

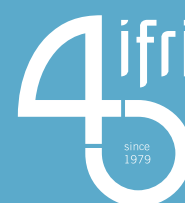
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Reviving the German Economy Balancing Economic, Social, and Defense Priorities

Marie KRPATA

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Ifri

27 rue de la Procession 75740 Paris Cedex 15 – FRANCE

Tél. : +33 (0)1 40 61 60 00 – Fax : +33 (0)1 40 61 60 60

E-mail: accueil@ifri.org

Website: ifri.org

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Paul Maurice is Secretary General of Cerfa and, together with Marie Krpata and Jeanette Süß, Fellow Researchers, as well as Hans Stark, Counselor on Franco-German relations, he is responsible for the publications of Cerfa. Catherine Naiker acts as Cerfa's assistant.

Author

Marie Krpata works as a Research Fellow at the Study Committee on Franco-German Relations (Cerfa) at the French Institute of International Relations – Ifri, where she dedicates her research activities to the European Union and the external relations of the Franco-German couple. She acquired her main study and work experiences in Austria, France, and Germany.

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Executive summary

Germany is facing fundamental challenges to its economic and social model and is seeking a new course. The German post-war model was hugely successful, leading to economic strength and prosperity over many decades, but now it is steadily faltering. The previously latent fear of deindustrialization is becoming more concrete, particularly due to the weakening of a key sector: the automotive industry.

Germany's industrial competitiveness is declining, and its export power is weakened by Chinese competition and American pressure.

The deteriorating geopolitical context is further exacerbating the situation of Germany's weakening industrial performance. The *Zeitenwende*, initiated by the "traffic light" coalition government, already signaled an awareness of Germany's vulnerability in a context where realpolitik prevails and where dependencies can be used for coercion (dependency on energy in relation to Russia, security and defense in relation to the United States, and economic dependency in relation to China).

The arrival of Friedrich Merz's government signifies the return of the Conservatives to the Chancellorship, but as part of a coalition with the Social Democrats, thus necessitating compromises and trade-offs. Easing Germany's "debt brake," establishing a Special Fund for Infrastructure and Climate Neutrality (Sondervermögen für Infrastruktur und Klimaneutralität, SVIK) for the next twelve years, and deploying resources in the military sphere have given the new government leeway to revitalize the country's economy.

However, difficult trade-offs must be made between priorities in terms of competitiveness, which raise questions about the German economic model; the preservation of social achievements, which are intended to maintain the German post-war model of prosperity; and defense imperatives, which require a significant effort by Germany to catch up militarily in light of the threats facing Europe. Germany's repositioning is taking place in a context in which it is torn between expectations for domestic policy and those at the European level.

In this context, it must be asked how Germany can reconcile these numerous imperatives and find the appropriate levels of government intervention. While it is necessary to make structural decisions to maintain and strengthen Germany's industrial base, already severely tested by external shocks, Germany is also increasingly called upon to lead at the European level. Can it succeed on both fronts?

Résumé

En quête d'une nouvelle boussole, l'Allemagne est confrontée à la remise en question des fondements de son modèle économique et social. L'économie allemande, pilier du modèle de réussite et de prospérité de l'après Seconde Guerre mondiale, est ébranlée et la crainte de la désindustrialisation, jusqu'à présent latente, se concrétise de plus en plus, notamment par l'affaiblissement d'un secteur phare comme celui de l'automobile. La compétitivité de sa base industrielle recule et sa puissance exportatrice est fragilisée par la concurrence chinoise et les pressions américaines.

C'est ensuite le contexte géopolitique dégradé qui aggrave la situation d'une performance industrielle qui s'essouffle. La *Zeitenwende* initiée par le gouvernement de la coalition « feu tricolore » marquait déjà une prise de conscience de la vulnérabilité de l'Allemagne dans un contexte où la *Realpolitik* prend le dessus et où les dépendances peuvent être utilisées à des fins de coercition (énergie par rapport à la Russie, sécurité et défense par rapport aux États-Unis et économie par rapport à la Chine).

L'arrivée du gouvernement de Friedrich Merz marque le retour des conservateurs à la chancellerie, mais dans le cadre d'une coalition avec les sociaux-démocrates, ce qui nécessite des compromis et des arbitrages. L'assouplissement du frein à la dette, la mise en place d'un fonds spécial pour les infrastructures et la neutralité climatique (*Sondervermögen für Infrastruktur und Klimaneutralität – SVIK*) pour les douze années à venir et le déploiement de moyens dans le domaine militaire donnent de la latitude au nouveau gouvernement pour redynamiser le pays.

Des arbitrages difficiles s'imposent cependant entre impératifs de compétitivité, qui soulèvent des questions sur le modèle économique allemand, impératifs sociaux, qui interrogent la durabilité du modèle de prospérité de l'Allemagne de l'après-guerre, et impératifs de défense, qui nécessitent un effort de rattrapage significatif de l'Allemagne sur le plan militaire, au vu des menaces auxquelles est confrontée l'Europe. Le repositionnement de l'Allemagne se fait en outre dans un contexte où elle est tiraillée entre des attentes en matière de politique intérieure et d'autres à l'échelle européenne.

Comment, dans ce contexte, concilier les nombreux impératifs et trouver les échelons d'intervention adéquats ? Alors qu'il est nécessaire de prendre des décisions structurantes pour maintenir et renforcer le tissu industriel allemand, déjà rudement mis à l'épreuve par les chocs extérieurs, l'Allemagne a aussi de plus en plus vocation à montrer la voie à l'échelle européenne. Sera-t-elle capable de réussir sur les deux tableaux ?

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Reviving the German economy: Balancing economic, social, and defense priorities

The German parliamentary elections in February 2025 were won by the Christlich Demokratische Union Deutschlands (CDU), followed by the far-right Alternative für Deutschland (AfD), and the Sozialdemokratische Partei Deutschlands (SPD). This outcome led to negotiations for a “grand coalition” between the CDU, its Bavarian sister party, the Christlich-Soziale Union (CSU), and the SPD. Even before this coalition was formalized and the newly elected Bundestag of February 2025 was convened, the outgoing parliament voted to relax Germany’s constitutional “debt brake” rule, notably to create a special fund for infrastructure and climate neutrality (*Sondervermögen für Infrastruktur und Klimaneutralität*, SVIK). This measure complements the exemption from the same debt brake rule for military spending exceeding 1% of gross domestic product (GDP). The objective was therefore twofold: on the one hand, to respond to a deteriorating security environment, and on the other, to inject new momentum into the German economy.

These two measures required a waiver of the constitutional principles established in 2009 and thus required approval by a two-thirds majority in the Bundestag. The CDU and SPD therefore mobilized the outgoing Bundestag to get them approved. This was because the incoming Bundestag (after the 2025 elections) reflected the successes of the parties at both extremes of the German political spectrum – the AfD and Die Linke – giving them a blocking minority, which they would likely have used. The measures were therefore passed by the *old* parliament, notably thanks to the Greens' votes, and have therefore increased the *new* government’s room for maneuver in economic policy.

The SVIK provides for the allocation of €500 billion over 12 years, with part of these funds going to Germany’s states (the *Länder*), which are now also authorized to take on debt (something previously impossible), and another portion allocated to Germany’s Climate Transformation Fund. Reactions to the bill thus introduced by the parties that would form the new government after the 2025 elections were as intense as they were varied: for

some it is a “fiscal bazooka”¹ (a term previously used during large-scale spending in the past, such as during the “Covid crisis”), or a “German Marshall Plan”² (a term used by the CSU, one of the governing parties); for others, it represents “fiscal hara-kiri”³ (an expression of the radical left, critical of the increase in military spending) or “debt spree”⁴ (the AfD). Praise from the governing parties thus stands in contrast to the criticism from parties at both extremes of the German political landscape, highlighting the divisions running through German society.

Indeed, Germany is seeking a new compass as the foundations of its economic and social model are being profoundly challenged. The German economy, a pillar of the post-World War II model of success and prosperity, is being shaken, and the fear of deindustrialization, which has remained latent until now, is becoming increasingly palpable, particularly amid the weakening of its flagship automotive sector. Moreover, Germany’s industrial competitiveness is declining, and its export strength is being undermined by Chinese competition and American pressure.

Furthermore, the deteriorating geopolitical context is exacerbating Germany’s flagging industrial performance. The *Zeitenwende*, initiated by the “traffic light” coalition government (2021-2025), had already signaled an awareness of Germany’s vulnerability, in a world dominated by realpolitik, and in which dependencies can be exploited for coercive purposes (Russia in energy, the United States (US) in security and defense, and China in economics). The work on Germany’s resilience, launched by the previous government, has had to be pursued, with an updated national security strategy and the Federal Government’s Strategy on China.

The arrival of Friedrich Merz’s government marks the return of the Conservatives to the Chancellorship, though as part of a coalition with the Social Democrats, which requires compromise and trade-offs. The relaxation of the debt brake, the establishment of the SVIK for the next twelve years, and increased military spending have given the new government the leeway to revitalize the country. The government has thus given itself the means to carry out the policies it has announced. Paradoxically, it is under a conservative-led government that such unprecedented expenditure is being deployed. This decision has also cost Friedrich Merz a great deal of political capital, as he had pledged not to reform the debt brake during the election campaign. Tinkering with this emblem of stability is a particularly delicate undertaking, given that it was

1. L. Strobl, “Le bazooka fiscal allemand fait bondir l’euro et le rendement du Bund” [Germany’s fiscal stimulus package sends the euro and Bund yields soaring], *Morning Star*, March 5, 2025, available at: www.morningstar.fr.

2. “Bundesrat stimmt milliardenschwerem Finanzpaket zu” [Federal Council approves multi-billion-dollar financial package], *Tagesschau*, March 21, 2025, available at: www.tagesschau.de.

3. *Ibid.*

4. “AfD post”, Facebook, January 13, 2026, available at: www.facebook.com.

precisely a budget debate—and thus public spending priorities—that brought down the previous government.

Beyond the frictions these decisions have sparked, the announced spending has raised high expectations, and the coalition will be judged on its results in this area throughout its term and when it comes time to take stock, as the next federal election approaches. The stakes are high, and numerous challenges have emerged regarding the allocation of funds, the timeline, and the resources needed to deploy the announced sums. Some critics raise the specter of an overly bureaucratic state with a sluggish administrative apparatus, incapable of acting with the agility and efficiency needed to deliver tangible benefits and positive externalities across sectors. The rapid construction of liquefied natural gas (LNG) terminals to reduce Germany's dependence on Russian gas shortly after the start of the invasion of Ukraine (in 2022) is thus held up as an example to follow. Yet the deployment of resources, however significant, is not enough; they must also be spent effectively. Consequently, prioritization is necessary.

The Merz government will be judged by the results of the measures initiated in March 2025, caught between competitiveness imperatives that raise questions about the German economic model, social imperatives that call into question the sustainability of Germany's post-war prosperity model, and defense imperatives that require Germany to make significant efforts to catch up militarily in light of the threats facing Europe. Germany's repositioning is also taking place in a context where it is torn between domestic policy expectations and expectations at the European level.

Given this context, how can the many imperatives be reconciled and the appropriate levels of intervention identified? While it is necessary to make structural decisions to maintain and strengthen Germany's industrial base, which has already been severely tested by external shocks, Germany also increasingly has a role to play in leading the way at the European level (*Gestaltungsanspruch*⁵). Will it succeed on both fronts?

5. The Coalition Agreement between the CDU, CSU, and SPD sets out the intention to constructively shape an effective, coherent and reliable European policy in the interests of Germany and Europe. The Koalitionsvertrag between the CDU, CSU, and SPD, p. 135, German Federal Government, May 5, 2025, available at: www.koalitionsvertrag2025.de.

Too little, too late: a German economy weakened by internal and external factors

In August 2023, the British weekly *The Economist* ran the headline “Is Germany once again the sick man of Europe?”⁶ Indeed, in 2024, Germany, Europe’s largest economy, was in its second consecutive year of recession,⁷ raising questions about the reasons for this modest performance, which are as much structural as they are cyclical. Investment activity in Germany has been weakening since the end of the first decade of the 2000s,⁸ and by November 2024, industrial production had fallen by 12% from 2018 levels.⁹ This decline is fueling fears of deindustrialization, even though industry accounted for 23% of Germany’s GDP in 2024.¹⁰ Both internal and external factors explain Germany’s economic decline.

A giant with feet of clay: the internal reasons for Germany’s economic decline

Several structural weaknesses can be identified to explain the poor state of the German economy.

A first weakness: due to a lack of investment, Germany suffers from outdated infrastructure, a fact regularly highlighted in recent years by numerous analysts, particularly those from economic institutes and think tanks (see Figure 1). In April 2024, for example, the IW Köln economic institute estimated infrastructure investment needs over the next 10 years at €600 billion.¹¹ This lag can be attributed to Germany’s “debt brake,” a

6. “Is Germany Once Again the Sick Man of Europe?”, *The Economist*, August 2023, available at: www.economist.com.

7. For 2025, the International Monetary Fund forecast growth of 0.1% in July 2025. “Economic Development: IMF Slightly Raises Growth Forecast for Germany”, *Die Zeit*, July 29, 2025, available at: www.zeit.de.

8. P. Scheuermeyer, “Investitionsentwicklung in Deutschland – eine Bestandsaufnahme” [Trends in investment in Germany – An overview], *Fokus Volkswirtschaft*, No. 485, Kreditanstalt für Wiederaufbau (KfW), January 23, 2025.

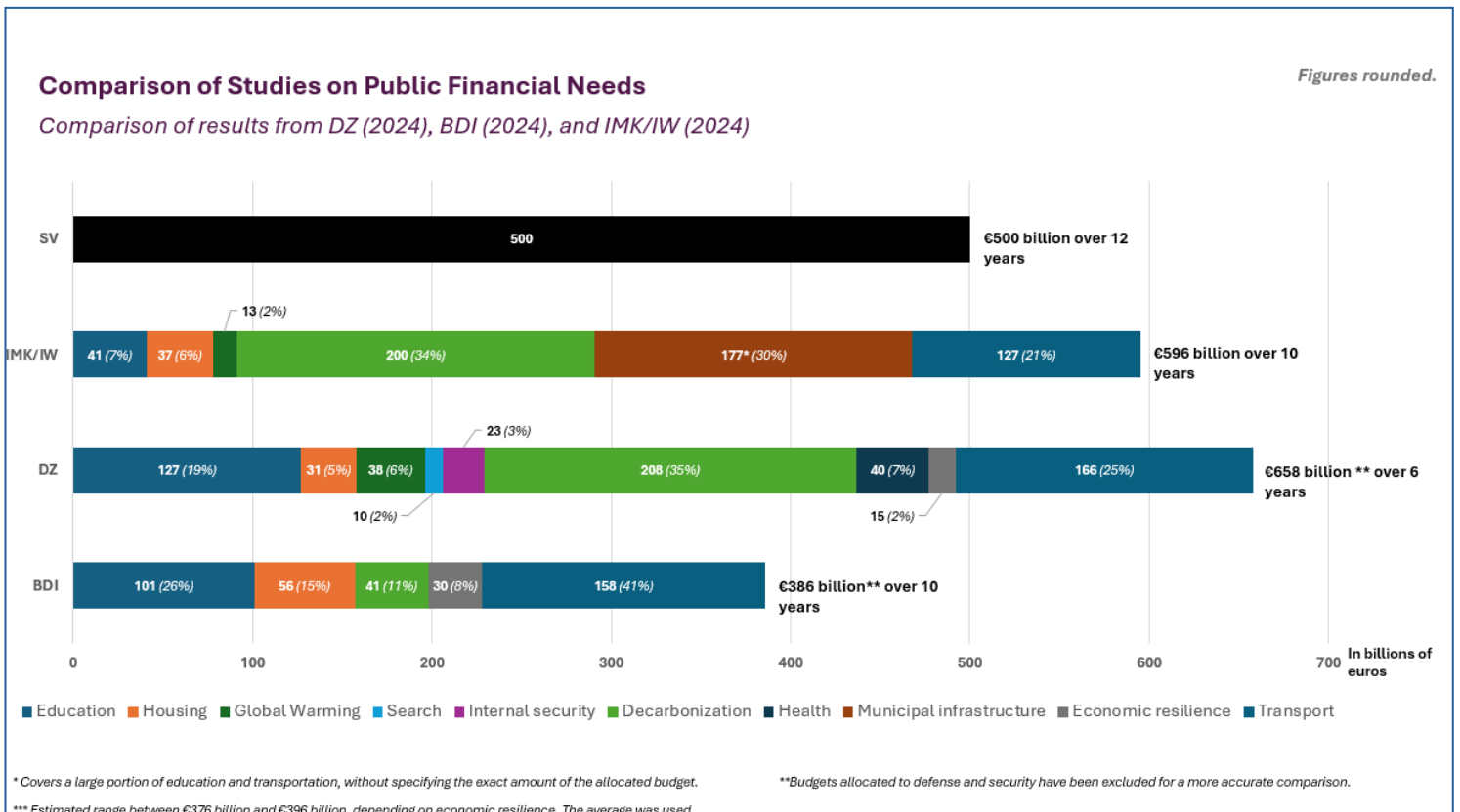
9. S. Sauer and K. Wohlrabe, *Wettbewerbsfähigkeit der deutschen Industrie* [Competitiveness of German industry], ifo Institute, ifo Schnelldienst Digital, November 20, 2024.

10. National Accounts, Federal Statistical Office (Destatis), May 23, 2025, Fachserie 18 Reihe 1.2, Domestic Product Calculation.

