

**Charting a New Course?
German Social Democracy Between
European Integration and Party Politics**

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Paper prepared for the Sixth Biennial European Community Studies Association Meeting,
Pittsburgh, PA, June 2-6, 1999.

I thank David M. Rowe for his comments on an earlier draft.

Socialist and Social Democratic governments, which now comprise the majority of the European Union governments, are faced with a dilemma. In the past, many of these parties advocated full employment and income redistribution through a combination of social welfare, taxation, and monetary policies. Such policies reflected their ideological views as well as a desire to appeal to their core working class constituents.

However, changes in the international political economy, and particularly European economic and monetary integration, have substantially narrowed the ability of governments to pursue such policies. National governments have ceded sovereignty over monetary policy to the independent European Central Bank (ECB), thereby restricting the ability of national governments to stimulate demand by lowering interest rates. The European Union's (EU) Stability and Growth Pact limits national government deficits to 3% of GDP, thereby removing much of government's ability to expand social welfare programs and engage in counter-cyclical demand management. With the removal of tariff and non-tariff barriers and capital controls, national governments are hindered from implementing redistributive measures without risking capital flight. Moreover, EU member governments are under pressure from the European Commission and their domestic business interests to restructure their regulatory and welfare systems and budget policies in order to further the aims of integration and create a more stable Euro. Thus, the room for maneuvering in the economic policy realm has become increasingly restricted. Leftist parties, committed to reducing unemployment and ensuring greater social equality, are limited in their ability to use monetary and fiscal policy tools. As leftist parties try to chart a new economic course in this political economic environment, many have found themselves riveted by internal tensions.

Nowhere have these tensions been greater or on more public display than in Germany. After 16 years out of government, Germany's Social Democratic Party (SPD) in September 1998 won the largest number of seats in Germany's lower house of parliament, the Bundestag (See Table 1 -- Appendix). It subsequently formed a coalition with the environmental Green party. The SPD was able to win the election, in part, by building a centrist electoral coalition that included middle and working class voters. The party chose a moderate, Gerhard Schröder, a self-made businessman, as its chancellor candidate, while Oskar Lafontaine, an advocate of more traditional leftist policies, remained head of the party. The party promised that the government would fight unemployment and achieve economic growth, while maintaining, and even expanding, Germany's social welfare state. Once in office, the SPD found it was difficult to carry out these promises. While economic and monetary union and the need to appease business interests and financial communities are pushing the SPD in the direction of market liberalization and restructuring measures, the need to appease labor and Leftist interests within the party and maintain a coalition with the Greens are pulling it toward more expansionary and interventionist policies. In trying to reconcile these interests, the SPD has pursued an inconsistent economic policy course that has angered trade union and Leftist members of the party, the business and financial communities, its coalition partner, the European Central Bank, and the governments of other EU member states -- in short, almost everyone.

The tensions within the German SPD are particularly severe because of Germany's institutional arrangements and partisan politics. The institutional framework privileges groups such as labor unions and requires the party leadership to placate those interests in order to stay in power. Yet, the party's ability to serve those interests is severely constrained. Moreover, the SPD faces electoral competition on the Left, not only from the Greens with whom it must compromise, but also from the Party of Democratic Socialism (PDS), which keeps him from moving too far to the center. Chancellor Schröder's lack of leadership autonomy makes it particularly difficult for the SPD to face the new political-economic challenges and placate the various interests that support his party.

In this paper, I first examine the dilemma faced by Social Democratic and Socialist parties in building an electoral coalition and serving traditional constituent interests in an increasingly integrated economy. I argue that the ability of leftist parties to successfully implement a more moderate economic stabilization program depends on the institutional and partisan political context in which those parties operate. I then examine the institutional and political context of the German SPD in order to explain the difficulties it faces in responding to the new economic and political environment. It is not simply enough for leftist parties to cobble together a winning electoral coalition by advocating moderate economic and social policies. In order to govern effectively, such parties need to alter the basic institutions which structure interests within the society and within their own party. Only then will they be able to implement a more moderate program and consolidate the support of the so-called "New Middle."

