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In March 2025, the German Parliament approved two spending measures that surprised Germany's European partners and international observers. The decision of the Bundestag and the Government is not only relevant for the German economy; it also has a significant scale and objective for the member countries of the European Union.

In fact, the announcement of the huge spending program was greeted with interest and sometimes with great appreciation outside the German borders. There are three essential reasons for the favorable reception of the German program:

- 1) Given its size, the German spending program can be the first European response to growing global protectionism, at least partially offsetting the depressive effect on European demand caused by the US Administration's tariff policy.
- 2) Being oriented towards strategic sectors such as military infrastructure and digital modernization, the German program can limit the damage of the weaponization of strategic and digital supplies by China and the United States in a phase of worsening international relations.
- 3) Finally, by implementing a fiscal expansion without changing the European fiscal rules, i.e. by guaranteeing the European economy greater strength but not less stability, the German program can contribute to the role of the euro as a reserve currency in a phase in which conditions of uncertainty about the future credibility of the dollar are manifesting themselves.

Although these reactions are understandable, this policy brief will focus on how the motivations for the fiscal stimulus initiative must be sought (also) on a different level relating to the internal politics of Germany and more precisely to the risk that conditions of economic stagnation can strengthen the extremist right-wing Alternative für Deutschland (AfD) party, thus jeopardizing the democratic stability of the country.

The risk of an expanding consensus of citizens for AfD also in the western Länder, and not only in those of the former GDR, has brought to light a "Western question" that contrasts with the now thirty-year-old question of the reconstruction of the disadvantaged regions of Eastern Germany.

The revival of production activities in the western regions requires a huge investment plan to interrupt the current of pessimism that has been spreading towards the industrial areas of West Germany, allowing the populist language of AfD to spread easily.

The fragmentation of the German party landscape made the last month of the outgoing Parliament the last available window to modify the article of the Basic Law that establishes the criteria for applying the "debt brake" (Schuldenbremse). Through the fiscal lever, at the service of a fairly targeted industrial policy, the two traditional parties - the Christian Democratic Union (CDU) and the Social Democratic Party (SPD) - intend to give the economy impulses, both on the demand and supply side, which can subtract consensus from the radicalization of political protest. This is an objective that is even more urgent due to the worsening of the international situation with the growing Russian threat to Europe's borders and the abandonment of Europe's traditional American partner in security guarantees and economic cooperation.

The decline in German productivity and the resulting stagnation of the economy could, however, depend on factors other than those addressed by the "fiscal turning point" approved by the Bundestag. The last part of this brief will advance the hypothesis that the difficulties mainly depend on macroscopic errors in corporate management. If this hypothesis were to be verified, the response of the "turning point", i.e., the fiscal stimulus, could be of little use. To correct the errors in corporate strategy and management, a reform of the governance and financial structures of the German companies would be necessary, in particular through the scrutiny of operators not inherent to the current governance system and therefore to non-German financial and banking operators. However, based on the documents of the coalition contract of the new government, there do not seem to be openings in this direction. The risk is that the economic results of the new legislature will not be those hoped for and that the political consequences of this will be dramatic.

A budget of about a trillion

On March 18, 2025, the Bundestag approved a budget of about a trillion divided into two spending programs. On the one hand, a special fund of €500 billion for infrastructure and climate protection investments was approved. On the other hand, the easing of the debt brake for certain defense expenditures was decided. This second measure required amendments to the German Basic Law in Articles 109 and 115, with the addition of paragraph h of Article 143.

The two programs are being pursued through two different financing channels. Investments in infrastructure and climate protection will be financed through a Sondervermögen, i.e., a special fund created under the Basic Law, while spending on defense, security, and aid to Ukraine will be made possible by an easing of the debt brake approved by Parliament in 2009 and since then included in the same Basic Law.

Regarding the 500 billion special fund, on March 14, 2025, the CDU/CSU, SPD and the Greens agreed on a special fund for infrastructure and climate protection. Three hundred billion will be used for additional infrastructure projects at the federal level and for the promotion of innovation. In addition, 100 billion euros are earmarked for the Climate and Transformation Fund (KTF) and another 100 billion euros will go to the regional states (Länder) for their projects to be coordinated with federal spending. The funds are to be made available and invested over a period of 12 years, i.e. from 2025 to 2036.