11. “IW Köln Infrastrukturbedarfe: Herausforderungen für die Schuldenbremse” [IW Cologne: Infrastructure needs: challenges for the debt brake], *IW Policy Paper*, No. 2, Institut der deutschen Wirtschaft (IW), 2024.

constitutional provision introduced in 2009 aimed at the strict control of public finances, which has been a veritable emblem of stability in Germany. It stipulates that the structural deficit must not exceed 0.35% of German GDP. Until now, this fiscal orthodoxy has constrained investment. Thus, the *Handelsblatt* daily newspaper, in an article on June 6, 2025, noted, for example, that only 10% of investment in Germany came from the government.¹² Thus, out of €900 billion in investments, only €127 billion had been invested by the government. So, while Germany aims for a digital and green transition, there is a gap between its ambitions and the resources allocated to achieve them. Moreover, under these circumstances, it is difficult to create the necessary conditions for legal certainty for companies wishing to invest.

Figure 1. A comparison of recommendations by economic institutes and think tanks regarding infrastructure spending compared to the SVIK



Source: "Adapting the debt brake pragmatically: Increase flexibility, maintain stability," German Council of Economic Experts, January 30, 2024, available at: www.sachverstaendigenrat-wirtschaft.de; S. Dullien, E. Jürgens et al., *Makroökonomische Auswirkungen eines kreditfinanzierten Investitionsprogramms in Deutschland* [Macroeconomic effects of a credit-financed investment program in Germany], IMK Report Nr. 168, May 2021; F. Heilmann, N. Gerresheim et al., "Was kostet eine sichere, lebenswerte und nachhaltige Zukunft? Öffentliche Finanzbedarfe für die Modernisierung Deutschlands" [What is the cost of a safe, livable, and sustainable future? Public funding needs for modernizing Germany], Dezernat Zukunft, September 9, 2024.

Graphic by Tristan Feucher © Ifri, 2026.

12. "Deutschland braucht mehr als Beton und neue Panzer" [Germany needs more than just concrete and new tanks], *Handelsblatt*, June 6, 2025, available at: www.handelsblatt.com.

A second weakness: a declining population and the retirement of baby boomers, which is expected to result in a labor shortage in the job market. With an estimated 16.5 million people set to retire by 2036, the IW Köln institute forecasts that only 12.5 million people will enter the job market during the same period.¹³ Germany is therefore compelled to rely on immigration. With this in mind, the country enacted a *Skilled Immigration Act* in 2023 to control arrivals into Germany and select immigrants based on their qualifications.¹⁴

A third weakness: the loss of competitiveness among Germany's traditional industry leaders in the face of growing competition from new players with more agile business models. For example, in the automotive industry, Volkswagen, BMW, and Mercedes—admittedly leaders in internal combustion engine vehicles—have not sufficiently prepared for the shift to electric and digital technologies. Furthermore, the recent relaxation of targets to end sales of internal combustion engine vehicles by 2035 is likely to widen this gap.¹⁵ Peter Leibinger, president of Germany's employer confederation (the Bundesverband der Deutschen Industrie, BDI), which represents German industrial interests, refers to the “arrogance of the German engineer”, in other words, the conviction that the technologies on which Germany has relied in the past are bound to endure, despite the emergence of new technologies and new international competitors.¹⁶ Yet today, many industrial sectors are facing the risk that their traditional know-how will become obsolete. During his March 2026 speech at the Bertelsmann Stiftung, Social Democratic Vice Chancellor and Finance Minister Lars Klingbeil stated: “Those who rely on the *status quo* today are choosing decline. All too often, we make excuses for doing nothing or for avoiding what is difficult. That is no longer an option.”¹⁷ Speaking in all seriousness, he noted soberly that Germany had rested on its laurels for too long: “This applies to politics. But it also applies to certain sectors of the German economy, which have been content for too long with existing economic models instead of investing in new ones”.¹⁸ While he believed that

13. P. Deschermeier and H. Schäfer, “Arbeitsmarkt: Fast 20 Millionen Erwerbstätige erreichen bis 2036 das Renteneintrittsalter” [Labor market: nearly 20 million workers will reach retirement age by 2036], *Press Release*, IW, October 14, 2024.

14. J. Süß, “Entre inertie et ouverture. L'Allemagne réforme son système d'immigration de travail” [Between inertia and openness: Germany reforms its labor immigration system], *Cerfa Notes*, Ifri, 5 July 2023, available at : www.ifri.org.

15. M. Scheppe, “Warum Audi, BMW und Mercedes noch immer am Diesel festhalten” [Why Audi, BMW, and Mercedes are still sticking with diesel], *Handelsblatt*, 8 January 2026, available at: www.handelsblatt.com.

16. C. Boutelet, “Sous les coups de boutoir de Donald Trump et de Xi Jinping, la grande rupture économique allemande” [Germany's major economic shift amid attacks from Donald Trump and Xi Jinping], *Le Monde*, August 30, 2025, available at: www.lemonde.fr.

17. L. Klingbeil, “Reformen für ein starkes Land”: Speech by Lars Klingbeil at the Bertelsmann Foundation” [“Reforms for a strong country”: Speech by Lars Klingbeil at the Bertelsmann Foundation], Federal Ministry of Finance, available at: www.bundesfinanzministerium.de.

18. *Ibid.*

“a few years ago, everyone was lagging behind us,” the opposite is true today: “Today, we are the ones lagging behind in many areas. We cannot afford that.”¹⁹ To reverse this trend, he proposed a “new German growth model” to enable Germany to become a technology leader.²⁰

With this in mind, Lars Klingbeil intends to transform his ministry into an “Investment Ministry,” potentially sparking a shift in mindsets.²¹ By implementing the SVIK, Friedrich Merz’s government aims to create the fiscal leeway needed to breathe new life into the country.

Germany in the turmoil of international economic developments

Assessing the state of the German economy also requires an approach that accounts for an increasingly uncertain international environment.

Germany’s heavy reliance on international trade, which was its strength in the past, is increasingly proving to be its Achilles’ heel. On the one hand, over the past few decades, Germany had increased its dependence on players like Russia for energy, as inexpensive Russian gas had long enabled the German industrial base to remain particularly competitive. The decoupling from Russian energy following Russia’s invasion of Ukraine in 2022 has significantly impacted energy-intensive industries, such as the paper, chemicals, and iron & steel sectors. While these sectors accounted for only 15% of German industrial production in 2021 (and 3.4% of total GDP), they accounted for 77% of industrial energy consumption in Germany.²² It should be noted that electricity and gas costs are three and five times higher, respectively, in Germany than in China or the United States, severely undermining the competitiveness of Germany’s industrial base.²³

On the other hand, Germany had been one of the major beneficiaries of post-World War II trade globalization, with an economy built on internationalized value chains. Now it must contend with heightened geopolitical tensions, increased protectionism from its main trading partners, and the growing fragmentation in international trade. Germany is the world’s third-largest economy in terms of GDP:²⁴ it is also the world’s

19. *Ibid.*

20. *Ibid.*

21. “Wer Klingbeil bei seiner Investitionsoffensive berät” [Who is advising Klingbeil on his investment drive?], *Handelsblatt*, September 1, 2025, available at: www.handelsblatt.com.

22. D. Schaller and M. Schasching, “Energieintensive Industrie unter Druck” [Energy-intensive industries under pressure], *ifo Schnelldienst*, Vol. 77, No. 6, June 19, 2024.

23. “Es liegt auch an China, auf Europa zuzugehen – Ein Interview mit Hildegard Müller” [It is also up to China to reach out to Europe – An interview with Hildegard Müller], *Internationale Politik*, March/April 2026.

24. *GDP, current prices (Billions of US dollars)*, International Monetary Fund, available at: www.imf.org.

third-largest exporter²⁵ and the world's third-largest importer.²⁶ Twenty-seven percent of jobs in Germany depend on exports.²⁷ Furthermore, its "exports-to-GDP" ratio stood at 41.8% in 2024 (compared to 33.9% in France),²⁸ highlighting the openness of the German economic model and the importance of exports to the economy. In 2025, Germany's trade surplus was nearly €200 billion.²⁹ In this context, the German economy was particularly affected by more restrictive measures from China, its main trading partner in 2025,³⁰ and from the United States, its second-largest trading partner in the same year.³¹

Following the Turnberry Agreement of July 2025 between Ursula von der Leyen and Donald Trump, Germany faces a 15% tariff rate on EU exports to the US,³² even though these tariffs were subsequently ruled illegal by the US Supreme Court on February 20, 2026.³³ Furthermore, the US president constantly reiterates US support for Europe in security and defense, and could use this as leverage against countries like Germany, which had a €52 billion trade surplus with the United States in 2025 (see Figure 2).³⁴ Washington could indeed increase pressure on Berlin to purchase more American weapons,³⁵ import more American energy,³⁶

25. "Merchandise Exports by Product Group – Annual (Million US dollars)", statistics for 2023, World Trade Organization (WTO) stats, available at: www.timeseries.wto.org.

26. "Merchandise Imports by Product Group – Annual (Million US dollars)", statistics for 2024, WTO stats, available at: www.timeseries.wto.org.

27. K. Kober, "Towards a New European Trade Strategy in Times of Geopolitical Upheaval: The German Perspective," *Cerfa Notes*, No. 176, Ifri, October 2023.

28. "Exports of Goods and Services as A Percentage of GDP", Eurostat, June 13, 2025, available at: www.ec.europa.eu.

29. "Ranking of Germany's trading partners in Foreign Trade", Statistisches Bundesamt (Destatis), February 20, 2026, available at: www.destatis.de.

30. *Ibid.*

31. *Ibid.*

32. "Explanation of the trade agreement between the European Union and the United States", European Commission, July 29, 2025, available at: www.ec.europa.eu.

33. N. Chapuis, "Droits de douane: la grande gifle de la Cour suprême à Donald Trump" [Tariffs: the Supreme Court's stinging rebuke to Donald Trump], *Le Monde*, February 20, 2026, available at: www.lemonde.fr.

34. "Ranking of Germany's Trading Partners in Foreign Trade", Statistisches Bundesamt (Destatis), *op. cit.*

35. Germany has committed to dedicating 5% of its GDP to defense (including 3.5% to "pure defense" and 1.5% to defense investments in the broader sense, such as cybersecurity and military mobility), as it committed to doing at the North Atlantic Treaty Organization (NATO) summit in The Hague on June 24 and 25, which should greatly benefit the US defense industry. See "The Hague Summit Declaration", NATO, June 25, 2025, available at: www.nato.int. Similarly, this is expected to take the form of commitments by several European allies to purchase additional US weapons for delivery to Ukraine in August 2025. See C. Körömi, "Countries Pledge Millions to Fund US Weapons for Ukraine", *Politico*, August 5, 2025, available at: www.politico.eu.

36. The joint statement between the United States and the EU states: "the European Union intends to procure US liquefied natural gas, oil, and nuclear energy products for an estimated \$750 billion through 2028," in the "Joint Statement on a United States-European Union Framework on An Agreement on Reciprocal, Fair and Balanced Trade", European Commission, August 21, 2025, available at: www.ec.europa.eu.

invest more in the American market,³⁷ and adapt digital legislation³⁸ to facilitate the operations of American companies in the European market. Another possible US expectation could be that Germany reassess its stance toward China to bring it more in line with the United States.³⁹

Germany is aware that US expectations of it are likely to increase, as Donald Trump did not hesitate to label it a “free rider”⁴⁰ within the Atlantic Alliance during his first presidency and to threaten to withdraw US troops stationed on German soil. This contrasts with the much more courteous tone of Joe Biden during his presidency and the close coordination between the US President and the German Chancellor, which had given Germany hope that Donald Trump’s first presidency might have been merely a blip and that this painful experience was not destined to repeat itself. Eager to maintain good relations with the United States, Friedrich Merz was well received by Donald Trump during his first official trip to Washington in June 2025, which may have reassured Berlin, even though the release of the new “National Security Strategy” by the Trump administration in December 2025 subsequently raised fears of a US shift away from Europe, to the point that Friedrich Merz described it as “partially unacceptable.”⁴¹ The Chancellor also added that the United States continues to need partners and that, even if it is unwilling to engage in dialogue with Europe, it could at least consider Germany a partner.⁴² Faced with Donald Trump’s unpredictability, Germany is nevertheless forced to admit that the German chancellor’s attempts to build a relationship with Donald Trump do not protect it against the threat of tariffs in response to Germany’s opposition to the US annexation of Greenland, one of the most recent points of friction.

Against the backdrop of war returning to the European continent, with Russia posing a threat, Germany finds itself deeply unsettled and shaken in its convictions. This is all the more true in light of the deteriorating

37. *Ibid.* The joint statement issued by the United States and the EU provides for: “European companies are expected to invest an additional \$600 billion in strategic sectors in the United States by 2028.”

38. This pressure prompted a strong reaction from German Chancellor Friedrich Merz during the Franco-German Ministerial Council on August 29, 2025, announcing, in particular, that a summit on EU digital sovereignty would be held in Berlin on November 18, 2025, to increase the resilience of the European economy, and stating during the press conference that the EU would not yield to any potential US threats regarding European regulation of digital service providers, emphasizing that European sovereignty was at stake. See “Conseil franco-allemand : la conférence de presse d’Emmanuel Macron et Friedrich Merz” [Franco-German Council: Press Conference with Emmanuel Macron and Friedrich Merz], LCI (YouTube), August 29, 2025, available at: www.youtube.com.

39. In September 2025, Donald Trump notably called on European NATO allies to impose “50% to 100% customs duties on China”. See P. Jacqué, P. Ricard *et al.*, “Les sanctions contre la Russie, pomme de discorde entre les États-Unis et l’Europe face à la Chine” [Sanctions against Russia: a point of disagreement between the United States and Europe in the face of China], *Le Monde*, 15 September 2025, available at: www.lemonde.fr.

40. D. Fräsch, “As Trump Threatens to Withdraw Military Forces from Europe, Locals Tell Themselves He Is Bluffing”, *Neue Zürcher Zeitung*, available at: www.nzz.ch.

41. “Merz kritisiert US-Sicherheitsstrategie” [Merz criticizes U.S. security strategy], *Süddeutsche Zeitung*, December 9, 2025, available at: www.sueddeutsche.de.

42. *Ibid.*

relations with the United States, which are forcing it to respond. On the very evening of the German federal elections of February 23, 2025, as he was about to become Chancellor, Friedrich Merz made remarks that may have surprised some with their clarity about the prospects for transatlantic relations, declaring that the EU must be independent of the United States. The catalyst for this was J.D. Vance's speech at the Munich Security Conference earlier in February, in which he asserted that freedom of speech was in danger and that the main threat in Europe came neither from Russia nor China nor any other external actor, but rather from within Europe itself, while subsequently expressing support for the far-right AfD party.⁴³ If it is not the United States' total withdrawal from the North Atlantic Treaty Organization (NATO), the sword of Damocles hanging over Germany is that the Alliance becomes a mere "paper tiger."⁴⁴

This sentiment is widely shared in France, where Emmanuel Macron, in February 2026, did not hesitate to call for a "Greenland moment"⁴⁵ (referring to US claims to Arctic territory) for European awareness of the "profound geopolitical rupture"⁴⁶ currently underway, in which Europe must act if it does not want to be "swept away"⁴⁷ from the international stage, particularly in the face of a United States that is increasingly "openly hostile"⁴⁸ and seeking to "dismember the EU."⁴⁹ Paris's stance toward the United States is typically firmer than Berlin's, as Germany is more militarily dependent on Washington than France is, although this does not mean that the awareness of a US distancing itself from Europe is not real in Germany, as evidenced by the German Global Defense Concept (also known as the "Military Strategy and Plan for the Armed Forces")⁵⁰ published in April 2026.

43. "Munich Security Conference 2025 – Speech by JD Vance and Selected Reactions", Munich Security Conference, 2025, available at: www.securityconference.org.

44. J. Manchester, "Trump Dubs NATO a 'Paper Tiger' over Strait of Hormuz", *The Hill*, March 20, 2026, available at: www.thehill.com.

45. "EmmanuelMacron Declares A European State of Emergency" *The Economist*, February 10, 2026, available at: www.economist.com.

46. *Ibid.*

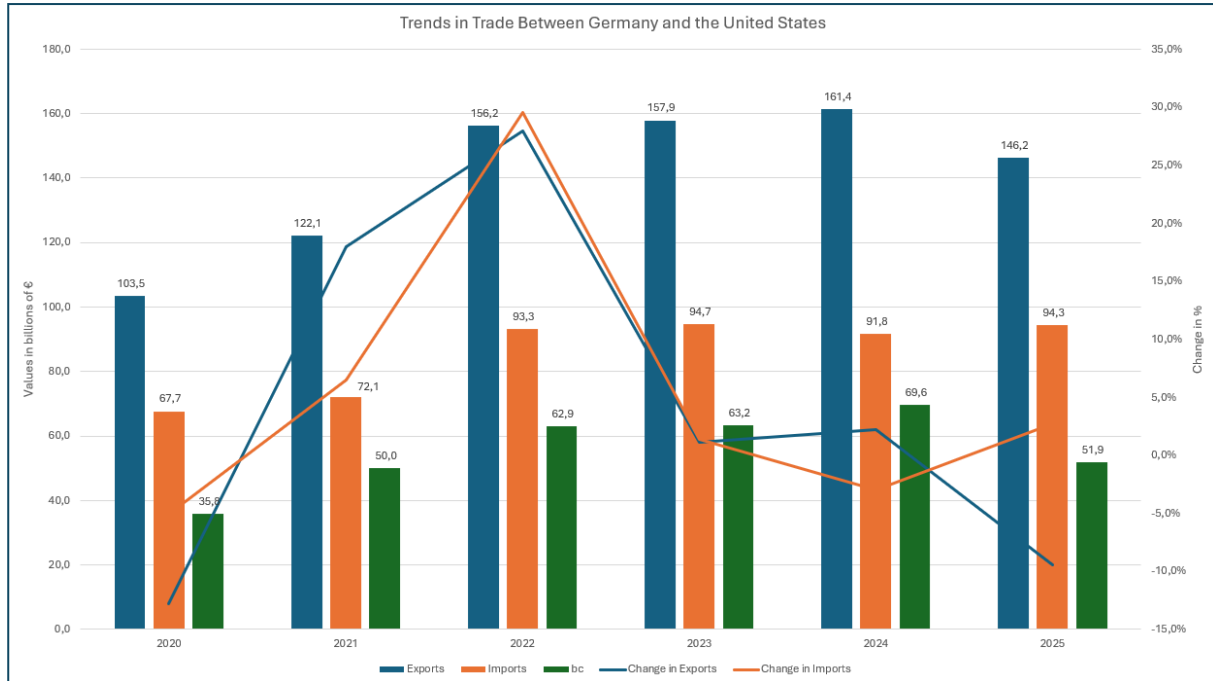
47. *Ibid.*

48. *Ibid.*

49. *Ibid.*

50. This document notes that: "The United States is essential to the Alliance, both politically and in terms of its military capabilities. However, the US states that it is increasingly orienting itself strategically toward the Western Hemisphere and the Indo-Pacific." Furthermore, it notes that Germany considers: "NATO must become more European in order to remain transatlantic," in "Gesamtkonzeption militärische Verteidigung. Militärstrategie und Plan für die Streitkräfte – Verantwortung für Europa" [Comprehensive concept for military defense. military strategy and plan for the armed forces – responsibility for Europe], German Federal Ministry of Defense, April 2026, available at: www.bmvg.de.

