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# Blinking Left, Driving Right

*Germany's flirtation with anti-capitalist populism.*

BY KLAUS C. ENGELEN

Recent rhetorical attacks against international corporate investors from the top echelons of Germany's governing Social Democratic Party, coupled with the crashing defeat of the Red-Green coalition in the latest state elections and the German chancellor's unexpected move to call a national election a year earlier than scheduled—all these developments can be seen as part of an "end game" for Gerhard Schröder and the Red-Green coalition.

In a major speech on the future SPD agenda at the party headquarters on April 13, party chairman Franz Müntefering zoomed in on "international profit-maximization strategies," "the increasing power of capital,"and moves toward "pure capitalism." Encouraged by the favorable response his anti-capitalistic rhetoric produced among party followers and confronted with ever more alarming polls from the Ruhr, he escalated the war of words. "Some financial investors spare no thought for the people whose jobs they destroy," he told the tabloid *Bild*. "They remain anonymous, have no face, fall like a plague of locusts over our companies, devour everything, then fly on to the next one."

When a so-called "locust list" of financial investors leaked from the SPD headquarters to the press, the "droning buzz" of

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**Franz Müntefering**

Some of the financial investors **Franz Müntefering** bad-mouthed as locusts in an April speech were much sought-after buyers of state firms and state assets that had been put on the market by Chancellor **Gerhard Schröder's** treasury secretary **Hans Eichel.** Even Müntefering was thought to have made deals with firms that he now considers a "locust plague."

The media buzz was immediate: "U.S. Companies in Germany: The Bloodsuckers" appeared on the cover of an IG Metall Union magazine.

*—K. Engelen*


the locust plague became louder, reaching major financial centers. The list included among others U.S.-based investment firms Kohlberg Kravis Roberts, Goldman Sachs, and Blackstone as well as several German private equity firms and hedge funds, all of which have bought and restructured German companies in recent years. Was Müntefering, by starting a debate about the evils of capitalism, trying to make political capital by attacking international capital?

The media buzz rose to the slander level when *Bild* came up with a giant locust and the Union Jack flag superimposed on the Frankfurt stock exchange and when an insect with a Yankee Doodle hat and the headline "U.S. Companies in Germany: The Bloodsuckers" appeared on the cover of an IG Metall Union magazine.

## AN ISSUE OF CREDIBILITY

What soon became an embarrassment for Müntefering and his governing Red-Green coalition and undermined their credibility is that some of the financial investors badmouthed as locusts were much sought-after buyers of state firms and state assets that had been put on the market by Schröder's finance chief Hans Eichel. Even Müntefering was thought to have made deals with firms that he now considers a "locust plague." Shortly after the Red-Greens took over the government in late 1998, none other than Müntefering, then minister of transportation, sold Autobahn Tank & Rast, a major chain of service stations, to Apax Partners. Later on, Apax sold Tank & Rast to Terra Firma Capital Partners, another locust firm.

And to give the German public a taste of how Anglo-Saxon corporate raiders operate in today's world of globalization, a group of foreign investors, led by Christopher Hohn, managing partner of The Children's Investment Fund (TCI), a British-based hedge fund owning 8 percent of Deutsche Börse, succeeded in ousting Werner Seifert as chief executive of Deutsche Börse and forcing its supervisory board chairman, Rolf Breuer, to resign at the end of this year. Disgruntled investors lead by Hohn forced Seifert, who was managing the world's largest publicly listed exchange, to drop plans to take over the London Stock Exchange with an informal offer of £1.35 billion. As the *Economist* sarcastically noted: "Mr. Breuer also chairs the supervisory board of Deutsche Bank, which acted

*Was Müntefering trying to make political capital by attacking international capital?*

# The New Players Under Merkel

With the crushing defeat of the Social Democrat-Green coalition in North Rhine-Westphalia leading Chancellor **Gerhard Schröder** to call for early elections, the prospect of a change of government in Berlin becomes more likely.

The pundits are already speculating who—under **Angela Merkel** as Germany's first-ever woman chancellor—will move in key positions when Schröder, his luckless finance minister **Hans Eichel,** and foreign minister **Joschka Fischer** step down.

The liberal Free Democrats are eager to continue the old tradition under former conservative governments of claiming the Foreign Ministry. Their candidate for this job would be **Wolfgang Gerhard,** who wants to merge the development ministry into the foreign ministry. Should Merkel's conservative Christian Democrats and their Bavarian sister, the Christian Social Union, win the absolute majority, such aspirations of the liberals will be shattered.