As regards defense spending, in the future a separate debt rule will apply for defense spending (Bundeswehr and other security measures). Under the new rule, all spending that would cause overall defense spending to exceed 1% of nominal GDP will no longer be included in the calculations relevant

to the debt brake and will therefore not be limited by it. The state will therefore be allowed to take on new debt for these expenses. The expanded definition of security implies that not only military defense, but also civil defense, cybersecurity and intelligence services will be able to benefit from this exception. In addition, a fixed investment quota is set so that the money can flow into new projects and not into current expenditures.

There are currently three possible scenarios regarding the implementation timeframe:

1. **Mid-2025 at the earliest:** After the Bundestag and Bundesrat have reached a rapid agreement, the first funds could already be paid into the budgets for the second half of 2025.
2. **Realistic - Late summer/autumn 2025:** Practical implementation (e.g. tenders for infrastructure projects, funding programs) will take time. Depending on the bureaucratic effort, utilization is expected from the third or fourth quarter of 2025.
3. **2026 at the latest:** In the event of delays, full use of the funds would not be possible until the 2026 financial year. The decisive factor will therefore be how quickly the government implements the necessary legislative and administrative processes.

Political motivations

As a result of the fragmentation of the German party landscape and the strengthening of extreme formations, after the elections of 23 February 2025, the outgoing Parliament potentially represented the last House of Representatives in which a two-thirds majority could be formed by the parties that in the last 40 years have represented the democratic-liberal and social demands (CDU/CSU, SPD and Greens).

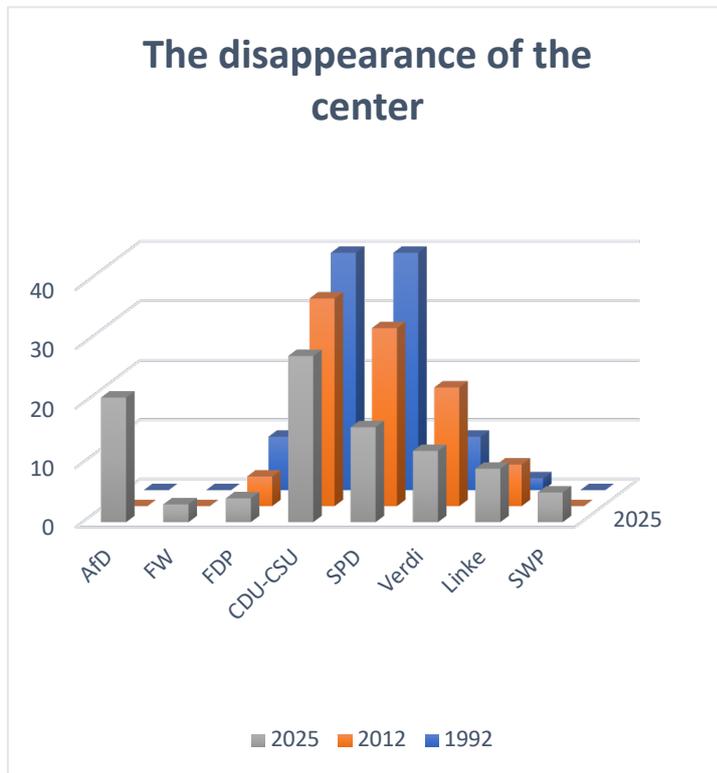
Given the growing importance of parties of extreme political radicalization and in particular AfD, the traditional centrist parties have taken steps to modify the margins of public debt that were limited by the "debt brake" (the brake sets the maximum deficit ceiling of the annual federal budget at 0.35% of GDP, while requiring a balanced budget of the Länder) and therefore allow Germany to implement public spending programs made urgent both by the fall in productivity, the structural stagnation of the economy and the new spending and investment needs linked to the international framework.

To amend the German Basic Law, not only the consent of two-thirds of the Bundestag is required, but also of the Bundesrat, the chamber of regional representatives. Since the number of parties capable of obtaining consensus on a local basis has also grown, the requirement of approval also by the Bundesrat made it even less predictable that in the future the conditions necessary for the majority required for a constitutional amendment could arise again.