Figure 2: The evolution of trade between Germany and the United States (2020–2025) in billions of euros



Source: Ranking of Germany's Trading Partners in Foreign Trade, Federal Statistical Office (Destatis), February 20, 2026, available at: www.destatis.de.
Graphic by Tristan Feucher © Ifri, 2026.

The economic consequences of potential US extortion tactics against Europe, driven by its reliance on security and defense, thus compound the costs Europe is already facing from its decoupling from Russian oil and gas. At the same time, Germany is increasingly concerned about the rise of Chinese industrial champions—first domestically and then internationally—fueled by generous state subsidies. Germany’s concerns have also involved the predatory acquisition of know-how through *joint ventures* that facilitate technology transfer from foreign companies to Chinese firms, creating a situation of unfair competition against their European counterparts, coupled with a gradual closure to foreign companies once the coveted know-how has been acquired, as part of a “dual circulation” strategy (at least until now, as China is today capable of producing goods of at least equivalent quality to Germany’s in many sectors). These worries are rising as Germany actually recorded a trade deficit of €89 billion with Beijing in 2025, more than €20 billion higher than in 2024,⁵¹ and a fourfold increase since 2020⁵² (see Figure 3). In terms of exports, however, Germany’s shipments to China decreased by 10 percentage points in 2025 compared to

51. Calculations based on the following sources: “Exports and Imports (Foreign Trade): Germany, Years, Countries (2020–2025)”, Code: 51000-0003, Federal Statistical Office (Destatis), available at: www.destatis.de.

52. *Ibid.*

2024.⁵³ Conversely, China exports massively to Europe by rerouting products it cannot export to the United States due to Donald Trump's trade-restricting measures.⁵⁴

Furthermore, it is hard for Germany to break free from its dependencies, as China is indispensable for supplying critical minerals, rare earths, and electronic goods, and because certain economic sectors, such as the German automotive and chemical industries, view China as an essential market. In this regard, in his speech at the Bertelsmann Stiftung in March 2025, Lars Klingbeil questioned the responsibility of major German automakers that are relocating their battery production to China or Eastern Europe, prompting the question: "Where has German economic patriotism gone?"⁵⁵ Noting that these decisions carry heavy consequences in terms of job losses, technological know-how, and added value for Germany's industrial base, he insisted that "short-term returns must not be the sole criterion for investment. This shows a lack of vision, especially in times of major upheaval."⁵⁶ This warning echoes the one issued by Friedrich Merz in January 2025, before he became Chancellor. During a speech at the Körber Stiftung, he warned of the risks of investing in China and called on companies to be vigilant in their activities there, and not to ask the government for help to save them in the event of problems with Beijing.⁵⁷ In this speech, Merz asserted that China belongs to an "axis of autocracies".⁵⁸

This stands in stark contrast to the concept of a "strategic partnership" between the two countries, which Chancellor Merz revived during his state visit to Beijing nine months after taking office.⁵⁹ One example of Germany's unease regarding China is its reluctance to impose countervailing duties on Chinese electric vehicle manufacturers. This reluctance stems from fears of potential Chinese retaliatory measures. Similarly, Beijing's export controls on critical minerals serve as a reminder to Berlin of Germany's supply chain vulnerability. While Berlin adopted a comprehensive strategy toward China in 2023 to address the hardening of Sino-German relations and formalize its ambition to reduce Germany's vulnerabilities vis-à-vis Beijing, German companies with a strong presence in the Chinese market hold a more mixed view. This was borne out in April 2025 by a letter from some 30 German business leaders addressed to Friedrich Merz's government calling for a

53. *Ibid.*

54. C. Schlautmann, "Trump und Xi verschieben Lieferketten – Ängste bestätigen sich" [Trump and Xi are shifting supply chains – fears are being confirmed], *Handelsblatt*, available at: www.handelsblatt.com.

55. L. Klingbeil, "Reforms for a Strong Country", *op. cit.*

56. *Ibid.*

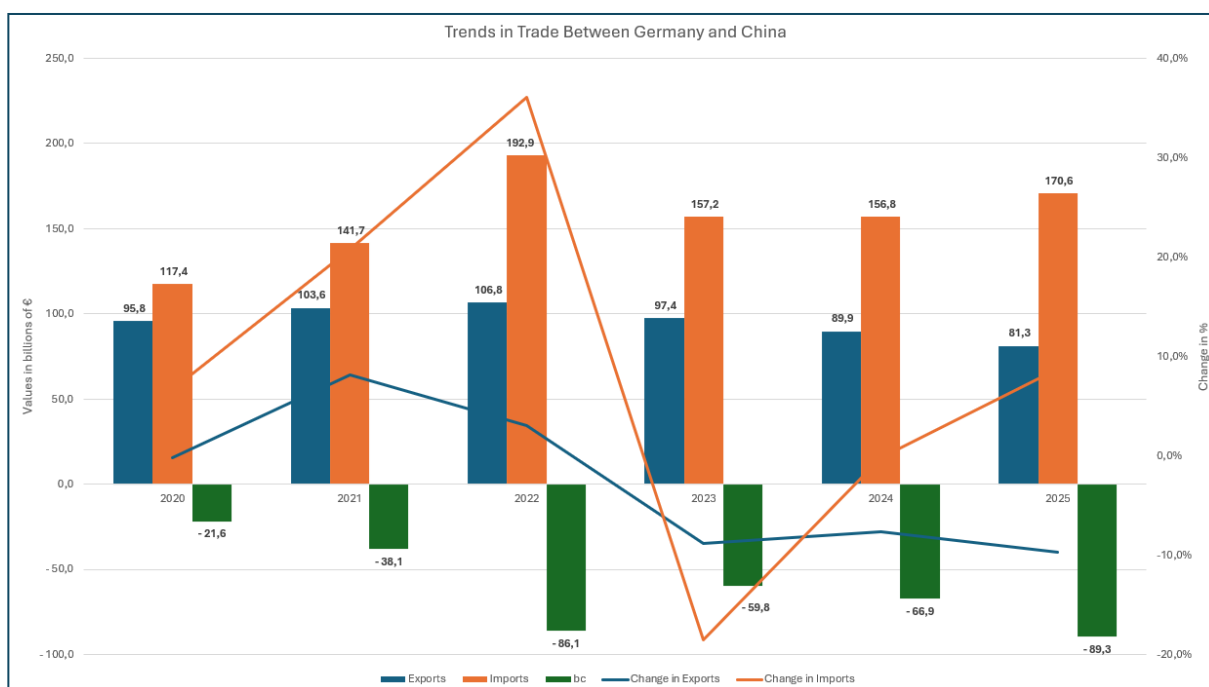
57. "Friedrich Merz zu außen- und europapolitischen Prioritäten für Deutschland" [Friedrich Merz on foreign and European policy priorities for Germany], Körber Foundation, January 23, 2025, available at: www.koerber-stiftung.de.

58. *Ibid.*

59. H. Roßbach, "Der Kanzler kritisiert nur leise" [The chancellor offers only mild criticism], *Süddeutsche Zeitung*, available at: www.sueddeutsche.de.

rapprochement with China.⁶⁰ This is especially true given that China presents itself as the defender of rules-based global trade, in contrast to the United States, which is becoming increasingly unpredictable in this regard.⁶¹ Meanwhile, Chinese companies are capturing more and more market shares at the expense of German firms, a situation described in Germany as the China shock 2.0.⁶²

Figure 3: The evolution of trade between Germany and China (2020–2025) in billions of euros



Source: Calculations based on the following sources: "Aus- und Einfuhr (Außenhandel): Deutschland, Jahre, Länder (2020-2025)", Code: 51000-0003, Statistisches Bundesamt (Destatis, available at: www.destatis.de).
Graphic by Tristan Feucher © Ifri, 2026.

Beyond the strained relations with Russia, the United States, and China that are affecting the German economy, regional instability—such as the war in Iran—poses an additional challenge to Germany’s hoped-for economic recovery. This war is indeed leading to rising energy costs and fears of shortages of goods transiting through the Strait of Hormuz. In the German weekly *Die Zeit*, journalist Mark Schieritz fears a “lost year” for the German economy.⁶³ In a de-escalation scenario, the Ifo economic institute

60. J. Löhner and G. Theile, “Braucht Deutschland eine neue China-Strategie?” [Does Germany need a new strategy toward China?], *Frankfurter Allgemeine Zeitung* (FAZ), April 14, 2025, available at: www.faz.net.

61. G. Theile, “Von Trump attackiert, von Xi hofiert” [Attacked by Trump, courted by Xi], *FAZ*, March 28, 2025, available at: www.faz.net.

62. M. Benninghoff, S. Gusbeth *et al.*, “Lieferketten am Limit – Deutschland in der Falle” [Supply chains at their limit – Germany in a bind], July 16, 2025, *Handelsblatt*, November 3, 2025, available at: www.handelsblatt.com.

63. M. Schieritz, “Deutsche Wirtschaft|Deutschland droht schon wieder ein verlorenes Jahr” [German economy | Germany faces another lost year], *Die Zeit*, March 16, 2026, available at: www.zeit.de.

has forecast growth of 0.8% for 2026 (i.e. 0.2 percentage points lower than initially projected), and growth of 1.2% for 2027. However, the institute has also forecast that growth for 2026 could reach only 0.6% in 2026 and 0.8% in 2027 in case the war escalates.⁶⁴

The exposure to such vulnerabilities in the German economic model, which, on the one hand, relies on imports for its industrial base and, on the other, on exports to sell the goods it produces, is becoming a risk to the country's prosperity.⁶⁵ Beyond the growing search for new trading partners, this raises the question of a reorientation of the German economy. This is taking shape through the stimulation of greater domestic consumption to break free from dependence on external growth.

64. "Irakrieg bremst Konjunktur in Deutschland" [War with Iran slows down the economy in Germany], *Der Spiegel*, March 12, 2026, available at: www.spiegel.de.

65. M. Koch, "Kommentar: Merz-Frust – Wer übellaunig startet, kann es gleich lassen" [Commentary: Frustration with Merz – If you start off in a bad mood, you might as well not bother], *Handelsblatt*, April 2, 2025, available at: www.handelsblatt.com.

Mobilizing resources: Both scattergun approaches and structural reform

In this context, and in order to revitalize the country's economy, the CDU, the CSU, and the SPD, with the support of the Greens, amended the German Basic Law (constitution) in March 2025 to establish: i) the SVIK over 12 years, and ii) a relaxation of the debt brake for military spending exceeding 1% of gross domestic product (GDP). To do so, they had to secure the two-thirds majority in the Bundestag, required to pass a constitutional amendment. In addition to these measures, which represent a break from Germany's traditional fiscal orthodoxy, the new government sought to pass measures to make Germany's economic base, which was losing competitiveness, more attractive, a move that has been generally well-received by the German business community.

A constitutional amendment to provide the German government with the necessary financial flexibility to revive the country's economy

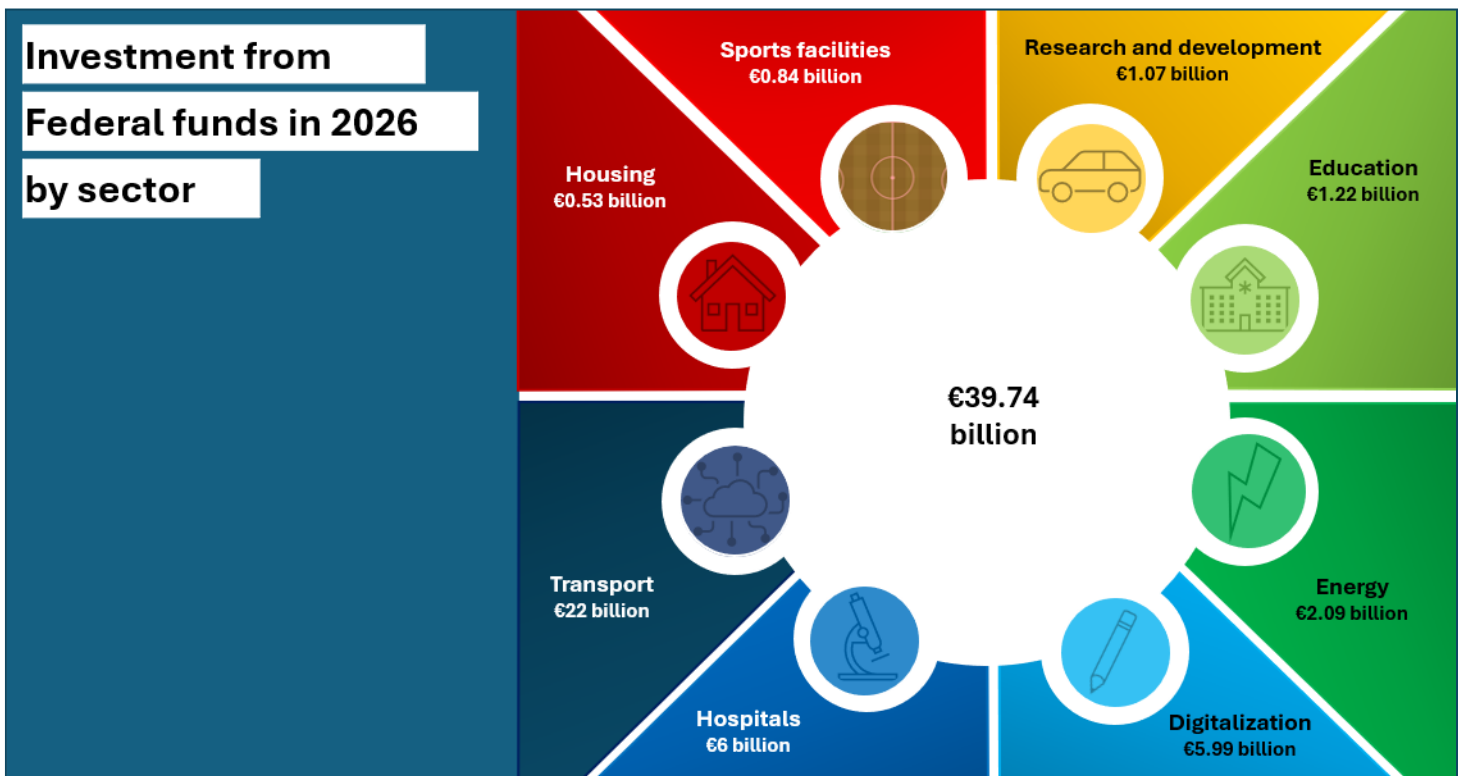
The relaxation of the debt brake is intended to give Germany the opportunity to catch up militarily and meet the target of spending 5% of its GDP on defense (including 3.5% on "pure defense" and 1.5% on defense investments in the broader sense, such as cybersecurity and military mobility), as it committed to doing at the NATO summit in The Hague in June 2025. Germany is thus focusing on expanding its military capabilities to create Europe's leading armed forces.⁶⁶ Underlying this is the persistent threat Russia poses to European security and the question of sustained US support for Ukraine, as well as its contribution to European security in general. Given these concerns, it was decided to relax the debt brake for military spending exceeding 1% of Germany's gross domestic product (GDP).⁶⁷

66. F. Merz, "Rede von Bundeskanzler Merz bei der Münchner Sicherheitskonferenz, 'Unsere Freiheit behaupten wir mit unseren Nachbarn'" [Speech by Chancellor Merz at the Munich Security Conference, "We Defend Our Freedom Together with Our Neighbors"], German Federal Government, February 13, 2026, available at: www.bundesregierung.de.

67. Friedrich Merz cites the rapidly evolving foreign policy situation. He is thus referring to the United States' disengagement from Europe, as touted by US President Donald Trump: "I want to make this very

The “civilian dimension” of these measures is the establishment of a €500 billion fund intended to address the backlog in infrastructure investments, specifically benefiting transportation, hospitals, energy infrastructure, education, research and development (R&D), digital infrastructure, sports facilities, and housing (see Figure 4). One-fifth of the total will be allocated to the *Länder*, and the remainder will be deployed at the federal level. Furthermore, one-fifth of this amount is earmarked for a Climate Transformation Fund (see Figure 5).

