

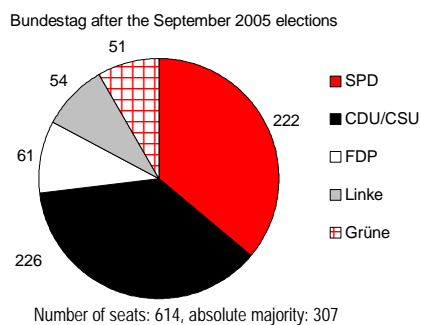
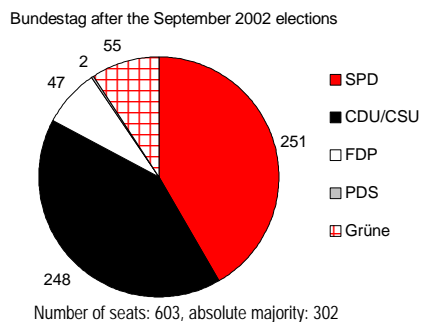
WHAT ECONOMIC ROUTE WILL THE GRAND COALITION TAKE?

After exploring various possibilities, the CDU-CSU and the SPD agreed on Monday 10 October to form a grand coalition, with Angela Merkel as Chancellor. The two parties will each have an equal number of ministerial portfolios: Edmund Stoiber becomes minister of the economy and of technologies; the conservatives will also be in control of internal affairs (Wolfgang Schäuble), defence, agriculture along with consumer protection, the family and training. The SPD has been awarded finance (Peer Steinbrück), labour including social affairs (Franz Müntefering), health (Ursula Schmidt reappointed), justice, foreign affairs (Frank-Walter Steinmeier), transport, environment and development assistance.

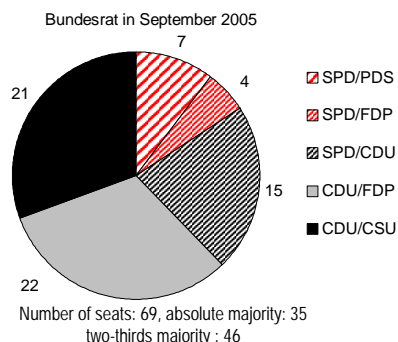
There is a great risk that this coalition will end up making the minimum possible reforms, since the two parties' positions on health insurance and the labour market, for instance, are almost irreconcilable. However, reform of pensions and of federalism could take place by 2009.

The 18 September elections have resulted in an unusual coalition

Despite the unpopularity of the SPD/Greens coalition, the SPD earned enough votes to allow it a role in government. The CDU/CSU won only 4 seats more than the SPD, hardly changing the power relationship that prevailed in 2002 (when the SPD had 3 seats more than the CDU/CSU). The distribution of the votes made it impossible to form the classic coalitions, since neither the SPD/Greens nor the CDU-CSU/FDP obtained an absolute majority.



The CDU-CSU does have a decisive influence in the Bundesrat. Since the May 2005 elections, in which it took the "Land" (state) of Rheinland North-Westphalia, the CDU-CSU/FDP coalition has had a two-thirds majority, enabling it to block virtually all bills voted in the Bundestag.



The grand coalition between the CDU-CSU and the SPD has 448 seats in the Bundestag (while the opposition parties have 166) and

36 votes in the Bundesrat (as opposed to 33 for the opposition and abstentions), enabling it to govern without the need to negotiate with the Greens, the FDP or the "Linke", three parties whose political convictions are so at odds as to make any consensus against the government impossible. The deputies' vote to elect Angela Merkel, who will be proposed as Chancellor by the President of the Republic, Horst Köhler, at the first plenary session of the Bundestag, will set the tone for the relationship between the opposition parties and the government, and the degree of cooperation to be expected between the SPD representatives and those of the CDU/CSU (any mass abstention by SPD deputies for the investiture of Angela Merkel would send a negative signal for the future of the grand coalition).

What progress for reform in the new coalition?

Only one historical precedent exists for a coalition like this. In 1965, when the FDP terminated the coalition with the CDU-CSU, a CDU-CSU/SPD coalition governed from December 1965 to October 1969, with Kurt Georg Kiesinger (CDU) as Chancellor, and Willy Brandt as Vice Chancellor and Minister of Foreign Affairs. It ended at the initiative of the SPD, after achieving significant reforms such as the constitutional review that allowed emergency laws (*Notstandgesetz*) and the revision of the electoral system that introduced a majority component into the proportional system. Judging by the difficult process involved in finding agreement on the formation of a grand coalition and the lack of acknowledgement of Angela Merkel's leadership even within the CDU/CSU, there is little chance for the government formed on 10 October to achieve as many reforms of its predecessor in the 1960s. Nonetheless, even that one was marked by significant interpersonal differences. If the statements of the future ministers concerning Angela Merkel are to be believed, the same will occur in this new edition of a grand coalition.

The agreement to form the grand coalition announces initial compromises between the SPD and the CDU/CSU, though they are minor in scope:

- to achieve 3% of GDP on R&D expenses by 2010;
- to maintain in effect the process of branch salary negotiations (*Tarifautonomie*) (a concession by the CDU-CSU, which wanted to see the process decentralised);
- the grand coalition announced its intention to simplify income taxes and to reduce tax exemptions (a concession by the SPD), though supplementary pay for night work, Sundays and holidays will be maintained (a concession by the CDU/CSU);
- it has committed to discuss a tax rebate for household with children (a CDU-CSU proposal) and the introduction of a parental leave benefit (called "*Elterngeld*," an SPD initiative).

