

# Contents

<i>List of Tables and Figures</i>	xi
<i>Preface</i>	xiii
<i>Notes on Contributors</i>	xiv
<i>List of Abbreviations</i>	xix
<i>Glossary</i>	xxi
<b>Introduction</b>	<b>1</b>
From sick man of Europe to economic powerhouse	2
Explaining the reform miracle	4
Withstanding the global economic crisis	5
The political context	6
Partisan de-alignment and electoral volatility	7
Political protest and the ‘angry citizen’	8
Party system fragmentation	9
Political leadership	10
Germany’s shrinking European vocation	11
Germany and the eurozone crisis	12
Foreign and security policy	14
<b>1 Government at the Centre</b>	<b>16</b>
<i>Christian Stecker and Klaus H. Goetz</i>	
The federal government in context	17
Inside the federal executive	23
Chancellor, chancellery, party and coalition	30
What future for the centre?	32
<b>2 The Reform of German Federalism</b>	<b>35</b>
<i>Charlie Jeffery and Carolyn Rowe</i>	
The evolution of Germany’s federal system	35
Uniformity in diversity	37
The need to reform German federalism	40
The first federal reform commission	42
The outcome of the First Federal Reform Commission	45
Taking forward the reform agenda: the new grand coalition	46

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The second set of federal reforms: tackling financial relations	50
Understanding non-reform: the two faces of German federalism	53
Conclusion	55
<b>3 Partisan Dealignment and Voting Choice</b>	<b>57</b>
<i>Russell J. Dalton</i>	
The erosion of traditional party loyalties	59
From habituation to voter choice	64
The changing basis of electoral choice	66
The two German electorates	75
<b>4 Parties and the Party System</b>	<b>78</b>
<i>Margret Hornsteiner and Thomas Saalfeld</i>	
The party system: an overview	79
Growing fragmentation and less reliable voters	84
A shrinking party on the ground	88
Organizational reform	91
Leadership change and policy reforms	93
The stability of the party in government	98
Conclusion	101
<b>5 Political Leadership</b>	<b>103</b>
<i>Ludger Helms</i>	
The institutional parameters of executive leadership	104
Patterns of leadership selection	106
Assessing leadership performance	107
The presidentialization of political leadership	108
Conclusion	116
<b>6 The Politics of Social Protest</b>	<b>118</b>
<i>Dieter Rucht</i>	
Patterns and trends in the social movement sector	119
Reactions to and impacts of protest politics	127
Comparative aspects and outlook	130
<b>7 The German Model in Transition</b>	<b>133</b>
<i>Anke Hassel</i>	
Fundamental features of the German model	134
Continuity and change in the German model	137
The German model and the great recession	141

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The German model and the crisis of the eurozone	143
Conclusion	146
<b>8 Economic Policy</b>	<b>149</b>
<i>Reimut Zohlnhöfer</i>	
Germany's economic problems at the turn of the century	151
The German 'economic policy reform miracle': adopting Agenda 2010 and beyond	153
The German response to the financial crisis	159
Back to normal? The economic policy reforms of the Christian–Liberal government since 2009	162
Conclusion	164
<b>9 Germany and the European Union</b>	<b>166</b>
<i>William E. Paterson</i>	
The European context	166
From reflexive multilateralism to reluctant hegemon	167
Tremors but not (yet) an earthquake	169
Merkel's European policy	171
The changing parameters of domestic politics	173
Changing bilateral relations	180
Managing the euro crisis	183
Conclusion	185
<b>10 Germany and the Euro</b>	<b>188</b>
<i>Andreas Busch</i>	
Monetary integration in Europe: a brief primer	189
Germany and the euro	190
Conflicts about the common currency	191
The German experience with the euro since 1999	194
The euro crisis after 2010	200
Analysing the German response	203
Conclusion	208
<b>11 Foreign and Security Policy</b>	<b>211</b>
<i>Alister Miskimmon</i>	
Germany in the EU and NATO	212
Germany's changing security environment	214
Libya and Germany's commitment to multilateral crisis management	221
Germany on the global stage	224
Conclusion	225

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<b>12</b>	<b>Welfare State Reform and Social Policy</b>	<b>227</b>
	<i>Martin Seeleib-Kaiser</i>	
	Historical overview	227
	Pension and labour market reforms	229
	Family policy reforms	233
	Socio-economic outcomes	234
	Drivers of change	235
	Conclusion	240
<b>13</b>	<b>Energy and Climate Protection Policy</b>	<b>241</b>
	<i>Stephen Padgett</i>	
	Climate protection and energy: trends and targets	242
	Policy context	246
	Energy security	249
	Sustainability	252
	Economic efficiency/affordability	257
	Managing the <i>Energiewende</i>	258
	Conclusion	259
<b>14</b>	<b>Citizenship, Migration and Cultural Pluralism</b>	<b>262</b>
	<i>Simon Green</i>	
	Historical background	263
	The reassessment of labour migration	265
	The quest for integration and citizenship	268
	Ethnic Germans, asylum and family reunification	275
	Conclusion	276
	<i>Guide to Further Reading</i>	279
	<i>Bibliography</i>	284
	<i>Index</i>	323

# Introduction

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REIMUT ZOHLNHÖFER

This new fourth edition of *Developments in German Politics* coincides with a critical juncture in the European economy and politics in which Germany occupies centre stage. The eurozone crisis of 2010–11 was stabilized by the pledge of the European Central Bank to do ‘whatever it takes’ to save the euro and its actions in buying distressed eurozone members’ sovereign bonds. Many of the underlying problems, however, remain unresolved. Growth in the southern periphery countries remains low; public and private debt is still too high; and the disparity in competitiveness between north and south is undiminished. The eurozone is thus at a crossroads. The problems are complex, and there are no straightforward solutions, but most are agreed that without decisive action the eurozone faces an uncertain future of muddling through from crisis to crisis as distressed economies struggle with debt.

Germany’s export-led economy benefits greatly from the euro, and ‘fixing’ the eurozone is its central foreign policy concern. One approach would be to deepen financial integration between eurozone countries, perhaps leading ultimately to a banking and fiscal union. The dilemma for Germany is that sharing responsibility for eurozone banks and fiscal policies entails sharing the attendant risks. As Europe’s largest and strongest economy, it could find itself underwriting the insolvent banks and sovereign debt of its eurozone partners. For Germany, a European *fiscal* union could mean a *transfer* union in which it was permanently responsible for subsidizing the poorer eurozone periphery. The terms of European banking and fiscal policy integration, and its institutional architecture, are therefore subject to deep differences between Germany and its partners, and are becoming increasingly evident in domestic political discourse.