The Social Democratic Dilemma

Social Democratic and socialist parties have received a great deal of attention in the scholarly literature in part because of the challenges such parties have faced in the post-war period.¹ As the percentage of the industrial working class declines, leftist parties can no longer solely rely on the industrial working class to win elections. They need to build larger electoral coalitions. This requires them to moderate their ideological appeals in order to appeal to centrist voters. At the same time, they cannot completely alienate their more traditional and loyal constituents, the working class, which still provide much of their support.²

During the 1950s and 1960s, the solution was to pursue full employment and social equity through counter-cyclical demand management and a comprehensive social welfare

¹ See for example Gosta Esping-Andersen, Politics Against Markets, (Princeton, NJ: Princeton University Press, 1985); Adam Przeworski, Capitalism and Social Democracy. (Cambridge: Cambridge University Press, 1985); Adam Przeworski and John Sprague, Paper Stones: A History of Electoral Socialism, (Chicago: University of Chicago Press, 1986); Fritz Scharpf, Crisis and Choice in European Social Democracy (Ithaca: Cornell University press, 1991); Herbert Kitschelt, The Transformation of European Social Democracy, (Cambridge: Cambridge University Press, 1994).

²For an analysis of the dilemma of Social Democratic and Socialist parties see, Przeworski 1985; Kitschelt, 1994.

policies. This helped socialist and social democratic parties electorally by allowing them to appeal to a broad center-left constituency, while at the same time serving the interests of labor. Many leftist governments in the early post-war period substantially expanded their social welfare states and incorporated labor into the policy-making process. But as economic growth stagnated and then declined, and as economic integration and capital liberalization proceeded, socialist and social democratic parties have found that their use of Keynesian macro-economic management has been severely curtailed.³ Moreover, such policies seemed to have less effect on structural unemployment caused by changes in the international political economy.⁴ The dilemma has become how to combine the traditional leftist concerns with the new economic environment, which increasingly calls for market liberalization and austerity measures in an effort to make the firms more competitive and attract investment.⁵

The degree to which leftist parties have successfully pursued market liberalization and social welfare restructuring policies has varied. This suggests that political-economic pressures alone are not sufficient to explain the policy choices of Socialist and Social Democratic parties. It is also important to examine the institutional and political context in which these parties operate.⁶ Institutions privilege certain interests within the society and within the party and affect the range of policies that leaders can pursue.⁷ For leftist parties, the degree to which the parties have been able to coopt, fragment or demobilize labor unions is critical for their ability to carry out market liberalization policies. Where Socialist or Social Democratic parties have been unable to do so, the parties have been constrained from pursuing more "business friendly" policies. It is also dependent on party competition and the conditions of government

³ See Scharpf 1991.

⁴See for example Peter Gourevitch et al. Unions and Economic Crisis: Britain, West Germany and Sweden, (London: George Allen & Unwin, 1984); Scharpf 1991.

⁵ While the changes in the international political economy do not necessarily mean that Socialist and Social Democrats must embrace neo-liberal policies, these parties are having a more difficult time finding policy solutions to help them deal with growing economic problems such as structural unemployment and serving traditional interests within the party. See Geoffrey Garrett and Peter Lange, "Political Responses to Interdependence: What's "left" for the Left?" International Organization, 45 (August 1991), who suggest that while all governments have to adjust to the increased competitiveness in the international political economy, there is not a pervasive trend toward neo-liberalism.

⁶ See for example Kitschelt 1994 and 1999. Kitschelt emphasizes the need to examine not only the political-economic environment but party competition and organizational structure of the party. The approach I take is similar, emphasizing the importance of party competition and the institutional context, which privileges certain interests and limits leadership autonomy.

⁷ See the discussion of rational choice institutionalism in Peter Hall and Rosemary Taylor, 1996.

formation.⁸ Those socialist and social democratic parties that face competition to the far left of the political spectrum have less freedom to implement liberalization and stabilization policies without losing crucial support. Moreover, their need to incorporate other leftist parties into government also limits their ability to pursue liberalization and stabilization policies. For the German SPD, the task has been particularly difficult because of the organization of labor unions and the party competition from the Greens and PDS.

The German Social Democrats

The German Social Democratic Party was established in the 19th century as a Marxist, industrial working class party.⁹ In the post-1949 period, the SPD retained its emphasis on the working class and Marxist ideology. With an improving economy and a declining working class, this proved to be a failing electoral strategy and the party was unable to win more than 30% of the popular vote. As a result, the SPD made significant changes in its platform in the 1959 Bad Godesberg Program. In order to appeal to a majority of the voting population, it renounced the Marxist overthrow of the capitalist system, accepted the idea of private property, and called for the democratization of society through economic and social policies. With no major competition on the left, the party sought in the early 1960s to minimize its differences with the Christian Democratic Union (CDU) and Christian Socialist Union CSU, its main competitors on the right.¹⁰ This in turn led to increased electoral support and the SPD was able to enter government, first as a junior partner to the Christian Democratic Union in 1966, and then in 1969 as the head of a ruling coalition with the Liberals (FDP).

