

LETTER FROM BERLIN



The Merz Government's Sly Tricks

How officials are circumventing the rules on borrowing.

BY KLAUS C. ENGELEN



As we previously reported, Friedrich Merz entered office with the firm conviction that in these times of disruption and upheaval, Germany as Europe's largest economy must be more present internationally and play a bigger global role. Together with his foreign minister Johann Wadephul, Merz has set himself an ambitious foreign policy agenda.

Some observers have called Merz the "*Außenkanzler*" (foreign chancellor) as he appears around the world. Merz met with U.S. President Donald Trump at the White House in Washington, met numerous times with French President Emmanuel Macron, and attended the historic 2025 NATO summit at The Hague. This has led some critics to accuse

Merz of neglecting Germany's extremely difficult economic and political domestic situation.

Over critical months, Merz stuck to his promise of an "autumn of reforms," until *The Economist* in its October 23 issue came up with the provocative headline: "Germany's much-ballyhooed 'autumn of reforms' is a damp squib. Friedrich Merz's government is drifting as the economy stagnates." In English, a "damp squib," originally meaning a dud firework, indicates fiasco, failure, or disappointment.

END OF THE GENEROUS *BÜRGERGELD*

In fairness to the chancellor, major welfare-state reforms were part of the March coalition agreement. On August 23, at the CDU

party conference in Osnabrück, Merz pointed to the forthcoming negotiations with the Social Democrats and highlighted the growing economic pressures that threaten Germany's generous social-support system. Merz declared that "Germany can no longer afford the present welfare state."

It took until the weekend of October 11 for the leadership of the ruling Christian Democratic Union/Christian Social Union and the Social Democratic Party to agree to a massive reduction in social benefits. The more generous *Bürgergeld* will be replaced by a *Grundsicherung* (basic security) effective from early 2026. According to Merz, "It will be difficult for those who do not participate.

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There will be much harder sanctions. In cases where work is not accepted, no money will be paid.” The chancellor expects savings of €5 billion, or around 10 percent of total basic social security costs next year.

To get a realistic picture of Germany’s social support for foreigners, in 2024 the share of foreign citizens receiving *Bürgergeld* is estimated at around 47 percent of the total 5.5 million recipients. A single adult receives €563, according to official figures. Responding to an inquiry by the AfD, the government confirmed that last year *Bürgergeld* expenditures amounted to €47 billion. This will probably not change much, since under the new *Grundsicherung* regime, support for single adults will remain the same.

New Ukrainian refugees arriving in Germany will face changes to their benefits, as a draft bill proposes moving them from the higher-tier *Bürgergeld* to the lower-tier benefits under the Asylum Seekers Benefits Act (*Asylbewerberleistungsgesetz*). After the marathon session on welfare reform, CSU head Markus Söder thanked SPD leader Lars Klingbeil “for sending the *Bürgergeld* into history.”

A VINDICATED REFORMER?

It took until December 2025 before the Merz coalition of CDU/CSU and Social Democrats were able to pass the highly controversial pension bill.

Chancellor Merz was able to quash a rebellion of his young party members. The youth wing of eighteen conservative MPs objected to the pension bill legislation that guarantees statutory pensions at 48 percent of previous income until 2031. For Merz, changing the pension package agreement reached with the SPD in long negotiations was out of the question. As it turned out, only seven of the “rebels” voted against the complex pension bill. This way, the



German Chancellor Friedrich Merz addresses the 2026 World Economic Forum in Davos. Merz has set himself an ambitious foreign policy agenda, though domestic issues such as benefits reform and keeping German industrial companies from relocating elsewhere have claimed much of his time.

319-vote “chancellor majority” in the 630-seat Bundestag was possible.

According to Reuters, the bill will “raise pensions by around €185 billion over the next fifteen years and let retirement-aged workers work tax

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free. ... The average state pension in Germany, now worth 48 percent of the average wage, will remain at that level until 2031, before falling slightly to 46.3 percent by 2039. ... In a bid to keep workers in the workforce for

longer, the bill will allow those who work beyond the retirement age of sixty-seven to earn up to €2,000 per month tax free.” It was Bavaria that pushed for the so-called “mother’s pension” crediting parents for time spent raising children.

