



# Risk Advisory

Helping our clients evaluate,  
manage and mitigate risk

The recent elections in Germany provide the focus for this edition of Risk Advisory. As the biggest economy in Europe, the stability and future direction of Germany clearly have far-reaching implications both for her immediate trading partners and for the wider global political situation.



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We are delighted to include a specially-commissioned article by the distinguished Financial Times political commentator, Quentin Peel, who considers the effects of the uncertain outcome of the election, and suggests that a solution to the crisis may come from an unexpected source.

Elsewhere, we consider the pivotal importance to both countries of Russia's relationship with Germany, and also take a look at Germany's history of domestic terrorism: with reunification continuing to pose challenges 16 years after the fall of the Berlin Wall, is there a danger that extremism may return to German soil?

Finally, we look at how business leaders view the result of the election and consider where the stimulus to revive the German economy needs to come from. We hope you enjoy the articles and welcome your comments or suggestions.

**Bill Waite**  
Group Chief Executive

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# Diary

## 24 - 25 October 2005

The CBI Conference Centre, London

### 'The City Briefing'

Organised by **Petroleum Economist**

A two day conference providing an insight into energy, economics, investment and risk in China & Russia.

Speakers to include:

- Oleg Babinov, The Risk Advisory Group
- Representatives from Standard Chartered Bank, Fulbright and Jaworski, ABN Amro and others

For more information please visit  
[www.petroleum-economist.com](http://www.petroleum-economist.com)

## 1 November

08.00 - 09.30, Location to be confirmed

### 'Popular revolutions in the Former Soviet Union - who's next?'

Free of charge

This breakfast will be looking at events in Belarus, Turkmenistan, Russia and Kazakhstan and the effects on businesses operating in the region.

Speakers to include:

- Oleg Babinov, Head of Emerging Markets
- Analysts from The Risk Advisory Group
- Guest speaker

## 9 November

08.00 - 09.30, Russell Square, London

### 'Computer forensics techniques'

Free of charge

This seminar will give delegates a basic understanding of the use of computer forensic techniques in the investigation and litigation support process. It will examine ways of searching large volumes of data, how to find hidden information and the preparation of protocols for electronic discovery.

Speakers to include:

- Simon Dawson, Head of Corporate Investigations

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## Germany's need for an elder statesman

*Quentin Peel, Financial Times*

The voters of Germany have got what they wanted: a split right down the middle of the new Bundestag, two weakened giant parties of the centre, and three significant splinter parties to left and right dictating the balance of power. It is a nightmare for politicians who must try to find a coherent government majority, and a deep disappointment to the business community that was hoping for a clear centre-right majority for Ms Angela Merkel, leader of the Christian Democrats.

That is the bad news. The good news is that Germany has the longest track record of forming coalitions between prickly partners of any country in Europe. In the federal government and the Länder, most combinations have been tried already, including 'grand coalitions' of Christian Democrats and Social Democrats, and 'traffic-light' coalitions of social democrats, liberal democrats and Greens. Hung parliaments are not necessarily a recipe for complete standstill.

So what is going to happen? All options are open except a deal with the hard-line Left. First choice for Ms Merkel, with her wafer-thin advantage over Chancellor Gerhard Schröder, is to persuade the Greens to join her natural CDU-FDP coalition. There is common ground on tax reform, labour market reform, and even some aspects of environmental policy. There are deep differences on nuclear energy, pacifism, and supporting EU membership for Turkey. Joschka Fischer, the outgoing Foreign Minister, says he will not join such a coalition, but it is a serious runner without him.

First preference for Mr Schröder is to persuade the liberal FDP to join his red-green alliance. On the economy, the ideological differences are even greater, although on social policy there is common ground. The FDP wants far more radical reform of taxes, labour markets and the burden of government than the SPD can stomach.

If neither of the three-way coalitions can be made to work, the two grand 'people's parties' of the centre, SPD and CDU, will be forced to work together. It is hard to see how that might happen under either Ms Merkel or Mr Schröder. They are both too divisive. An elder statesman is needed.