*German president* **Horst Köhler** *could have considerable influence on personnel positions in a Merkel government.*

Even if Merkel and the CSU's **Edmund Stoiber** miss taking an absolute majority, there is a chance that Stoiber—who narrowly lost to Schröder in 2002—might aspire to the foreign ministry. More likely, Stoiber would move to Berlin as Merkel's new "Super Minister for Finance and the Economy." But there is also the chance that **Friedrich Merz**—Merkel's major rival who left CDU to join an international law firm—might be called back as the new finance minister. "Asking Merz to get the budget in order and reform the tax system might be a strategic move," says a Frankfurt banker. "This way she will get her major rival cut down to size because giving grandiose budget speeches in the Bundestag and getting the state finances consolidated in the reality of federal Germany are two different things."

On important international positions, Merkel will probably ask the advice of the man whom she has to thank for her rise to prominence: German president **Horst Köhler.**

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Ironically, thanks to Merkel and her liberal Free Democrat partner **Guido Westerwelle,** Köhler will play a key role in the next election process. Both asked Köhler to be a candidate for the highest office in the land. But enticing Köhler from the most influential position a German ever had in the international financial system—head of the International Monetary Fund—came at a high price. Since Köhler abruptly left the IMF, placing German candidates in key international positions has become much more difficult.

Nonetheless, Köhler—a CDU member—will have considerable influence. With a conservative-liberal victory this fall, all bets are off on a German candidate succeeding **Otmar Issing** on the European Central Bank managing board. Schröder's likely candidate, **Peter Bofinger,** won't be out of the running. **Jürgen Stark,** deputy governor of the Bundesbank and a former finance secretary, would be a qualified German candidate should his boss, **Axel Weber,** stick to his declared intentions not to move on the ECB. Stark, who served under former finance minister **Theo Waigel,** would

*The pundits are already speculating who will move in key positions when* **Gerhard Schröder** *[left], his luckless finance minister* **Hans Eichel** *[center], and foreign minister* **Joschka Fischer** *step down.*

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have strong backing from Stoiber but also from key CDU bigwigs. Stark is also highly regarded on the international stage and familiar to readers of *TIE*—see his most recent article on page 52 of this issue.

Other candidates qualified to succeed Issing include **Gerd Häusler** and **Klaus Regling.** Both are also talked about as possible successors for **Caio Koch-Weser** as deputy finance minister, the key international finance job. Häusler is currently head of IMF's international capital markets division, where he arrived from a stint on the managing board of Dresdner Bank AG. Regling is running the European Commission's General Directorate for economic policy and has found himself in conflict with Eichel when Germany failed to meet its Maastricht budget criteria year after year. While Häusler has the backing of the Free Democrats, Regling is backed by the CDU, a fact that Schröder ignored when he nominated Regling to the strategically important EU position. There already is talk in the Berlin finance ministry of the "Köhler Duo," i.e., Häusler as successor to Koch-Weser and **Axel Bertuch-Samuels** as new head of the key international finance department. Bertuch-Samuels was chief of staff of Köhler's office at the Bonn finance ministry, at the German Savings Bank Association, at the European Bank for Reconstruction and Development, and at the IMF. Some feel, however, that Bertuch-Samuel "has been out of the country for many years and lacks proven management experience, very much needed."

A key figure with influential backers in the CDU leadership is **Hans Reckers,** presently on the Bundesbank board. He belongs to what insiders call the "Andean Pact," the major rival power grouping with three ambitious governors—**Roland Koch** (Hesse), **Christian Wulff** (Lower Saxony), and **Peter Müller** (Saarland). Many years ago, so it is told, they decided while on an Andean tour to work together on the road to power. A newer member is **Günther Oettinger** (Baden-Württemberg) who succeeded in forcing his predecessor, the aging governor **Erwin Teufel,** to step down.