Differences of perspective over the management of the euro crisis and the future of the euro have created political tensions across the eurozone and in Germany. The southern periphery countries suffer from ‘austerity fatigue’, engendering anti-European sentiment and political instability that put pressure on beleaguered governments struggling to fulfil the terms of bailouts. For its part, Germany suffers from an incipient ‘bailout fatigue’. Under Chancellor Angela Merkel’s Christian–Liberal coalition

## 2 Introduction

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(2009–13) cross-party and public support for German participation in bailouts for Greece, Portugal and Spain was conditional on their being accompanied with tough austerity packages. In 2013 this consensus was breached by a new party, the *Alternative für Deutschland* (Alternative for Germany), which stood for respect of the ‘no bailouts’ clause in the European Union (EU) treaty and for new flexibility for countries to leave the euro. And whilst Merkel’s 2013 election campaign emphasized solidarity with poorer EU partners, and Germany’s economic interest in stabilizing the euro, it also defined a limit – in the form of ‘no eurobonds’ – beyond which she would not go in the interests of European financial integration. So the expectation of Germany’s EU partners that a new Merkel government would be more amenable to the consolidation of the euro is unlikely to be fully realized. The new coalition partner, the SPD, basically accepted the position of the previous government on the eurozone.

### **From sick man of Europe to economic powerhouse**

The German political economy is inextricably linked with the crisis of the euro. As Andreas Busch shows in Chapter 10, the current account deficits that lie at the heart of the sovereign debt crisis in the eurozone periphery countries has been fuelled in large part by the competitiveness of the German export economy. This crisis in turn will have important consequences not only for Germany’s role in Europe but also for German economic policy. As Europe’s largest and strongest economy Germany will have to carry the bulk of any financial burden of any bailouts that become necessary, and this will put severe strain on government finances.

This situation could hardly have been anticipated in 2003, when Germany languished as the ‘sick man of Europe’. Its economic woes were reflected on almost every relevant indicator. Unemployment remained stubbornly high, growth was low and the budget deficit exceeded the limit of 3 per cent of GDP set by the EU’s Stability and Growth Pact in four consecutive years between 2002 and 2005. Many observers doubted Germany’s ability to recover its economic health. Two reasons were given for this pessimism. First, the German political system seemed unable to produce significant reform. The governing parties at the time, particularly the Social Democratic Party (SPD), were torn between rival factions that disagreed on most aspects of economic and social policy. What is more, electoral competition deterred parties from the kind of unpopular reforms that experts deemed necessary to revive the German economy.

And the *Bundesrat* (second chamber of parliament) was under the control of the opposition, giving it a veto over reforms. Given this state of affairs, many observers believed it to be extremely unlikely that major reforms would be forthcoming (König et al., 2003: 105).

Second, the German variety of ‘organized capitalism’ with its focus on centralized wage bargaining, patient capital (i.e. long-term financing of businesses via house banks) and cooperative interfirm relations was seen as doomed. The very foundation upon which the post-war German economic model rested was thus in danger. Wolfgang Streeck (2009a: 96) in particular argued that German capitalism was in a process of ‘disorganization’, understood as ‘a decline in centralized control and authoritative coordination in favor of dispersed competition and spontaneous ... individualized decisions’. Streeck and Hassel (2003) spoke about ‘the crumbling pillars of social partnership’; shareholder value gained in importance as capital became less patient; ties between companies loosened; and trade unions and employer organizations weakened. Thus, the viability of the German model was questioned by many authors (see Busch, 2005).

Yet, ten years later, things seem to have changed fundamentally. Germany has adopted a number of substantial reforms in all relevant areas of economic and social policy, as Reimut Zohlnhöfer and Martin Seeleib-Kaiser show in Chapters 8 and 12. Corporate tax rates have been reduced quite substantially, ending (for the time being) a 20-year-long debate. Although the business tax rate is still not below the EU average, it is at least not far above average any more, as it had been for a very long time. Pensions have been reduced and the pension age increased. Moreover, family policy has been reformed extensively with an earnings-related benefit for parents staying at home to take care of infants during the first year after birth, and a legal right for a child’s place in day care from age one. These reforms aim at an increase of labour force participation of young mothers in particular and depart very clearly from the traditional German male-breadwinner/female-caregiver model. The comprehensive Hartz reforms of the labour market head in a similar direction. By substantially reducing benefits for the long-term unemployed, tightening the conditions under which unemployed persons can reject a job offer, and making low-wage employment more attractive the government has tried to boost labour market participation. Again this is a departure from the traditional path of coping with unemployment in Germany via early retirement and disincentives for female labour market participation. Finally, the German government responded to the financial crisis that started in 2007 in an unprecedented manner, as it adopted bank rescue measures and stimulus packages of volumes previously unheard of in the Federal Republic.

## 4 Introduction

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These reforms seem to have worked. Observers now refer to the German ‘employment miracle’ (OECD, 2012a: 10; Reisenbichler and Morgan, 2012). The German economy and the labour market in particular have weathered the multiple crises since 2007 remarkably well. Unemployment is lower and employment higher in 2013 than they were before the crisis. Thus, Germany has outperformed many of its peers in the last half-decade.

### **Explaining the reform miracle**

How can this outcome be explained in the light of the allegedly institutionally induced reform gridlock and the disorganization of German capitalism? Institutional reform, more precisely the reform of federalism, could provide one answer to this question. As Charlie Jeffery and Carolyn Rowe discuss in much more detail in Chapter 2, the *Bundestag* and *Bundesrat* set up a commission in 2003 to work out proposals for a reform of the federal system. The main aim of this first reform commission was to reduce joint decision-making. This meant that on the one hand the *Länder* were to be given more competences for which they would be responsible on their own, while on the other hand the number of bills for which approval of the *Bundesrat* was necessary was to be reduced. After intricate negotiations the reform which turned out to be the most extensive reform of the federal constitution to date was finally adopted in 2006 (a second part dealing with financial issues was adopted in 2009).

Although the reform of federalism did reduce the number of bills needing *Bundesrat* approval, there are two reasons why it cannot explain economic policy and welfare reforms. First, most of these reforms, e.g. the Hartz labour market reforms, were adopted before the reform of federalism had come into effect. So for them, the old rules applied. Second, *Bundesrat* approval remained necessary for most key decisions in the area of economic policy and the welfare state. For example, almost two out of three of the most important economic and social policy reforms that were adopted under the 2005–09 grand coalition of the Christian Democratic Union/Christian Social Union (CDU/CSU) and the Social Democratic Party (SPD) needed the approval of the *Bundesrat* (Zohlnhöfer, 2011). Therefore, the reform of federalism can certainly not solve the puzzle of the German ‘reform miracle’ between 2003 and 2007.

So why were comprehensive reforms possible? Why did the constellation of a government led by the Social Democrats and a second chamber controlled by the bourgeois opposition not lead to deadlock as predicted? In Chapters 8 and 12, Zohlnhöfer and Seeleib-Kaiser point to two inter-



related factors. First, the problems in the economy and the welfare state were so serious that it was impossible for policy-makers to deny or ignore them. Second, the two main parties' perceptions about the reasons for the dismal economic performance began to converge at the beginning of the new decade. The CDU and the liberal Free Democratic Party (FDP) had already argued in the mid-1990s that Germany's high statutory tax rates and the ever-growing burden of the welfare state impaired competitiveness. While still in government at the end of the 1990s, the CDU/CSU and FDP therefore tried to reform (business) tax and all relevant social security programmes. The SPD, however, did not (yet) agree with this diagnosis. Consequently they blocked those reforms that needed the approval of the Bundesrat, and revoked the rest of the reforms after the change of government in 1998. Only after the failure of their attempts to reduce unemployment through demand management (Zohlnhöfer, 2004) did Chancellor Schröder eventually initiate the Hartz labour market reforms. Given their programmatic convergence it was no surprise that the grand coalition of CDU/CSU and SPD (2005–09) essentially continued on that reform path.