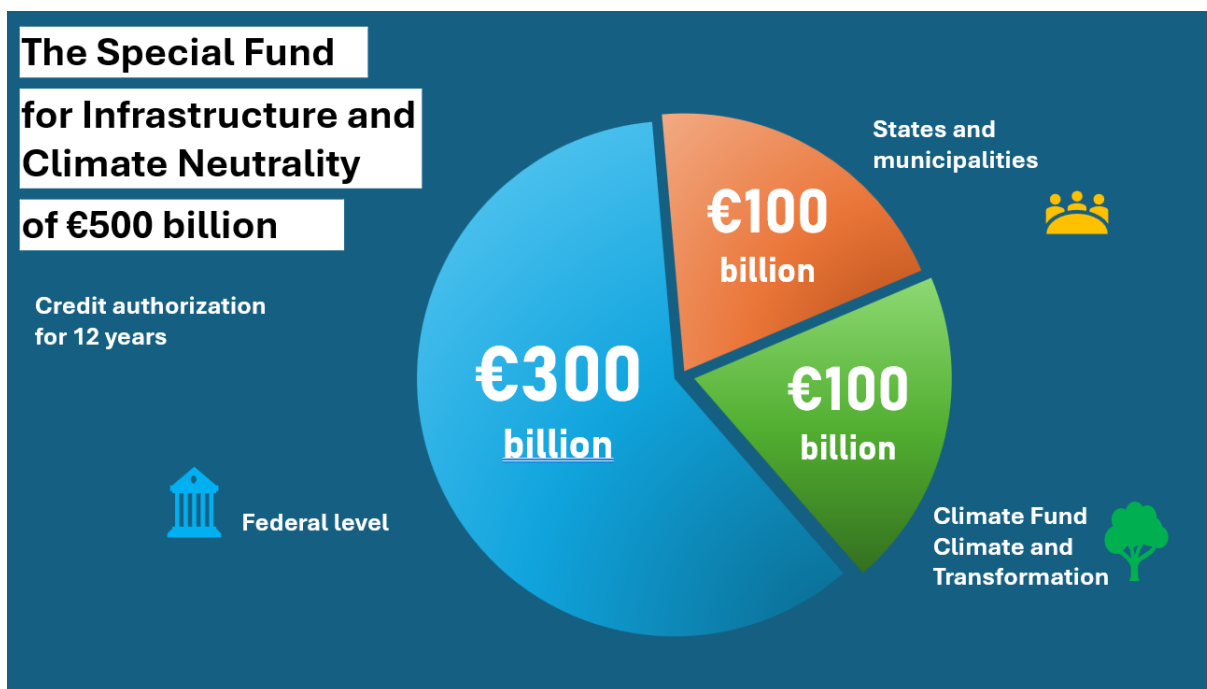
Figure 4: A breakdown of the SVIK by sector



Source: *The Special Fund for Infrastructure and Climate Neutrality*, Federal Ministry of Finance, available at: www.bundesfinanzministerium.de.
Graphic by Tristan Feucher © Ifri, 2026.

clear: In view of the threats to our freedom and peace on our continent, the rule for our defense now has to be ‘whatever it takes.’” Merz also justifies the SVIK on the grounds of defense spending. See “Bei den Staatsfinanzen wird geklotzt, nicht gekleckert” [When it comes to public finances, they’re going all out], Deutschlandfunk, March 22, 2025, available at: www.deutschlandfunk.de.

Figure 5: Allocation of the SVIK across the federal government, the *Länder*, municipalities, and the Climate and Transition Fund



Source: *The Special Fund for Infrastructure and Climate Neutrality*, Federal Ministry of Finance, www.bundesfinanzministerium.de.
Graphic by Tristan Feucher © Ifri, 2026.

To pass these measures, which required a constitutional amendment, a two-thirds majority was needed in both the Bundestag and the Bundesrat. Given the composition of the new Bundestag, where the far right and the radical left together hold a blocking minority, it was decided to pass this amendment using the majority from the outgoing Bundestag. This unorthodox approach drew widespread criticism. Furthermore, the Greens, now in the opposition and whose support for these measures was necessary, gave their approval on the condition that the goal of carbon neutrality by 2045 be included in Germany’s constitution, the *Grundgesetz* or Basic Law. Another condition was the principle of “additionality,” aimed at ensuring that the funds deployed are not used to finance current expenditures already included in the budget or campaign promises, but rather for sustainable infrastructure projects that will provide a real long-term stimulus to the German economy (see Appendix 1).⁶⁸ It should be recalled that under the previous “traffic light” coalition government, the Greens especially had been in favor of greater budgetary flexibility.

68. “Additionality” applies when the main budget already reaches an investment rate of at least 10%. Additional investments in the defined areas can then be financed by the SVIK. The federal government thus ensures that investments will be higher than in previous years. See “Das Sondervermögen für Infrastruktur und Klimaneutralität” [The special fund for infrastructure and climate neutrality], German Federal Ministry of Finance, available at: www.bundesfinanzministerium.de.

However, their ambitions were clearly blocked by their coalition partners, the Liberals (FDP), and were also contested by the Conservatives, who were in opposition. Once in power following the 2025 federal election, the Conservatives' reversal of loosening the debt brake, to launch an unprecedented infrastructure and defense investment project, sparked much criticism and bitterness among the Greens. Having been forced to accept the Conservatives' previous refusals to raise spending limits, the Greens ultimately paved the way for them to pursue a bolder policy backed by substantial funding. It is worth noting that a special €100 billion fund to modernize the German military had already been established in 2022 in the context of the Russian invasion of Ukraine, and that its scope was limited to the Bundeswehr, as desired by the CDU and CSU. By contrast, the Greens would have preferred to expand it to include cyber defense and civil protection—and potentially also humanitarian aid and energy security—given that the Russian threat encompasses hybrid aspects that must be countered just as much as conventional warfare.⁶⁹ This may explain the Greens' demands to ensure that SVIK funds are used responsibly. These demands are shared within the Conservative party, where the new spending programs, which run counter to the party's traditional policy, have also drawn significant criticism. It is, however, widely accepted among experts that the debt brake has in the past prevented faster growth in Germany and that, for Germany to be more competitive today, future-oriented investments would have been needed. In other words, the debt brake, strictly speaking, has also acted as a brake on economic dynamism. Based on this observation, it is worth noting that the coalition partners, the CDU/CSU and the SPD, have stipulated in the Coalition Agreement that a commission of experts must redefine the rules of the debt brake in a sustainable manner.

This reflects the fact that the measures announced in early 2025 offer only a temporary solution, and that attitudes may be slowly shifting, encouraged by institutions such as the Bundesbank⁷⁰ and the International Monetary Fund,⁷¹ which had urged Germany to pursue a more expansionary fiscal policy. However, passing a law to reform the debt brake will be a real challenge, given the majority in the new Bundestag elected in 2025. This is especially true since, at the CDU convention on December 8, 2018, the party pledged not to cooperate with either Die Linke or the AfD,⁷² some of whose votes would nevertheless now be necessary to amend the constitution.

69. C. von Bullion, P.-A. Krüger *et al.*, “Die Grünen haben so gut wie nichts bekommen” [The Greens got practically nothing], *Süddeutsche Zeitung*, May 31, 2022, available at: www.sueddeutsche.de.

70. “Central Government’s Debt Brake: Options for Stability-Oriented Further Development”, *Deutsche Bundesbank Monthly Report*, German Central Bank, April 2022, available at: www.bundesbank.de.

71. G. Sher, “Options for Creating Fiscal Room for Investment and Other Spending Needs: Germany” International Monetary Fund, July 2024, available at: www.imf.org.

72. “Unsere Haltung zu Linkspartei und AfD” [Our stance on the Left Party and the AfD], CDU, February 7, 2020, available at: www.handelsblatt.com.

Added to this has been a shift in the political debates regarding the long-term reform of the debt brake. It is supported by the SPD but has drawn criticism from conservatives in the CDU, with Chancellor Friedrich Merz already stating that Germany's maximum debt capacity has been reached and that it is therefore not feasible to take on additional debt. The SPD, for its part, is convinced that a long-term solution must be found to make Germany's economic base more efficient by investing in future technologies and preventing fiscal austerity from leading to aging infrastructure.⁷³ Due to the Conservatives' obstruction on this issue, the SPD is making the outcome of discussions on electoral reform—which the CDU would like to advance and for which another Bundestag committee has been established—contingent on the outcome of discussions on reforming the debt brake.⁷⁴ Fundamentally, opinions differ on the duration of the exemption from the debt brake for military spending, as this measure is considered temporary. The SPD fears that ending the exclusion of defense spending from the debt brake could quickly prompt budget cuts in other areas as a complementary policy. Furthermore, SPD representatives would like to see investments exempted from the debt brake in the future, a proposal the CDU/CSU rejects.⁷⁵ Nevertheless, against the backdrop of the war in Iran and the challenges this poses in terms of rising energy costs, uncertainty for businesses regarding investments, and fears of potential shortages of certain goods and energy sources transiting through the Strait of Hormuz, some voices are already calling for the activation of the emergency clause, which could lead to a further relaxation of the debt brake.⁷⁶

A longer-term reform of the debt brake thus appears to be compromised by the current balance of political forces in the Bundestag, which are delaying several decisions for the future that businesses nevertheless expect, in the interest of planning security. Added to all this are political calculations.

73. "Staatsverschuldung: SPD widerspricht Merz bei Reform der Schuldenbremse" [National debt: SPD disagrees with Merz on reforming the debt brake], March 11, 2026, *Handelsblatt*, available at: www.handelsblatt.com.

74. R. Roßmann and V. Timmler, "Wahlrecht und Schuldenbremse | Zwei Kommissionen, kein Ergebnis" [Voting rights and the debt brake | Two commissions, no results], *Süddeutsche Zeitung*, March 10, 2026, available at: www.sueddeutsche.de.

75. M. Greive and J. Hildebrand, "Koalition: Reformkommission zur Schuldenbremse in zentralen Punkten uneinig" [Coalition: reform commission disagrees on key points regarding the debt brake], *Handelsblatt*, January 30, 2026, available at: www.handelsblatt.com.

76. M. Greive and J. Hildebrand, "Iran-Krieg: Muss die Schuldenbremse erneut ausgesetzt werden?" [War with Iran: Should the debt brake be suspended again?], *Handelsblatt*, March 16, 2026, available at: www.handelsblatt.com.

Additional measures to strengthen the competitiveness of Germany's economic base

In addition to relaxing the debt brake and the SVIK, Germany is implementing programs to increase the attractiveness of its economic base. During the campaign for the February 2025 parliamentary elections, Friedrich Merz's CDU had promised an "economic turnaround" (*Wirtschaftswende*)⁷⁷ with an "Agenda 2030"⁷⁸ program, in reference to Gerhard Schröder's "Agenda 2010" from the early 2000s, which consisted of major social and labor market reforms that drew widespread criticism but which are also generally considered to have enabled a resurgence of growth in post-reunification Germany. In this vein, the Merz government has presented a "Bill for an Immediate Fiscal Investment Program to Strengthen Germany's Economic Base".⁷⁹ This includes measures to support competitiveness, such as lowering the corporate tax rate from 15% to 10% starting in 2028; tax breaks for businesses, particularly for the purchase of electric company vehicles; and 30% depreciation allowances on the purchase of capital goods for businesses starting July 1, 2025, through 2027.⁸⁰ These tax breaks are expected to total €46 billion through 2029.⁸¹

In addition to these measures, various ministries intend to demonstrate that revitalizing the German economy is their top priority. They are encouraged in this effort by various German economic institutes such as DIW Berlin, the Kiel Institute, RWI Essen, Ifo Munich, and IWH Halle, which in September 2025 issued an assessment of the state of the country's economy and the priorities on which the government must act.⁸² Beyond the advice from economic institutes, the Chancellor, the Minister of Finance, and the Minister for Economic Affairs and Energy are also engaged in close dialogue with major industry associations, such as the automotive, steel, and machine tool industry federations, as well as with the Confederation of German Employers' Associations (BDA), the Federation of German Industries (BDI), the German Chamber of Commerce and Industry (DIHK), and the German Confederation of Skilled Crafts (ZDH).

77. J. Olk, "Wirtschaftswende-Versprechen nach einem Jahr kaum erfüllt" [Promises of economic recovery have barely been fulfilled after a year], *Handelsblatt*, February 23, 2026, available at: www.handelsblatt.com.

78. "Agenda 2030 – Neuer Wohlstand für Deutschland, Beschluss des Bundesvorstandes der CDU Deutschlands" [Agenda 2030 – New prosperity for Germany, resolution of the federal executive committee of the CDU of Germany], CDU, January 10–11, 2025, available at: www.cdu.de.

79. "Growth Booster to Strengthen Germany as a Business Location", German Federal Government, June 4, 2025, available at: www.bundesregierung.de.

80. *Ibid.*

81. A.-S. Chassany, "Friedrich Merz Plans €46bn Corporate Tax Breaks to Revive German Economy", *Financial Times*, June 4, 2025.

82. J. Olk, "Ökonomen legen Zwölf-Punkte-Plan für Deutschland vor" [Economists present a twelve-point plan for Germany], *Handelsblatt*, September 25, 2025, available at: www.handelsblatt.com.

Furthermore, to better address the challenges faced by small and medium-sized enterprises (SMEs), a Federal Government SME Delegate has been appointed.⁸³ These numerous exchanges aim to provide the government with a holistic view of the challenges faced by *Standort Deutschland*, enabling it to address them through the most comprehensive bottom-up approach possible.

In addition, the government intends to focus on growth sectors to boost Germany's competitiveness, and on reducing the administrative burdens that hinder businesses. Thus, among the priorities are simplification and a "federal modernization program" that focuses on five key themes: less bureaucracy; faster procedures; more efficient, resilient, and efficiency-oriented government structures; digital procedures; and high-quality legislation.⁸⁴

Among the sectors receiving special attention from the government is the digital sector, with a dedicated ministry, the Ministry for Digital Affairs and State Modernization, headed by Karsten Wildberger (CDU). In addition, there is also a ministry dedicated to space, called the Federal Ministry of Research, Technology, and Aerospace, led by Dorothee Bär (CSU). Other technologies are also in the government's sights, such as nuclear fusion, quantum technology, and artificial intelligence.

The Merz government has generally been welcomed by the German business community. Peter Leibinger, for example, has stated that, "The federal government has gotten off to a good start; it's addressing the right issues," citing tax cuts and the reduction of bureaucracy as examples.⁸⁵ The impression given is of new momentum for the economy, with the aim that the announced public investments will restore confidence among private actors, who, in turn, will inject capital into the German economy. The €500 billion are viewed as an "investment booster."⁸⁶ Consequently, there is hope for a crowd-in effect that would amplify the impact of the measures taken and lead to an even more significant economic rebound.

In this regard, the creation of a *Deutschlandfonds* is noteworthy.⁸⁷ It is part of a project called "Made for Germany," announced in July 2025, when

83. Gitta Connemann (CDU). J. Olk, "Mittelstand übt scharfe Kritik an der Bundesregierung" [Small and medium-sized businesses are sharply criticizing the federal government], *Handelsblatt*, October 5, 2025, available at: www.handelsblatt.com.

84. J. Fokuhl, M. Greive *et al.*, "Bürokratieabbau: Bund und Länder planen große Staatsreform" [Cutting red tape: Federal and state governments plan major government reform], *Handelsblatt*, December 2, 2025, available at: www.handelsblatt.com.

85. D. Delhaes, J. Fokuhl *et al.*, "Kanzler Merz' Neun-Punkte-Plan für die Wirtschaft" [Chancellor Merz's nine-point plan for the economy], *Handelsblatt*, June 23, 2025, available at: www.handelsblatt.com.

86. Y. Osman, D. Schwarz *et al.*, "Sewing sieht Stabilität der Kapitalmärkte gefährdet" [Sewing sees the stability of the capital markets at risk], *Handelsblatt*, September 4, 2025, available at: www.handelsblatt.com.

87. M. Greive and J. Olk, "130 Milliarden Euro für die Wirtschaftswende" [130 billion euros for the economic transition], *Handelsblatt*, December 18, 2025, available at: www.handelsblatt.com.

major companies such as Siemens, Deutsche Bank, Volkswagen, Porsche, Mercedes-Benz, and SAP pledged to invest more than €600 billion in Germany by 2028. With the aim of signaling renewed confidence in *Standort Deutschland*, the Chancellor, who welcomed more than 60 companies to the Chancellery for the occasion, stated that Germany was “on the cusp of one of the largest investment projects Germany has seen in recent decades.”⁸⁸ Friedrich Merz intends to reinforce this confidence by appointing former banker Martin Blessing as the government’s investment commissioner.⁸⁹ His role is to attract more private capital to supplement the expected increase in public spending. The goal is therefore to enhance the attractiveness of Germany’s industrial base, and Germany aims to position itself as a safe destination for investment, where the rule of law prevails, and in which a predictable environment is highly valued by investors in an otherwise turbulent international context.

We may also be seeing the beginnings of a shift in mindset within the business community regarding the relationship that representatives of the business and political spheres should maintain. Thus, Peter Leibinger, president of the Federation of German Industries, calls for “resilience” and “sovereignty” as well as a “new form of collaboration between politics and the economy” through a “common technology strategy” for the defense industry, new technologies, and securing raw materials. This represents a shift in rhetoric in a country where the business and political worlds typically overlap little. Perhaps this is also due to the profile of Peter Leibinger, CEO of Trumpf, a company specializing in laser manufacturing and a key link in the supply chain for ultra-sophisticated chips, which finds itself caught up in the turmoil of geo-economic issues and Sino-American rivalry. Indeed, Trumpf is just as affected as companies like Zeiss, or the better-known ASML (to which it supplies lasers), by the restrictions on exports to China, following an agreement between the United States, Japan, and the Netherlands under the previous US administration.