*—K. Engelen*

**Peter Bofinger**

**Jürgen Stark**

**Gerd Häusler**

**Klaus Regling**

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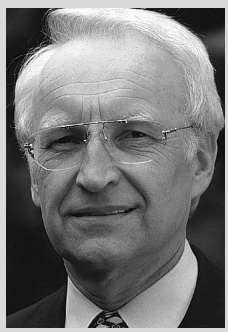
*—K. Engelen*

*The CSU's* **Edmund Stoiber***: An election victory could see him in the foreign ministry, or more likely as Merkel's new "Super Minister for Finance and the Economy.*



as adviser and financier for Deutsche Börse's bid for the LSE—a conflict of interest that would beggar belief in Britain or America." And the magazine continues: "In forcing out Mr. Seifert and Mr. Breuer, Deutsche Börse's shareholders have thrown a spotlight on the cozy and tight-knit club that operates at the top of German business."

Then Germany's financial supervisors joined the act. The financial supervisory agency BaFin saw "indications that some hedge funds acted in concert when they blocked Deutsche Börse AG's plans to take over the London Stock Exchange." According to BaFin, this has called into question the legality of international investors' actions in ousting Deutsche Börse AG's top management. BaFin president Jochen Sanio announced that his agency had written to some hedge funds abroad and asked them to provide certain information within a specific time. According to Sanio, BaFin will base its investigation on a recent court ruling that "shareholders that set up a backdrop of threats in order to influence decisions are acting in concert." Under the German takeover code, any party holding at least 30 percent of voting rights in a company is required to make a public offer for all of that company. Some shareholders try to circumvent the 30 percent threshold by arranging for third parties buy shares on their behalf. In order to prevent companies from doing this, the acting-in-concert rule was included in the code. Shareholders who jointly discuss their decisions concerning the company—not just takeover issues—are liable to fall within the scope of the acting-in-concert rule.

## STILL GERMANY, INC.?

What happened to Deutsche Börse is putting pressure on German policymakers to think about the nature of what remains of "Deutschland AG"—and thus German capitalism. So far, calls for imposing a longer holding period on hedge funds investing or buying German companies haven't gone far in spite of Eichel's warning that without such restrictions, international private equity firms and hedge funds could do with other German publicly listed companies what they have done with Deutsche Börse. However, a group of experts appointed by Schröder from the ministries of finance, economy, and justice came out against curbing the activities of hedge funds on a national level but will work on tougher transparency rules on an international level, in particular through the Financial Stability Forum (FSF), the key forum for regulators and finance officials of the world's major financial centers.

Schröder's interministerial experts advised the government against adopting rules modeled on French law that restrict voting rights for shares held by certain types of investors. Instead, the group recommended that companies grant a dividend bonus to shareholders who exer-

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cise their voting rights as an incentive to attend annual meetings and to prevent small groups of shareholders from manipulating meeting results. The experts also suggested lowering the ownership threshold at which shareholders are forced to publish the size of their holdings in a listed company. Investors should make public their stake if it rises to 5 percent of total equity.

Thus, on June 13, Schröder will address a major conference in Berlin on the role of international capital in the German economy that was scheduled at the height of the locust debate some weeks ago. Since Schröder and his party chairman Müntefering lost their political base in North Rhine-Westphalia, the locust plague that for weeks had dominated the newspapers and television talk shows has all but vanished.

In light of the expert group's recommendations there are indications that Schröder will reject a crackdown on hedge funds and equity firms, confirming his policies of deregulation and making markets more effective.

But it was revealing that two top German bankers—Deutsche Bank chairman Rolf Breuer and Commerzbank head Klaus-Peter Müller—are calling for new controls for international hedge funds. "Nobody can understand how small banks are put under the most stringent financial supervision, but hedge funds with their much bigger role in financial market must only register an address," criticizes Müller. "There has to be a level playing field for all. Hedge funds must have to tell where their funds are coming from the same as banks." Müller blames the lack of supervision over hedge funds on U.S. authorities, arguing that "this is an international supervision issue since almost 70 percent of hedge funds originate in the United States. As long as the Fed [U.S. Federal Reserve] isn't taking up this issue, not much will change," says Mueller.

### FREE MARKET REFORM RECORD

The attacks on Anglo-Saxon corporate investors that the SPD chairman Müntefering started in the run-up to the crucial North Rhine-Westphalia state elections were, ironically, in sharp contrast to the free market-oriented capitalist reforms that the Red-Green coalition government under Schröder and finance minister Hans Eichel has been pursuing and implementing since taking over from the government of Helmut Kohl. The conservatives and liberals under Kohl—the chancellor of German Unity — had reigned for sixteen years without daring to modernize "Deutschland AG." As mentioned previously in *TIE,* it was Schröder and Eichel who pushed through major reforms that at the time were highly unpopular and controversial and had one common goal: breaking up an antiquated bank-financed industrial structure—Germany Incorporated—that was strongly protectionist against foreign investors gaining control through infusions of capital.