As can be seen in Fig. 1, over the last thirty years the share of the electorate that voted for the two largest parties (CDU and SPD) has significantly decreased; to the point that in the future the so-called Grosse Koalition may no longer obtain an absolute majority of votes. In the course of the last decades, moreover, the number of parties represented in Parliament has doubled, also making the formation of new coalitions particularly complex. In the last legislature, the first three-party coalition formed by the SPD, the Greens and the Liberal Party disintegrated politically precisely in coincidence with the emergence of fiscal limits that were more stringent than expected (following a ruling by the Constitutional Court), such as to make the spending programs of the inhomogeneous coalition incompatible.

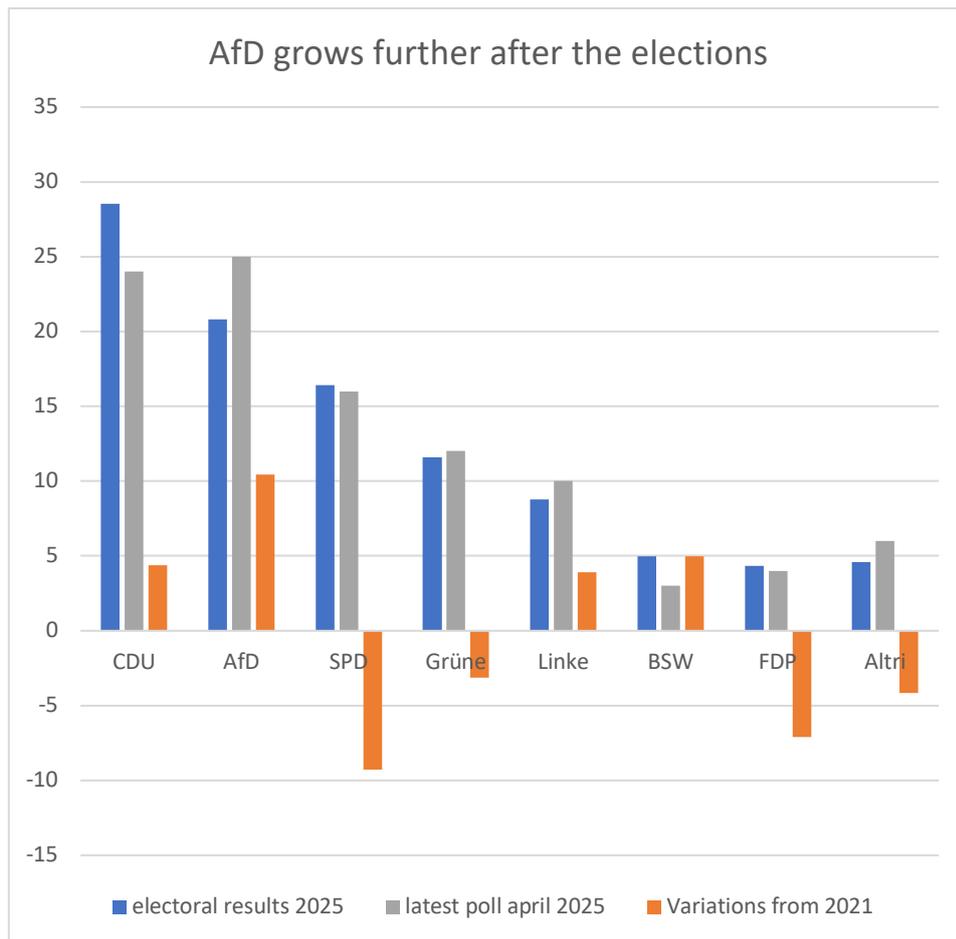
Not only did the outgoing Parliament offer the last available window to make the country fiscally governable in the years (and perhaps decades) to come, but a further cause for concern was linked to the fact that starting from the next legislature it is not possible to exclude the involvement of AfD in the government, should that party emerge victorious in the elections scheduled for 2029.

Figure 1



The main goal is to stop AfD

In the federal elections of February 23, Alternative für Deutschland saw its votes double compared to the previous elections, rising to 20.8%. The exploit did not end with the protest vote, but continued afterwards. After the elections, in fact, according to the polls, AfD grew further while the CDU, the party that won the elections, dropped significantly. According to some surveys, during April 2025, AfD would collect a higher number of "voting intentions" than the CDU and would therefore be the largest party in Germany for the first time (Fig 2).