However, despite the business community’s generally favorable reception of the government, skepticism persists regarding its ability to rise to the challenge facing *Standort Deutschland*. In December 2025, Peter Leibinger told the German Press Agency that “the German industrial base is undergoing an unprecedented crisis,”⁹⁰ even referring to a “free fall.”⁹¹ He estimated that the decline in industrial production in 2025 was

88 Chancellor’s statement on the “Made for Germany” initiative – Kraftvolles Signal für mehr Investitionen in Deutschland [A strong signal for increased investment in Germany], German federal government, July 21, 2025, available at: www.bundesregierung.de.

89. “German government names former Commerzbank CEO Martin Blessing as commissioner for increasing foreign investment”, Reuters, September 22, 2025, available at: www.reuters.com.

90. “Industrie: BDI-Chef Leibinger sieht Standort ‘im freien Fall’” [Industry: BDI President Leibinger says Germany is “in free fall”], *Handelsblatt*, available at: www.handelsblatt.com.

91. *Ibid.*

2 percentage points compared to the previous year, describing Germany's situation not as a mere "economic downturn,"⁹² but as a genuine "structural decline,"⁹³ drawing on figures showing a capacity utilization rate of 70% in chemical plants, for which the situation is scarcely more encouraging than in the machine tool and steel industries. According to Peter Leibinger, German industry is steadily losing ground, and the government's response is too timid amid a worrying outlook for employment and prosperity. Peter Leibinger also commented on the need for the SVIK to be used transparently and not to finance consumption-related expenditures.

It should be noted that the country's economic recovery is a priority for the Chancellor, who has outlined a nine-point plan in an internal Chancellery document on the subject.⁹⁴ Also, during a speech at the Hertie School on September 24, 2025, Finance Minister and Vice-Chancellor Lars Klingbeil detailed his six priorities for strengthening both the European and German economies, two levels he views as intrinsically linked.⁹⁵ Meanwhile, the Federal Ministry for Economic Affairs and Energy, supported by renowned economists such as Veronika Grimm, Justus Haucap, Stefan Kolev, and Volker Wieland, developed a four-point plan in October 2025 to revitalize the country.⁹⁶

This series of announcements shows that measures to reverse the economic momentum of recent years, marked by stagnation, are considered a matter of urgency. What Chancellor Friedrich Merz announced with great fanfare as an "autumn of reforms"⁹⁷—implying a difficult period at the end of 2025 when certain structural economic decisions setting a new course were to be made—has, however, disappointed due to a lack of conclusive results and has been mocked by some who warned of the onset of a "winter of layoffs".⁹⁸ This is indeed a major cause for concern, particularly in the chemical and automotive sectors, where bad news continues to accumulate. These developments come at a time when clear decisions must be made. Yet the trade-offs involved are proving difficult.

92. *Ibid.*

93. *Ibid.*

94. D. Delhaes, J. Fokuhl *et al.*, "Wirtschaftspolitik: Kanzler Merz' Neun-Punkte-Plan für die Wirtschaft" [Economic policy: chancellor Merz's nine-point plan for the economy], *Handelsblatt*, June 23, 2025, available at: www.handelsblatt.com.

95. L. Klingbeil, "Eine europäische Agenda: Lars Klingbeil zu Deutschlands Investitionsstrategie und der Zukunft der EU" [A european agenda: Lars Klingbeil on Germany's investment strategy and the future of the EU], YouTube, September 25, 2025, available at: www.youtube.com.

96. J. Olk, "'Wachstumsagenda' – Reiches Ökonomen legen Vier-Punkte-Plan vor" ["Growth agenda" – Reich's economists present four-point plan], *Handelsblatt*, October 6, 2025, available at: www.handelsblatt.com.

97. "Germany's Much-Ballyhooed 'Autumn of Reforms' Is a Damp Squib", *The Economist*, October 23, 2025, available at: www.economist.com.

98. "Ohne Herbst der Reformen folgt der Winter der Entlassungen" [Without an autumn of reforms, a winter of layoffs will follow], Initiative Neue Soziale Marktwirtschaft (INSM), available at: www.insm.de.

A change of course that raises both hopes and concerns

Germany's shift away from its traditional policy of fiscal discipline has generally raised high hopes among other EU member states, which hope to benefit from these measures. However, this has also raised concerns about a potential widening of the gap with Germany, the continent's largest economy. While these measures certainly allow the German government to create the necessary room for maneuver to implement the coalition program, they have also cost the Chancellor a great deal of political capital in Germany. He is forced to take this into account and will likely be limited in his ability to act in other areas, both in domestic policy—where compromises with his coalition partner are also necessary—and at the European level. Beyond political interests that are sometimes convergent and sometimes divergent, the implementation of these measures raises questions because the deployment of resources, however substantial, will not suffice if these funds do not effectively reach the final beneficiaries or if they are held up by authorization procedures that delay implementation.

A German U-turn that highlights the trade-offs required at the national and European levels

The trade-offs raised by the relaxation of the debt brake and the creation of the SVIK are varied. To begin with, these measures in themselves are the result of an initial trade-off. They allowed the incoming government to create the necessary room for maneuver to finance the policies outlined in the Coalition Agreement that would be finalized subsequently. The alternative would have been to pursue a less ambitious policy within the regular budget. The creation of the SVIK broke a real taboo and was justified by the need to address the new geopolitical reality. Formally speaking, the method of creating a special fund to sidestep the issue of debt appears unorthodox. Talking about a “special fund” is a euphemism to avoid using the anxiety-inducing term “debt.” However, people in Germany are under no illusions about the implications of deploying these sums, which must be repaid no later than January 1, 2044. Indeed, a panel of linguists has awarded the *Unwort des Jahres* prize, given to the most misused expression of the year, to the SVIK for its deceptive and

euphemistic nature.⁹⁹ Previous “special funds” had already been launched, such as the 2022 special fund to modernize the German military. Fundamentally, during the election campaign, Friedrich Merz’s CDU, which won the election, had firmly rejected any idea of relaxing the debt brake. When it subsequently adopted a radically opposing policy, a portion of the CDU’s electorate felt betrayed. Friedrich Merz therefore staked a great deal of political capital to ensure this measure came to fruition. The criticism he faced was the price the incoming government had to pay to create a comfortable margin of maneuver to carry out its policies and relieve itself of the pressure to seek funding elsewhere for long-neglected infrastructure projects that are deemed essential.

At the same time, there is the question of whether the SVIK is compatible with the European Stability and Growth Pact (SGP), an issue raised by two researchers from the Brussels-based think tank Bruegel, one of whom has since become the chief economist at the German Ministry of Finance.¹⁰⁰ Germany’s public expenditure path and the flexibility to increase defense spending were finally approved by the Council of the EU, in October 2025.¹⁰¹ Germany’s debt-to-GDP ratio of 63.5%¹⁰² only slightly exceeds European criteria, so it still has a comfortable margin of maneuver. Furthermore, Commissioner Valdis Dombrovskis, whose portfolio covers economic affairs, highlights the “additional flexibility” of the new rules should a member state wish to invest more.¹⁰³ Moreover, the announced public investments will ideally be complemented by private investments, and it is therefore expected that their contribution to growth should offset the debt incurred. For this reason, the rating agency Standard & Poor’s (S&P), which serves as a benchmark for assessing the financial solvency of nations, continues to place its full confidence in Germany and has maintained the country’s triple-A rating.¹⁰⁴

99. “Das ‘Unwort des Jahres’ lautet Sondervermögen” [The “Word of the Year” is “special fund”], *Der Spiegel*, January 13, 2026, available at: www.spiegel.de.

100. A. Steinbach and J. Zettelmeyer, “Das Milliardenpaket von Merz könnte als Papiertiger enden” [Merz’s billion-euro package could end up as a paper tiger], *Handelsblatt*, April 24, 2025, available at: www.handelsblatt.com.

101. “Economic Governance: Council Approves Germany’s Budgetary Expenditure Path and Flexibility to Increase Defense Spending” Council of the EU, October 25, 2025, available at: www.consilium.europa.eu.

102. “Schuldenstandquoten der EU-Mitgliedstaaten Bruttoschulden (konsolidiert) in % des Bruttoinlandsproduktes” [Debt-to-GDP ratios of EU member states: gross debt (consolidated) as a percentage of gross domestic product], Destatis, April 22, 2025, available at: www.destatis.de.

103. J. Diesteldorf, “Brüssel mahnt Deutschland zu Reformen und Schuldenkontrolle” [Brussels urges Germany to implement reforms and control its debt], *Süddeutsche Zeitung*, June 4, 2025, available at: www.sueddeutsche.de.

104. “Germany ‘AAA/A-1+’ Ratings Affirmed; Outlook Stable,” Standard & Poor’s, June 13, 2025, available at: www.spglobal.com.

Nevertheless, fears of an inflationary effect exist among the German economists who are most skeptical of the easing of the debt brake and the creation of the SVIK.¹⁰⁵ These same economists envision scenarios in which Germany's debt level could rise to 118% of GDP by 2040, in the event of an economic downturn and if Germany is unable to weather the present economic shock. Furthermore, in other European countries, while there is general enthusiasm for Germany's willingness to invest more and the hope of benefiting from the multiplier effect this could create, there is also some concern that these measures might reinforce imbalances in Germany's favor and lead to a crowding-out effect: i.e., a situation where investors rush into the German market while neglecting other European markets.

Given this observation, another trade-off must be considered: to what extent will the European dimension play a role in Germany's economic recovery? It should be noted that Germany is increasingly seeking to enhance its stature at the European level, and to act more assertively, thus ensuring that its political clout and its ability to shape European policy are more in line with its economic weight. During a speech at the Hertie School on September 24, 2025, Lars Klingbeil stated, "We are showing the way in Europe as Germany. [...]. It is important for Europe that Germany assumes this leading role." The largest investment drive Germany has ever seen is viewed as a manifestation of this *leadership*, as investing in shared public goods, in cross-border road or energy networks, means thinking about these investments on a European scale. Klingbeil also emphasized the importance of increasing the EU's own resources in preparation for negotiations over the next Multiannual Financial Framework (for 2028-2034), of further leveraging the internal market by deepening it, and of facilitating financing for European companies in this market through the Savings and Investment Union. As an advocate of a strategic European industrial policy and a "Buy European" preference, Klingbeil has also called for greater European cooperation in defense. Based on these positions, which reflect a desire to become more involved in the European market amid an increasingly hostile international environment, the statements of the Vice-Chancellor and the Chancellor—and, increasingly, those of representatives from the business community—are broadly aligned (see Figure 6).¹⁰⁶

105. J. Olk, "Wachstumsagenda' – Reiches Ökonomen legen Vier-Punkte-Plan vor", *op. cit.*

106. "Eine europäische Agenda: Lars Klingbeil zu Deutschlands Investitionsstrategie und der Zukunft der EU" [A european agenda: Lars Klingbeil on Germany's investment strategy and the future of the EU], Hertie School, YouTube, September 24, 2025, available at: www.youtube.com.

Figure 6: Statements by Chancellor Friedrich Merz, Christian Sewing the CEO of Deutsche Bank, and Finance Minister Lars Klingbeil

<p>Friedrich Merz at the Körber Foundation, January 24, 2025</p>	<p>“Regaining our capacity for action begins with putting an end to the incessant public squabbles within the government. It is the responsibility of the Federal Chancellor to ensure that differences of opinion within his cabinet are resolved internally and that the resulting decisions are jointly defended vis-à-vis the outside world. In recent years, these public squabbles have meant that neither our partners nor our opponents knew Germany’s position on certain international policy issues. Under my leadership, this lack of clarity in our positions will not happen again. The clarity of our positions is not only a matter of defending our interests, but is also part of our responsibility as Europe’s leading economy and the EU’s leading member state.”</p>
<p>Friedrich Merz in a “9-Point Plan” circulated internally within the Chancellery, June 23, 2025.</p>	<p>Priority 9: Defining a Franco-German economic agenda, particularly regarding policy towards China, the creation of a European Capital Markets Union, and a “sovereign” European cloud.</p>
<p>Christian Sewing, CEO of Deutsche Bank, during the presentation of the “Made for Germany” initiative, July 21, 2025</p>	<p>“Together, and in close collaboration with the federal government, we want to get Germany back on track to become the engine of growth for a strong Europe.”</p>
<p>Lars Klingbeil at the Hertie School, September 24, 2025</p>	<p>“As Europe’s leading economy, Germany assumes a leading role and a leading responsibility. [...] We want to lead the way in Europe as Germany. [...] It is important for Europe that Germany assumes this leading role.” He went on to emphasize in his speech that the largest investment drive Germany has ever seen is a manifestation of this leadership.</p>
<p>Friedrich Merz at the Munich Security Conference, February 13, 2026</p>	<ul style="list-style-type: none"> • “Great power politics in Europe is not an option for Germany. Leadership based on partnership: yes; hegemonic fantasies: no. Never again will we Germans go it alone. That is a lasting lesson learned from our history. We defend our freedom together with our neighbors, solely with our neighbors, our allies, and our partners. We rely on our strength, our sovereignty, and our ability to demonstrate mutual solidarity in Europe.” • “We know this: in the long run, we will succeed only if we bring other Europeans along with us. That is what we are doing, and for us Germans, there is no other way. We are at the heart of Europe. If Europe tears itself apart, Germany tears itself apart.”
<p>Lars Klingbeil at the Bertelsmann Foundation, March 25, 2026</p>	<ul style="list-style-type: none"> • “I want Germany to assume its responsibilities in Europe and in the world.” • “We have experienced moments that have highlighted our weaknesses. Moments when we were vulnerable to blackmail. On energy issues. Or during trade negotiations with the United States. But we have also seen how much our own strength expands our room to maneuver. When we Europeans stood united and clearly stood up to President Trump on the issue of Greenland.” • “Brussels is too slow. That doesn’t fit the world we live in today. That’s why, at the start of the year, I launched the E6 format in collaboration with my French counterpart. I want the six largest economies in the EU to pick up in pace. Kanzler Merz’ Neun-Punkte-Plan für die Wirtschaft Since my first day at the Ministry of Finance, I have been pushing for us to simplify the European capital market and remove barriers to investment by 2026. This will make us stronger and more independent.”

Sources:

- “Friedrich Merz zu außen- und europapolitischen Prioritäten für Deutschland”, Körber Foundation, January 23, 2022, available at: <https://koerber-stiftung.de/>.
 - D. Delhaes, J. Fokuhl et al., “Kanzler Merz’ Neun-Punkte-Plan für die Wirtschaft”, Handelsblatt, June 23, 2025, available at: www.handelsblatt.com.
 - “Statement des Bundeskanzlers zur Unternehmensinitiative ‘Made for Germany’ –Kraftvolles Signal für mehr Investitionen in Deutschland”, German Federal Government, July 21, 2025, available at: www.bundeskanzler.de.
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 - “Lars Klingbeils Plan für die Modernisierung Deutschlands”, Bertelsmann Foundation, March 25, 2026, available at: www.bertelsmann-stiftung.de.
Graphic by Tristan Feucher © Ifri, 2026.

This reflects a growing awareness within German political and business circles that the German and EU levels of action are intrinsically linked and that the single market provides a critical mass that enables European companies to fully realize their potential. To achieve this goal, the internal market must be made more efficient and its strengths must be leveraged, which include stability and predictability through the rule of law,¹⁰⁷ as well as the size of the market, which represents 450 million potential consumers.¹⁰⁸ At stake is the EU's competitiveness, a central theme in the reports by Enrico Letta¹⁰⁹ and Mario Draghi¹¹⁰ in 2024, which, however, have not yet yielded the expected results,¹¹¹ as the gap with China and the United States has widened further, and Germany has been particularly hard hit. Furthermore, according to an IMF study (2024), the level of intra-European trade barriers, resulting from the application of different regulations or standards, amounts to an *ad valorem* cost of 44% for manufactured goods and 110% for services.¹¹² For this reason, Germany is calling for greater harmonization and simplification at the European level, a point notably highlighted by the Noyer-Kukies report on the ability of innovative companies in Europe to raise capital in Europe.¹¹³

Beyond the European level, Germany's international efforts are also intensifying. The fact that Friedrich Merz is more engaged on the international stage than his predecessor has earned him the label as the "Chancellor dedicated to international affairs," implying that he is "more invested in foreign affairs than in domestic ones" (*Außenkanzler*).¹¹⁴ Merz, however, is careful not to give the impression that he is neglecting domestic policy. Thus, according to the Chancellery, a dynamic foreign economic policy is essential to the success of the German economy. The Chancellor's numerous trips abroad, therefore, do not reflect a lack of interest in domestic policy. On the contrary, the Chancellor sees it as his mission to

107. "Emmanuel Macron Declares A European State of Emergency", *The Economist*, *op. cit.*

108. "Special Address by President von der Leyen at the World Economic Forum", European Commission, January 20, 2026, available at: www.ec.europa.eu.

109. E. Letta, "Much more than a Market", European Council and Council of the EU, April 2024, available at: www.consilium.europa.eu.

110. M. Draghi, "The Future of European Competitiveness", European Commission, September 2024, available at: www.commission.europa.eu.

111. Of the 383 recommendations in the report, only 43 have begun to be implemented—just over 11%, according to the tally by the European Policy Innovation Council think tank. See "Draghi Observatory & Implementation Index: Only 1 in 10 Measures Implemented", European Policy Innovation Council, September 4, 2025, available at: <https://thinkpic.eu>.

112. According to an IMF study (2024), the high level of intra-European trade barriers amounts to an *ad valorem* cost of 44% for manufactured goods and 110% for services. See "A Recovery Short of Europe's Full Potential", International Monetary Fund, October 2024: available at: www.imf.org.

113. J. Kukies and C. Noyer, "Financing les entreprises innovantes en Europe" [Financing innovative companies in Europe], Ministry of the Economy, Finance, and Industrial, Energy, and Digital Sovereignty, January 19, 2026, available at: www.tresor.economie.gouv.fr.

