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Germany must resist the lure of easy debt

Berlin should be selling reforms, not largesse

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The economic fallout from the war between the U.S. and Iran is impossible to ignore. The German government recently halved its own growth forecast to 0.5%. The longer the war drags on, the deeper the scars will be for growth, investment and jobs. In the worst case, Germany could slip back into recession.

To contain the risks for the German economy, lawmakers from the center-left SPD have floated the idea of suspending the constitutional “debt brake” – a rule in Germany’s Basic Law that tightly limits new federal borrowing – to cushion the shock. In an interview, the Social Democratic floor leader, Matthias Miersch, called it the government’s duty “to prevent a collapse of our economy.” In fairness to Miersch, he presented relaxing the rule as a last resort – an ultima ratio, as he put it, “in the worst case.”

The wrong signal at the wrong time

Even so, talking at this stage about a looming “collapse” sounds – to put it mildly – somewhat shrill. The situation is serious, but it is not an emergency. Yet under the Basic Law, such an emergency would be required to loosen the debt brake. The government knows this. How else could it justify having cut VAT on fuel since 1 May to push down prices at the pump – [a fairly pointless measure](#) – if a genuine state of emergency were truly just around the corner?

It is therefore good news that Chancellor Friedrich Merz, the conservative head of the German government, has promptly rejected the idea of loosening the debt brake. Speculating now about watering down the rule only fuels the already widespread belief that the state will solve every problem for its citizens – as it recently tried to do with its attempt to lower fuel prices.

The war is weighing heavily on the German economy

Knee-jerk call for more borrowing

Debt cannot solve every problem – and where it helps at all, it does so only temporarily. The moment when rising interest costs crowd out other public spending is inevitable. It will arrive sooner rather than later if those in power fail to show a firm will to reform. A “no-worries” policy mix – endlessly turning the debt screw – undermines voters’ willingness to accept the need for tough reforms. Yet reforms are urgently needed in Germany right now – not least in light of the looming wave of baby boomer retirements hitting pay-as-you-go statutory pension and health-insurance systems. The government should be making the case to citizens for the need to reform instead of repeatedly showering them with handouts. Even now, deficits in public budgets are reaching levels comparable to the true emergencies of the global financial crisis and the pandemic (see Fig. 1).

The debt brake has already been dismantled

Calling it a “debt brake” at all is close to euphemism. The softening of what had previously been a strict rule in spring 2025 was less a reform than a demolition job. As a long-standing advocate of modernizing the old mechanism, I have to admit with some frustration that the governing grand coalition – the traditional power-sharing alliance of the center-right CDU/CSU and the center-left SPD – [threw the baby out with the bathwater](#).

It is entirely reasonable to take on debt for investment – say, in infrastructure. Every entrepreneur does the same. But the German government’s current massive build-up of debt for higher defense spending is much harder to justify.

Germans can repeat like a mantra that they must “invest” in military resilience – but defense spending is consumption, not investment. An investment is defined by the fact that today’s outlays generate additional income tomorrow, which can then service the debt. That is not the case for armaments.

On top of that, the reform of the debt brake stipulated that defense spending above 1% of domestic output could be financed through borrowing. Yet Germany had already reached 2%. In other words, the government simply wrote itself a fresh blank cheque for debt worth 1% of GDP.

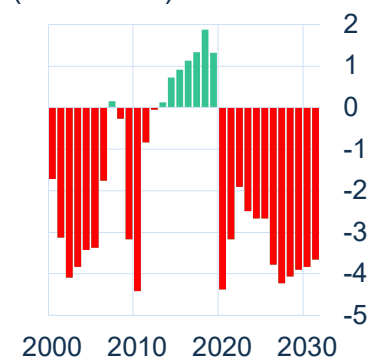
The German state’s share of the economy – the ratio of public spending, including social security, to GDP – already exceeds 50% (see Fig. 2). Former German chancellor Helmut Kohl once quipped that socialism begins beyond a 50% state share. That is surely an exaggeration, but as a warning that the country is heading in the wrong direction, it should give us pause.

Germany has the “misfortune” of having been so fiscally conservative in the past that it can now afford more debt than many comparable countries (see Fig. 3). But for how much longer? How safe is Germany’s AAA top rating from the agencies?

Better not to find out.

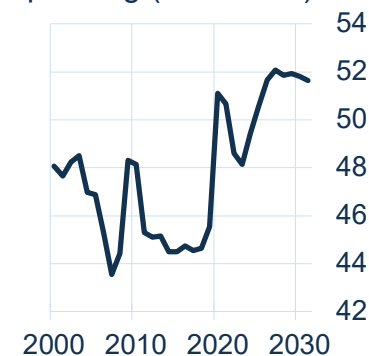
Real reforms, not fiscal band-aids

Fig. 1: General government balance (% of GDP)



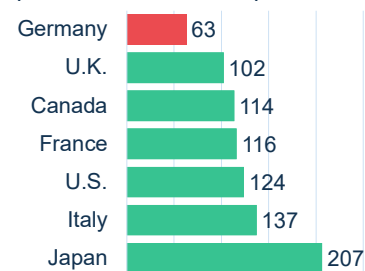
Source: IMF, LBBW Research

Fig. 2: Government spending (% of GDP)



Source: IMF, LBBW Research

Government debt (% of GDP, 2025)



Source: IMF, LBBW Research

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