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Germany’s budget is taking shape

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The draft federal budget falls short on the need to ramp up investment

In a rare display of unity, German Chancellor Olaf Scholz, Vice Chancellor Robert Habeck, and Finance Minister Christian Lindner unveiled their draft for the country’s 2025 federal budget last weekend. It's a political achievement that many would have considered implausible, given the ongoing clashes within the squabbling government coalition. This budget is a strong signal that Germany's politically diverse “traffic light”-coalition of the center-left SPD, the environmentalist Green Party, and the pro-business FDP intends to navigate its complex "ménage-à-trois" until the regular federal election in September 2025. A cabinet decision on July 17th is expected to rubber-stamp the compromise.

Germany’s cantankerous coalition bands together!

On paper, the budget looks quite solid

According to the draft, the German federal government plans to spend 481 billion EUR in 2025, only about 1% more than this year. The constitutional debt brake will be maintained. A "state of emergency" that would allow for its suspension cannot be reasonably declared. Germany's public debt ratio is likely to decrease further.

At the same time, the Finance Ministry proudly announced that investment expenditures will reach a record level of 57 billion EUR. This may be accurate in absolute numbers. Anything else would have been utterly shocking after the high inflation episode over the last two years. Yet, the record in nominal capex spending barely makes a real dent in the backlog of investments (see last week’s To the point). Compared to what is necessary, it is nowhere near enough. What is needed to remove the investment backlog is a large excavator, not an espresso spoon. The Ger-

“Record-level investments” are not enough man Economic Institute (IW) estimates that an additional 600 billion EUR in public capital expenditures will be required over the coming decade, on top of what was already planned. With the debt brake and the simultaneous promise not to raise taxes, such volumes are not feasible. A special fund for clearly defined investments would be advisable instead. A two-thirds majority would be needed in implement this. The opposition is unlikely to agree to this, as pre-election campaigning is already in full swing.

Bookkeeping alchemy and gimmicks

A bit of a shell game is involved as well

Due to the economic downturn and resulting loss of revenue, the adherence to the debt brake can only be ensured through some accounting sleight of hand. For instance, the cyclical component of the debt brake rule will be reformulated. This should add a few billion euros in flexibility, without changing anything in the real world. The same applies to how gains and losses from the issuance of government bonds are accounted for. And finally, a supplementary budget in 2024 will result in higher reserves available in 2025. Those gimmicks buy a little time, but the fundamental challenges remain unaddressed. For example, it is unclear how defense spending will be financed once the special military fund set up after Russia's invasion of Ukraine runs out in 2027.

Growth initiative: a good first step

Measures to stimulate growth

Simultaneously, the leadership of Germany's government coalition presented a comprehensive package of 49 measures known as the "Growth Initiative", aimed at doubling the potential growth of the economy by 0.5 percentage points. Many of the measures are welcome – such as strengthening work incentives, streamlining regulations, or easing tax rules for companies. However, to advance growth in the targeted manner, the initiative remains too piecemeal. But some credit is due: at least, it is a first step in the right direction. The journey is made by walking…