Incoming German government presents coalition agreement

The political leaders of CDU, CSU and SPD just presented their coalition agreement. At first glance, it looks like a long list of good intentions, but lacks a bit of prioritisation. It will be growth-positive in the short term, but could soon run into a fiscal feasibility reality check

The incoming German Chancellor, Friedrich Merz, announcing the coalition agreement

It looks like Germany will have a new government soon, but not before Easter, as Friedrich Merz intended on election eve. The political leaders of CDU, CSU and SPD just presented the outline of the coalition agreement. It is an agreement that will now be subject to a member vote by the SPD, followed by Friedrich Merz becoming next chancellor and government leader of Germany in around a month from now.

Long wish list

To quote Mark Twain: the new federal government probably didn't have time to be brief, so it drafted a coalition agreement of 144 pages. When looking at the economic policy plans, the coalition agreement looks like a 'wish list' with many good elements that, however, eventually could never see the light of day due to fiscal limitations. Or to paraphrase Mark Twain again: the coalition agreement looks a bit as if the coalition parties didn't have the time (or willingness) to decide on real priorities, so they just wrote down everything down. From a Germany Funds to corporate tax cuts, accelerated depreciation rules for investments and income tax cuts to stable pensions, VAT cuts for particular interests and subsidies for e-cars to reducing bureaucracy, a leaner public administration, and the abolition of the so-called supply chain law. Many good elements, but also many short-term elements whose effects can quickly fizzle out.

Here are some of the highlights:

- Setting up a Germany Fund to support innovation in SMEs and start-ups. This fund will get 10bn euro from the government and should attract some 90bn euro from the private sector.
- Corporate taxes will be reduced by a total of 5 percentage points in five steps from 2028 onwards.
- An innovation booster via faster depreciation of investments in 2025, 2026 and 2027.
- Income tax cuts for lower and middle income households.
- Additionally, tax-free overtime bonuses are to be introduced, as well as tax incentives for voluntarily working longer in old age.
- Cut in electricity taxes plus intention to cap energy and network prices.
- Several subsidies and tax relief for electric vehicles.
- Several initiatives to reduce regulation, bureaucracy and public administration.

Let's not forget that the biggest decision was already made before the official coalition negotiations had actually started: the fiscal u-turn with a 500bn euro investment package, more fiscal space for state governments and de facto unlimited spending power for defence.

New government will be forced to prioritise soon

All in all, as so often with German coalition agreements, the plans and intentions are good. And, on the positive side, Germany will get a new government about two months after the election. The economic problems also seem to be recognised. However, when it comes to solutions for these problems, the convenient option has been chosen: let's simply do everything – structural reforms, subsidies, and investment incentives. The risk is high that many of these plans will never see daylight due to fiscal constraints. The coalition partners wanted to rush to an agreement as the world is obviously not waiting for Germany to agree on a government. Mission accomplished. In the past, these kind of coalition agreements never had a long shelf life as governments had to face unexpected external and internal challenges. It looks as if this time around will not be that different. It won't take long before the incoming government will have to do what it avoided to do now: prioritise.

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