Furthermore, there is already a consensus within the grand coalition on a number of points: the lowering of corporate tax, the elimination of death duties if a company's business is continued (proposals jointly validated by the two big parties at the jobs summit last March), the continuation of the lowering of subsidies and tax incentives that were deemed too costly and unfair (the *Koch-Steinbrück initiative* proposed in 2003 jointly by the CDU Minister-President of Hesse, and the former SPD Minister-President of Rheinland North-Westphalia).

Since the two parties' opinions are much more antagonistic on the issue of reforming the labour market and health insurance, few results can be expected in these fields from the coalition: conditioning the payment of unemployment benefits on an active job search should be strengthened and the term of the benefits reduced; health insurance contributions by employers should be frozen. The two large parties' opposition in these areas is great enough to lead to the break-up of a grand coalition, a factor that should induce them to put aside their more ambitious ideas (for the CDU/CSU – making the law on layoffs – the *Kündigungsschutz* – more flexible; and for the SPD the introduction of a minimum wage). However, a more in-depth reform of pensions, for which the debate is much more mature and less partisan, has hopes of occurring. Both large parties, since the publication of the Rürup report in 2003, have acknowledged the need to improve the financing of dependency insurance and to postpone the starting age for the pension. The 2003 law specifies that the pension age

issue must be examined in 2008. The grand coalition might advance the timetable on this.

It is also possible for the reform of federalism to occur. Considered during the previous coalition, it collapsed in December 2004 when the SPD refused to transfer responsibilities from the Federal State to the *Länder*. The goal of such a reform is to reduce the number of laws that must be considered in the Bundestag (this number has risen from 15% in the fifties to 60% now) so that the legislative process can gain in speed and efficiency.

In the short term, the major problem lies in the still disastrous situation of the public finances. Contrary to what they claimed in their pre-electoral programmes, the two large parties will have to come to some agreement to rein in the public deficit to close to 3% of GDP by 2007, most likely through cost-saving measures. Such an objective, required by the EU's stability pact (even in the revised form of March this year), is incompatible with the lowering of income tax demanded by the CDU-CSU (€ 5.5 billion). If agreement is found on how to finance it, the reduction in corporations tax proposed by the two parties (a cost of € 3–6 billion to reduce it from 25% to 22%, as proposed by the CDU-CSU or to 19% as proposed by the SPD) could be achieved. As for the increase of VAT by 2 points proposed by the CDU/CSU, it could be achieved, despite the risks that it would harm spending by households, since the SPD is not totally opposed to it.

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	Major proposals by the CDU-CSU	Likely reforms of the grand coalition	Major proposals by the SPD
Labour market	<ul style="list-style-type: none"> ⊘ Make the rules on dismissal more flexible ⊘ Reduce unemployment insurance contributions, financed by increasing VAT ⊘ Reduce subsidised jobs ("Hartz" jobs) ⊘ Reintroduce the professional certificate (<i>Meisterbrief</i>) that the SPD abolished in 2004 for a number of professions 	<ul style="list-style-type: none"> ⊘ Reduce the term of unemployment benefits (<i>A/G I</i>) by 2006 ⊘ Increase incentives to return to employment ⊘ Lighten the costs for hiring lower-skilled workers (<i>Kombi</i>) ⊘ Extend the minimum wage law for foreign workers (<i>Arbeitsnehmerentendegesetz</i>), currently applied only to the construction sector, to other industries 	<ul style="list-style-type: none"> ⊘ Introduce a minimum wage
Health insurance	<ul style="list-style-type: none"> ⊘ flat contribution (<i>Gesundheitprämie</i>) 	<ul style="list-style-type: none"> ⊘ A freeze on employer contributions ⊘ Reduce expenses (reduce reimbursements, raise deterrent fees, restrict services) 	<ul style="list-style-type: none"> ⊘ Universal health insurance (<i>Bürgerversicherung</i>)
Taxation	<ul style="list-style-type: none"> ⊘ Reduce income tax ⊘ Increase VAT by two points 	<ul style="list-style-type: none"> ⊘ Reduce subsidies and tax exemptions ⊘ Reduce the corporate income tax from 25% to 22% for the CDU, and to 19% for the SPD ⊘ Reform death duties for companies 	<ul style="list-style-type: none"> ⊘ Create a special tax for higher income earners (<i>Reichensteuer</i>)
Federalism	<ul style="list-style-type: none"> ⊘ Transfer all responsibilities for education to the <i>Länder</i> 	<ul style="list-style-type: none"> ⊘ Clarify the responsibilities of the Federal Government and the <i>Länder</i> ⊘ Finance reform (distribution of tax revenues) ⊘ Maintain the system of horizontal equalisation (the <i>Länder</i> with budget surpluses help those with deficits) 	<ul style="list-style-type: none"> ⊘ Maintain the shared authority between the Federal Government and the <i>Länder</i> on education.

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