As part of a major corporate tax reform, Schröder and Eichel made sure that German banks and insurance companies like Deutsche Bank and Allianz could sell their industrial holdings on a tax-free basis. This way they opened up the German industrial and financial system to foreign investors,

Against fierce opposition by German states with opposition conservative governors, Schröder and Eichel succeeded in restructuring the Deutsche Bundesbank, and establishing a new single regulator, the BaFin, to supervise the banking, insurance and securities markets under one roof.

Schröder's opposition challenger, Angela Merkel, kept her powder dry in the "locust" debate. "Merkel realizes that the rush of foreign buyers of depressed German corporate and real estate assets has just started," says a high official of Deutsche Börse. "What we have seen so far is nothing compared to what is going to happen. Should Merkel take over the government, she will have to deal with the political fallout of even more spectacular takeovers by international equity firms and hedge funds with tens of thousands of job losses."

—*K. Engelen*

**Angela Merkel**

*But as it turned out, demonizing equity firms and hedge funds was seen by many skeptical voters as "blinking left and driving to the right."*

Together with his British colleague Gordon Brown, German finance minister Eichel played a key role in modernizing the EU financial supervisory structures. With Berlin's finance secretary Caio Koch-Weser as chief negotiator with the EU Commission, the Schröder government agreed on the phase-out of state guarantees for the Landesbanks, a crucial step toward improving the competitive position of private-sector banks.

As part of far-reaching reforms of Germany's security markets, the rules for international hedge funds were liberalized in order to make it easier for institutional investors to bring capital into the German economy.

Another major challenge came in adjusting to the Sarbanes-Oxley Act in terms of more stringent capital market laws, corporate governance rules, and new controls and oversight for the accounting profession. Since July of last year, the major German accounting firms are supervised by the new agency established under Sarbanes-Oxley, the Public Company Accounting Oversight Board. A new law enforcing tougher transparency standards for Germany's top managers of publicly listed corporations remains a bone of contention.

Only last year the Red-Green government pushed through parliament special legislation to make German venture capital firms more competitive in terms of the taxation of earnings on equity with international competitors.

### "LOCUSTS" RESPOND

So it didn't come as a surprise that Holger Frommann, head of the German Private Equity and Venture Capital Association (or BVK), was outraged by having the members of his association labeled as "raiders" or "plunderers." He pointed out that at the end of 2004, private equity firms in Germany had an annual "turnover" of €114 billion employing about 640,000 people. Frommann hopes that the "locust plague" debate will not damage Germany's international competitiveness considering that in the first quarter this year member firms are bringing in new equity capital of €419 million.

Also, city treasurers who are selling thousands of non-performing real estate properties from public owners—in particular residential apartment blocks—are taking issue with Müntefering's campaign against those who are providing the purchase money.

According to Herbert Gehring, Dresden's city treasurer, German states, cities, and small communes will be selling a million public apartment units through 2010 to outside investors, with many of those investors coming from abroad. Considering the state of the German real estate market, Deutsche Bank analyst Tobias Just says that special equity funds from the United States such as Fortress "can leverage $2 billion in equity to buy about $10 billion worth of real estate in Germany since prices have been depressed for years."

Joachim Jahnke, former vice president of the European Bank for Reconstruction and Development (EBRD) and author of a book on Germany's role in globalization, tries to put private equity and hedge funds into perspective. "While private equity funds and hedge funds have been dominating the headlines due to spectacular takeovers and restructurings of German companies, their funds come from banks, pension funds, insurance companies, and other institutional investors. Europe's share of the funds such international investors move globally is about 15 percent. Of this, three-quarters goes to the United Kingdom, with Germany receiving only 1 percent of the investment turnover, clearly behind other EU countries such as France, Spain, Sweden, the Netherlands, and Ireland. Globally such funds administer about $1 trillion. In the United States and United Kingdom, such funds count for about 40 percent to 70 percent of daily share turnover at the stock exchanges."