As the party tried to appeal to a broader range of voters, the factionalism within the SPD increased. There had historically been disputes between those who wished a more orthodox Marxist program and those who wished to pursue a reformist program within the existing capitalist system. After the Bad Godesberg accord in which the reformist program was officially adopted, disputes arose over advisability of joining a government with the CDU. Later, after the SPD came to power, disputes arose between those advocating more radical economic reforms and those pursuing more moderate reforms. Party supporters criticized the leadership for undertaking only modest reforms.

⁸ On the importance of government formation, especially the effects of divided government see Alberto Alesina and Howard Rosenthal, Partisan Politics, Divided Government and the Economy, Cambridge: Cambridge University Press, 1995.

⁹ For a history of the SPD, see SPD Vorstand. Sozialdemokratie in Deutschland. Bonn: 1996; G. Braunthal, The West German Social Democrats, 1969-1982, (Boulder, CO: Westview, 1983); G. Braunthal, Parties and Politics in Modern Germany (Boulder, CO: Westview, 1996); and W. Paterson and A. Thomas, eds. The Future of Social Democracy. (New York: Oxford/Clarendon, 1986)

¹⁰ Braunthal, 1983: 141.

During the 1960s and 1970s, the SPD faced new factional challenges. Membership in the SPD grew during the 1960s among young, educated students and professionals, who pushed a more leftist agenda and demanded greater democratization and participation.¹¹ Many of these new members were critical of the party for giving up its class identity to win elections. They favored increased taxation on the wealthy and on property and an end to private property speculation. Some sought to ally with far left and communist organizations. Some of their demands were at odds with the more moderate leadership and even with members of the labor unions. These new younger members joined the Jusos (Young Socialists in the SPD), an association that recruits new members and party candidates. While the SPD needed the support of these younger members to win elections, they also feared that some of the more radical Juso demands would scare away centrist support. Thus, the SPD moved against the more leftist Juso leaders and blocked attempts by the Jusos to capture party organizations in some districts.¹²

Their influence limited by the party hierarchy, some younger members left the party to join new peace and ecology movements including the Greens. During the 1980s, the SPD increasingly lost support to the Greens, which Kitschelt describes as a leftist-libertarian party.¹³ Like the more traditional leftist parties, the Greens share a mistrust of the marketplace and private investment and a commitment to greater social equality, but they also emphasize greater emphasis on participation, democratization, and environmental and peace issues.¹⁴ This emphasis on quality of life issues often puts the Greens in conflict with the more traditional labor interests in the party, who emphasize the need to protect jobs and ensure economic growth. After the SPD moved into the opposition in 1982, it sought to remove the challenges posed by new social movements and particularly the Greens by moving further Left.¹⁵ This however, did not prove to be a successful electoral strategy. The party suffered three major national electoral defeats including a dismal showing in the elections of 1990, when Oskar Lafontaine, who espoused a more leftist agenda, led the party to its lowest share of votes since 1957.¹⁶

The SPD was optimistic that it could regain power in the 1994 national elections. The party nominated Rudolf Scharping as its Chancellor candidate. Scharping advocated a moderate economic policy program that promised to increase taxes on the wealthy, cut national expenditures including welfare programs, and establish a solidarity pact with business. While

¹¹ See Kolinsky, 1990; Kitschelt, 1989; Markovits and Gorski, 1993.

¹² Braunthal, 1983: 86.

¹³ Kitschelt 1989; 1994.

¹⁴ Kitschelt, 1989.

¹⁵ Indeed, the challenge from the Greens altered the SPD's party program. For example in 1983, the SPD renounced its support of NATO's dual track strategy.

¹⁶ The SPD received 33.5% of the vote in 1990.

these positions were not all embraced by the labor unions, the unions supported the SPD.¹⁷ But Scharping's endorsement of an SPD-Green-PDS coalition in Saxony-Anhalt in June 1994 allowed the CDU to paint the SPD as a far Left party, sympathetic to the former communists, and contributed to a fourth electoral defeat for the SPD.

