Germany: Schroeder government under pressure as recession bites

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Germany faces worsening economic prospects and permanently high unemployment. As a result, the Schroeder government is coming under ever-greater pressure to make further cuts in the welfare state in order to improve conditions for big business.

After a year in which economic forecasts were regularly revised downwards, they have now reached a new low. According to figures from the German Institute for Economic Research (DIW) and the Munich Ifo, economic growth of approximately only one percent is expected for this year. In its annual appraisal last November, the government's panel of experts had announced an expected growth rate of 2.4 percent. Chancellor Gerhard Schroeder reduced this figure at the beginning of August to "Two, or at least 1.5 percent". Economic growth last year amounted to 3 percent.

In view of this strong economic deceleration, Schroeder was forced to shift his prognosis for achieving an unemployment target of 3.5 million by the next general election in 2002 to some time afterwards. Many large and small firms have imposed a recruitment freeze, and either announced or carried through job cuts. In July, the number of unemployed was only around 100,000 lower than at the same time last year—at just over 3.8 million.

This development is increasingly threatening the government's financial policy—the reorganisation of state finances and the lowering of ancillary wage costs, which are supported by big business. Finance Minister Hans Eichel's cuts programme was based on new debt in the federal budget this year being at the most two percent of GDP, or 43.7 billion marks, reducing to zero by 2006. The government had committed itself to reducing ancillary wage costs consisting of employers' contributions to insurance schemes covering long-term care, unemployment, pensions and sickness, from a level of 42.3 percent at the beginning of the legislative period to under 40 percent by autumn 2002. At present they are about 40.9 percent.

In order to achieve this target, the Social Democratic Party-Green Party coalition government introduced an "eco-tax" as well as fundamental pensions and health reforms. Together with reforms that lightened the tax burden by 45 billion marks, they have had some draconian social effects, which were only barely covered over by the previously relatively stable economic situation. The present worsening economic data has made the government's economic policy come tumbling down like a pack of cards.

According to various prognoses, continuing high unemployment, and the drop in social insurance contributions this entails for which the federal government must cough up, as well as lower tax receipts threaten to create a hole in the budget of between 5 to 20 billion marks. The president of the Federal Labour Office, Bernhard Jagoda, explained that the 1.2 billion mark federal subsidy for the shortfall in unemployment insurance contributions so far this year would only be enough given an "extremely vigorous revival in the jobs' market this autumn".

Representatives of the various old age pension insurance schemes indicated recently that they were not reckoning on contributions dropping from their present 19.1 percent to 19.0 percent by 2002, a central government target. Herbert Rische, president of the Federal Social Insurance Institution for white collar employees (BfA), would not exclude an increase in pension contributions next year: "The pressure is rising to increase contributions in the coming year."

Economics expert Bert Ruerup also sees "no possibility" of lowering pension contributions: "Labour Minister [Walter] Riester will be lucky to hold them at around the 19.1 percent level". Despite a further increase in the eco-tax, there can be no lowering of pension contributions in the coming year, thus increasing labour costs. According to Ruerup, ancillary wage costs could next year lie above rather than below the 41 percent level.

Faced with this development, the media, big business, the conservative opposition and even sections of his own party have besieged Schroeder to immediately change his course. The focus of this barrage is the demand to deregulate the jobs' market, and for drastic cuts in unemployment and welfare benefits, in order to force through the creation of a low wage sector. The health reforms are also to be further intensified.

Hesse state premier Roland Koch (Christian Democratic Union) is championing the measures. Following a fact-finding trip to Wisconsin in the US, Koch wants to force all those receiving welfare payment to work. He received support from his colleague in Lower Saxony, Sigmar Gabriel (Social Democratic Party), who said, “Koch was right”.

Others in the SPD and the Greens have joined in the chorus. The Green Party’s finance expert Christine Scheel demanded that the government introduce rapid reforms in the jobs’ market, which could not be postponed to the next legislative period. Scheel called for the merging of unemployment and welfare benefits, replacing job creation schemes by direct wage subsidies and the introduction of additional incentives to start work.

Rezzo Schlauch, the Greens’ parliamentary faction leader, regretted that the SPD had abandoned too quickly its target of lowering ancillary wage costs. SPD health expert Florian Gerster warned of drastic cuts in health provision. He proposed cuts in the services paid for by the health insurance schemes for orthodontic and psychological treatments, saying: “We should not be accused of making promises before the election that we are not going to touch such services, only then to say after the election—A compulsory contribution of 15 percent or more is inconceivable”.

Chancellor Schroeder is not at all averse to such suggestions. In the spring, he announced an offensive against the unemployed and those on welfare with the words, “no one has the right to be lazy”. At that time, his cabinet was planning to introduce drastic reforms in the social security system, following the American example, forcing some welfare recipients to work in return for receiving state benefits.

Following a wave of vocal protests and expressions of indignation, Schroeder dropped this project. The cuts introduced by the federal government in 1999 have already led to several devastating defeats in state elections, since the SPD’s core voters stayed at home in their thousands. This only changed when the CDU was immersed in a financial scandal. Now Schroeder is afraid of a similar development, if he introduces a new round of cuts before next year’s federal elections. This is why he has postponed all further reforms to after the *Bundestag* elections, and said he will pursue a “steady-handed” policy.

This has brought comparisons with his predecessor, Helmut Kohl, who was always being castigated because he “sat out” problems. The latest edition of news magazine *Der Spiegel* accuses Schroeder of having lost his “image as a man of action”, mutating from the “getting things done chancellor to the Mikado chancellor,” which only recalls the “paralysing rigidity of the Kohl era”.

In its August13 edition, the *Sueddeutsche Zeitung* gloats, “In the West, those with steady hands are also the heroes. However, they don’t put their hands in their trouser pockets when things get hot.” The paper presents Schroeder with the bitter alternative of either repelling the voters with radical reforms or becoming “the guardian of the reform blockage”. The paper gave Schroeder the following advice as he began his journey through former East Germany, Poland and the Czech Republic: “In East Germany, the rash transfer of the West’s welfare system and wage standards produced lasting unemployment, which other post-communist states overcame much faster”. But at what social price, the authors do not say.

Well-known voices from the Christian Democrats and the main employers’ associations have accused Schroeder of inaction or creating “self-made ruins”. In order to calm down this disquiet, at the beginning of August the government introduced tax exemptions worth 300 million marks for medium-size enterprises. The tax measures instituted in December 1999 had mainly benefited larger companies and finance operations, whose share values experienced a bonanza at that time. This awaked the discontent of the medium-size enterprises, which can now, thanks to a so-called two-year refinancing reserve, dispose of shares without having to pay tax on the profits this brings in, on the condition that the proceeds are invested into another enterprise within two years. The Christian Democrats and the employers’ federations have supported this decision “as a step in the right direction” and have called for further similar measures.

How quickly Schroeder will accommodate the demands of big business remains to be seen. However, the recent disputes have made one thing clear: The political balancing act with which Schroeder tries to meet the demands of business, while at the same time keeping hold of the SPD’s traditional voters in the working class, is coming unstuck, making a confrontation between the government and broad social layers inevitable.