Figure 2

There are propaganda reasons to imagine a further rise of the radical right party linked to the fact that the current leader, Alice Weidel, comes across as a politically toothless personality. The fear is that a more effective populist tribune could emerge (the past founder of the Austrian radical right Jörg Haider is often used as an example), one capable of mobilizing the anti-system vote throughout the country with slogans that recall the National Socialist regime.

A scenario in which AfD led or inspired the policy of the German government would mean a political alignment of Berlin with the pro-Russian and anti-European positions of the American presidency. As is known, both President of the Russian Federation Vladimir Putin and US Vice President JD Vance have offered political support to AfD against the pro-European positions of the traditional German parties. A Washington-Berlin-Moscow axis would then be formed that would represent perhaps the definitive turning point in the history of Western liberal democracies.

Other reasons point in the same direction. In Fig. 3, taken from the vote analysis published by the German newspaper *Frankfurter Allgemeine Zeitung*, it is noted that the increase in AfD votes in the last elections is largely due to the attraction of citizens who had not voted in the previous elections (“Nichtwähler”). Another share of the new AfD voters is made of citizens who had previously voted for the CDU.

The hypothesis that the AfD electoral reservoir is not completely exhausted is “supported” by Fig. 4, which shows that the voter turnout of German citizens, although it has grown significantly since 2009, has not yet reached the levels before the 1990s.

Figure 3

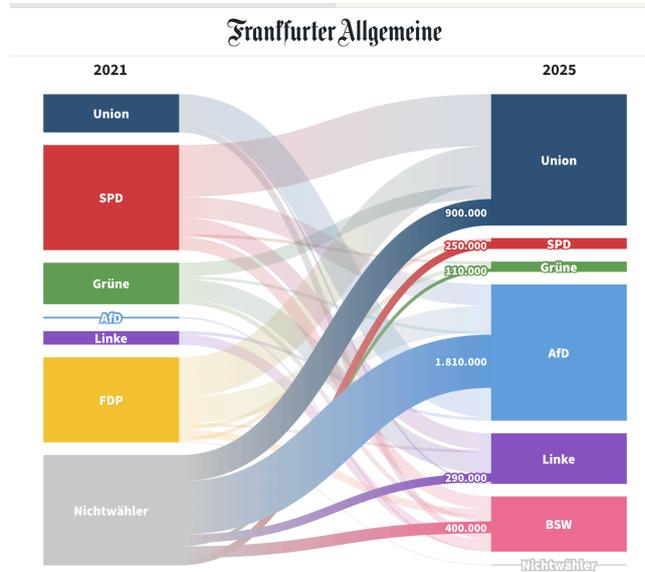
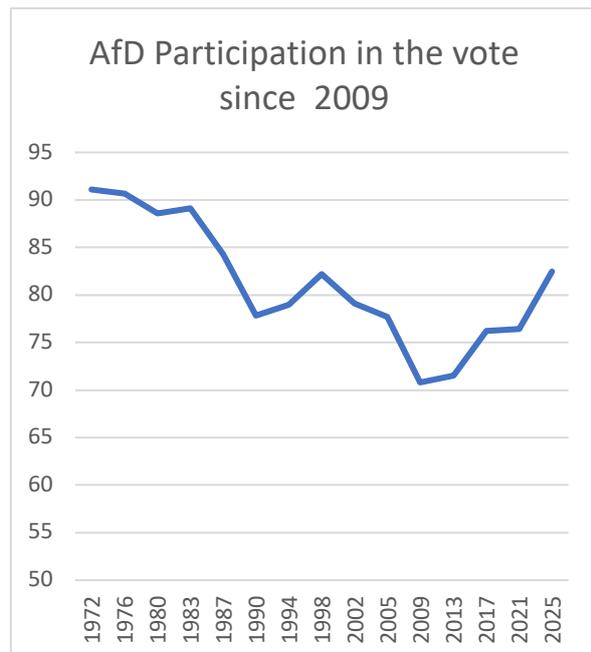