### **Withstanding the global economic crisis**

When the financial crisis hit Germany in the autumn of 2008, these two parties also managed to respond reasonably fast to what turned out to be the deepest recession in the history of the Federal Republic. Although the bank rescue packages and stimulus programmes were far from coherent – reflecting at least in part some remaining partisan differences – Germany recovered remarkably fast from the recession. The increase in the country's debt between 2007 and 2012 remained far below the OECD average. At the same time, unemployment actually fell from 8.7 per cent in 2007 to 6.0 per cent in 2011 – in sharp contrast to countries like the UK or the USA where there was a steep rise in joblessness.

This impressive employment performance has spurred talk about a German miracle. It's a miracle, however, that can be explained. The labour market reforms of the early 2000s as well as emergency responses to the great recession have clearly played their part in mitigating the employment effects of the crisis. But, as Anke Hassel shows in Chapter 7, firm-level cooperation was also important. Indeed, some would argue that this is the crucial factor in explaining recent German employment performance. Rather than undermining the viability of the German model, the process of disorganization has enabled firms to make use of 'internal flexibility instruments' (Reisenbichler and Morgan, 2012: 559). These instruments boosted firms' competitiveness prior to the crisis and

## 6 Introduction

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allowed them to hoard labour rather than letting employees go when the crisis hit. Hoarding labour was a rational thing to do in the German variety of capitalism since it spared them the need to look for highly skilled workers once the crisis was over. Thus, as Hassel argues, the crisis has shown that the liberalization and disorganization of the German economy are shaped by the characteristics of the old German model, which is thus unlikely to converge on an Anglo-Saxon model of capitalism anytime soon.

Nonetheless, although labour market reforms may have boosted German employment performance, they have also caused new problems which need to be addressed. First, as Seeleib-Kaiser shows in Chapter 12, liberalizing reforms have led to a substantial increase of ‘atypical’ and low-paid work and consequently to a rise in inequality and poverty in Germany over the past 15 years – although poverty is still way below American levels. The grand coalition government which came to power after the 2013 election has agreed to introduce a general minimum wage and to take action to fight the poverty of certain groups, in particular pensioners. Second, the problem of demographic change needs to be addressed in the near future. The increase in the statutory pension age will be phased in until 2029 but is very likely not to be sufficient. Similarly, the remarkable changes in family policy have not (yet) resulted in increasing fertility rates. Although net immigration helps mitigate the situation it is likely that any future government will have to deal with the diverse problems of demographic change. If Germany is burdened with supporting the distressed countries of the eurozone, it will make it more difficult to solve the newly arising problems of inequality and to invest in infrastructure and education as the two most important assets of Germany’s political economy.

### **The political context**

The capacity of political parties and their leaders to meet the challenges of reforming the economy, regaining international competitiveness, containing the costs of the welfare state and managing the crisis in the eurozone depends in large part on the political context. In many ways the political landscape is becoming more difficult for policy-makers. As Russell Dalton shows in Chapter 3, the weakening of traditional ties between citizens and parties means that voting behaviour continues to become more fluid and volatile. This is reflected in an increasingly fragmented party system, with a decline in the two large catch-all parties and an increase in support for smaller parties mobilizing around particular issues. Political leaders are thus less able to shape the political agenda and have to be more

attentive to public opinion on issues like the environment, nuclear power, social justice and European integration. Yet despite these trends, government has remained remarkably stable, due largely to the cartel-like behaviour of the main political parties, an elite consensus on the main lines of policy, and the leadership skills of Chancellor Merkel in reconciling elite consensus with public opinion.

### **Partisan de-alignment and electoral volatility**

‘Partisan de-alignment’ refers to a weakening of the ties between political parties and their voters. Traditionally, social class and religion created enduring alliances between social milieu and parties that shared their political vision. Social status was thus central to political identity and electoral choice, with the Ruhr steelworker voting predominantly for the SPD and the middle-class Catholic supporting the CDU/CSU. Widespread affluence and social security, however, and the disengagement of large sections of society from church activity, has eroded these ties. Whilst religious activity remains a guide to political loyalty, fewer voters are church-going. And although social class is still a factor in electoral choice, class boundaries are less clearly defined, and there are fewer manual workers in the old industrial sectors. Consequently, more and more voters lack the sense of social group identity which structures electoral choice.

The decline of old electoral alignments is compounded by the emergence of new cultural conflicts surrounding globalization and cross-border migration. Global economic competition creates winners (skilled professionals able to compete in international markets) and losers (the unskilled in sectors that are vulnerable to competition). Whilst the former embrace liberal cosmopolitan values, the latter retain a strong sense of national identity, which shapes their attitudes towards issues like immigration and multiculturalism. Most mainstream party elites tend towards cosmopolitanism, which alienates more traditionally oriented voters.

The erosion of long-term party preferences engendered by social group belonging or individual party attachment has changed the basis of electoral choice. Although some people still vote for the same party at election after election, an increasing number of them now approach each election with an open mind. Choice depends on voters’ perceptions of party competence in confronting the issues they regard as important, or their perceptions about chancellor candidates. Increasingly, these judgements are made during the election campaign. The last three elections (2005, 2009 and 2013) have seen a steady increase in the percentage of ‘late

deciders', some leaving it as late as the actual election day. There has also been an increase in the percentage of people switching votes between parties from one election to the next. In 2009 around 25 per cent of voters reported switching party. Moreover, an increasing percentage of people now split their vote between parties (Germans have two votes: one for a constituency candidate and one for a party list). These tendencies point towards a more sophisticated, informed electorate exercising choice rather than following habit.

### **Political protest and the 'angry citizen'**

The weakening of links between voters and parties is reflected in the rise in the politics of protest, articulated outside the party arena through protest movements. As Dieter Rucht shows in Chapter 6, Germany is a very active 'movement society' with a high volume of protest mobilization (Berlin alone has around 4,000 protest events annually). Protest movements fill gaps in the party system, mobilizing the *Wutbürger* ('angry citizen') who demands a say on issue positions that are not represented by the political parties. Rucht identifies four types of protest. First, there are new social movements – left liberal groups promoting human rights; citizen participation; peace and disarmament; women's, gay and lesbian rights; environmental protection; and opposition to nuclear energy. A second type of social protest focuses on labour, welfare and social security. Traditionally mobilized by trade unions, this type of protest now embraces a wider range of activists in welfare organizations and the global justice movement, targeting welfare cuts, minimum wages, working conditions and unemployment. A third set of protest movements is located on the radical right, motivated by xenophobia and opposition to immigration. Fourth, there is a disparate category of ad hoc or 'pop-up' groups that form around specific issues, such as airport runway extensions (Frankfurt, Munich and Berlin) and the construction of a massive new railway station complex in Stuttgart.

