To the point!

Cross-Asset- and Strategy-Research

Germany’s budget: few reforms, much spin

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From fiscal saint to sinner: Part II

Last week, I used this column to address the lamentable state of France's public finances. There, political divisions and a lack of parliamentary majorities have prevented the approval of a 2026 budget. Yet another French government had to tender its resignation as a result.

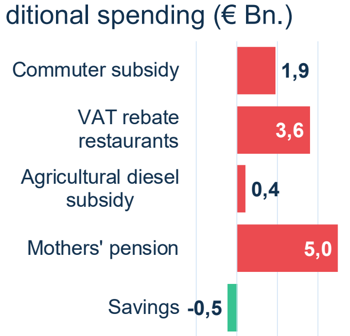
Before Germans gleefully judge the dire situation across the Rhine, let’s recall that Germany has only just finalized its own budget *for the current year*. The Bundestag will not even vote on the 2026 budget until late November at the earliest. You may recall: the previous German government collapsed largely due to disagreements over the budget. So far, so French. But even the new government under Chancellor Friedrich Merz needed more than four months to get this year’s budget off the ground. While this effort has now culminated in the approval of the 2025 budget by the CDU/SPD-majority parliament last Thursday, the passing of the budget deserves a closer examination.

Never before has the German budget been passed this late

A distinct absence of ambition

Admittedly, it's no small challenge to overhaul fiscal policy when most of the fiscal year has already passed. But in light of the government's bold proclamations that Germany is on the verge of an economic “autumn of reforms” the budget feels strikingly unambitious. The planned savings amount to just €460 million – a mere 0.1% of the original expenditure plans by the old government, equivalent to a mere €5.50 per citizen. These sums are trifling compared to the “election giveaways” (see Fig. 1). If a budget is indeed the numerical expression of political priorities, then this budget does not display any meaningful reform-minded policy. A robust “reform autumn to be reckoned with” – as CDU Secretary-General Carsten Linnemann enthusiastically promised – may yet happen. But the budget is no precursor of it.

Fig. 1: Budget savings and additional spending (€ Bn.)



Source: ftd.de, tagesschau.de, LBBW Research

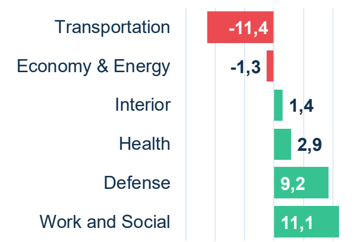
Shunting spending around to the detriment of investment

When the outgoing Bundestag hurriedly amended the constitutional debt brake (a strict fiscal rule limiting new debt), the participation of the Green Party was crucial for achieving the required two-thirds majority. Back then, the Greens demanded one essential condition: the €500 billion "special fund" (Sondervermögen), financed through additional borrowing, should exclusively support new investments, not previously planned. To avoid merely shifting regular, pre-planned funding into the special fund, a clause on "additionality" was enshrined in Article 143h of the German Basic Law, the country's constitution. However, the wording of the constitutional article is rather wishy-washy: "Additionality exists when an appropriate investment quota is achieved within the federal budget for the respective fiscal year." But what exactly is "appropriate"?

The constitution demands additionality

From Merz's government's point of view, the budget plans proposed by the collapsed "traffic-light-coalition" evidently featured "inappropriately" high levels of investment. A comparison of the two budgets – the draft of the previous coalition versus what the Bundestag has now approved – reveals significant shifts in priorities (see Fig. 2). The CDU/SPD coalition is funneling funds away from investment-oriented expenditures toward higher levels of current spending, especially for social programs. Specifically, where the traffic-light coalition had earmarked €53 billion for public investment, Merz's government has scaled this back to €38 billion. Magically, these capex expenditures reappear within the debt-financed Infrastructure Special Fund.

Fig. 2: Net changes compared to draft of 2025 budget of the collapsed traffic light coalition (€ billions, by ministry)



Source: ifo-Institut, LBBW Research

With these creative (and barely concealed) accounting maneuvers, the government undermines the constitutional principle of additionality. But more importantly, this approach demonstrates a regrettable unwillingness to present German citizens with an honest accounting of the state of public finances. This sleight-of-hand drives national debt upward while shifting the fiscal burden onto future generations. The irony of Chancellor Merz lamenting that Germany is "living beyond its means" is difficult to ignore. Strictly speaking, an economy with a current account surplus of nearly €250 billion (2024 figures) with the rest of the world is – by definition – actually living *below* its means.

A new commission to reform the debt brake gets underway

Meanwhile, last week also saw the launch of an expert commission tasked with reforming the debt brake. The initiative comes a bit late to the table. The damage is already done by excluding recurrent defense expenditures (which are *not* investments generating financial returns) from the debt brake. Based on the composition of this commission and the entrenched positions of its members I consider a set of consensual recommendations highly unlikely. Therefore, the commission will at least, not exacerbate the situation. But it appears equally unlikely that it will provide genuine solutions to Germany's pressing fiscal challenges.

At best, a commission buys some time

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