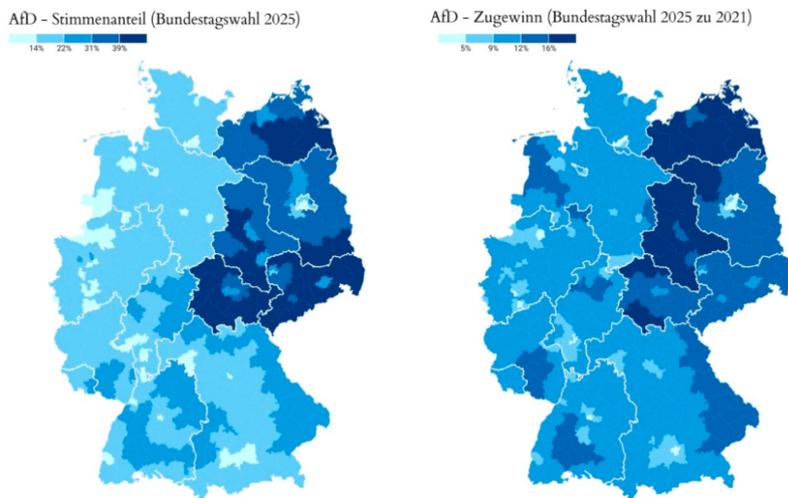
Figure 4



The Western Question

In Fig. 5 (taken from the vote analysis published by Julius Kölzer on Bundeswahlleiterin data) the traditional concentration of the AfD vote in the eastern Länder can be seen in the left map. However, in the right map it can be seen how the increases in votes between 2021 and 2025 were also very significant in the western Länder.

Figure 5



One possibility that an initial statistical analysis supports is that the increase in consensus for the far-right anti-system party is occurring in constituencies where a crisis in traditional production sectors is manifesting itself. At a conceptual level, the reasons for this phenomenon – a divergence of personal destiny linked to technological development – have been presented by the author in the book “Viaggio al termini dell’Occidente” (Luiss University Press 2019).

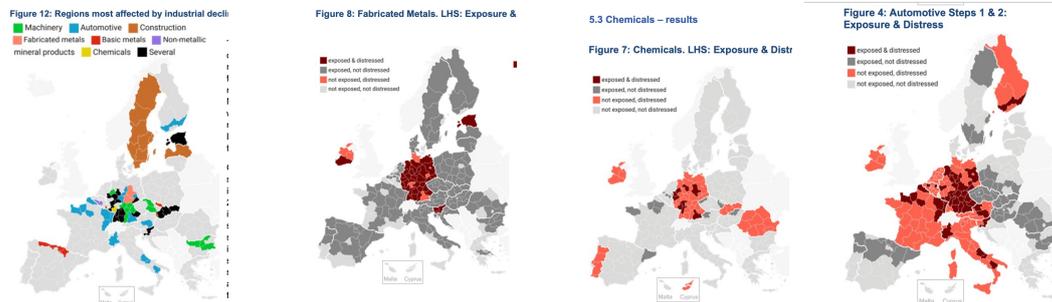
Fig 6 reports the estimates of the decline of some important production sectors (metallurgy, chemical, automotive) in Europe. These estimates, published¹ by Henri Heikkinen, Nicoas Listl and Andreas Reuter for the DG Grow of the European Commission and based on an analysis of the European regions (Nuts 2), highlight how a prevalent number of the major crises in important production sectors in Europe are manifesting themselves precisely in Western Germany.

¹ https://single-market-economy.ec.europa.eu/publications/mapping-impact-industrial-decline-european-regions_en

Figure 6

Industrial decline in the western Länder

(data from DG Grow: «Mapping the Impact of Industrial Decline on European Regions») March 28,



«In Germany, fully 26 of 38 regions (68%) are strongly impacted, with twelve of them (32%) suffering from the decline of several sectors at once (black regions). The industrial demise culminates in the southwestern region Saarland which struggles with the impacts of an ailing automotive, machinery, basic and fabricated metals industry»

A group of economists (Schularick, Hüther, von Weizsaecker, Südekum, Füst) has devoted attention to the emergency of the German production system and has formulated a position paper adopted by CDU and SPD as an analytical basis for the fiscal stimulus of about a trillion euros. The analysis pays great attention especially to the western regions.