Some of these protest movements have entered the party system, challenging the dominance of the old established parties. The Greens are a classic example of the 'challenger party', emerging from the peace and environmental movements in the 1980s, becoming established in the party system and entering government between 1998 and 2005. More recently, the *Linke* (Left Party) emerged in 2007 out of a merger between the Party of Democratic Socialism (PDS) – until then confined to eastern Germany – and a west German movement of opposition to welfare cuts and labour market reform. The *Piratenpartei* (Pirate Party) sprang from the movement for internet freedom and digital privacy in 2009. And in

2013, the *Alternative für Deutschland* (Alternative for Germany) was formed as a reaction against German participation in bailouts for distressed eurozone countries. Movements such as these that capture the attention of the media and have the potential to affect voting behaviour can put political leaders on the defensive. A dramatic example of this was Chancellor Merkel's U-turn over nuclear energy in 2012, reversing her previous decision to prolong the life of Germany's nuclear power plants in the face of massive protests fuelled by the Fukushima catastrophe.

## Party system fragmentation

As a consequence of partisan de-alignment and the rise of protest parties, the German electorate – once the model of stability – is now subject to increasing volatility. In the 1980s and 1990s the party system consisted of two relatively stable blocs: first, the CDU and its Bavarian sister party the CSU along with the FDP on the Right; second, the SPD and the Greens on the Left. Within these blocs the two large *Volksparteien* (people's parties) – the CDU/CSU and SPD – were heavily dominant, acting as the pillars of the system. Despite a long-term decline from their high point in the 1970s, the *Volksparteien* together still accounted for around 75 per cent of the vote in the 1990s and early 2000s. Their decline has accelerated sharply since then, however, reaching an all-time low of 56 per cent in 2009 before recovering to 67 per cent in 2013.

*Volkspartei* decline has been notably asymmetrical. Whilst the CDU/CSU share of the vote has declined steadily over the last three decades, it retained about 35 per cent of the vote between 1998 and 2009. Its recovery to 41.5 per cent in 2013 shows that *Volkspartei* decline is not an immutable law, and that given favourable circumstances – a flourishing economy and a popular leader – a party can buck the trend. The SPD, on the other hand, has been unable to recover from the electoral haemorrhage it suffered in 2009, and it is now confined to an electoral ghetto at around 25 per cent. Its decline can be seen as the legacy of Chancellor Schröder's programme of welfare cuts and labour market reform in the early 2000s, the main losers from which were the party's core electorate of blue-collar workers. Subsequent attempts by the SPD to disassociate itself from Schröder's legacy have lacked credibility.

The corollary of this pattern of *Volkspartei* decline is the rise of small parties, and in particular the rise in support for 'outsider' parties like the Left Party, the Pirate Party and the Alternative for Germany. Of these, only the former has succeeded in attaining the 5 per cent of the vote required to enter the *Bundestag* (parliament), though this is sufficient to exert a debilitating effect on coalition-building, since it 'robs' the SPD and

Greens of seats required to build a coalition of the Left. And whilst the Alternative for Germany narrowly failed to win seats in the *Bundestag* in 2013, its votes were decisive in squeezing the FDP below 5 per cent, thereby depriving the centre right of a majority. In short, the decline of the *Volksparteien* along with increased support for small outsider parties has led to a weakening of the two-bloc party system. Two of the last three elections have seen both the centre-right and centre-left blocs falling short of a government majority, resulting in grand coalitions between the CDU/CSU and the SPD.

Yet despite the decline of the main political parties, and party system fragmentation, German government has remained relatively stable, compared to other European countries. In the last three decades, only one government (that of 2002–05) has ended prematurely. Moreover, the Grand Coalition of 2005–09 worked smoothly and effectively, and a majority of Germans (52 per cent) in 2013 saw a grand coalition as their preferred government outcome. Margret Hornsteiner and Thomas Saalfeld in Chapter 4 account for this paradox with the concept of a ‘party cartel’. On critical political issues the mainstream parties tacitly agree not to disagree, and thus to maintain a consensus that supports governments formed across the left–right blocs.

## **Political leadership**

Another explanation for government stability in the face of party system fragmentation may be found in the quality of political leadership. As Ludger Helms notes in Chapter 5, in turbulent times democratic regimes are in desperate need of leadership. Angela Merkel’s leadership style does not conform to the usual model of a strong leader with charisma and a visionary policy agenda. On the other hand, it may be argued that her rather ‘unheroic’ policy style is well adapted to dealing with complex and difficult issues in a world of uncertainty. Eschewing the certainties of ideological policy agendas, she favours a pragmatic approach to policy-making, weighing all sides of an issue before coming to a decision. She is also adept at compromise, which is an asset in grand coalition governments. These qualities – along with her instinct for keeping in touch with public opinion – have enabled her to establish a personal popularity extending well beyond her own party. In the election of 2013, 60 per cent of Germans preferred her as chancellor over her SPD rival. Merkel’s policy style is criticized by some as reactive and hesitant, citing her tardiness in committing Germany to measures to stabilize the euro. Her cautious incremental approach, however, may be the best way to persuade reluctant Germans to assume the burdens of eurozone hegemony.