Academics such as Paul J. J. Welfens are also highly critical. "For everybody it was obvious that Müntefering was making political capital by attacking foreign capital." In Welfens' view, "Schröder, Eichel, Müntefering, and the ruling SPD-Greens have a huge credibility problem as far as their tax reform of 2000 is concerned. The Red-Green government paved the way for German companies to sell major equity holdings to foreign investors on a more or less tax-free basis. This was intended to open up "Deutschland AG" by pushing restructurings in banking and industry. But as it turned out, not many German investors but more and more foreign investors—through private equity firms and hedge funds—have obtained major stakes in German companies and other assets. To the big surprise of the German business and political elite, most foreign investors come to Germany and want to get the kind of corporate governance they have been used to in London or on Wall Street. What happened to Deutsche Börse is a case in point".

### POLITICAL FALLOUT

All this brings us to the question: Did the anti-capitalist debate about private equity firms and hedge funds eventually swing voters of the SPD who are still suffering under Schröder's Agenda 2010 that brought deep cuts in unemployment transfers, welfare payments, and pensions as well as higher health care costs? While French anti-globalization forces apparently were successful in helping to vote down the EU constitution, the highly controversial SPD campaign against corporate raiders from abroad did not make much difference with disgruntled voters. Look at the results of the North Rhine-Westphalia state elections. With the specter of a locust plague, Müntefering attempted an election ploy that Chancellor Schröder had successfully applied in the last national election to hold on to power. He held his razor-thin majority in spite of major failures and blunders in

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his first term. Schröder did show leadership when devastating floods hit large parts of East Germany. But he also gained support by harshly attacking U.S. President George W. Bush for his plans to invade the Iraq and by positioning himself as a leader who is opposed to German solders dying in a new Middle East war.

But as it turned out, demonizing equity firms and hedge funds was seen by many skeptical voters as "blinking left and driving to the right" before elections. Müntefering was accused of inconsistencies in his effort to get political mileage out of attacking international investors, not only from the opposition parties. For weeks, business leaders accused Müntefering and the SPD of damaging Germany's investment climate and thus threatening much-needed jobs.

However, evidence in the opinion polls indicates that the locust campaign masked a deep-seated aversion to the negative consequences of capitalism and globalization among broad segments of the population not only in Germany but also in France and other parts of Europe. Such negative consequences include ever-higher job losses through corporate restructurings and bankruptcies and ever-higher unemployment through competition from the new EU member states and emerging economies in China and the rest of Asia. In the case of Germany, a large part of the social system is based on contributions of employers and employees and an alarmingly shrinking regular wage base is requiring every higher transfers from public sector budgets.

This may explain why Schröder's opposition challenger, Angela Merkel, kept her powder dry in the "locust" debate.

As the free-market oriented Free Democrats which governed in coalition with the Christian Democrats from 1982–98 were blasting Müntefering and the Red-Greens for chasing away much-needed foreign investors and thus causing even more job losses, the conservative opposition didn't make big headlines. "She knows why," says a Frankfurt banker. "Merkel realizes that the rush of foreign buyers of depressed German corporate and real estate assets has just started. What we have seen so far is nothing compared to what is going to happen. Should Merkel take over the government, she will have to deal with the political fallout of even more spectacular takeovers by international equity firms and hedge funds with tens of thousands of job losses."

On economic reforms Merkel is no Margaret Thatcher. This explains why most economists are not expecting a burst of reforms if the Social Democrats lose power in the fall. Merkel is facing powerful rivals in the upper house from her own conservative Christian Democratic Union and the Bavarian Christian Social Union when it comes to implementing long-stalled cuts in subsidies to business and private pressure groups such as home builders.

In a recent report, the economists of Commerzbank warn not to expect too much of a boost to the German economy if Merkel becomes chancellor. A victory could give the opposition a majority in both houses of the Berlin parliament and improve its leverage to put through more rigorous economic and labor market reforms. But the Commerzbank economists note that "so far both camps are lacking in thought-through concepts, so hopes shouldn't be set too high." They may be right.

When it comes to major election issues—high taxes, high unemployment, and high health costs that all add to bloated payroll taxes and deter job creation—Merkel's party still is far from presenting convincing alternatives. One reason that the Christian Democrats and the Bavarian Christian Social Union have a hard time coming up with compromises on many contested issues is that both parties have strong labor wings that have grown stronger after Schröder shocked traditional workers with cuts in labor market support and welfare payments under his Agenda 2010. As in other recent state elections, more workers and unemployed defected from the Social Democrats to the conservative Christian parties than ever before in post war elections. This doesn't bode well for Schröder's party in the forthcoming fall elections, with or without a debate about a "locust plague." ◆

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