Growing unemployment and sluggish growth became the key issues in the run-up to the 1998 election. Unemployment in Germany reached a post-war high of 11.8% in spring 1998. The saliency of economic issues allowed the SPD to ignore some of the quality of life issues of the New Left and focus on creating a centrist coalition built around a moderate economic program. The party chose Gerhard Schröder as its chancellor candidate, although Oskar Lafontaine remained the head of the party. Schröder had led the Jusos from 1978-80, but was also known as a pragmatist and friendly to business. Lafontaine, who had been the premier of the Saarland, a stronghold of labor unions in declining sectors, advocated more traditional leftist policies. With these two at the head of the party, the party sought during the electoral campaign to attract both labor union and centrist voters. The party maintained its emphasis on reducing unemployment, but advocated liberalization and modernization policies designed to stimulate investment and growth. For example, Schröder said he would support business efforts in greater investment in high technology and entrepreneurial areas in an effort to create new jobs. He also suggested decreasing the tax burden on individuals and corporations and reducing non-wage labor costs. However, he also promised to preserve Germany's generous welfare state. For example, he promised to roll back the modest cuts in pensions and sick pay made by the Christian Democratic/Liberal alliance. Schröder's promises to maintain the welfare state cuts led to concerns particularly among business, that the Social Democrats would sacrifice inflation and fiscal austerity to create jobs. But to reassure business interests and middle class voters, Schröder chose Jost Stollman, a millionaire businessman and entrepreneur, who was a strong advocate of liberalization, as the shadow economic minister.¹⁸ Lafontaine's position as party chair helped placate labor interests during the campaign.

The party's strategy of reassuring business while promising to pay greater attention to social equality worked as a vote maximizing strategy. In the September 1998 election, the SPD received 41% of Germany's 60.5 million votes. In order to pursue his policies, Schroeder had hoped to form a grand coalition with the Christian Democrats. This would have allowed him to overcome the objections of some of the more entrenched and leftist interests within the Social Democratic party to his supply side and budget reducing policies. But the election results forced him to negotiate a coalition agreement with the Greens, who received 6.7% of the vote. The new government has a 21 seat majority in the 669 seat Bundestag.

¹⁷ Braunthal, 1983:167-8.

¹⁸ While Stollmann angered labor union leaders by suggesting that Germany should lengthen the hours stores can remain open and that the SPD should not promise new jobs since such promises are "without meaning." "Ein attraktiver Mann soll besser schweigen," *Süddeutsche Zeitung*, 29. June 1998, p. 3.

The Governing Dilemma

Many of Schröder's policy promises during the election had been vague in the hopes of satisfying various groups and building a successful electoral coalition. Once in power, the SPD had to choose specific policies to deal with Germany's economic problems. The party leadership found itself pulled in two opposing directions. On the one hand, the SPD leadership recognized that Germany was competing in global economy with liberalized capital markets. Such an environment required the government to maintain business confidence to ensure business investment in the German economy and spur economic growth.¹⁹ As the government states in its coalition agreement, "The new government is aware that global developments, and here in particular the internationalization of financial markets, has a direct influence on the economic and social situation in the European member states."²⁰ Moreover, to compete in the more integrated European and global marketplace, businesses in Germany need to modernize and reduce costs. To achieve this, Schröder argued that Germany must undertake structural reforms and implement policies designed to stimulate investment, such as a 35% top corporate tax rate for all German businesses. He also called for establishing an alliance between government, business and labor to create jobs.

But the SPD also found itself pulled in the direction of pursuing expansionary, redistributive policies that relied on greater government intervention and that improved both wages and social benefits by labor and leftist interests within the party. This hope was reinforced by the formation of a Red-Green coalition and the selection of Lafontaine as the Finance Minister in the new government. Lafontaine immediately moved policy areas from the Economics Ministry to the Finance Ministry in order to consolidate his power over economic policy.²¹ Lafontaine argued that the way to deal with Germany's economic problems was not market liberalization but rather the stimulation of demand through the lowering of interest rates, a redistribution of income and greater government management of the economy.²² Lafontaine argued, for example, that monetary policy must carry a bigger responsibility for reducing unemployment and called for the ECB to cut interest rates. He also suggested that the budget deficit constraints in the EU's Stability and Growth Pact were too severe. He advocated a shortened work week and part-time work with full benefits as a means of addressing the unemployment problem. Such proposals, designed to address the concerns of labor, alarmed business and financial markets. Some German firms even suggested that they would take their

¹⁹See Charles Lindblom, Politics and Markets, (New York: Basic Books, 1977) for a discussion of need for business confidence.

²⁰<http://www.spd.de/politik\koalition\index.html>

²¹ As a result of this, Stollmann decided not to take the Economics Ministry job after it became clear that he would be marginalized in the new government.

²² See Oskar Lafontaine and Christa Müller, Keine Angst vor der Globalisierung, (Bonn, Dietz, 1998).

investments out of Germany if Lafontaine's tax proposals were passed.