# Index

- absolute majority 17–18, 21, 36, 182  
*Abwrackprämie* (scrapping bonus) 160  
 Ackermann, Josef 184  
 Anti-Counterfeiting Trade Agreement (ACTA) 123  
 Adenauer, Konrad 13, 16, 1820, 30, 101, 107, 111, 173–4, 280  
 Afghanistan 30, 211, 215, 218–19, 275  
 Agenda 2010 31, 115, 117, 137, 153, 156, 198, 204  
 ‘Alliance for Jobs, Innovation, and Justice’ 198  
 ‘Alliance for Jobs, Training and Competitiveness’ 155  
*Alternative für Deutschland* (AfD) 2, 9–10, 69–70, 77, 80, 82, 95–6, 179, 206, 209  
 Altmeier, Peter 179, 251, 259  
 Ashton, Catherine 224, 225  
 Asmussen, Joerg 178  
 asylum 122, 125, 129, 170, 263–5, 275–7  
 atypical work 6, 227, 234  
*Ausländergesetz* (Foreigner’s Law) 263, 269  
 austerity 1–2, 153, 180–1, 183, 203, 205, 209, 220, 226  
 Australia 267  
 Austria 130, 143, 185, 196, 199  
 Baden Württemberg 38–9, 51, 54, 81, 83, 89, 98, 193, 256  
 Bahr, Daniel 112  
 bailout 1–2, 9, 18, 51–2, 149, 165  
 bank rescue package 5, 160–1  
 Barroso, José Manuel 14  
 BASF 249–50  
 Basic Law/ German Constitution 12, 16, 21, 23, 26, 27, 36, 42, 47–8, 52, 55, 104, 112, 158, 176–7  
 Bavaria 9, 38–40, 43–4, 54, 59, 80–1, 89, 110, 163, 179, 239  
 Belgium 196, 199  
 Berlin 8, 30, 38–9, 51–3, 71, 73, 84, 89, 118, 121, 126, 128, 173, 179–80, 182–3, 191, 212, 214, 221–5, 242, 273, 277  
 Berlin Wall 11, 30, 191, 243–4, 259  
*Betreuungsgeld* (Parenting Benefit) 163  
 Bismarck, Otto von 135, 227, 228  
 Blair, Tony 107, 173, 182  
 Böhmer, Maria 270  
 Brandenburg 38–9, 51  
 Brandt, Willy 19–20, 30, 111  
 Bremen 38–9, 51–2, 89  
 BRICS 224  
 Brüderle, Rainer 112  
 Brussels 22, 167, 170, 173, 183  
 Bulgaria 267, 276  
*Bundesbank* 12, 13, 21, 24, 176, 177–8, 181, 186, 190–2, 205–8  
*Bundesrat* 3–5, 21, 23, 25, 28, 32, 36–9, 41–2, 44–9, 51–2, 55, 105, 152–3, 158, 162, 251  
*Bundestag* 4, 9, 10, 17–19, 31–4, 41–7, 49, 51, 58, 60, 64, 65, 67, 70, 72, 79, 81–3, 86, 95, 98–101, 105–7, 110, 113–17, 157–63, 177, 179, 184, 193, 198, 204, 206, 209, 225, 237, 271, 274  
*Bundeswehr* 213, 214, 218–22, 226, 266  
*Bürgerdialog* (citizens’ dialogue) 91  
*Bürgerkonvent* (citizens’ convention) 92  
 Bush, George W. 211, 217, 224  
 Cabinet 16, 19, 23–5, 27–9, 90, 95, 98–9, 104, 109–12, 255  
 Cameron, David 183  
 Canada 267–8, 270  
 capitalism 3–4, 6, 60, 119, 131, 134–7, 237  
 cartel party 78, 92  
 catch-all party 6, 26, 30, 78  
 Chancellery 22–4, 28, 30–3, 106, 111–13, 115, 156, 270  
 Chancellor 1, 5, 7, 9–11, 13–14, 16–20, 23–8, 30–4, 47, 50, 58, 67, 72–4, 83–4, 97–8, 103–17, 134, 149, 152, 154–7, 161–2, 164, 168–76, 178–9, 181–6, 189, 191, 193, 198, 201, 203–9, 211, 216, 225–7, 237–9, 250, 252–3, 255–6, 259, 261, 264, 273, 277  
 Chancellor Democracy 30–1, 33, 107  
 childcare 233–9  
 China 211, 215, 222, 224–5  
 Chirac, Jacques 167, 172, 182, 183  
 Christian Democratic Union (CDU) 4–5, 7, 9–10, 18–22, 24, 26–7, 30, 32, 34, 44, 46–7, 51, 57, 59, 61, 64, 67–9, 71, 73–7, 79–86, 88–91, 93–8, 101, 106, 110, 113, 116, 157–8, 162, 172, 179, 207, 209, 214, 239, 248–9, 253, 256, 259, 264–7, 271–2, 274, 277

- Christian Democratic Union (CDU) (*cont.*)  
 elections 7, 9, 18, 20, 59, 67–9, 74–7,  
 80, 85, 110, 158  
 ideology 70–2, 79, 80–1, 93–8, 277  
 membership 88–90  
 organization 91  
 policies 5, 67, 93, 116, 152, 157–8,  
 160–3, 179, 207, 214, 237, 239, 248,  
 256, 259, 265–6, 272, 277
- Christian Social Union (CSU) 4–5, 7, 9–10,  
 18–22, 24, 26–7, 32, 34, 44, 46–7, 51,  
 59, 61, 64, 67–9, 71, 73–6, 79–81,  
 83–6, 88–90, 93–8, 101, 110, 113,  
 116, 157–8, 162–3, 172, 179, 206–7,  
 209, 214, 248, 156, 164–5, 167, 272,  
 274, 277  
 elections 7, 9, 18, 20, 59, 67–9, 74–7,  
 80, 85, 110, 158  
 ideology 26, 70–2, 79, 80–1, 93–8, 277  
 membership 88–90  
 policies 5, 67, 93, 116, 152, 157–8,  
 160–3, 179, 207, 214, 237, 248, 256,  
 265, 272, 274, 277
- Citizenship Law 264, 268, 272–3  
 Clement, Wolfgang 238  
 Cold War 40, 83, 211–17, 220, 228  
 collective bargaining 135, 137–8, 198, 239  
 Cologne 77, 121  
 Common Agricultural Policy (CAP) 166,  
 167  
 Common Foreign and Security Policy (CFSP)  
 212–26  
 Common Security and Defence Policy (CSDP)  
 217, 219, 222  
 competitiveness 1–2, 5–6, 143–6, 155, 165,  
 183–4, 190, 198, 200, 202–3, 229,  
 236, 249, 252–3, 260  
 Coordinated Market Economies (CME)  
 135–6, 146  
 Council of Europe 22  
 Crisis, Debt 2, 106, 188  
 crisis, economic 5, 18, 20, 22, 31, 149,  
 159, 164, 203, 227, 232  
 crisis, euro 1, 149, 162, 163, 165, 183,  
 204, 207  
 crisis, financial 3, 5, 33, 52, 133–4, 141–2,  
 144, 146, 149–51, 154, 159–61, 165,  
 211, 220, 256, 267  
 current account deficits/surpluses 144, 165,  
 203  
 Cyprus 180  
 Czech Republic 166, 172, 184, 185
- deadlock 4, 40–1, 253  
 debt brake 52, 55  
 Delors, Jacques 177, 191  
 De Maizière, Thomas 24, 170  
 democracy 30–1, 33, 39, 42, 55, 69, 81,  
 83–4, 106–7, 121, 123–4, 131–2,  
 206
- demographic change/ development/ reasons  
 6, 35, 89, 133, 140, 148, 237, 266,  
 268, 278
- Deutsche Islam Konferenz* (German Islam  
 Conference) 270, 274  
 Deutsche Partei (DP) 18–19  
 Deutschmark 175, 190–4, 200, 208  
*Deutscher Gewerkschaftsbund* (Federal  
 Trade Union Federation) 121  
 disarmament 8, 120  
 Dobrindt, Alexander 24  
 Draghi, Mario 184, 185, 208  
 dual citizenship 264, 269, 271, 272, 278  
 Dualization 139, 146, 147, 231
- Economic and Monetary Union (EMU)  
 144, 194, 197, 201–10  
 Edathy, Sebastian 112  
 education (policy) 6, 24, 36, 45, 48–9, 69,  
 135, 139, 209, 228–39, 249, 278
- Einspruchsgesetz* (Bill Not Needing  
 Bundesrat Approval) 21  
 election 2, 6–8, 10–11, 13–16, 18–21,  
 26–7, 30, 34, 41, 44, 46, 49–50,  
 57–60, 62–76, 79–87, 91–2, 96–8,  
 105–7, 109, 113–14, 116–17, 153,  
 155–8, 162, 164, 172–3, 179, 181–4,  
 186, 193, 198, 206–7, 209, 211, 213,  
 223, 225, 237–9, 248, 251, 253, 256,  
 260, 264–5, 271–2, 274, 277
- Electoral Alternative for Labour and Social  
 Justice (WASG) 84  
 electoral-professional parties 78, 90  
 employment 3–6, 39, 69, 133, 136, 139,  
 142, 145, 147, 153, 155, 158, 183,  
 200, 227–9, 234–5, 237–40, 248
- Energiewende* (Energy Transformation)  
 123, 242, 245, 248, 254, 258–61  
 Eon 248–50  
 Erhard, Ludwig 19–20, 30, 107, 111  
*Erststimme* (First Vote) 65  
 EU enlargement 12, 166–7, 169  
 euro 1–2, 10, 18, 22, 82, 95, 144, 149,  
 161–5, 174–5, 183–4, 188–210,  
 229  
 eurobonds 2, 13, 179, 186, 207, 209  
 European Central Bank (ECB) 151, 177,  
 178, 184, 185, 186, 190, 192, 194,  
 197, 202, 203, 205, 206, 208  
 European Commission 14, 142, 253, 258  
 European Constitutional Court 105  
 European Council 145, 172–3  
 European Court of Justice (ECJ) 12, 176,  
 177, 186  
 European Financial Stability Facility (EFSF)  
 202, 204, 205  
 European Fiscal Compact 202, 207  
 European integration 7, 11, 12, 22, 31, 80,  
 95, 105, 173, 175, 178–80, 191, 193,  
 206, 209, 212, 216