For Friedrich Merz, indicated as chancellor by the government coalition, it is a question of reconstructing an optimistic sentiment on the prospects of a country that is the last in Europe in which a populist party has not become the first party by popular consensus. Some of his economic advisors have highlighted a relationship between fiscal austerity and political radicalism. This is an analytical statement that is not exactly common in Germany. A recent paper² by Schularick and others highlights the contribution of a restrictive budget policy in Adolf Hitler's rise to power. Between 3/1930 and 5/1932, Chancellor Brüning implemented tax increases and spending cuts in the midst of a deep recession. By the end of this phase, the Nazi Party had become the largest party, winning the elections in July 1932. Six months later, Adolf Hitler was appointed Chancellor.

The Economist commented in late 1931: “Coming on top of three previous Emergency Decrees, which have already reduced terribly the German standard of life, and imposed, as it is, in the middle of a crisis in which Germany has five million unemployed, her stock markets closed, her tale of bankruptcies mounting to catastrophic figures, and her whole economic system 'frozen' by credit restrictions and standstill agreements, this latest 'turn of the screw' will undoubtedly place a dangerous strain on the psychology of the German people.” Schularick et al. seem to estimate the effect of austerity on GDP at 1%, an impact that is therefore not prevalent compared to the size of the recession (the fall in GDP was greater than 5% over the two years), but from a political-economic point of view it is more relevant to

² https://www.stephanieettmeier.com/files/ugd/709433_db403fec08dd469caafbf4b7808bddb6.pdf

consider it plausible that an expansionary policy would have attenuated the recession to a greater extent than the direct impact of the restriction.

The analogy with the Weimar period is however misleading because the perception that German citizens have of their personal well-being varies greatly. Table 1 shows the answers of German citizens to questions about their personal economic condition. Not only are non-negative answers equal to 95% of the population but the share of those who believe they are “very good or good” has increased significantly since 2009.

Table 1

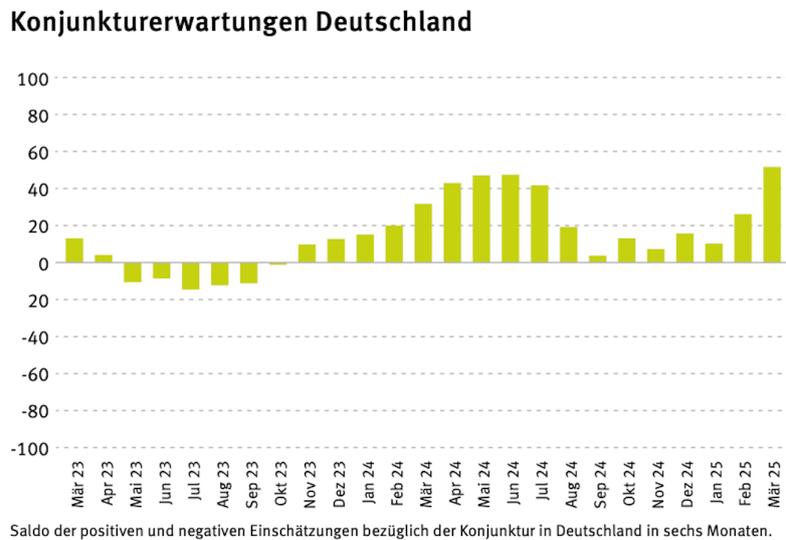
	2005	2009	2019	2024
Very good or good	45	42	50	57
So so	36	41	38	38
Rather poor	18	16	11	4
Don't know	1	1	1	1

Given the positive assessment of citizens about their own personal circumstances, the reaction of Germans to the announcement of a large fiscal package by the governing coalition was “Ricardian”. Faced with unprecedented size and speed of debt, Germans reacted negatively. This may explain why in the March and April polls, approval ratings for the CDU and SPD fell, while those for the AfD rose sharply.

73% of voters, including 44% of CDU-CSU supporters, believe that Merz misled voters by not stating his intentions for fiscal expansion before the vote. In the meantime, however, the “business sentiment” (ZEW indicator on current expectations, shown in Fig. 7) has seen its strongest increase in a long time. If this latter signal ends up prevailing and gives rise to an expansive response from private investors, it

is likely that the positive effects on the German economy will also end up having repercussions on the consensus of citizens.

