Germany's showdown on historic fiscal stimulus is approaching

The CDU/CSU and SPD have until 25 March to get their fiscal stimulus package and the necessary amendments to the debt brake approved by parliament. As the deadline approaches, stumbling blocks have begun to emerge

Friedrich Merz, the probable next German chancellor

At the end of a historic week for Germany, which started with the announcement of a €500bn investment fund, changes to the debt brake to allow for higher defence spending, and the removal of the balanced-budget restriction for state governments, the CDU/CSU and SPD have already presented a draft law.

This draft law proposes official amendments to the German constitution and consolidates all proposed changes into a single bill. Consequently, the final vote will be an all-or-nothing decision. To change the Constitution, a two-thirds majority in both parliament and the Federal Council is required. The draft law will be debated in parliament this upcoming Thursday and voted on Tuesday, 18 March.

The inaugural session of the newly elected parliament is set for 25 March. It's important to note that the CDU/CSU and SPD lack a two-thirds majority and thus rely on support from other parties, ideally the Greens. While no date has been set for a vote in the Federal Council, the majorities there are unlikely to shift quickly. However, in the Federal Council, the CDU/CSU and SPD also lack a two-thirds majority and depend on the Greens, which sit in several state governments together with either CDU/CSU or SPD.

Possible stumbling blocks are getting bigger

Over the weekend, three influential Green politicians (and members of three state governments) argued that they couldn't support the current draft law. In short, they are calling for stricter controls to ensure that investments are targeted, and they would only like to see defence spending of more than 1.5% GDP (instead of 1% GDP) to be excluded from the debt brake.

This is the expected pushback and shows that the coming days will bring more political excitement out of Germany. Let's also not forget that not everyone at the CDU/CSU will be happy with the U-turn the party took on the debt brake, having campaigned against any changes and now going all in. The desire to lead the next government, however, will probably be stronger, leaving the Greens as the potential stumbling block.

CDU/CSU and SPD have presented the first outline of a possible coalition agreement

On Friday, the CDU/CSU and SPD presented the results of their informative talks, revealing an outline of a potential coalition agreement. However, this has led to increased obstacles.

While the speed and efficiency demonstrated by the three parties, led by the likely next German chancellor, Friedrich Merz, is impressive, the paper raises many additional financing concerns. In short, the paper is more a collection of (sometimes) good intentions rather than a coherent strategy to radically enhance German competitiveness.

For instance, the three parties aim to attract new industries while maintaining the automotive sector's key role. They propose reducing the electricity tax and constructing new gas power plants. Other measures include tax relief through income tax reform, higher subsidies for commuters, tax incentives for corporate investments, and a reduced VAT for restaurants. Additionally, they suggest a higher minimum wage without altering the retirement age, among other proposals.

Why is this paper now an obstacle? Because it will worsen the next government's financing problems as it is a long list of costly policy measures with very few proposals to cut expenditures elsewhere. As a consequence, there is a risk that the €500bn infrastructure investment fund will be 'repurposed' for more consumptive than investment expenditures. Therefore, it makes sense to have stricter controls to ensure that the infrastructure money is targeted. Something the CDU/CSU and SPD could still include in a revised draft law after Thursday's discussion.

Historic fiscal stimulus could come but reform agenda still missing

All in all, last week brought back optimism to the German economy. The swiftness with which the potential coalition partners agreed on a historic fiscal stimulus package and a preliminary coalition agreement has been impressive. And a welcome change compared to the almost endless coalition talks in other European countries. It shows that the parties, or at least the politicians involved, have understood that they have no time to lose and need to leave personal and political interests behind. So far, they have.

The outline paper presented on Friday, however, suggests that there is still a long way to go to combine new fiscal stimulus with a real reform agenda. While targeted additional spending aimed at improving competitiveness can only be celebrated, there is an increasing risk that the incoming government could repeat the mistake of the former government: trying to mask political differences with money that isn't there.

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