- Europeanization 22, 35, 95, 140, 150, 170, 222, 226
- European Monetary System (EMS) 189, 190
- European Security and Defence Policy (ESDP) 216
- European Stability Mechanism (ESM) 18, 22, 33, 91, 95, 202, 206–7
- European Union Treaty 2
- euro periphery/southern periphery 1, 2, 149, 165
- eurozone 1–2, 9–10, 12–14, 82, 133–4, 143–7, 151, 165–6, 169–70, 172, 175–6, 178–82, 184–6, 188, 190, 194–5, 197–8, 200–5, 208, 210–11, 213, 215, 218, 221, 225–6, 282
- family policy 3, 6, 116, 233–4, 236–40, 266
- Federal Civil Service Law 28
- Federal Constitutional Court  
(*Bundesverfassungsgericht*) 51, 176–7, 181, 184, 186, 207
- Federalism 4, 21, 35–56, 279
- Federal Labour Office 155–6
- Federal Reform Commission 42, 44–5, 50–1, 54
- Federal Republic 3, 5, 11–12, 14, 16, 18, 20, 22, 26, 30–1, 35, 42, 47, 50, 56, 58–9, 61–4, 67, 79, 87–8, 103–7, 113, 159–60, 166–7, 176–7, 179–80, 182, 186, 190–1, 194, 197, 200, 203
- feed-in tariff 252–4, 257–60
- Finland 185, 196, 199, 203
- fiscal transfer 45
- fiscal union 1
- Fischer, Joschka 31, 114, 171, 172, 174, 179, 225
- France 11–14, 120, 130, 131, 166–72, 174, 180–3, 186, 196, 197, 199, 202, 211–17, 221, 222, 226, 239, 251, 269, 271, 273–5
- Frankfurt 8, 118, 129, 178, 192, 272
- Free Democratic Party (FDP) 5, 9–10, 19–21, 26–7, 34, 44, 47, 58, 64, 67, 69, 71, 73, 74, 76, 79–81, 83, 86–7, 89–91, 94–8, 101, 112–13, 152, 158, 160, 162–3, 172, 179, 193, 206–7, 209–10, 214, 248, 253, 255, 259–60, 264, 271
- elections 10, 20, 27, 58, 67, 69, 80, 86–7, 101, 113
- ideology 26, 71, 76, 79, 94–8
- membership 89–90, 206
- organization 91, 206
- policies 5, 47, 113–14, 162–3, 179, 207, 209, 248, 255, 259–60,
- Friedrich, Hans-Peter 113, 274
- Fukushima 9, 114, 117, 129, 242, 249, 256
- G8 22, 128, 171
- Gabriel, Sigmar 24, 32
- Gates, Robert 220
- Gauck, Joachim 15, 113
- Gauweiler, Peter 206
- Gemeinschaftsaufgaben* (Joint Tasks) 36
- Genscher, Hans-Dietrich 27, 114, 191
- German Model (Modell Deutschland) 3, 5–6, 133–48, 228–9, 231
- German Right-Wing Party (DRP) 82
- Giscard d'Estaing, Valéry 181, 189
- Global Justice Movements (GJMs) 120–1, 124–5
- globalization 7, 35, 41, 133, 150, 183, 236
- Glos, Michael 112
- grand coalition 4–6, 10, 18, 20–1, 26–7, 31–2, 34, 46–8, 50, 52–3, 55, 67, 75, 105, 107, 113, 154, 157–8, 186, 209, 214, 234, 236, 238, 250, 260, 265, 267
- Greece 2, 144, 165, 184, 196, 199, 201–4, 209
- Greenpeace 124
- Greens, The 8–10, 34, 44, 57, 58, 64, 67–76, 80, 83, 86, 89, 90, 94–8, 100, 113, 129, 154, 155, 179, 186, 206–8, 236, 246–52, 255–6, 271
- elections 58, 67–71, 76, 83, 86
- ideology 8, 57, 64, 70–1, 83, 94–8,
- membership 8, 89,
- organization 92
- policies 154, 157, 171, 179, 206, 207, 225, 247–8, 251, 252, 255–6, 264, 277
- gridlock 4, 41, 150, 153, 164, 229
- Gröhe, Hermann 24
- Gross Domestic Product (GDP) 2, 38–9, 133, 141–2, 150–1, 159, 161, 189, 200–1, 244
- Guttenberg, Karl-Theodor zu 27, 112, 219
- Hamburg 38–9, 89, 124
- Hartz 3–5, 84, 114, 121, 138, 155–6, 231, 237, 281
- Hartz, Peter 237
- Hartz IV 84, 114, 121
- Hartz Reforms 3–5, 138, 231
- Heiligendamm 128
- Hendricks, Barbara 24
- Herzog, Roman 133
- Hessen 38–9, 54, 89
- Heusgen, Christoph 171
- Hollande, Francois 181, 182
- Hombach, Bodo 111
- human rights 8, 120, 250
- Hungary 166, 276
- Hypo Real Estate 33, 159, 161
- IMF 184, 203
- immigration 6, 8, 47, 95, 116, 237, 262–77