What one should not overlook is that Die Linke, the far-left party, made the decision to abstain from the vote on pensions, saving Merz from potential humiliation. Argues *Politico*, “German Chancellor Friedrich Merz’s conservative-led coalition received an unsolicited political lifeline from an unlikely place—but one that comes at a cost.”

FISCAL POLICY WILL PLAY A KEY ROLE

The German economy remains stuck in crisis. According to the Munich Ifo Institute, fiscal policy will play a decisive role for the remainder of

the year. “Measures from the coalition agreement ... should provide relief for companies and households. Fiscal stimuli will amount to €9 billion in 2025, €38 billion in 2026, and €19 billion in 2027. If the measures are implemented rigorously and the high level of uncertainty recedes as a result, fiscal policy may haul the German economy out of the crisis: The quarterly GDP growth rates could reach up to 0.4 percent, underutilization of economic capacities could be reduced, and a recovery phase could be triggered. In 2027, it is even likely to lead to overutilization as a result of the fiscal stimuli.”

The Ifo forecast also noted, “After stagnating in the first half of 2025, the price-adjusted gross domestic product is expected to grow by 0.2 percent this year. Economic output is forecast to increase by 1.3 percent and 1.6 percent respectively in 2026 and 2027.”

INDUSTRIAL COMPANIES LEAVE GERMANY

“Flucht aus Deutschland” (“Flight from Germany”) is the headline for *Handelsblatt* on October 23, 2025. “The majority of energy-intensive companies are redirecting new investments abroad. Germany is losing a large part of industrial investment.” This is the result of a survey of 240 senior managers in Europe and the United States. Among top managers active in Germany, 31 percent indicated they are in the process of relocating production to other continents or expanding production there; 42 percent are investing in other European countries or postponing investment in Germany.

The surveyed managers came from energy-intensive industries such as basic chemicals, steel, glass, and cement. Other industry observers confirm the grim picture. Christoph Günther, CEO of InfraLeuna, reaches the devastating conclusion: “Many

companies have for years been unable to fully utilize their plants and now conclude that generating added value in Germany is no longer possible.”

According to lawyer Yvonne Hanke of the law firm Ritter Gent, which specializes in advising energy firms, German companies are exam-

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ining potential relocations not only to the United States but also to China and India.

Handelsblatt’s two-page report on the need for relocation can be considered a manifestation of Germany’s worsening industrial crisis.

As *Die Welt* reported on November 5, 2025: “200 closed production sites, 40,000 jobs threatened—the alarming state of the chemical industry.” Germany’s chemical industry is the largest in Europe and ranks fourth globally behind China, the United States, and Japan.

Handelsblatt’s front page on September 10, 2025, pointed to yet another industrial disaster: “90,000 auto jobs threatened.” *Handelsblatt* cited a study by the German Economic Institute (IW), commissioned by Germany’s Ministry of Economic Affairs, showing that thousands of jobs in the auto industry could be lost.

THE €500 BILLION DEBT PLAN CHANGES THE COUNTRY

On June 24, 2025, Lars Klingbeil, finance minister and SPD co-party head, unveiled the coalition’s decision to tap credit markets for a massive debt-financed €500 billion fund—€400 billion for infrastructure

and €100 billion for environmental projects—to be implemented over twelve years. A similar scheme will rearm the Bundeswehr, part of what the Anglo-Saxon world has praised as “Germany’s One Trillion Debt Miracle.”

On the military side, Germany plans to reach the new NATO defense-spending target of 3.5 percent of GDP by 2029. To finance this, Germany will borrow €850 billion over the coalition’s legislative term. According to projections by the Stability Council of the federal and state governments, Germany’s debt will rise above 80 percent of GDP by 2029, up from 62.5 percent last year.

As expected, the question of how to spend the €500 billion debt plan over the coming decade has become “Germany’s mega bone of contention.” According to the Cambridge Dictionary, a bone of contention is something people argue about strongly over a long period of time—which is exactly what is happening in what is still the world’s third-largest economy, but one whose key manufacturing sectors are shrinking and whose companies are leaving for better economic conditions abroad.

There is broad backing for Germany’s rearmament. But the way the ruling coalition has so far been using the infrastructure *Sondervermögen* (special fund) to replace regular spending—in disregard of the pledged principle of additionality—is raising fierce opposition across the country.

