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# Germany's reforms: miracle or mirage?

## The federal government in Berlin is finally getting into gear

Unlike the national football team, Germany's government finally seems to know how to score: last week it presented a [reform package](#) that turned out to be surprisingly substantial, given how modest expectations had been. Almost everything is in there – pensions, taxes and the labor market, as well as deregulation and so on. Markets initially welcomed the plans, and even the commentators partially resisted their usual reflex to talk down whatever the government proposes. The fact that the coalition has put anything on the table at all is a pleasant surprise, given that poor polling numbers (see fig. 1) make reforms harder to push through, since they always come with some degree of pain.

### A central problem: the pension system

Even the toughest nut to crack – reforming Germany's public pension system – has now been tackled by the coalition. It was high time. The fact that the large baby-boomer cohorts are riding off into the professional sunset is [putting severe strain](#) on the country's pay-as-you-go system, in which current workers finance current retirees. At the end of June, the German pensions commission submitted its final report to the chancellor and the labor minister. And Friedrich Merz announced that his government would implement all of its proposals. The core element is a funded pension pillar: part of the pension contributions is to be invested in capital markets, and the resulting returns should, over time, reduce the subsidies required for the statutory pension system and allow for a higher benefit level.

Building up that capital stock, however, takes time. At the same time, current pensions are not supposed to fall, even though they will continue for now to be financed on a pay-as-you-go basis.

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## Merz gets going!

Fig. 1: Satisfaction with the government's performance (June 2026)



Source: [Ilium.de](#), LBBW Research

To resolve this dilemma, the commission has proposed additional contribution payments: starting in 2028, pension contributions for the capital-funded pillar are meant to rise by 0.5 percentage points per year, reaching an extra two percentage points by 2031. On the commission's numbers, this implies that the overall contribution rate to the statutory pension system would have to climb from today's 18.6% to almost 22.5% by 2032. Without building up the capital stock, the rate would "only" reach 20.4%. Over the long term, a funded component can ease the burden on the system, but in the short to medium term it will likely weigh somewhat on demand and jobs.

The planned labor-market reforms are not enough to offset this negative effect. The centerpiece is an easing of job-protection rules for high earners with annual incomes above EUR 177,450, weakening Germany's traditionally strong job security. That will undoubtedly make it easier for start-ups to hire staff, since they will be able to shed employees more easily if the business fails.

The much-touted tax reform is also more patchwork than breakthrough. A relief of EUR 10 bn is envisaged for low and middle incomes. That is a mere 0.2% of GDP. The basic allowance (previously EUR 12,348, now to rise to EUR 12,900) and the per-child allowance (previously EUR 4,878, rising to EUR 5,123) are to be increased. In the cold light of day, this is barely more than compensation for inflation. For mini-jobbers – people in marginal part-time employment – by contrast, tax burdens would even go up. Since mini-jobs are predominantly held by women, the gender pay gap, [relatively high in Germany](#), is likely to widen rather than narrow. At the upper end, the reform takes a somewhat bigger bite out of high earners' incomes: from EUR 250,000 upward, a tax rate of 45% is to apply; from EUR 280,000, 47%. Currently, the 45% rate kicks in only above EUR 278,000.

### What else is in the package

In health care, employees who fall ill will in future have to provide a doctor's note from the very first day – and risk infecting others in the waiting room. It is hardly surprising that doctors are up in arms about this. Perhaps even more troubling is the underlying presumption that the people are lazy slackers and feign illness en masse. According to media reports, Berlin's to-do list also includes abolishing the currently contribution-free co-insurance for spouses in statutory health insurance, who are most often women. For many households this would mean a direct financial burden and a fundamental shift in the system.

Merz also promises to cut red tape. In future the state is meant to regulate less obsessively. That is encouraging, since businesses regularly cite bureaucratic costs as their single biggest obstacle to investment. But in this area the devil will be in the details, and for now the announcements remain vague.

At least it is a start. But the package still falls short of the "great leap forward" Merz had hinted at in a rare Maoist flourish.

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In the short term, funded pensions can weigh on growth

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Minor tax reform

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Deregulation as the trump card?

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