114. D. Delhaes, J. Fokuhl *et al.*, "Kanzler Merz' Neun-Punkte-Plan für die Wirtschaft" [Chancellor Merz's Nine-Point Plan for the Economy], *Handelsblatt*, June 23, 2025, available at: www.handelsblatt.com.

protect the German economy and promote Germany's appeal and industrial base, particularly with foreign investors. He thus finds himself in a constant balancing act between his presence in Germany and on the international stage, with the added dimension of the European level, where Germany increasingly aspires to take a leadership position.

Now that Friedrich Merz has opened the floodgates to unprecedented debt to modernize Germany's defense capabilities and create the SVIK, another issue arises, namely that of collective European debt, which Germany has traditionally opposed strongly. Yet a country like France, which has long harbored hopes of developing a common debt instrument, is unlikely to get its way on this point. It is indeed unrealistic to expect Friedrich Merz to stake his political capital once again on such a thorny issue, especially at the European level,¹¹⁵ which is more abstract in the eyes of German citizens. This is particularly so given that the CDU's popularity has taken a heavy hit in most of the *Länder* it governs. Yet the issue was brought back into the spotlight by the French President in an interview with *Le Monde* in February 2026.¹¹⁶ Emmanuel Macron, referring to the reports by Enrico Letta and Mario Draghi on the internal market, estimated that €800 billion per year in public and private investment is needed to finance strategic sectors, such as cleantech, chemicals, steel, and the automotive industry to boost the EU's competitiveness, particularly vis-à-vis the United States and China: and if defense is added, the figure would rise to €1.2 trillion per year. The German reaction was swift: "Protectionism cannot be the model for Europe's prosperity,"¹¹⁷ was the sentiment heard in Berlin, and jointly issued Eurobonds are indeed contentious, as Germany believes that European debt (for which it would bear a significant burden) also requires efforts from other European partners, and especially more responsible management of public finances on the part of Europe's most indebted member states.

115. In this regard, the German Council of Economic Experts (*Sachverständigenrat*) stated in its 2025/26 Annual Report: "European bond issues involving Germany as a fiscal policy anchor of stability would open up new scope at more favourable conditions, especially for highly indebted member states. For Germany itself, however, participation would be economically unattractive and risky, as it can finance itself more favourably on its own and would bear higher risks with joint debt and possibly even trigger them.[...] However, joint European borrowing can only strengthen the EU – if at all – under strict fiscal and institutional conditions. It would have to go hand in hand with the transfer of competences and decision-making power in fiscal and budgetary policy to the European level, i.e. a deepening of political union". See *Perspektiven für morgen schaffen, Chancen nicht verspielen* [Creating new prospects for tomorrow, not squandering opportunities] – 2025/26 Annual Report of the Council of Economic Experts, Council of Economic Experts, November 9, 2025, p.384, available at: www.sachverstaendigenrat-wirtschaft.de.

116. "Emmanuel Macron : 'C'est le moment pour l'UE de lancer une capacité commune d'endettement, à travers des eurobonds'" [Emmanuel Macron: "Now is the time for the EU to establish a common debt-issuing capacity through Eurobonds"], *Le Monde*, February 10, 2026, available at: www.lemonde.fr.

117. T. Gutschker, "Den Ton geben jetzt Merz und Meloni an" [Merz and Meloni are now setting the tone], *FAZ*, February 11, 2026, available at: www.faz.net.

In this context, it is important to understand the pressures facing Friedrich Merz. It should be recalled that, following the federal elections, he was not elected chancellor in the first round of voting in the Bundestag. Many commentators speculated about discontent, including within the ranks of the Chancellor's party, particularly over the reversal of the relaxation of the debt brake and the creation of the SVIK, which may have cost him valuable votes.¹¹⁸ Even though he ultimately prevailed, the measures taken remain a sensitive issue, and voices within his own electorate continue to highlight the risk of an intergenerational divide. This presents another challenge for the government of how to strike the right balance between spending over the coming decade to revitalize the country by committing unprecedented sums, and, at the same time, ensuring that this pays off in both the medium and long term, so that repaying the funds deployed is as painless as possible for the young people of today and tomorrow (Appendix 2). The CDU's youth wing, *the Junge Union*, argues that incurring debt today means sacrificing future generations. They submitted a motion titled "No Further Relaxation of the Debt Brake" at the CDU Congress in February 2026.¹¹⁹ This has now become a red line that Friedrich Merz must navigate, further limiting the government's room for maneuver.

In fact, the government is walking a tightrope. On one side are the Social Democrats, who criticize the increase in defense spending, which is likely to lead to budget cuts in social programs, especially as the multiplier effect of military spending is questionable.¹²⁰ On the other, there are those who believe that the Federal Republic is living beyond its means and that greater austerity is needed to make Germany's industrial base more competitive. To address these conflicting criticisms, one must view the exemption of defense spending from the debt brake (supported by the CDU/CSU) and the creation of the SVIK (championed by the Social Democrats) as complementary measures. This dual approach was the result of a compromise and made the formation of the black-red coalition possible. Since then, the government has

118. "Merz scheitert im ersten Wahlgang bei Kanzlerwahl" [Merz fails to win the chancellorship in the first round of voting], *Tagesschau*, May 6, 2025, available at: www.tagesschau.de.

119. M. Greive and J. Hildebrand, "Koalition: Reformkommission zur Schuldenbremse in zentralen Punkten uneinig" [Coalition: reform commission disagrees on key points regarding the debt brake], *Handelsblatt*, January 30, 2026, available at: www.handelsblatt.com.

120. Tom Krebs and Patrick Kaczmarczyk of the University of Mannheim produced a study in June 2025 demonstrating that the multiplier effect of military spending could be 0.5 or even zero. "An additional euro invested in the arms industry therefore generates at most 50 cents of additional economic output [...]. By way of comparison, targeted investments in public infrastructure can be expected to have a fiscal multiplier of 2, and for the development of childcare infrastructure in daycare centers and schools, this multiplier can even reach 3," write the study's authors. "From an economic perspective, the planned militarization of the German economy represents a risky gamble with a low overall economic return," the economists conclude. See T. Krebs and P. Kaczmarczyk, "Wirtschaftliche Auswirkungen von Militärausgaben in Deutschland" [The economic impact of military spending in Germany], University of Mannheim, June 2025, available at: www.vwl.uni-mannheim.de. The IW Cologne Institute estimates the multiplier effect of military spending at 0.8. See T. Hentze, "Ökonomische Restriktionen für die Umsetzung des Finanzpakets" [Economic constraints on the implementation of the financial package], IW Cologne, March 22, 2025, available at: www.iwkoeln.de.

been seeking the right balance and prioritization in public spending to strike a middle ground, with Conservatives fearing excessive spending while the Social Democrats fear the dismantling of social gains. These two visions are therefore difficult to reconcile.

The regional elections in Baden-Württemberg and Rhineland-Palatinate in March 2026 demonstrated that the AfD is capable of capitalizing on concerns about Germany's economic situation, as the party continued its rise, gaining a stronger foothold in Germany's western *Länder*. In the *Handelsblatt*, Dietmar Neuerer and Annett Meiritz have explained that "encouraged by its electoral successes in western Germany, a two-pronged strategy is taking shape: the AfD continues to court workers, where the SPD is particularly vulnerable, while simultaneously seeking to strengthen its ties with the business community."¹²¹ Thus, the AfD parliamentary group presented an economic position paper drafted during a meeting in Cottbus on April 11, 2026, offering a harsh assessment of the state of the German economy and outlining a number of proposals for Germany's economic recovery.¹²² This echoes the origins of the AfD party, which date back to the aftermath of the 2007 economic and financial crisis, when, bringing together figures from the conservative-liberal movement, it targeted a Eurosceptic electorate opposed to saving the Eurozone, with the AfD refusing to allow Germany to act as Europe's paymaster. Subsequently, and particularly after the "migration crisis" of 2015, the party took an anti-immigration turn. The AfD also presents itself as the party that gives a voice to East Germans, as reflected in its electoral performances in regional elections in Saxony (9.7%), Thuringia (10.6%), and Brandenburg (12.2%) since 2014.¹²³ In this regard, the persistent economic and social inequalities between East and West Germany serve as fuel for the party, which is overrepresented in the "new *Länder*".¹²⁴

The rise of the AfD has been gradual, steadily increasing its electoral performance until it reached second place in the February 2025 federal elections. Entrepreneurs in the small and medium-sized business sector are proving, in particular, to be increasingly receptive of the AfD. Previously loyal to the FDP (or the CDU), they are increasingly drawn to this party, led by Alice Weidel. Thus, while 40% of FDP voters in 2021 remained loyal to the party in 2025, 17% of the votes cast for the FDP in the 2021 federal elections

121. D. Neuerer and A. Meiritz, "Partei setzt nach Wahlerfolgen voll auf Wirtschaft" [Following its election victories, the party is focusing entirely on the economy], *Handelsblatt*, March 24, 2026, available at: www.handelsblatt.com.

122. "Neue Wirtschaftskraft entfesseln – Bürger und Unternehmen entlasten" [Unleashing new economic potential – easing the burden on citizens and businesses], Alternative for Germany (AfD) Parliamentary Group in the German Bundestag, April 11, 2026, available at: www.afd.net.

123. F. Virchow, "Alternative für Deutschland (AfD), un parti d'extrême droite?" [Alternative for Germany (AfD): An Extreme Right-Wing Party?], *Cerfa Notes*, No. 152, Ifri, March 19, 2020, available at: www.ifri.org.

124. "Bundestagswahl 2025 – Ergebnisse in den Regionen" [2025 Federal election – Results by region], *Tagesschau*, February 2025, available at: www.tagesschau.de.

shifted to the AfD in 2025. This was the second-largest shift of votes away from the FDP, with the largest going to the CDU and CSU (25%).¹²⁵

Furthermore, until now, there has been a “firewall” (*Brandmauer*) against the far right in Germany. However, business circles now seem increasingly open to engaging with the AfD. Indeed, the Association of Family Entrepreneurs (*Verband der Familienunternehmer*) represents only 6,500 of Germany’s 3 million family entrepreneurs, but it includes well-known names such as BMW, Bahlsen, Bertelsmann, Melitta, and Oetker. At the end of 2025, it showed itself open to dialogue with the AfD, sparking heated debates.¹²⁶ The increasingly porous barrier between the business world and the AfD is also evident in the Association of Women Entrepreneurs (*Verband der Unternehmerinnen*), which is following in the footsteps of the Association of Family Entrepreneurs.¹²⁷ In response to these alignments, the BDI has stated that it does not seek dialogue with the AfD, and some members of the Association of Family Entrepreneurs, such as Rossmann and Vorwerk, have announced they are ending their membership in the Association. Voices are being raised to point out that the AfD advocates policies that would be harmful to German businesses and the German industrial base if it came to power, including skepticism toward the EU and the euro, opposition to foreign labor, as well as a certain closeness to Vladimir Putin’s Russia¹²⁸ and the MAGA movement in the United States.¹²⁹

As the business daily *Handelsblatt* has recently reported, in the current context, “the debate over Germany’s industrial attractiveness is intensifying in the wake of massive layoffs at Volkswagen and the impending wave of corporate relocations. The AfD sees this as a new opportunity to mobilize support.”¹³⁰ According to a February 2026 poll mentioned in the same article, the AfD is even considered as the party that inspires the most confidence among respondents regarding its ability to advance the German economy, *behind* the CDU, but *ahead* of the SPD (see Figure 7).¹³¹ This is a sign that the ruling coalition will be judged by the results of the SVIK, with the AfD lying in wait, ready to point out failures and position itself as an alternative “that knows better” in the upcoming federal elections. Hence the

125. “Wie die Wähler wanderten” [How the voters shifted], *Tagesschau*, February 24, 2025, available at: www.tagesschau.de.

126. K. Gelinsky, M. Frühauf *et al.*, “Soll die Wirtschaft mit der AfD reden oder nicht?” [Should the business community engage with the AfD or not?], *FAZ*, November 25, 2025, available at: www.faz.net.

127. K. Werner, “Auch Verband der Unternehmerinnen knüpft Kontakt zur AfD” [The association of women entrepreneurs is also reaching out to the AfD], *Der Spiegel*, November 25, 2025, available at: www.spiegel.de.

128. “Aktuelle Stunde – Verhältnis der AfD zu Russland debattiert, Bundestag” [Current affairs debate – AfD’s relationship with Russia debated, Bundestag], November 5, 2025, available at: www.bundestag.de.

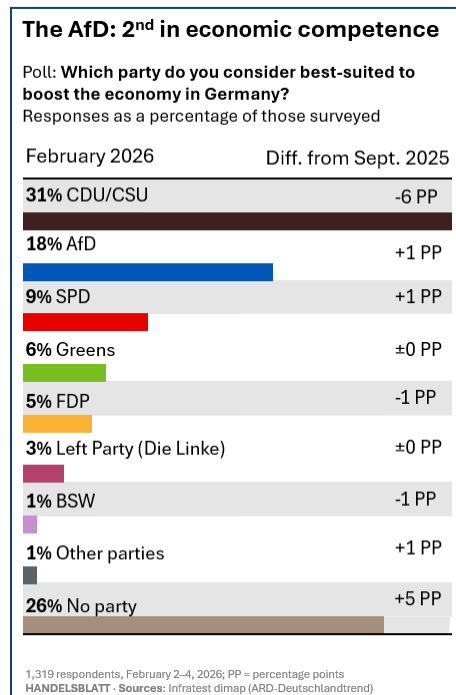
129. “Allianz der ‘Patrioten’: Wie nah stehen sich AfD und MAGA?” [Alliance of “Patriots”: How Close Are the AfD and MAGA?], *ZDF heute*, December 14, 2025, available at: www.zdf.de.

130. D. Neuerer and A. Meiritz, “Partei setzt nach Wahlerfolgen voll auf Wirtschaft,” *op. cit.*

131. *Ibid.*

interest among conservatives and social democrats in finding common ground to implement the SVIK as effectively as possible.

Figure 7: Poll on the economic competence of German political parties



Source: D. Neuerer and A. Meiritz, "Party Focuses Entirely on the Economy Following Election Successes," *Handelsblatt*, March 24, 2026, available at: www.handelsblatt.com.
Graphic by Tristan Feucher © Ifri, 2026.

Does the effectiveness of spending match the scale of the resources deployed?

In addition to the trade-offs and prioritization issues raised regarding the allocation of funds under the SVIK, questions also concern the allocation of these resources and the relevance of public action in the face of the profound industrial changes reshaping the country.

Indeed, the real challenge lies primarily in the concrete implementation and the speed of deploying these funds, as several obstacles exist, particularly regarding the capacities available for planning, authorization, and implementation. The government of Friedrich Merz is seeking to invoke the concept of "overriding public interest" (*überragendes öffentliches Interesse*),¹³² which would allow it to bypass certain regulations that could

132. The aim would be to accelerate the planning, permitting, and implementation phases. "It is necessary to fundamentally review the laws governing planning, construction, the environment, public procurement, and administrative procedures," as stated in the Coalition Agreement between the

hamper the implementation of the SVIK. Given the urgency of the situation, this concept had already proven useful for the construction of LNG terminals in northern Germany to compensate for the loss of Russian energy supplies starting in 2022. Sectors affected by the acceleration of these procedures would include renewable energy, mobile telecommunications, and fiber-optic technologies. In December 2025, the coalition committee¹³³ agreed on the rules governing infrastructure development to enable accelerated planning and permit-granting procedures (the Chancellor referred to a “qualitative leap”), a move that has, however, drawn criticism from those who fear it will come at the expense of environmental protection.¹³⁴

Germany’s federal structure is another factor to consider when assessing the effectiveness of the SVIK. The distribution of the €100 billion among the *Länder* is governed by the “*Königssteiner Schlüssel*” (Figure 8 and Figure 9), a formula which combines population size (accounting for one-third) and tax revenue (accounting for two-thirds). This raises a particularly relevant question, given that the allocated funds should be directed toward fostering greater territorial and social cohesion. In this regard, there is a debate over whether the states should allocate significant funds to municipalities, which, due to their responsibilities, will be heavily relied upon to implement the infrastructure plan and other announced economic measures. In this context, the mayors of the state capitals of 13 *Länder* sent a letter to the Chancellor in October 2025, warning that the gap between municipal revenues and expenditures is widening and that municipalities are at the limit of their capacity.¹³⁵ In March 2026, a conference on infrastructure in Eastern Germany was held. This was an opportunity to highlight regional inequalities in Germany, with a widening gap between the richest and poorest regions. The SVIK must help reduce these inequalities. The German Institute for Economic Research (Deutsches Institut für Wirtschaftsforschung, DIW), in a study cited by the *Handelsblatt*, warned that “to ensure genuine additionality, it is essential to strengthen municipalities’ financial resources, establish reliable financing structures, and develop planning and public procurement capacities,” failing which, the SVIK will not reduce regional inequalities as intended.¹³⁶

CDU/CSU and the SPD. See *Verantwortung für Deutschland*, Coalition Agreement between the CDU/CSU and the SPD, May 6, 2025, available at: www.koalitionsvertrag2025.de.