HOW BERLIN IS PREPARING

A full-page report in Berlin’s *Tagesspiegel* illustrates how German cities and municipalities are preparing to receive *Sondervermögen* funds.

In the November 15 issue, Berlin mayor Kai Wegner (CDU) and Raed Saleh, SPD head in the state legislature, presented and defended a list of seventy-five projects that could be

financed over the coming years from the €5.25 billion Berlin will receive from the €500 billion infrastructure fund over twelve years.

The city's CDU and SPD leadership agreed on a list of projects that could be downloaded online to ensure transparency. A full newspaper page was needed to present how Berlin might use the *Sondervermögen* money.

Among the selected projects were new trees, bridges, hospitals, and affordable housing. "We have launched one of the greatest investment offensives Berlin has ever experienced," the mayor said. "We are embarking on a 'fresh-cell treatment' for investment in the German capital."

To obtain an economic assessment of the project list, *Tagesspiegel* invited Martin Beznoska from the German Economic Institute (IW). He objected to €167 million for bridge repairs and €232 million for repairs to streets and waterways, arguing that these should be financed from Berlin's regular city budget. He also questioned the €700 million earmarked for planting new trees for the same reason.

This Berlin example shows how cities and municipalities across Germany are preparing to apply for additional funds from the *Sondervermögen* in the coming years.

OUTRAGE OVER MISUSE OF THE DEBT PLAN

On November 10, 2025, the German Economic Institute (IW) published an explosive research paper titled: "Sondervermögen: Every second euro misused."

Tobias Hentze, the economist who authored the paper, found that "almost 50 percent of planned additional debt by 2029 will be used to plug budget gaps." With the German economy still in crisis, the Merz coalition is using "a whole range of tricks" to circumvent rules requiring that additional borrowing be spent

on extra investment in defense and infrastructure. According to IW estimates, Berlin plans to borrow an additional €271 billion by 2029; of this, roughly €133 billion—almost half—will be misused for other government expenditures.

No wonder that the next day the *Financial Times* published the headline: "Merz accused of using debt

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'bazooka' for welfare and tax cuts. Two prominent institutes and the Bundesbank sound alarm over use of new borrowing."

A few days later, *Eurointelligence* added, "We have been reporting that the German government has been abusing its new infrastructure investment vehicle—which allows for €40 billion in investment spending per year—as a slush fund to expand consumption expenditures. The Council agrees with that assessment. It says that the infrastructure facility is used to shift expenditures from the core budget to the fund to make room for more spending; to cover fiscal gaps; and to fund consumption expenditures directly. In other words: the government is misusing the fund. All parties in the coalition are contributing to the fiscal abuse."

The most influential and vocal critic of the government's financial management is Clemens Fuest, president of the Ifo Institute in Munich.

Under the headline "Stop the Misuse of New Debt," the influential economist—who taught at

Oxford University before coming to Munich—is on a collision course with Berlin over what is needed: "additionality, strategy, and an overall concept."

Fuest writes: "Three things are crucial in managing this borrowing. First, the funds must not be diverted. They should go into genuine additional infrastructure projects and defense spending. This principle of additionality ought to be obvious, yet it is often ignored. If money earmarked for investment in the core budget is cut and shifted into the new debt-financed special funds, that is a misuse of borrowing. The political motive is clear: once money is freed up in the core budget, it can be spent elsewhere—for instance, to plug deficits. That way, governments avoid the unpleasant task of reviewing and cutting existing, typically consumptive, spending. From a macroeconomic perspective, such tricks are harmful.

Second, there needs to be a long-term vision and a credible strategy for how the funds are used. In the case of infrastructure borrowing, policymakers should spell out what infrastructure should look like in, say, 2040.

Third, debt-financed spending should be embedded in a coherent economic and fiscal-policy framework."

"None of these three requirements appear to be met in Germany today," is the alarming message from the leading German economic think-tank. "The rules of additionality are simply too weak." It continues, "A recent analysis by the central bank of Germany (Deutsche Bundesbank) reaches a damning verdict: of €37 billion in new borrowing for infrastructure, actual investment rises by only about €2.5 billion. In other words, 93 percent of the funds are diverted. In defense, €32 billion in additional borrowing results in only €11 billion in higher spending—again, two-thirds of the funds are shifted elsewhere." ♦