From the CDU, Horst Köhler, the federal president, would have been ideal if he did not have that job already. Kurt Biedenkopf, former CDU secretary-general and then premier of the eastern state of Saxony, would be a radical, reforming choice, a westerner who has been a success in the east, but at 75 he may be thought too old. Edmund Stoiber, the Bavarian premier, is too right-wing for the SPD. Wolfgang Schäuble, former interior minister, now foreign policy spokesman for the CDU, is a more likely choice.

From the SPD, Franz Müntefering, the party leader, is not a unifier, and has pushed the party leftwards in the election campaign. Peer Steinbrück, former premier of North Rhine-Westphalia, is most often mentioned as a compromise choice. Otto Schily, the interior minister, might be another.

There is more common ground between the CDU and the SPD than election rhetoric

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would suggest, although not on a radical liberalising agenda. They can agree on limited corporate tax reform, curbing the budget deficit, and possibly even on cautious further labour market liberalisation. Both know that pensions and health service costs need to be curbed. They would have a big Bundestag majority for a limited programme.

The last German 'grand coalition', from 1966 to 1969, was not a great failure: it provided a typically German transition from a government of the centre-right to one of the centre-left. The voters seem to have said they want the same – but this time to shift from left to right. It is a big disappointment for those who were banking on a radical change of direction to galvanise the sluggish German economy. But that was too much for the voters to stomach.

“It is a big disappointment for those who were banking on a radical change of direction...”

Quentin Peel is International Affairs Editor of the Financial Times. If you would like to know more about this topic, please contact him at [quentin.peel@ft.com](mailto:quentin.peel@ft.com)



## Russia and Germany - an uncertain future?

*Jennifer Moll, The Risk Advisory Group*

Although it may take several weeks for a ruling coalition to form now that the German election is over, it seems clear that Russia will maintain its privileged relationship with Germany, more through economic necessity than political pragmatism.

An outright victory for Angela Merkel would not have suited Russia well. President Vladimir Putin relies on Germany as a strong supporter, and it is no secret that in promising to take a more conservative approach to relations with Russia, Merkel also wanted to mend Germany's relationship with the United States. Merkel's sceptical attitude towards Putin and alignment with the US would probably have meant increasing criticism from Germany of Russia's democratic development and the situation in Chechnya.

Perhaps more damaging to Russian interests and foreign policy, however, is Merkel's stance on Eastern Europe. Hoping to improve German relations with Poland, the Baltics and Ukraine, Merkel also promised not to overlook their interests when dealing with Russia. Not only would this have severely weakened bilateral relations, but this aspect of Merkel's foreign policy would have been a severe setback to Russia's hopes for progress in EU-Russian relations: Germany has been a driving force for European relations with, and confidence in, Russia. Germany's willingness to move ahead of the rest of the EU on such issues as visa regulations has also kept Russia interested in the EU. Should Germany revive its relationship with the Baltics, however, this is likely to change. Putin's foreign policy has already been frustrated by the demands of Estonia, Latvia and Lithuania in the EU; adding another voice, and such a powerful one, to their positions could lead to a significant worsening of EU-Russian relations.

Merkel's foreign policy priorities, of course, stand in marked contrast to Gerhard Schröder's personal relationship with Putin. As one of Putin's main supporters, Schröder has described the Russian President as a 'democrat through and through'. During their 32 visits to each other's countries since Putin came to power in 2000, Schröder has become Putin's most important political partner in Europe, if not in the world. In early September, President Putin visited both Chancellor Schröder and Angela Merkel, hoping to secure Russo-German partnership regardless of the election's result. Although a clear election victory for Merkel may have brought a chill to the warm relations, Putin's caution now seems unnecessary: even if she had won a clear majority, Merkel's foreign policy, with regard to Russia at least, would have been severely constrained by the interests of German big business.