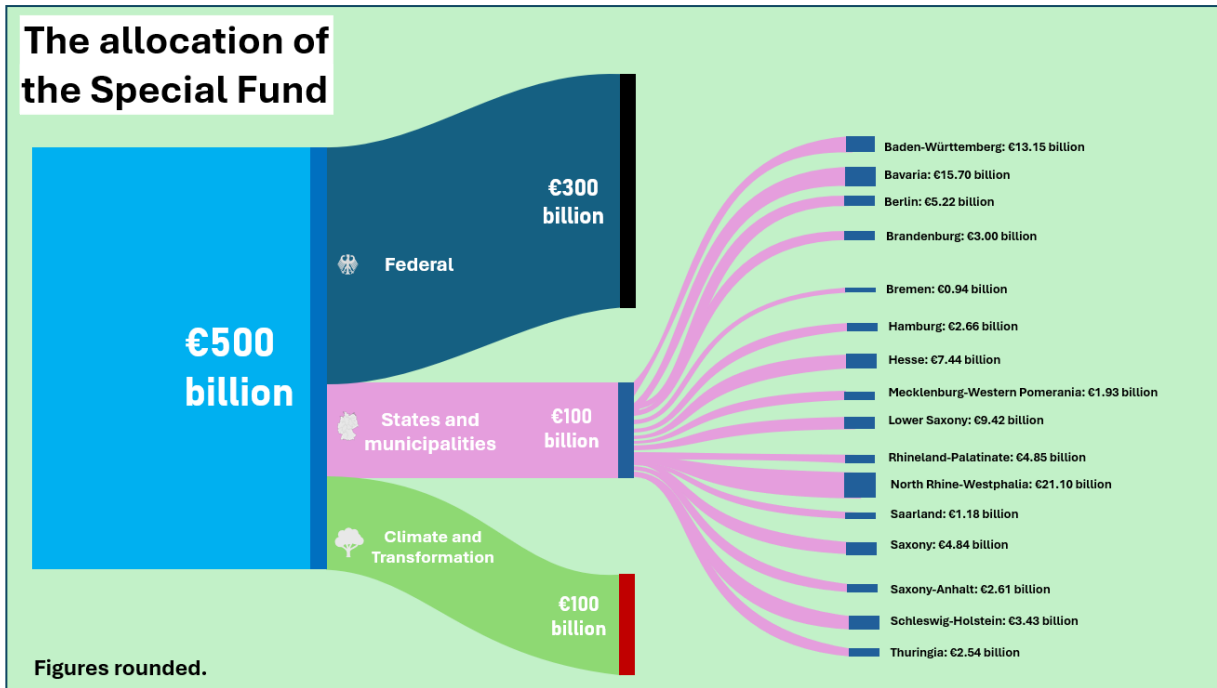
133. The coalition committee coordinates cooperation between the coalition partners. It is an informal body composed of prominent figures from the coalition parties and the government.

134. M. Bauchmüller, H. Roßbach *et al.*, “Koalitionsausschuss – Die Regierung will schneller bauen und klüger sparen” [Coalition Committee – The government wants to build faster and save more efficiently], *Süddeutsche Zeitung*, December 11, 2025, available at: www.sueddeutsche.de.

135. C. Henzler and R. Muschel, “Brief an Merz – Deutschlands Landeshauptstädte rufen um Hilfe” [Letter to Merz – Germany’s state capitals call for help], *Süddeutsche Zeitung*, October 28, 2025, available at: www.sueddeutsche.de.

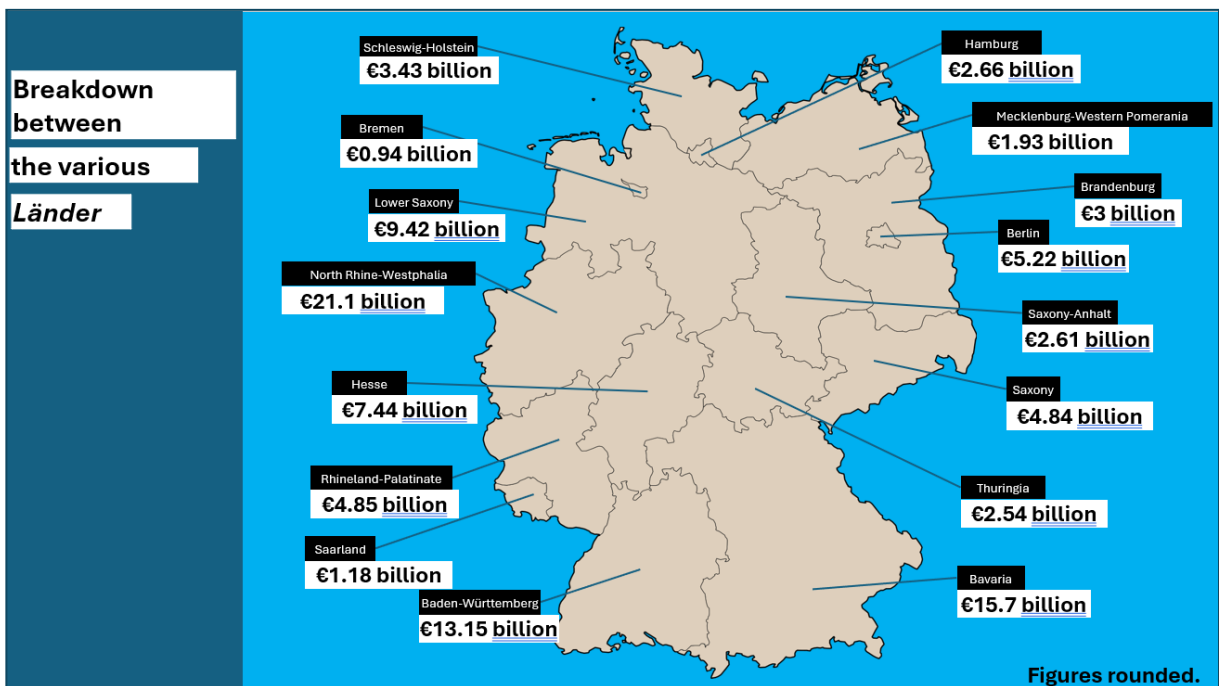
136. V. Kowsky and J. Olk, “Infrastruktur: Welche Landkreise vom 500-Milliarden-Sondervermögen profitieren müssten” [Infrastructure: Which counties stand to benefit from the 500-billion-euro special fund], *Handelsblatt*, March 13, 2026, available at: www.handelsblatt.com.

Figure 8: Distribution of the SVIK



Source: "The Special Fund for Infrastructure and Climate Neutrality", Federal Ministry of Finance, available at: www.bundesfinanzministerium.de.
Graphic by Tristan Feucher © Ifri, 2026.

Figure 9: Allocation of the SVIK among the various federal states



Source: "The Special Fund for Infrastructure and Climate Neutrality", op. cit.
Graphic by Tristan Feucher © Ifri, 2026.

In addition to allocating resources to develop infrastructure in Germany—taking into account regional disparities and the need to adapt procurement and permitting procedures—there is also the question of government support for major industrial transformations. The automotive industry is a perfect example of this. It remains by far the most important industrial sector in Germany in terms of revenue. It is a source of national pride, generates 770,000 direct jobs¹³⁷—particularly in Lower Saxony, Bavaria, and Baden-Württemberg—and creates synergies with other sectors such as new information and communication technologies (NICT), the chemical industry, and steel production. But it is also a systemic industry facing serious difficulties, as demonstrated by the numerous layoff announcements in recent years: there have been 110,000 job cuts in the automotive industry since 2019.¹³⁸ Structural changes are necessary due to the challenges posed by the transition to electric vehicles, competition from China and the United States, and the impact of geopolitical tensions on the sector, particularly shortages of critical minerals and semiconductors. Chancellor Friedrich Merz reiterated in his opening speech at the Munich International Motor Show in September 2025 that “the automotive industry is and will remain a key sector.”¹³⁹ He also championed *Made in Germany* technological leadership in this sector.¹⁴⁰ His presence at this event underscores that defending this industry is a government priority.

At the same time, it is worth noting the government’s lack of clarity regarding which technologies to promote. Many conservative politicians, such as Markus Söder¹⁴¹ of the CSU in Bavaria and Manuel Hagel¹⁴² of the CDU in Baden-Württemberg, as well as Greens like Winfried Kretschmann, Minister-President from 2011 to 2026, advocate “technological openness.” This involves maintaining internal combustion engine vehicles, which have traditionally been a pillar of the German economy, by opening the door to synthetic fuels and biofuels, while also planning for the transition to electric and hydrogen-powered vehicles. Baden-Württemberg is particularly affected by the transformation of its industrial landscape and economic stagnation, which have led to a full-blown crisis in the automotive sector

137. “Bundeskanzler Merz eröffnet IAA 2025” [Chancellor Merz to open the 2025 IAA], German Federal Government, September 9, 2025, available at: www.bundesregierung.de.

138. C. Boutelet, “Friedrich Merz à Pékin et à Hangzhou : l’Allemagne confrontée à la concurrence croissante de la Chine” [Friedrich Merz in Beijing and Hangzhou: Germany faces growing competition from China], *Le Monde*, February 24, 2026, available at: www.lemonde.fr.

139. “Bundeskanzler Merz eröffnet IAA 2025”, German Federal Government, *op. cit.*

140. *Ibid.*

141. Markus Söder called for the termination of the planned end of sales of new internal combustion engine vehicles in 2035, arguing that decisions should be made by engineers rather than bureaucrats. See “Merz fordert Flexibilität beim Verbrenner-Aus” [Merz calls for flexibility regarding the phase-out of internal combustion engines], *Tagesschau*, September 9, 2025, available at: www.tagesschau.de.

142. Manuel Hagel believes ending the sale of new internal combustion engine vehicles starting in 2035 “hinders innovation, weakens our industry, jeopardizes thousands of jobs, and does nothing for our climate.”

Ibid.

and numerous layoffs. The automotive industry and its many suppliers (Mercedes, Porsche, Bosch, ZF, Mahle, etc.) face the challenge of the end of sales of new internal combustion engine vehicles in 2035 and the transition to electric vehicles.¹⁴³ Cem Özdemir, the newly elected Minister-President of Baden-Württemberg who succeeded Winfried Kretschmann, and a member of the Green Party, emphasized the need for a pragmatic approach to avoid rushing the transition to electric vehicles.¹⁴⁴ For this transition to electric vehicles and their adoption by customers to succeed, Özdemir believes that more charging stations must be deployed, that purchase and tax incentives must be implemented and maintained, that the battery industry (on which electric vehicles rely) must develop in Europe, and that the price of electricity for charging must be affordable. The Green Party politician believes that synthetic fuels and hydrogen should be developed and used beyond the automotive sector for other modes of transportation, such as aviation and road freight. Cem Özdemir also believes that it is not enough to set arbitrary deadlines, such as 2035 for the end of sales of new internal combustion engine vehicles. German society must also equip itself with the means to achieve these ambitions, and part of that involves a vehicle fleet comprising various types of engines, including both hybrid and electric models, which would moreover facilitate a smoother transition for suppliers, who have a strong presence in Baden-Württemberg.

Like these politicians, the powerful German Association of the Automotive Industry (Verband der Automobilindustrie, VDA) is advocating relaxing the EU-wide target to end sales of new internal combustion engine vehicles by 2035. Others are warning against easing climate goals. This is the case for Armand Zorn, vice-chair of the SPD parliamentary group. In his view, “anyone who questions the phase-out of fossil fuel combustion engines may win applause in the short term, but compromises our country’s long-term competitiveness and destabilizes the economy.”¹⁴⁵ For his part, Lars Klingbeil reiterated during his speech at the Hertie School in September 2025 that “the future of the automotive industry is electric.”¹⁴⁶ The fear associated with relaxing climate targets is that uncertainty about which technologies will dominate in the future will weaken the sector. These disagreements are symptomatic of a Germany searching for direction, whose political representatives fear making decisions that are too

143. C. Busse, “Baden-Württemberg – Özdemir braucht jetzt ein Konzept gegen die Wirtschaftskrise” [Baden-Württemberg – Özdemir needs a plan to tackle the economic crisis now], *Süddeutsche Zeitung*, March 9, 2026, available at: www.sz.de.

144. C. Budras, “Özdemir über Verbrennerverbot: ‘2035 schon mathematisch nicht erreichbar’” [Özdemir on the ban on internal combustion engines: “By 2035, it’s already mathematically unfeasible”], *FAZ*, November 10, 2025, available at: www.faz.net.

145. “IAA in München: Merz fordert Flexibilität beim Verbrenner-Aus” [IAA in Munich: Merz calls for flexibility on the phase-out of internal combustion engines], *Tagesschau*, September 9, 2025, available at: www.tagesschau.de.

146. L. Klingbeil, “Eine europäische Agenda: Lars Klingbeil zu Deutschlands Investitionsstrategie und der Zukunft der EU”, *op. cit.*

assertive and unpopular: in this case, a transition to electric vehicles that is too rapid could accelerate the decline of suppliers in the German automotive industry, leading to further layoffs.

Aside from the technologies that will form the backbone of Germany's industrial base in the future, lies the question of the roles government and businesses should play. Is it possible to strike a balance between a government that promotes investment in batteries or develops charging infrastructure, and businesses that, in return, commit to ensuring the long-term viability of their operations and the associated jobs within Germany's industrial base? While the SPD supports "a strategic industrial policy,"¹⁴⁷ its stance contrasts with the CDU's less interventionist vision, which tends to limit government action to improving the framework conditions and removing bureaucratic obstacles or tax burdens for businesses.¹⁴⁸ During the campaign for the German federal elections in February 2025, Friedrich Merz had promised an "end" to what he called "subsidy mania."¹⁴⁹ Katherina Reiche, the Federal Minister for Economic Affairs and Energy, who advocates for "more market and less micromanagement,"¹⁵⁰ also shares this perspective. Other views exist, however: Sebastian Dullien, Director of the German Institute for Macroeconomics and Economic Research (Institut für Makroökonomie und Konjunkturforschung, IMK), laments, for example, the absence of an "industrial policy which is fitting for the geopolitical challenges [Germany] faces."¹⁵¹ This certainly demonstrates that there is a pluralistic debate on the subject, but also that the government, made up of personalities with sometimes divergent convictions and subject to various pressures, is still feeling its way and has not yet settled on a firm position.

Another factor currently shaping Germany's industrial landscape is the boom in the defense sector, driven by geopolitical developments and the resulting policy decisions. This is evident in companies like Rheinmetall and Helsing, whose operations are expanding rapidly. The industry giant Rheinmetall has seen its stock price rise by 2,000% since the start of Russia's war of aggression in Ukraine.¹⁵² Rheinmetall has also built Europe's largest munitions factory in Unterlüß, Lower Saxony, at a cost of

147. *Ibid.*

148. J. Olk, "Ökonomen legen Zwölf-Punkte-Plan für Deutschland vor" [Economists present a twelve-point plan for Germany], *Handelsblatt*, September 25, 2025, available at: www.handelsblatt.com.

149. J. Olk, "Wirtschaftswende-Versprechen nach einem Jahr kaum erfüllt" [Promises of economic recovery have barely been fulfilled after a year], *Handelsblatt*, February 23, 2026, available at: www.handelsblatt.com.

150. J. Olk, "Wachstumsagenda' – Reiches Ökonomen legen Vier-Punkte-Plan vor", *op. cit.*

151. J. Olk, "Wirtschaftswende-Versprechen nach einem Jahr kaum erfüllt", *op. cit.*

152. R. Tyborski, J. Blume *et al.*, "Rüstungskonzern: Rheinmetall sucht Käufer für die Autosparte" [Defense contractor: Rheinmetall seeks buyer for its automotive division], *Handelsblatt*, July 16, 2025, available at: www.handelsblatt.com.

€500 million.¹⁵³ NATO Secretary General Mark Rutte, German Defense Minister Boris Pistorius and Vice Chancellor and Finance Minister Lars Klingbeil were present at the inauguration. Decisions to strengthen military capabilities in Europe—particularly among allied nations that made commitments to this effect at the Hague Summit in June 2025—represent a real opportunity for companies in the sector. For example, Germany plans to triple its defense spending by 2029 to reach €160 billion.¹⁵⁴

The consensus within the ruling coalition is that today's geopolitical situation requires strengthening Germany's military capabilities.^{155,156,157} And while the arms industry helps offset layoffs expected in the automotive sector, it also addresses two current priorities in Germany: strengthening defense capabilities and securing jobs. In another sign of the rapidly expanding defense sector, certain regions have adapted to the new international reality and the needs it entails by welcoming companies that manufacture military equipment, such as drones, which are delivered directly to Ukraine. This is the case in Bavaria, which is home to companies like Helsing, Tytan, Stark, and Quantum that supply the Ukrainian military with equipment or plan to do so as part of the "Building with Ukraine" initiative.

However, while paving the way for greater defense capabilities is no easy task in Germany, where many taboos still surround this issue, there is, nevertheless, growing acceptance of these changes. In his speech at the Hertie School in September 2025, Vice Chancellor Lars Klingbeil called for the creation of a genuine European internal defense market, the promotion of joint armaments projects, and efforts to achieve greater European interoperability. He also highlighted the need to harness the strong innovation potential inherent in the defense sector.¹⁵⁸ This involves, in particular, relaxing university regulations that hinder defense-related research to facilitate synergies between the defense and other sectors, when the resulting innovations have dual-use applications. In this way, the benefits of easing debt constraints on military spending are extended to

153. J. Jansen, "Rheinmetall eröffnet neues Werk für Artilleriemunition" [Rheinmetall Opens New Artillery Ammunition Plant], *FAZ*, August 27, 2025, available at: www.faz.net.

154. R. Tyborski, J. Blume *et al.*, "Rüstungskonzern: Rheinmetall sucht Käufer für die Autosparte", *op. cit.*

155. This means Germany plans to triple its defense spending by 2029, reaching €160 billion. It intends to meet the Hague targets by 2029, six years ahead of other allied nations. It plans to increase its military personnel from the current 180,000 to 460,000 by 2035 (260,000 active-duty soldiers and 200,000 reservists). Furthermore, Germany is actively participating in reinforcing NATO's eastern flank, with a brigade deployed in Lithuania.

