

How the Main Political Parties Plan to Make the German Economy Great Again

In this second part of our German election coverage, we take a look at how to tackle Germany's most pressing economic problems, the main political parties' policy proposals and the complicated German election math



In four weeks, the German elections will be history. We will know the results of these crucial elections, not only for Germany but also for Europe. However, we are unlikely to know the composition of the next German government and its policy priorities. With less than four weeks to go, the election campaign is entering its hot phase. Let's dive into what needs to be done to make the German economy great again, what the main political parties have to offer, and what could happen after the elections.

How to make the German economy great again – some ideas

The election campaign has entered the final stretch. Several television debates over the next weeks and strategic voting can still significantly impact the final election results. The two main topics dominating the election campaign are the economy and, increasingly, immigration, especially after last week's tragic event in Aschaffenburg, where an Afghan man killed a two-year-

old boy and a man who tried to help.

The German economy currently faces many problems. The three most pressing structural economic issues are energy, the changing role of China, and deteriorated competitiveness due to a decade-long underinvestment. Here's what we think needs to be done to solve or at least tackle these issues.

Energy

Germany's energy sources are renewables and coal. For the sake of the green transition and energy autonomy, the transition towards renewable energies needs to continue. However, there are currently two main problems associated with the full shift towards renewables: network problems and insufficient storage capacities to offset periods with no wind and no sun, as well as the costs. Consequently, Germany needs to step up investments in renewables and innovation but also needs to present a better way to accompany this transition by ensuring secure and stable energy imports, subsidising energy prices to ensure stable prices, and/or rethinking nuclear power plants.

China

China's changing role in the global economy, from a welcome export destination for German exports to a fierce competitor in both Chinese and global markets, will be hard to tackle. An obvious route for Germany could be via protectionism at the European level. A subsidy race against China would be lost from the start. A more disruptive way to deal with the China factor could be to completely focus on new sectors that are not prone to Chinese competition. This would require a complete overhaul of the economy or at least industry, in other words: Schumpeterian creative disruption.

Competitiveness

Closely linked to the 'China factor' is Germany's deterioration in international competitiveness, a result of chronic underinvestment by both the public and private sectors over the last decade. To restore competitiveness, Germany needs an investment offensive, reduction of red tape, and structural reforms.

Increasing investments is not only about higher public investments. To revive private investments, the next government will have to provide typical public goods, i.e., a functioning conventional and digital infrastructure as well as education at the highest standards. This will not be possible without stepping up public investments. Further incentives to support private investments should include tax cuts and faster depreciation of certain corporate investments. Finally, to effectively tackle red tape, investments in e-government seem unavoidable.

Additionally, two important economic issues related to competitiveness are defence and pensions. Regarding defence, the new US administration is another argument in favour of stepping up defence spending. The irony is that higher defence spending could eventually also help the domestic industry, as over the last years, the largest part of European defence spending went to the US. However, given Germany's history, the question is whether Germany and the rest of Europe would like to see Germany spending up to 5% of GDP per year on its military. A better option would be to follow the idea of a European Defense Fund. Turning to pensions, Germany's pay-as-you-go system and the projected increase of the old-age dependency ratio from currently

some 30% to 50% over the next 25 years require significant structural changes, with options ranging from higher retirement ages to higher contributions, capital market-funded additional pensions, and incentives for individual long-term capital market-based savings.

Sacrificing the Holy Schuldenbremse?

Looking at this long list of policies needed to make the German economy great again, it is impossible to see any substantial overhaul happening without higher public spending. Just to make up for the underinvestment of the last decade, Germany would need to invest around 1.5% of GDP every year for the next ten years. Of course, there will always be room to cut some public expenditures, but finding the fiscal space for all the required policies exclusively in austerity looks like a mission impossible. Therefore, the next government will have to agree on looser fiscal policies, be it via changes to the constitutional debt brake or via special funds, if it wants to achieve a real overhaul of the economy.

Will the political parties deliver?

From the past, we know that election programmes often look like wish lists or declarations of intention and not so much clear proposals cast in stone. Looking at the election programmes of the four parties that are most likely to participate in the next government in whatever combination (CDU, SPD, Greens, and FDP), shows clear differences in how to tackle the main economic problems.