Germany is still one of Russia's largest trading partners and leading investors. The recent agreement between Gazprom and Germany's E.ON and BASF to build a \$5 billion gas pipeline under the Baltic Sea emphasises not only the close relations between Germany and Russia under Schröder and Putin, but also Russia's

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importance to Germany. Many analysts have argued that what was once called a Russo-German energy dialogue has now become an energy alliance. Russia currently supplies up to 40 percent of Germany's energy needs, and this figure will increase significantly when the gas pipeline comes online in 2010.

German-Russian economic relations remain strong. German-Russian trade turnover hit a record of \$23 billion in 2004, and there are already 3500 enterprises with 100 percent German or Russian-German capital operating in Russia: accumulated German investment in the Russian economy amounts to \$9.3 billion. Although a new government may lead to a slight chill in relations with Russia and to better relations with Eastern Europe, Germany's economic, energy and business interests dictate that a strong partnership will continue.

“German-Russian economic relations remain strong.”

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## Radicalism in modern-day Germany - Baader Meinhof and the Red Army Faction

*Sarah McBrien, Janusian Security Risk Management*

The Baader-Meinhof Gang (BM) and its successor, the Red Army Faction (RAF), adhered to an obscure fusion of anti-capitalist and anarchist beliefs, and were the vanguard of a movement aiming to sweep away the post-war 'fascist' German state. 34 victims and 27 gang members were killed during their reign of terror that plagued Germany until the late 1990s, when the group was officially dissolved.

The Baader-Meinhof Gang experienced a revival – in media attention at least – in January 2005, when Berlin's Kunst-Werke Institute for Contemporary Art staged an exhibition called 'Imagining Terror: the Red Army Faction'. Incensed opponents of the exhibition accused it of glorifying the bloodiest period in post-war Germany by exploiting terrorist memorabilia at a time when 'terror chic' is on the rise. From high streets to catwalks BM leader Andreas Baader's guerrilla garb has made a comeback, with the magazine *Der Spiegel* even running a 'Prada-Meinhof' fashion feature depicting models in combat poses.

Though seemingly harmless, this cult of terror, in which the RAF has reached Guevarasque levels of fame, provides a throwback to the popular support that BM enjoyed in its formative years. Many young Germans in the 1960s – including figures like the outgoing Foreign Minister, Joschka Fischer – were sympathetic to the cause. As BM expert Richard Huffman states, the passive popular support of the movement at the period was 'the last, and perhaps only, time that a significant portion of a western democracy expressed open support for terrorism as an avenue for societal change'.

The brutal tactics that the group later resorted to, including decapitating GIs and maiming printing press workers, quickly lost them much of their support, however, and BM dreams of a proletarian backlash were thwarted. Yet it caused a climate of fear and a strengthening of terror laws, much like in present day Britain, which persisted into the late 1990s.

The question now remains whether such revolutionary – or even terrorist – organisations enjoy real backing in a state whose ailing economy has seen barely any growth over the past five years and where regional discrepancies are rife. It seems a stretch of the imagination to argue that 'terror chic' might equate, however slightly, to a genuine following for revolutionary movements. It is true that poor economic performance and regional divides can be conducive to rising levels of discontent and to growing adherence to dissident causes of the revolutionary type that BM espoused. Yet certain features are missing from the current German political and economic climate that would drive discontents to radical violence. BM and the RAF sprang from the 1960s student riots that were a direct result of thwarted nationalism and a reaction to governments seen as implicated in the Third Reich.

Furthermore, political dissent in Germany has found other outlets since the demise of

"The question now remains whether such revolutionary organisations enjoy real backing..."



the 60s and 70s groups. The origins of the Green party lay in alternative, non-violent protests against the status quo. In a sense, the RAF sanctioned the switch from revolutionary protest to peaceful petitioning *within the establishment* in its public dissolution in 1998. 'It was a strategic error not to build up a social-political organisation next to the illegal, armed one,' the statement read, thus admitting that advances could not be made without engaging in legitimate political processes.