The differences in policy positions between Schröder and Lafontaine reflect the underlying dilemma Social Democratic parties face. In order to win electorally and to ensure growth in an integrated economic market, the SPD is pushed to pursue moderate economic stabilization policies. At the same time, the SPD must also consider the entrenched interests within the party, particularly labor, and the need to maintain a coalition with the Greens. It also seeks to differentiate itself from the neo-liberal parties on the center-right. The SPD-Green government's first four months in office were marked by increasing tensions between Lafontaine and Schröder over economic policy issues. Lafontaine's sudden and unexpected resignation on March 11, 1999 and Schröder's decision to head both the party and government alleviated some of these tensions.²³ Indeed, the resignation of Lafontaine relieved Germany's business community and the governments of other EU member states. It led some to suggest that Schröder could move forward with his attempt to create a new middle in Germany and implement the structural reforms necessary to spur growth and relieve Germany's growing unemployment as Tony Blair had sought to do in Great Britain.²⁴

But even with Lafontaine out of the picture, there is no guarantee that Schröder will be able to successfully implement a consistent economic policy course. Even though he has been able to overcome the opposition of his chief rival, he must still placate the leftist interests within the party and the parties to his left. To understand the difficulties Schroeder faces, we need to examine the political-economic, partisan and institutional constraints facing the party.

The Political Economic Environment

The current economic environment has made it increasingly difficult for the SPD to satisfy the various factions within the party. First, European monetary union (EMU) has deprived the party of monetary and fiscal policy as economic tools to deal with unemployment problems. While the SPD was also limited by the German Bundesbank from pursuing expansionary policies, the Bundesbank was more likely to consider Germany's specific political and economic situation in making decisions about interest rates.²⁵ Indeed, the Federal Bank Act of 1957, which set up the Bundesbank, states that while the Bundesbank is independent of the federal government, it is to "support the general economic policy of the federal government

²³ Financial Times, March 13/14, 1999, p. 2. It also led to relief among many of EU member states. One British government official said, "His departure removes the specter of monetary union leading to high taxation and will make it easier for us to sell the Euro to voters. (Financial Times, March 12, 1999, p. 2).

²⁴ See, for example, the editorial in the Financial Times, March 12, 1999, p. 13.

²⁵ See Scharpf, 1991.

while carrying out its mandate." ²⁶ The European Central Bank, which now controls monetary policy, sets the interest rate based on the economy of all 11 EMU members and has no such mandate. The 11 countries, which make up Euro-land, have different economic cycles. The Irish economy, for example, has been heating up much more quickly than other EU member countries. In Germany, economic growth is sluggish.²⁷ The differences across countries make it difficult for the ECB to come up with a single interest rate that all countries can live with. Indeed, Lafontaine argued that the ECB's rate was simply too high given Germany's economic downturn.

A related problem is that the ECB is trying to establish its own legitimacy. This requires it protect its independence by not caving in to political pressures to lower interest rates. Lafontaine tried unsuccessfully to persuade the ECB into cutting interest rates to help offset Germany's slow growth. This only stiffened the resistance among Europe's new central bankers to interest rate cuts. Wim Duisenburg, president of the ECB, argued, in response to Lafontaine, that interest rates were already at a historic low.²⁸ Despite the fact that some economists argued that the rates should be lowered to help spur the German economy, the ECB did not budge while Lafontaine was in office. The Euro soared in value after Lafontaine's resignation and the ECB in April did reduce interest rates by a half point.

Monetary union also limits the ability of government to pursue high deficit spending as a means of stimulating the economy. This is due to the Stability and Growth Pact, agreed to in June 1997, which prevents countries from increasing their debt to more than 3% of GDP unless they wish to pay substantial fines. The Pact rules out an easing of fiscal policy at a time, even when growth in Germany is falling well below growth in other EU member states.

Not only is the ability of the SPD to pursue traditional macroeconomic policies to deal with unemployment limited, but it is being pushed in the direction of market liberalization and austerity measures by the Commission. The European Commission has recommended that countries reduce their budget deficits and restructure their welfare policies in order to ensure that countries can compensate for the loss of monetary tools. It has told Germany, for example, to reduce its government deficit in coming years by cutting subsidies, transfers to households and government consumption.²⁹ However, this is problematic for Social Democrats, which during the electoral campaign promised to roll back the modest cuts made by the previous government and indeed did so during its first months in office.

²⁶ Sections 3, 12 Federal Bank Act, as quoted in Scharpf, p. 206.

²⁷ Michael Emerson et al., One Market, One Money.

²⁸ Financial Times, February 18, 1999, p. 1.

