic light"-coalition. This could drive voters into the arms of populists. Conditions like in [Austria](#), where right-wing populists became the strongest force, could be the result.

Bone of contention: Finance and migration

The sticking points in the negotiations were foreseeable. LBBW Research had already noted in its [analysis](#) of the election programs before the vote that the programmatic overlaps between CDU/CSU and SPD are few and far between. And that the dispute would ignite particularly over migration and fiscal policies is also no surprise. On immigration, the SPD is resisting Merz's bold campaign promises. And the tax plans of the two potential coalition partners could not be more different: The SPD aims to relieve lower and middle incomes and burden the wealthy, while the CDU/CSU is pushing for relief for the better-off (see illustration). Fortunately for the coalition partners, the Federal Constitutional Court recently declared the solidarity surcharge lawful. Otherwise, the budget holes created by concessions to interest groups in the exploratory talks – from mother's pensions to VAT reductions for restaurateurs – would be even larger. However, little noteworthy has emerged about concrete cost reductions.

As frustrating as it may sound: The coalition is, in former chancellor Angela Merkel's parlance, "without alternative." No one desired it, with the possible exception of the satirical profession. But it must succeed. Otherwise, the economically reckless far-right AfD threatens to take pole position in the next election. Let us hope that the unequal partners find constructive collaboration!

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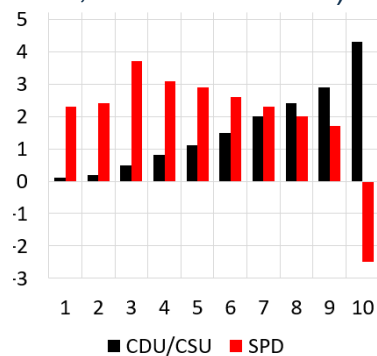
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Failure Would Be Grist to the Populists' Mill

Percentage change of disposable income by income decile (1 = poorest 10%; 10 = richest 10%)



Source: Election Programs, ZEW, LBBW Research

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