As a consequence – though intelligence suggests the RAF regrouped as early as 1999 – it appears that there is little threat to Germany from home-grown revolutionary terrorism. As in many other European countries, however, significant threats are building up in other areas. On the one hand, it must be remembered that members of the so-called Hamburg cell co-ordinated and even carried out the 9/11 bombings, and the threat from Al-Qaeda related terrorists – of both the imported and the home-grown brands – persists. On the other hand, the ultra right-wing extremism that has again reared its head across Europe has found support in Germany. The National Democratic Party, said to be a loosely-veiled incarnation of Nazism, even gained 12 representatives in the state parliament, the *Landtag*, in the 2004 state elections in Saxony.

After nearly four decades of terror, the spectre of left-wing radicalism has faded, yet Germany is left facing two equally challenging threats: those of Al-Qaeda inspired Jihadism, and of ultra-right militancy. One powerful benefit can be drawn from the RAF's lengthy campaign, however: Germany's security forces are well-schooled at combating terrorist activities and look set to meet any threats to internal security head on.

“...there is little threat to Germany from home-grown revolutionary terrorism”

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## Germany's economy - no way out?

Alex Leslie, *The Risk Advisory Group*

The German economy has been picking up lately. Exports continue to be strong and Chancellor Schröder's labour reforms, such as they are, are starting to bite. Inward investment is slightly up and consumer confidence is said by some to be returning to Germany. However, unemployment is still running high and the East is still a basket-case.

A month ago, the world saw Germany putting its money where its mouth was. The electorate was tired of undelivered promises and an economy that was failing to spark. Presented with the new leader of the CDU, Angela Merkel, Germany scented again the winds of change: Germany's first woman Chancellor not least among these. More importantly, the CDU was thinking about radical tax reforms and seemed to be keen to sharpen the edges of Germany's market economy. Business was looking forward to a shift to the right and so, it seemed, was the electorate.

As the election drew near, the cracks started to show. Merkel was openly criticised by her own party and polls began to show the voters returning in swathes to the devil they knew. For the last two weeks of campaigning, Germany did not know where to look: Merkel seemed to lose confidence and her plans for the economy and her economic advisor, Paul Kirchhof, had both been widely attacked. Spotting a weakness in his opponent, Schröder played to his strengths and seduced many voters back to the SPD with his homely brand of German solidity.

The result mirrors this state of affairs exactly. The German political spectrum is almost a perfect pyramid. For every person on the centre right, there is one on the centre left. For every hard line leftist, there is an opposite number on the right. Some people want labour reform and others don't. En bloc, Germany wants the economy to get better but not if there have to be victims of this, a sentiment that was echoed by Eberhard von Koerber in a recent interview in *Handelsblatt*. While this result reflects an admirable evenness, it is disastrous for business.

Widely hailed as 'catastrophic', the election result means that no clear direction is likely to come from the Bundestag. The CDU appear to have won the vote, although the SPD is claiming that the CDU and CSU cannot claim to be one party. Therefore, Schröder maintains, the SPD have the largest share of the vote and the consequent right to form a coalition. Owing to the spread of the vote, neither political bloc can coalesce to form a majority without coming to an accommodation with a party of a distinctly different hue. The king-makers, the FDP and the Greens, both hold about ten percent of the vote and are both run by powerful politicians (although Joschka Fischer has now said he will no longer lead the Green Party).

Business seems divided over what it favours most out of the options on the table. A right of centre party probably offers the most advantageous deal to business but, in its absence, neither the Jamaican nor Grand options seem to be hugely different. The truth is that the political parties both sit so close to the centre that there is little significant difference between the two main options. One single message is coming out of

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the business community and that is that Germany needs a stable government which is 'regierungsfähig' and it needs it fast.

More important, according to some commentators, is the need to stimulate consumer demand, which is currently growing at the slowest rate in the world according to a recent article in *The Times*. Forecasters are lowering their estimates of Germany's growth in the coming year, downgrading it from 1 percent to  $\frac{3}{4}$  percent. If Germans cannot be persuaded to start spending, no amount of tinkering with fiscal instruments is going to bring about the radical demand-led changes that Germany needs.

This is the root of the problem. The German consumer needs inspiration and leadership: neither quality, however, has been much in evidence in this election.

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