²⁹ See European Commission, "Commission Recommendations for the Broad Guidelines for the Economic Policies of the States and the Community Members," 11/144/98-N, Brussels, May 6, 1998.
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Economic and monetary union may also increase unemployment in the short term, thereby increasing the burden on the German state. Increased competition and mergers, for example, may result in as many as half of the 166,000 bank branches across the continent may have to close,³⁰ Already in Germany there have been several mergers including one between Bayerische Vereinsbank and Bayerische Hypo-Bank. This consolidation could lead to greater unemployment at a time when Germany is already experiencing substantial unemployment. While unemployment has subsided somewhat from its post-war high of nearly 5 million people or 11.8% in spring 1998, it is still well over 10% and in some eastern German states it is close to 20%³¹ Higher unemployment may force Germany to undertake austerity measures now in order to reduce their deficits so that it can stay within the limits agreed to under the Stability and Growth Pact.

Finally, the increasing liberalization of capital flows makes it more important for the SPD to reassure business interests, a lesson French President Francois Mitterand learned already in the early 1980s.³² The loosening of capital controls and greater integration of markets across Europe and globally makes it easier for firms to move capital, as well as production. It also limits the ability of the government to raise corporate taxes or pursue potentially inflationary policies, which only alarm business and financial markets and may lead them to take their capital investments elsewhere. This then undermines economic growth, which is necessary for the SPD if it is to tackle the problem of unemployment.

In short, economic and monetary union makes it more difficult for the Social Democratic party to pursue traditional economic policies designed to deal with unemployment and serve their working class interests. Instead, the political-economic environment reinforces the need to move toward market liberalization and austerity measures to spur growth.

The Electoral Limitations

While the political economy pushes the SPD to pursue liberalization and economic stabilization policies, these can work against the electoral and governing interests of the party. On the one hand, the SPD has become a catch-all party, which requires it to attract not only working class but middle class voters, in order to wrest control from the center-right Christian Democrats.³³ But the SPD also differentiates itself from the center right through its emphasis

³⁰ "The Euro," Business Week, April 27, 1998, p. 93.

³¹ For example, in Mecklenburg-Vorpommern 18%; Brandenburg 16.6%, Sachsen-Anhalt, 19.4%, and Sachsen 16.5%. See Süddeutsche Zeitung, 8 July 1998, p. 21.

³² See for example Dani Rodrik, Has Globalization Gone Too Far? (Washington, D.C.: Institute for International Economics, 1997) for a discussion of the impact of capital liberalization.

³³ See Otto Kirchheimer 1966.

on maintaining the generous welfare state, which benefits many public sector and working class voters. It also faces substantial competition on the left from the Green Party, which first entered the Bundestag in 1983 and is currently the SPD's junior coalition partner, and the Party of Democratic Socialism (PDS), which is the former communist party of the German Democratic Republic and which entered the Bundestag in 1990. In choosing its economic strategies, it cannot only think about the economic effects but also the political ones.

Being in coalition with the Greens, the SPD has been forced to integrate more leftist concerns about democratization and environmental issues into its policy agenda or risk losing its support. Indeed, in its coalition agreement with the Greens, the government stresses that it will work towards "ecological modernization."³⁴ Such compromises, however, often puts it at odds with its traditional labor union support and risks the loss of more centrist support, as well as alarms the business community.

In addition, the SPD also faces competition from the PDS, which was able to vault over the 5% threshold for the first time at the national level in the last parliamentary elections. The PDS' stronghold has been in eastern German where unemployment in some regions is as high as 21%. The PDS emphasizes the need to reduce unemployment through more traditional Keynesian policies. It also opposes monetary union. The SPD, on the other hand, supported economic and monetary union as a means of promoting growth and jobs.³⁵ Dieter Schulte, the head of the German Labor Union Federation (DGB) said, "We expect positive effects in the labor market (from the Euro). We have profited already from the single market since we have been able, through the removal of trade barriers, to sell more products to our EU partners. The single currency, with the removal of currency fluctuations is likely to improve this even more."³⁶ Similarly, Schröder has argued, "Europe will be less dependent on the fluctuation of the dollar and speculative effects of financial markets."³⁷ The SPD's more centrist economic policies and emphasis on supply-side policies, as well as its support of monetary and economic union, helped fuel support for the PDS during the campaign.

The need to consider partisan competition on the left is not a new issue for the SPD. The party faced difficulties in the 1980s as it increasingly lost votes from younger voters to the Greens. Now that it is in power and in coalition with the Greens it must make some compromises in order to hold the ruling coalition together. However, it must be careful not to alienate labor and centrist support. Moreover, the SPD faces additional difficulties with the new competition from the PDS. The economic problems in eastern Germany are acute and the PDS has been

³⁴<http://www.spd.de/politik/koalition/index.html>.