156. É. Tenenbaum and L. Péria-Peigné, "Zeitenwende : la Bundeswehr face au changement d'ère" [Zeitenwende: The Bundeswehr's Paradigm Shift], *Strategic Focus*, No. 116, Ifri, September 29, 2023, available at: www.ifri.org.

157. J. Möhring, "Bundeswehr: From *Zeitenwende* to *Epochenbruch*", *Cerfa Notes*, February 25, 2026, Ifri, available at: www.ifri.org.

158. L. Klingbeil, "Eine europäische Agenda", *op. cit.*

other sectors. This is what the economic advisors to the Minister of Economy and Energy, Katherina Reiche, recommended in their four-point plan in October 2025.¹⁵⁹ They also suggested relaxing arms export regulations to make the German arms industry more competitive. These considerations indicate that, despite lingering reluctance in some quarters, the defense industry is set to play a greater role in the German economy.

159. J. Olk, “‘Wachstumsagenda’ – Reiches Ökonomen legen Vier-Punkte-Plan vor”, *op. cit.*

Conclusion

Critics who argue that SVIK funds are primarily being used for consumption-related expenditures—which would violate the “additionality” criterion—are becoming increasingly vocal. For example, in November 2025, in an interview with the *Frankfurter Allgemeine Zeitung*, Monika Schnitzer (the Chair of the Council of Economic Experts) endorsed the idea of the SVIK but warned that the government, “is trying far too hard to preserve the *status quo* or hand out election handouts instead of investing in the future.”¹⁶⁰ This refers in particular to measures such as reducing the value-added tax rate for restaurants or introducing a pension bonus for mothers, which are often mentioned in this debate.

More recently, on the first anniversary of the SVIK’s implementation, two economic institutes released figures suggesting that the “additionality” requirement has not been met: the Ifo Munich estimates that 95% of SVIK spending is consumption-related, while the IW Köln puts the figure at 86%. Experts at the IW Cologne have stated: “One year after the Bundestag approved the SVIK, disillusionment persists. The CDU and SPD had the opportunity to close the investment gap, but they have not seized it so far,”¹⁶¹ noting further that the funds allocated for investments in 2025 compared to those in 2024 barely offset inflation. The Ifo Institute, for its part, points out that debt has risen without a corresponding increase in investment. Economists at the Munich-based economic institute estimate that the government incurred €23 billion in debt under the SVIK in 2025, which was not used for new investments.¹⁶²

In an editorial in *the Handelsblatt*, Miriam Meckel described this use of the fund as “misappropriation” and compared the situation to the *Dieselgate* scandal.¹⁶³ This is a sign that, beyond questions of efficiency, there is a broader issue of trust in the ruling coalition. The increased fiscal flexibility created by the SVIK must therefore be accompanied by fiscal consolidation; otherwise, future generations will face a twofold burden:

160. J. Pennekamp and M. Schäfers, “Ich halte das für Unsinn” [“I think that’s nonsense”], *FAZ*, November 20, 2026, available at: www.faz.net.

161. T. Hentze, “86 Prozent des Sondervermögens im Jahr 2025 zweckentfremdet” [86 percent of the special fund will be misappropriated in 2025], German Economic Institute, available at: www.iwkoeln.de.

162. “Regierung hat 95 Prozent der neuen Schulden für Infrastruktur im Jahr 2025 zweckentfremdet” [The government diverted 95 percent of the new debt for infrastructure in 2025 to other purposes], Ifo, March 17, 2026, available at: www.ifo.de.

163. M. Meckel, “Es kann nicht sein, dass in Deutschland nichts mehr funktioniert” [It can’t be that nothing works anymore in Germany], *Handelsblatt*, March 23, 2026, available at: www.handelsblatt.com.

“repaying the debts [created by the SVIK]” and having to “make do with dilapidated infrastructure [that will not have been renovated],”¹⁶⁴ is the worst-case scenario depicted by economic journalist Roman Pletter in *Die Zeit*. The German government, on the defensive, insists it is managing “the new fiscal leeway at its disposal with caution,” combining a “stimulus for growth” with “austerity measures,”¹⁶⁵ as stated on the Ministry of Finance’s website. Moreover, in a speech at the Bertelsmann Foundation in March 2026, Lars Klingbeil asserted that “the year 2026 will require courage from us; Germany needs fundamental reforms.”¹⁶⁶ He emphasized that crises and problems cannot be resolved by injecting ever more money, observing that projects implemented too slowly or in which funds are invested inefficiently should expect a reduction in funding.¹⁶⁷ These remarks were intended to be reassuring: the government will not settle for piecemeal measures. Concerns have been heard, and a bonus-malus system will be implemented to address potential inefficiencies. Meanwhile, certain parties, such as the Greens¹⁶⁸ or the AfD,¹⁶⁹ have already raised the possibility of filing a complaint with the Constitutional Court in Karlsruhe regarding the misuse of funds under the SVIK, while the FDP has already taken the matter to the Constitutional Court, arguing that the relaxation of the debt brake as such is unconstitutional.¹⁷⁰

The government is defending itself against these less-than-flattering preliminary assessments of the SVIK. To be transparent, it has posted a counter on its website showing the funds allocated to date and recalling the timeline for the SVIK’s implementation (see Figure 10). While indeed decided in March 2025, funds could not be effectively used retroactively for the year 2025 until October 2025, which explains the delay in the SVIK’s launch.

164. R. Pletter, “Sie begehen politischen Kreditbetrug, Herr Merz!” [You are committing political, fraud Mr. Merz!], *Die Zeit*, March 17, 2026, available at: www.faz.net.

165. “Investitionsoffensive für das ganze Land” [Investment drive for the entire country], March 19, 2026, Federal Ministry of Finance, available at: www.bundesregierung.de.

166. L. Klingbeil, “Reformen für ein starkes Land”, *op. cit.*

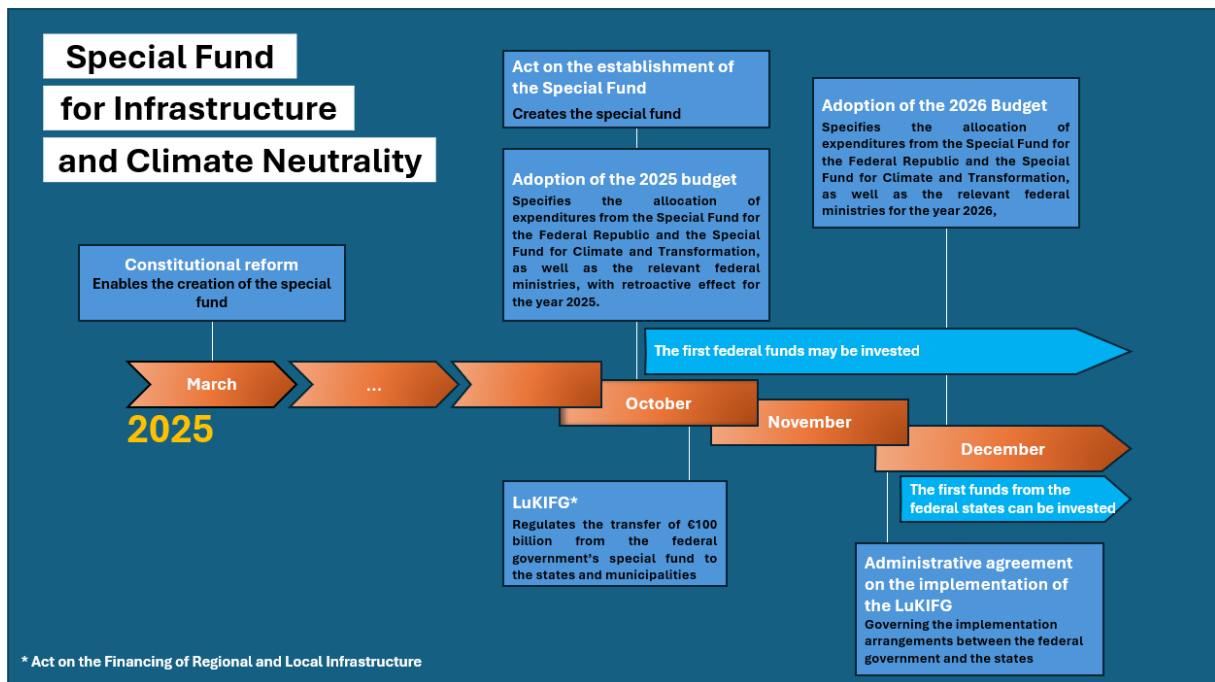
167. *Ibid.*

168. I. Grabitz, “Katharina Dröge: ‘Das zeigt, dass die Union nicht mit Geld umgehen kann’” [Katharina Dröge: “This shows that the Union doesn’t know how to handle money”], *Die Zeit*, March 17, 2026, available at: www.zeit.de.

169. E. Conesa, “En Allemagne, le bilan en demi-teinte de la réforme du frein à la dette” [In Germany, the mixed results of the debt brake reform], *Le Monde*, available at: www.lemonde.fr.

170. F. Gathmann, D. Hipp *et al.*, “Ex-FDP-Abgeordnete klagen gegen rot-schwarze Sondervermögen” [Ex-FDP-Abgeordnete klagen gegen rot-schwarze Sondervermögen], *Der Spiegel*, March 31, 2026, available at: www.spiegel.de.

Figure 10: SVIK Implementation Timeline



Source: *The Special Fund for Infrastructure and Climate Neutrality*, Federal Ministry of Finance, available at: www.bundesfinanzministerium.de.
Graph by Tristan Feucher © Ifri, 2026

The SVIK highlights numerous complex issues that will require carefully considered and well-informed responses, as it will be impossible to satisfy all parties. This entails navigating delicate trade-offs in a context marked by significant uncertainties and an increasingly fragile economic model in Germany. Given generational divides on the one hand and the need to prioritize between social and military spending on the other, or choosing the appropriate level of intervention (Germany, Europe or more internationally), the deployment of €500 billion over the next 12 years highlights divisions within the country, while generating many competing expectations.

For the SVIK to have maximum impact, it will be necessary to ensure its effective implementation by adapting allocation and authorization procedures, addressing human resources issues, and ensuring that allocated funds do not widen regional disparities within Germany. Issues of social and territorial cohesion, if mismanaged, could be exploited politically by parties such as the AfD, which are increasingly making inroads into the German political landscape.

Consequently, in the face of internal and external factors of instability—both structural and the result of profound changes—the question arises as to whether Germany is in a phase of decline or whether it will be able to bounce back by capitalizing on its many strengths.

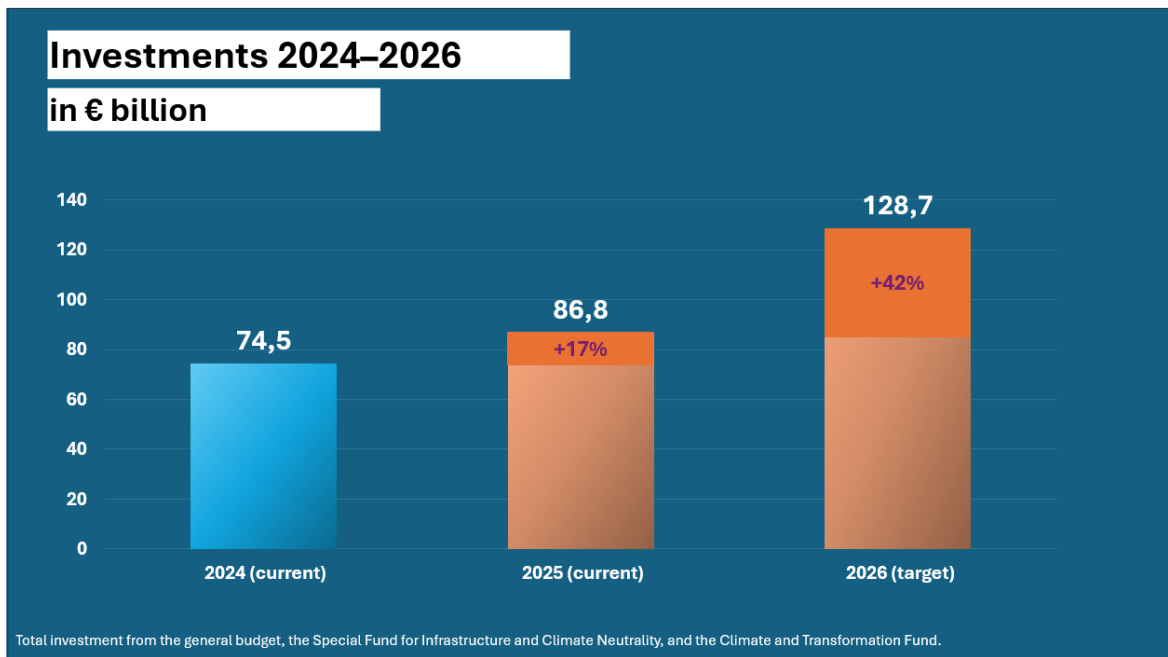
The eyes of other European states are fixed on the “economic locomotive of Europe” with the hope that the sums invested will have a multiplier effect that will reinvigorate the entire EU, given that Germany’s critical mass will inevitably have an impact on other European economies. The competitiveness of Europe’s economic base (*Standort Europa*) is at stake, for it is at the European level that competitiveness against US and Chinese competitors is measured, and on which many jobs depend. By launching a 12-year SVIK, Friedrich Merz’s government, under pressure from the AfD, has created the necessary fiscal leeway to demonstrate that centrist parties are capable of proposing constructive economic solutions by creating the conditions needed to breathe new life into the country.

Many challenges the previous government had already sought to address, notably by reassessing its dependence on Russia and increasing investment in its military, are likely to intensify. Catching up on ground lost in past decades and reducing its exposure to the United States in security and defense, trade, and increasingly in energy is no easy task. Similarly, Germany will have to adapt to China, an indispensable partner for its supply and market needs. Its highly outward-looking model, which was Germany’s strength during the heyday of globalization, is making it increasingly vulnerable as it struggles to reposition itself in an international landscape marked by uncertainty and unpredictability.

The challenges facing Germany are significant. However, it has demonstrated its ability to respond swiftly to Russia’s war of aggression against Ukraine by finding alternatives to Russian hydrocarbons and building LNG terminals in record time. This could serve as a model for the successful implementation of infrastructure modernization plans in Germany. If these projects are carried out effectively, positive effects can also be expected in terms of social and territorial cohesion, given a doubting population that has endured severe shocks to its economic model in recent years.

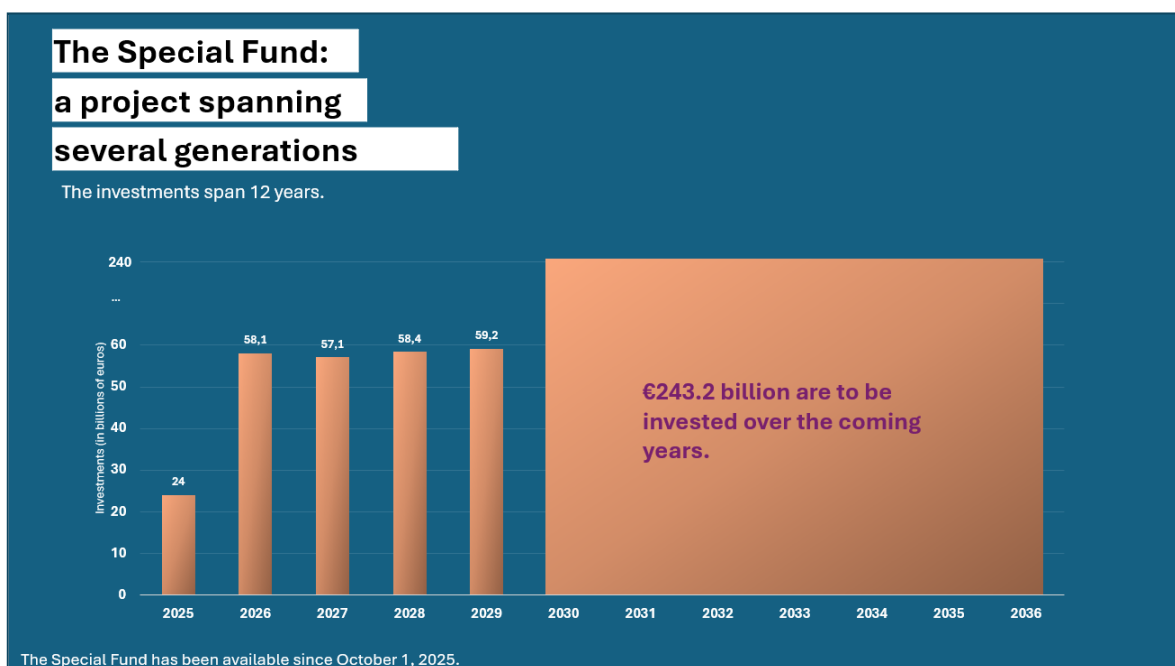
Appendices

Appendix 1: Investments 2024–2026 (current and targeted)



Source: Special Fund for Infrastructure and Climate Neutrality, Federal Ministry of Finance, op.cit.
Graph by Tristan Feucher © Ifri, 2026.

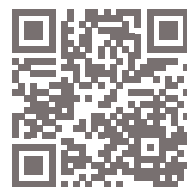
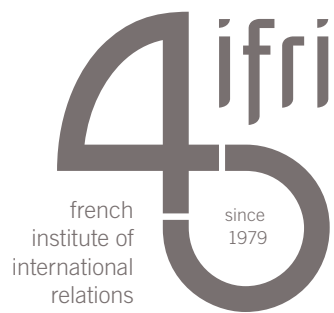
Appendix 2: Investments under the SVIK 2024–2036 (current and targeted)



Source: The Special Fund for Infrastructure and Climate Neutrality, Federal Ministry of Finance, www.bundesfinanzministerium.de.
Graph by Tristan Feucher © Ifri, 2026.

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