Figure 7



For Merz, the revival of the economy is the fundamental pillar of the strategy, even if the priority political need is to remove the issue of immigration from AfD.

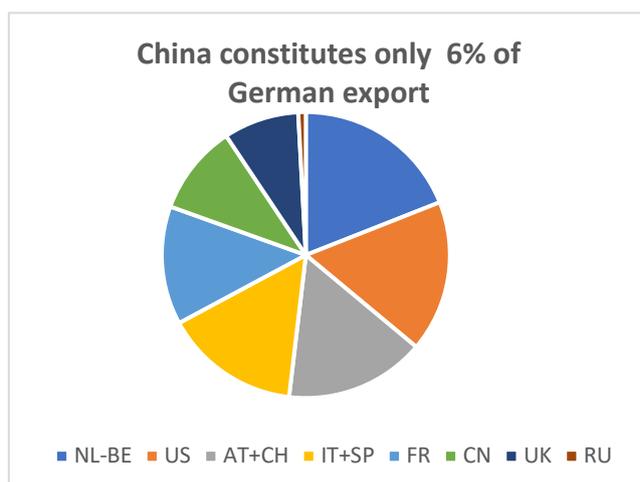
The CDU can be considered the last large European “Volkspartei” party that has survived in the new millennium. However, it risks being overtaken on the right by radical parties, as has happened to almost all popular parties in other European countries. The paradox is that the issue of migration has become the most critical for the country - together with the state of the economy - because it is used in political discourse and the media, but according to citizens it is not at the top of their problems. Table 2 shows how the objective of limiting immigration is considered important for the country by 70% of citizens, but personally important by only 28% of citizens.

Table 2

	Important for the country	... and for me
Economic revival	75	29
Cost of housing	71	31
Energy security	70	37
Fighting Inflation	70	63
Limit immigration	70	26
Strengthen healthcare	69	46
Securing pensions	67	51

The Unconventional Explanation of the End of the German Model

The explanation of Germany's economic difficulties is now a prisoner of a catchy, but probably incorrect, formula according to which the German model broke because it was based on Chinese demand, cheap Russian energy, and security provided by America. However, as can be seen in Fig. 8, German exports to China are only 6% of the country's total exports. Moreover, the cost of energy affects the cost of producing a car by less than 1%. As for American security, today we look at it differently than in the past.