³⁵ Schröder initially opposed EMU but changed his mind after an SPD candidate for mayor in Hamburg, who ran an anti-EMU campaign, lost soundly.

³⁶ SPD. Vorstand. Globalisierung: Herausforderung und Chance. Bonn: SPD, 1998, p. 17.

³⁷ SPD, Globalisierung: Herausforderung und Chance, Bonn: SPD, 1998, p.17.

successful in exploiting those problems. If Schröder moves too far to the center or fails to adequately address the concerns of east Germans he also risks losing their support.

The Institutional Limitations

A further constraint on the SPD leadership is the institutional framework within which the party operates. As a result of its party organization and its relationship to labor unions, the SPD leadership lacks policy autonomy. In terms of party organization, the party leadership of the SPD has much less centralized authority over its party organization than the British Labor party, making it difficult for the chancellor to shape the party agenda from above. This is the result of Germany's federal structure, the electoral system, and the attempts to democratize the party during the 1970s. The federal character of the country means that regional party associations have substantial power, particularly in choosing candidates for parliament and delegates to the national conventions.³⁸ The representatives of the strongest regional party organizations are often influential in setting the national agenda. The electoral system also contributes to the strength of state party organizations and undermines the ability of the national leadership to autonomously set policy. In the federal election for the Bundestag, the lower house, every voter may cast two ballots -- one for the local constituency candidate, and one for a party list. Who gets to run in which district and who gets on the state's list and how high up on the list they will be placed is determined by activists in the regional (state) party organizations.³⁹ Some regional party organizations are more leftist-leaning than the party leadership. The intra-party organization of the SPD also gives various factions the opportunity to influence the policy agenda. The party has several associations that are affiliated with the party and that recruit members and candidates. These include the Jusos, which represent younger members, and the Association of Workers (AFA). These associations reflect various social and economic interests within the party that are important to the party leadership if it wishes to get elected and stay in power. Moreover, the fact that the party chair and chancellor can be two different people -- as in the case of Willy Brandt and Helmut Schmidt in the 1980s and Schröder and Lafontaine in the 1990s -- while allowing the party to placate various interests within the party also makes it more difficult for the chancellor to set the policy agenda. Thus, Schröder is constrained from pursuing a new economic course because he must find accommodation with the various factions represented in different states and with the party's left.

A second institutional constraint on the party is the power of labor unions. After WWII, the labor union movement in Germany became more unified. It organized workers by industrial sectors into a single national labor union federation, the German Labor Union Federation (DGB), rather than separate ideological unions. The DGB is made up of 17 sectoral unions. While labor unions in Germany organize less than 40% of the German work force, skilled industrial and public service employees are particularly well organized. The German economy is still

³⁸ Braunthal 1983: 29.

³⁹ See Lewis Edinger, West German Politics, (New York: Columbia University Press, 1986).

dominated by its industrial sector and hence unions are still very influential. This makes it difficult for the SPD to free itself from more traditional leftist forces.

Not only is the unionized industrial sector still strong, but the links between the party and the DGB are strong. While the DGB is in theory politically neutral, most union officials are Social Democratic Party members and many hold positions in state and national government. The heads and leading members of the Ministry of Labor, for example, are often from the DGB. And federal ministries, like the Ministry of Labor, often act as spokesmen for their particular interests.⁴⁰ Moreover, many labor union leaders are members of Bundestag. Within the SPD, the DGB also has a voice through the Trade Union Council, which helps ensure better coordination between the SPD and the DGB.

The SPD relies on labor unions for political support and hence the SPD must be conscious of their concerns. Union members have been most concerned about unemployment and social benefits. They support redistribution of income and have resisted restructuring and austerity measures.⁴¹ Labor unions can adversely affect the SPD's political support in two ways. First, labor union members can withdraw their support and abstain from voting for the SPD, which undermines the ability of the SPD to win against center right parties. Second, it can undertake more militant action. Labor unions are guaranteed the right to strike by the German Basic Law. They have tended not to use this much because of their institutionalized influence of labor in Germany and the lack of public support for such strikes. However, as the labor unions are threatened by unemployment and less able to win policy concessions from the SPD, they may use strikes more often to achieve their goals. The Metalworkers Union, for example, pushed earlier this year for a 6% pay hike, despite sluggish growth rates in Germany. Emboldened by the election of an SPD government, the unions argued they needed to make up for the low wage increases they had received in the past few years under the CDU/Liberal government. After a threatened strike, companies agreed to a 3.5% increase, despite protests by the companies that they could not afford such a large increase. This has made Schröder's job of reassuring business interests and solving Germany's unemployment problems more difficult. In short, the institutional framework opens the party to various factions which the limits the ability of the party leadership to autonomously set a policy course. The influence of labor unions, in particular, is quite strong. Moreover, partisan competition on the left also limit the latitude of the SPD to construct a new middle by pursuing economic liberalization policies.