Energy

All four parties intend to invest more in renewable energy, some more detailed than others. At the same time, however, the SPD and Greens plan to lower energy prices (hinting at subsidies), while the CDU and FDP want to reopen nuclear power plants and invest in micro nuclear reactors.

China

China plays a role in all party programmes, mentioned around ten times in each programme. However, China matters in terms of derisking and foreign policy, but no party combines a reaction to China's transition with direct policy proposals.

Competitiveness

As expected, the economy plays an important role in all party programmes. All four parties plan to reduce income taxes. However, while the CDU and FDP are also in favour of corporate tax cuts, the SPD and Greens are proposing subsidies for corporate investments. All four parties plan to reduce bureaucracy and stimulate innovation; the 'how' often remains unclear.

Debt Brake

When it comes to the financing of their plans, most parties remain vague. The German research institute 'Institut der deutsche Wirtschaft' estimated that the proposals could cost between 30bn euros (SPD) to 138bn euros (FDP). While the SPD and Greens want to finance investments with a 100bn euro fund, the CDU and FDP hope for higher economic growth over the next years and want to stick to the current constitutional debt brake.

Better but not yet good enough

Taking all these proposals together, Germany has an almost stereotypical election campaign when it comes to the economy. Centre-left parties are in favour of debt-funded investments, while the centre-right parties hope for the positive effects of deregulation on growth to finance tax cuts. At the same time, it is becoming increasingly clear that even in a best-case scenario with reforms and investments, any new government will not try to overhaul the old economic business model but rather try to rejuvenate the old one. Less red tape, some tax cuts to stimulate spending and investments, possibly attempts to lower energy costs and infrastructure investment – all of which feature in any European economist's wish list, and a growth booster for the economy; at least temporarily.

Whether these measures will really be sufficient in competing against China and the US is a completely different question. What Germany would get after the elections is a refurbished model of its economy – clearly better than the old one with cracks, battery failures, and very few gadgets, but also not a shiny, sparkling new model that makes the competition speechless.

What do the polls say?

And who will be responsible for the refurbishment? Four weeks ahead of the elections, the CDU and Friedrich Merz are still leading in the polls, with slightly above 30% of the votes, while the extreme-right AfD stands second on some 20%. The SPD currently stands at 16% and the Greens at 14%, while the “conservative-left” Sahra Wagenknecht Alliance (BSW), FDP, and left-wing Die Linke are predicted to score 5%, 4%, and 4% respectively.

Before doing the math, remember that the German election system is complicated as it is a hybrid election system in which voters cast one ballot for a candidate representing a constituency and a second for a particular party's list of candidates in a federal state. Only parties that win 5% of the second vote can enter parliament. However, parties that win at least three constituency seats ('Direktmandat') will still be entitled to seats in parliament even if the national vote for the party is below 5%. As there is another party, Freie Wähler (Free Voters), in Bavaria which could also clear the 5% hurdle or get three constituency seats, the next assembly could consist of between four and eight parties. This makes any prediction of the distribution of seats (and majorities) extremely difficult.

To complicate things further, last week's murder of a two-year-old boy in Aschaffenburg has intensified the debate on stricter immigration. The CDU's leading candidate Friedrich Merz presented a law-and-order plan he would implement on the first day in office, which will almost make it impossible to form a coalition with the Greens. Currently, a coalition with the SPD would not break over stricter immigration laws, but no one knows how the SPD will position itself after the elections. In case of a severe defeat, it is hard to see how Olaf Scholz would still lead the SPD. Whether such an event would then lead to the party's shift towards the political right or left remains uncertain.

All in all, and returning to the starting question of how to make the German economy great again, a majority for either SPD and Greens or CDU and FDP would bring the highest level of policy certainty, though with very different priorities. Such a two-party coalition would probably avoid the permanent in-house quarrels the current government had. However, it looks unlikely that the German voter will give such a clear guidance. In fact, it increasingly looks as if the German elections will be over in four weeks from now but that finding the next German government will take much longer.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.