- inflation 128, 143–4, 150–1, 162, 177, 189–90, 194, 197–8, 201, 205
- interest rate 143, 144, 151, 194, 196–202, 205
- International Security Assistance Force (ISAF) 218, 219
- Iran 213, 225
- Iraq 14, 120, 182, 211, 233, 275
- Ireland 144, 183, 196–9, 202–4
- Italy 120, 130, 196, 199, 201, 202, 224
- Japan 159, 189
- joint-decision trap 37, 41, 47
- Kaczyński, Jaroslav 182
- Karlsruhe 105, 176, 206
- Keynesianism 189, 190, 204
- Kiesinger, Kurt Georg 19–20, 30–1, 107, 111
- Kohl, Helmut 11, 13, 17, 19–20, 26–7, 30–1, 97, 101, 108, 110, 114, 151–3, 168, 171, 173–4, 178, 191, 193, 252, 264
- Köhler, Horst 218
- Kosovo 14, 211
- Kyoto Protocol 253
- Lafontaine, Oskar 115, 158
- Länder* 4, 20–3, 27–9, 32–4, 35–40, 42–56, 60, 63, 75, 77, 153, 166, 175, 193, 242, 270, 273–4, 276
- Länderfinanzausgleich* (Fiscal Equalization Scheme) 36, 55
- late decider 7–8, 66
- liberal market economies (LMEs) 135–7, 141
- liberalization 6, 130, 146–7, 152, 257, 269, 272, 278
- Libya 211, 212, 214, 220–6
- Linke, Die (Left Party) 8, 9, 11, 25, 34, 58, 64, 67–73, 76, 82, 84, 94–7, 100, 129, 158, 175, 179, 206
- elections 58, 67–8, 70, 76, 84, 158
- ideology 11, 71, 94, 96, 175, 179
- membership 84, 89, 129
- organization 8, 84
- policies 82, 95, 97
- Lisbon Treaty 13–14, 172–4, 183, 212, 221, 224
- Lower Saxony 38, 39, 40, 106, 271
- Maas, Heiko 24
- Maastricht Treaty/Deficit Criterion 11, 37, 151, 176, 177, 192, 193, 201, 206, 212
- Malta 166
- Mannheim 77
- manufacturing industry 132, 141, 142, 145, 147, 161, 231, 233, 243, 244, 255, 257
- McAllister, David 271
- Mecklenburg-West Pomerania 38–9, 53
- Media 9, 26–7, 32, 41, 44, 90, 106, 109, 111, 122–9, 218, 237, 271
- median-voter theorem 99–100, 102
- Merkel, Angela 1–2, 7, 9–11, 13, 19–20, 24, 27, 30–1, 33, 47, 67, 72, 74, 98, 103–17, 149, 151, 154, 160, 162–3, 167, 169, 171–6, 178–9, 181–6, 201, 203–9, 213–14, 218–19, 221, 223, 225–6, 238–9, 241, 248, 250, 253, 255–6, 258–61, 265, 273
- and CDU 98, 116, 209, 239, 248
- and eurozone crisis 1–2, 13, 149, 183–5, 200–8,
- and foreign policy 114, 169, 171–3, 186, 213–14, 218–19, 221, 225–6, 250
- leadership 1, 7, 10, 31, 103, 106–8, 239, 241, 256, 261
- and nuclear policy 9, 256
- role in elections 10, 67, 74, 109–10, 116, 253
- Meyer-Landrut, Nikolaus 183
- middle class (*Mittelstand*) 7, 57, 60, 68–9, 81
- Migrationshintergrund* (Migrant Background) 270, 271, 276, 278
- Minister for Foreign Affairs 24
- Minister for Special Tasks (Head of the Chancellery) 24, 111
- Minister of Defence 24, 26
- Minister of Economic Cooperation and Development 24
- Minister of Economics and Energy 24, 32
- Minister of Education and Research 24
- Minister of Family Affairs, Senior Citizens, Women and Youth 24
- Minister of Finance 24, 26, 161, 163, 189
- Minister of Food and Agriculture 24
- Minister of Health 24
- Minister of Justice and Consumer Protection 24, 26
- Minister of Labour and Social Affairs 24
- Minister of the Environment (Nature Conservation, Building and Nuclear Safety) 22, 24, 27
- Minister of the Interior 24
- Minister of Transport and Digital Infrastructure 24
- Minister's Office 29
- Ministry for European affairs 31
- Mitterrand, François 11, 168
- Müller, Gerd 24
- Munich 8, 15, 118
- Müntefering, Franz 44, 112, 161
- Nahles, Andrea 24
- Nationaldemokratische Partei Deutschlands* (NPD) 82, 274

- Nationalsozialistischer Untergrund* (NSU) 274
- Netherlands 120, 130, 143, 144, 172, 173, 196, 199, 203, 174, 265
- Network Development Act 254
- Network Expansion Acceleration Act 254
- new social movements (NSMs) 8, 118, 120–1, 124
- non-wage labour costs 152, 153, 158
- North Atlantic Treaty Organization (NATO) 14, 22, 80, 187, 211–20, 222–5
- North Rhine-Westphalia 38, 39, 49, 84, 89, 159, 248
- nuclear exit 247, 248, 255, 256
- nuclear power 7, 9, 118, 120, 123, 129, 213, 242, 247, 251, 254–6, 260
- Obama, Barack 217, 223–4
- Occupy Movement 121, 125, 129
- Office for Cabinet and Parliamentary Affairs 29
- Opel 161
- opposition parties 3–4, 8, 17–18, 20–1, 26, 30, 42, 75, 84, 105, 109, 114, 121, 150, 153, 156–7, 164, 179, 191–3, 205, 228, 237–9, 247, 251, 266, 277
- Optimum Currency Area 143, 197, 201
- Ordoliberalism 134, 170, 171, 178, 204
- Organisation for Economic Co-operation and Development (OECD) 5, 22, 133, 141, 144, 149–52, 228, 230, 267
- Öttinger, Günther 116
- Özdemir, Cem 271
- Pact for the Euro 202, 207
- Papandreou, Giorgos 201
- participation 2–3, 8–9, 14, 62, 84, 87, 92, 113, 120–1, 139, 186, 219, 236–7, 255
- partisan 5, 7, 9, 57–77, 96, 98, 153–4, 157, 164, 235, 240
- Party of Democratic Socialism (PDS) 8, 64, 73, 80, 84, 86, 89, 94–5, 100, 129, 175, 179
- peace 8, 57, 120, 123, 125, 214, 221, 223
- pension 3, 6, 83, 104, 134, 136–7, 152–4, 158, 228–31, 233, 236–7, 239–40
- Pirate Party (*Piratenpartei*) 8–9, 57, 64, 77, 84, 92, 96–8, 128–9
- Pofalla, Ronald 111
- Poland 166, 180, 182, 185, 226, 276
- Politikverdrossenheit* (Political Malaise) 41
- Politikverflechtung* (Joint Decision Making) 36–7, 48–9
- Portugal 2, 196, 199, 201, 202, 203
- poverty 6, 138, 228, 229, 230, 235, 239
- presidentialization 103, 108–17
- Press and Information Office 24, 29
- privatization 160, 237, 240
- Putin, Vladimir 250
- recession 5, 67, 70, 133, 137, 141, 144, 159–61, 172, 200, 204, 208, 227, 229, 232, 267–8
- reform miracle 4, 153–4
- Reformstau* (Reform Logjam) 41, 150, 164
- Reichsverfassung* (Imperial Constitution) 104
- religion 7, 57, 61, 68, 70, 75, 94
- Renewable Energy Sources Act 253, 255, 260
- rescue package 5, 160, 161, 163, 201, 205
- retrenchment 227, 236, 238
- Rhineland-Palatinate 38–9
- Riester, Walter 237
- Romania 267, 276
- Rösler, Philipp 112, 251, 259, 271
- Röttgen, Norbert 27, 113, 259
- Russia 222, 224, 225, 249, 250, 261
- RWE 248, 249
- Saarland 38–9, 51–2, 84
- Sarkozy, Nicolas 180, 183, 201
- Sarrazin, Thilo 273, 278
- Saxony 38–9, 82, 159
- Saxony-Anhalt 38–9
- Schäuble, Wolfgang 24, 27, 163, 209, 270
- Schengen Agreement 224
- Schleswig-Holstein 38–9, 52–3, 84
- Schmidt, Christian 24
- Schmidt, Helmut 17, 19, 20, 30, 106, 172, 174, 181, 189
- Schmidt, Renate 238
- Schröder, Gerhard 5, 9, 11, 14, 19, 20, 26–7, 30–1, 67, 72–4, 83–4, 97–9, 103, 105–7, 109–17, 134, 152–6, 164, 168, 174, 182, 193, 198, 211, 214, 219, 223, 225, 237–8, 250, 252, 256, 264, 277
- and European integration 11, 31, 168–9, 174, 193
- and foreign policy 14, 114, 182, 211, 214, 218–19, 223, 225, 250
- and Hartz Reforms/ Agenda 2010 5, 9, 83–4, 134, 154–7, 198, 238
- and SPD 9, 30, 154–7, 164
- leadership style 31, 106–7, 114–16
- role in elections 109–10
- Schwesig, Manuela 24
- Second World War 36, 78, 159, 167, 208, 215, 228
- Seehofer, Horst 110, 112
- semi-sovereign state 176, 205, 215
- shareholder 3, 135, 141, 250
- short-time work 232, 233
- Sikorski, Radoslaw 182
- Silberberg, Reinhard 171
- Single European Act 37, 191
- Slovakia 166, 185
- Slovenia 166