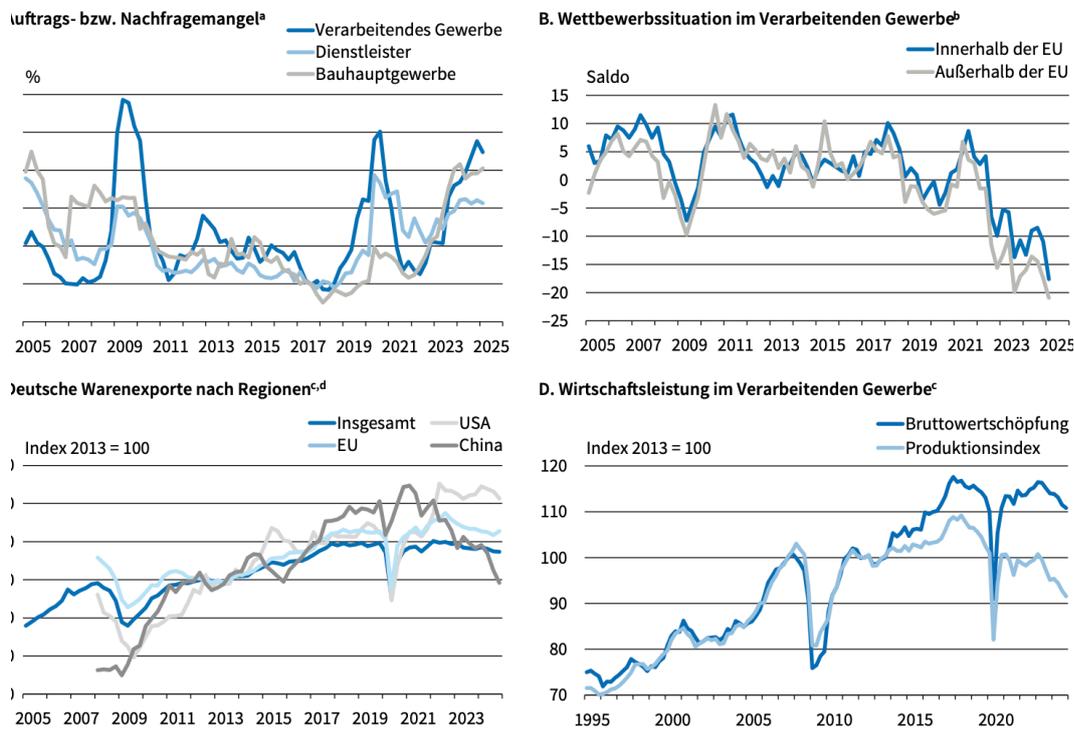
Figure 8

When asked what stopped the German economy, the Bundestag replied that the problem was the lack of public support. As pointed out, the German “Western question” has in fact replaced the “Eastern question” that had dictated the political agenda since the unification of 1990. If Merz wants to ensure democratic stability, he must create optimistic expectations about the well-being of citizens in the western regions. To do so, the public budget must compensate for the lack of consumption and investment.

From the point of view of macroeconomic symptoms, the explanation is quite convincing. The cyclical and structural indicators published monthly by the Ifo Institut (Fig. 9) signal both a lack of demand and a lack of supply. Both deficiencies have been compensated by moving the highest value-added sectors of the production chains to Germany in a context of global integration and flourishing trade development. These conditions could be missing in the near future.

Figure 9

njunkturelle und strukturelle Indikatoren



teil der Unternehmen, deren Produktion wegen Auftrags- bzw. Nachfragemangel behindert wird. ^b Differenz der prozentualen Anteile der Unternehmen, deren Wettbewerbssituation sich verbessert bzw. verschlechtert hat. ^c Preis-, saison- und kalenderbereinigt. ^d Nominale Exporte deflationiert mit den Erzeugerpreisen des arbeitenden Gewerbes nach Regionen.
 lle: Ifo Konjunkturumfragen; Statistisches Bundesamt; Berechnungen des Ifo Instituts. © Ifo Insttit

A different way of looking at the German economic parable is to refute both the triple breakdown of the model (outsourcing of demand, energy and security) and the lack of Keynesian stimulus. The unconventional hypothesis is that the German economy has been declining due to a consistent series of managerial errors committed by the top management of chemical, mechanical, banking and automotive companies and by those who were supposed to supervise and fire those managers. A network of collusion between corporate bodies has sclerotized production and avoided sanctioning management and planning errors.

If this hypothesis were plausible, then it would be useful to subject German managers to the whip of a European and not national capital market. However, this is not likely to happen because the agreement between the parties on the government program provides for the safeguarding of the German financial system as it is. It only gives pro-forma support to the European capital market and says nothing about common supervision, tax harmonization, or a European safe asset.

According to the coalition agreement, the CDU/CSU and the SPD are committed to the "further development of the European Savings and Investment Union", as already stated in the preparatory document of the working group on budget and finance. But the agreement does not address in detail controversial issues such as the creation of a European supervisory body, a clear commitment to the European capital market, the harmonization of insolvency law or a common tax law. The document contains long-standing reservations about the banking union: "the concerns of smaller banks and savings banks must be consistently taken into account in regulation." This also applies to the appropriate risk assessment in a European deposit protection system, which must take into account the requirements of the tripartite banking system of savings banks, cooperative banks and private banks. The agreement also notes that the coalition parties reject "a communitarized European Deposit Insurance Scheme (EDIS) without preconditions."

If these intentions are confirmed in the government's action, it is unlikely that the German governance system will open up to dynamic systems – market actors or non-German banks – capable of challenging the managers who have so far controlled the largest companies. The old system – of which Merz is a constituent part – will end up protecting itself, with the risk of fueling citizens' dissatisfaction with the economy and with the ultimate danger that this dissatisfaction will take the form of a rebellion against democracy.