Conclusion

⁴⁰ Edinger, p. 192.

⁴¹ The institutionalized power of the unions within the SPD have allowed unions to support more centrist candidates like Scharping or Schröder during electoral races, even though they might not like their emphasis on market solutions, in part because they know that once in power they could reassert their position.

The first months of the Social Democrats rule in Germany was marked by severe tensions between its various factions. The resignation of Oskar Lafontaine in March, while alleviating some of these tensions, does not solve the German SPD's underlying dilemma. On the one hand, the SPD needs to pursue liberalization and restructuring policies to appease business interests and promote economic growth. On the other hand, if it pursues such policies it risks losing the support of the unions and giving more support to parties like the PDS. It also risk losing the support of its coalition partner -- the Greens.

Indeed, in some ways the resignation of Lafontaine has increased the difficulties for the SPD. Lafontaine acted as a lightning rod for criticism, deflecting criticism from Schroeder. More importantly, Lafontaine helped hold together both the SPD and the SPD-Green coalition. During the election, he kept union support behind Schröder and quelled younger voter opposition to Schröder's candidacy. Once the SPD was in power, Lafontaine placated the leftists within the party including the Jusos and trade union members, with his policy proposals. With Lafontaine out of the picture, groups like the AFA have warned the party leadership that more business friendly policies, like revisions to Lafontaine's tax reform proposals, are unacceptable. They are likely to resist efforts to change the course set by Lafontaine.

Thus, there is no guarantee even with the removal of Lafontaine that Schröder will be able to chart a new course. The move to monetary union and the Stability and Growth Pact constrain his ability to pursue traditional welfare states and Keynesian policies, but he is also politically constrained from undertaking liberalization and austerity measures. If he is unable to move forward with the restructuring of the economy, he may be unable to successfully deal with Germany's sluggish economic growth and will risk losing electoral support from both labor and centrist voters.

Why does Schröder seem to face more difficulties forming a new middle than some of his leftist compatriots like Tony Blair in Great Britain? Part of this has to do with partisan and institutional differences between Britain and Germany. Blair has been able to distance himself from labor far more than in Germany, in large measure because of Thatcher's weakening and fragmenting of the labor union movement during the 1980s. He also has greater autonomy in setting the direction of the party's program since the Britain has a less decentralized party system and he faces no challenge from the left.

There are, however, several ways that Schröder might be able to pursue a new economic course. For one thing, the SPD could seek to form a coalition with the Liberal Party, which would allow the SPD to move in a more centrist direction as it did under Schmidt who undertook austerity measures. However, such a governing strategy could potentially alienate some of the SPD's constituents who might choose then to abstain from voting, vote for the Greens or PDS, or undertake more militant labor action. Second, as a result of recent state elections in Hesse, the Social Democrats and Greens lost their majority in Germany's upper house, the Bundesrat. This may make it easier for Schröder to pursue a more centrist economic policy, since he will need the support of Christian Democrats in the Bundesrat to get policies passed. Indeed, on the changes to immigration and citizenship laws the SPD was forced to

compromise in order to get legislation through the Bundesrat. Third, Schröder has also been helped by the ECB decision to cut interest rates by one half point in April. In announcing the move, which took many analysts by surprise, ECB president Duisenberg said that the move is a signal to government to pursue restructuring policies.⁴² Indeed, the ECB is likely to take much of the criticism for the slow growth in Europe.

But while these recent events may encourage Schröder to pursue liberalization and restructuring measures, he is still faced with substantial institutional opposition. The only way to overcome the resistance of the labor union and New Left opposition to his policy proposals is through institutional change. Only by restructuring institutions in a way as to grant the party leadership more autonomy and that demobilizes or coopts leftist interests in the party will the Chancellor be able to set a more moderate course. This will be difficult because the states in Germany will seek to guard their positions as will the unions as they become increasingly threatened by changes in the political-economic environment. Thus, the SPD remains caught with limited maneuvering room between the need to restructure and liberalize in response to new economic changes and the institutional constraints of the party.

⁴² Financial Times, April 9, 1999.

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Appendix**Table 1****Bundestag Election, 27. September 1998**

	% Vote	Seats
SPD	40.9	298
CDU	28.4	198
CSU	6.7	47
Bündnis 90/Grün	6.7	47
FDP	6.2	43
PDS	5.1	36