- Social Democratic Party (SPD) 2, 4–5, 7, 9–10, 18–20, 22, 24, 26–7, 30, 32, 34, 44, 46–7, 49, 51, 57–9, 61, 64, 67, 68–9, 71, 73–7, 79–81, 83–5, 87–98, 101, 110, 113, 115–16, 152, 154–8, 161–2, 164, 172, 179, 186, 193, 198, 207, 235–6, 239, 248, 249, 251, 255, 259, 264–5, 267, 273, 277
- elections 9, 58, 60, 67, 68–71, 75–7, 80, 83, 85, 87, 101, 153, 156
- ideology 70–1, 79
- membership 88–90, 92
- organization 2, 91–2, 115, 153, 156–7
- policies 2, 5, 67, 83, 94–8, 152–3, 154–8, 161–2, 179, 183, 186, 198, 207, 235–6, 239, 240, 248, 251, 255, 264, 267, 277
- social policy 2–4, 26, 138, 143, 147, 150, 155, 158, 227–40
- social protection 136, 227–34, 238
- Socialist Reich Party (SRP) 82
- Solana, Javier 171
- Solidarity Pact 55
- Spain 2, 130, 144, 196–9, 201, 203–4, 266
- Spöri, Dieter 193
- Stability and Growth Pact 2, 133, 157, 169, 202
- Stark, Juergen 178, 205
- State Secretaries 28–31
- Steinmeier, Frank-Walter 15, 24, 98, 111, 161, 171, 186, 250
- stimulus package 3, 23, 141, 160, 161
- Stoiber, Edmund 43–4, 72, 110, 182
- Stuttgart 8, 118, 121, 125, 272
- Stuttgart 21 18, 125
- Sweden 60, 228, 275
- Switzerland 120, 130
- Syria 214, 275
- tax 3, 5, 21, 36, 43, 51–2, 94–5, 113, 119, 124, 129, 134, 138, 140, 145, 150, 151–4, 157–8, 160, 162–5, 207, 233, 235, 252, 256–60, 270
- terrorism/terrorist threats 32, 48, 214
- Thatcher, Margaret 106, 115
- Third Reich 11, 106, 174, 176
- Thuringia 38–40, 51
- trade union/labour union 3, 8, 59, 121, 123, 124, 129, 135, 155, 156, 158, 198
- transfer union 1
- Trichet, Jean-Claude 178
- troika 145, 203
- Turkey 186
- Tusk, Donald 182
- Ukraine 250
- unemployment 2–5, 8, 38–40, 53, 70, 84, 121, 133–4, 136–9, 142, 149–52, 154–5, 158, 160, 163–5, 190, 194, 198, 200, 202, 227–9, 231–4, 236–40, 267
- unification (Germany) 35, 38, 58, 61–4, 69, 70, 75–80, 88, 133, 137, 138, 142, 152, 153, 175, 191, 193, 212–17, 228, 236, 240, 243, 263, 266–9, 274
- unit labour costs 142, 144, 198, 199
- United Kingdom 5, 146, 149–52, 182–4, 205, 211–17, 221–2, 230, 242–4, 267, 269, 275
- United Nations (UN) 212, 214, 222, 223, 225
- USA 5, 14, 112, 114, 141, 146, 149–52, 180, 182, 189, 211, 216–17, 220–5, 230–3, 235, 239–40, 243, 262.
- Van Rompuy, Hermann 220
- Vice Chancellor/Vice Chancellery 32, 67
- Veto 3, 21, 26, 37, 41, 44, 46, 48–50, 105, 150, 153–4, 156, 158, 163–5, 177, 184, 229, 240, 242
- veto player 37, 48, 105, 154, 164, 229, 240, 242
- vocation, European 11, 14, 166–9, 173, 177, 178, 186
- Volkskammer* (Parliament of GDR) 63
- Volkspartei* (People's Parties) 9–10, 57
- Von der Leyen, Ursula 15, 24, 239
- Wanka, Johanna 24
- Weber, Axel 178, 205, 206, 208
- Weidmann, Jens 178, 206
- Weimar Republic 16–17, 104, 106, 131, 226
- welfare state 4–6, 31, 94, 114, 134–6, 147, 150, 152, 154–5, 158, 227–40
- Werner, Pierre 189
- Westerwelle, Guido 113, 221, 223
- working class 59–60, 68
- Wulff, Christian 116, 274
- Wutbürger 8, 118, 126
- xenophobia 8
- Zukunftsdialog* (Future Dialogue) 114
- Zustimmungsgesetz* (Bill Needing Bundesrat Approval) 21, 105
- Zuwanderungsgesetz* (Immigration Law) 265, 267, 270, 275–7
- Zweitstimme* (Second Vote) 65, 85