



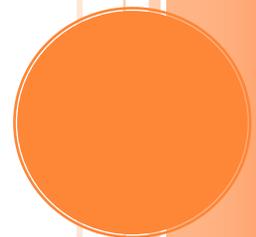
**MACROECONOMIC**  
Analysis & Policy Studies

## **Fiscal Policy Easing in Germany: An Economic growth driver in Post Covid Era**

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# **Fiscal Policy Easing in Germany An Economic Growth Driver in the Post-Covid Era**

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## **Abstract:**

Germany, the largest economy in the European Union, has been following the policy of fiscal prudence and a balanced budget approach. The decade-old policy of the debt brake and “black zero” has made Germany's economy vulnerable, as it focused more on ensuring balanced budgets than on public investment needed to foster growth and development. The COVID-19 pandemic, the energy crisis, and the Russia-Ukraine war have highlighted the weaknesses of this approach. In order to combat the impact of these crises, the government announced changes to its long-standing debt brake policy. The federal government of Germany has exempted defense spending from the 1% of GDP limit set by the debt brake. It also announced a €500 billion infrastructure fund to invest in renewable energy, roads, defense, telecommunications, and digital infrastructure. The new policy has brought confidence among investors and industrialists about positive growth in the coming years. Germany should also keep in mind that short-term targets such as balanced budgets should not come at the cost of long-term economic growth. While the state has the ability to spend, that does not mean it should do so without restraint or responsibility. This paper discusses these issues and suggests that although maintaining fiscal discipline is important, Germany must also invest in infrastructure and energy to prevent future crises and ensure sustainable economic growth.

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## Introduction

For over a decade, Germany has been one of the few countries that has been maintaining a balanced budget. The covid crisis and Russia- Ukraine war has seriously affected the economies in Europe. This has been disrupted since the advent of the covid-19 pandemic, which has caused the lockdown and brought a halt to the production activity.

Fiscal policy refers to the government operations in which it uses spending and taxation as tools to influence economic activity. It remains a central tool of the government in macroeconomic management. It helps the government to stabilize the output across economic cycles, generate employment, support aggregate demand and ensure long term fiscal sustainability. During periods of economic crisis, governments often adopt expansionary fiscal policies, such as increase in government spending and/or reducing taxes to stimulate the economy. Conversely, in times of overheating or high inflation, contractionary policies may be used to cool the economy.

In the Euro Area, Germany plays a pivotal role as the largest economy in the European Union, contributing nearly a quarter of the EU's total GDP. Known for its strong industrial base, export-oriented growth model, and fiscal prudence, Germany is often seen as the leading driver of economic growth in Europe. Germany's economic decisions not only influence its national trajectory but also the broader stability and direction of the Eurozone. However, the COVID-19 pandemic dealt a severe blow to the German economy, leading to a 4.6% contraction in GDP in 2020, and also led to major disruptions in global supply chains, and a significant slowdown in consumer and industrial activity in Germany. In response, the German government temporarily suspended its constitutionally mandated "debt brake" (*Schuldenbremse*) and launched large-scale fiscal interventions, including a €130 billion stimulus package and expansive liquidity support to stabilize businesses and protect jobs through programs like "*Kurzarbeit*" (short-time work).

The economic policy of "debt brake" was originally introduced in the year 2009, during the global financial crisis under Chancellor Angela Merkel and Finance Minister Peer Steinbrück, aimed to limit structural deficits at the federal level to 0.35% of GDP and

required the 16 German states (“Länder”) to maintain balanced budgets. Enshrined in “Article 109, paragraph 3” of Germany’s Basic Law (Grundgesetz), it effectively prohibits both the federal and state governments from borrowing beyond a narrow margin. No other G7 country has such strict constitutional constraints on public borrowing, making Germany uniquely fiscally conservative among advanced economies. Despite its goal of ensuring intergenerational justice and preserving the state’s financial capacity to act, the debt brake has come under growing criticism—especially as Germany’s economy continues to face structural stagnation, aging demographics, weakened industrial competitiveness, changing global dynamics and the long-term effects of the pandemic.

In March 2025, the newly elected federal government began to rethink and revise Germany’s decade-old fiscal orthodoxy, recognizing that strict adherence to the debt brake was constraining the country’s ability to invest in much-needed areas such as digital infrastructure, green energy, and defense. As a result, the government has initiated steps to ease fiscal constraints and boost public investment, signaling a historic shift in German economic policy.

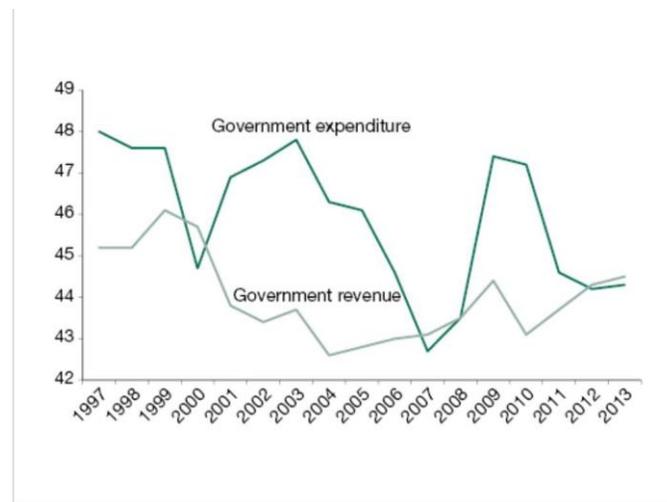
This paper argues that fiscal policy easing in Germany post-pandemic has played a significant role in fostering economic recovery and enabling long-term growth, despite persistent debates over fiscal conservatism, intergenerational equity, and constitutional debt limits. Through a detailed analysis of the policy shift, this research aims to understand the motivations, consequences, and future implications of Germany’s evolving fiscal stance.

### **Fiscal policy from 2009 to 2019**

The global financial crisis that unfolded in 2007–2008 had a profound impact on the German economy. Initial turbulence emerged in the financial sector, with institutions such as IKB Deutsche Industriebank and Sachsen Landesbank requiring immediate state intervention. By 2008, the contagion had reached Hypo Real Estate, intensifying financial instability. As the crisis deepened, Germany entered a period of sharp economic

contraction—GDP declined significantly, with a peak year-on-year drop of 7.9% recorded in the second quarter of 2009.

In response to the escalating crisis, the Federal Ministry for Economic Affairs and Energy (BMWi) outlined a structured recovery strategy in late 2008, which was subsequently endorsed by the Federal Government. The plan was divided into three core phases: first, stabilizing the banking sector and ensuring the continuation of credit supply; second, supporting domestic demand and production through targeted public investment; and third, laying the groundwork for renewed economic growth.



Source: Eurostat, 2014.

Fig 1: Government expenditure and revenue in Germany in % of GDP.

In Stabilizing the banking sector and avoiding credit crunch, the German parliament has adopted a series of measures in order to stabilize the German financial markets, thereby guaranteeing the financial stability and solvency of the banking institutions and reinstating the trust in the German banking system. The government has created a Financial Market Stabilization Fund (SoFFin) in order to avoid the liquidity shortages and to create favorable conditions for the financial services company's equity bases. This fund can issue guarantees of up to 400 billion euros for the debt instruments and liabilities of financial-sector enterprises. It can also provide support by recapitalizing a financial (service) institution and taking over risk positions (liabilities and securities).

Apart from this, the Federal Government took measures, a combination of the automatic stabilizers and public investment in order to guarantee employment and to increase consumption and ensure growth. These measures include raising the child benefit and tax allowance to families with children, reducing the contributions to statutory unemployment.

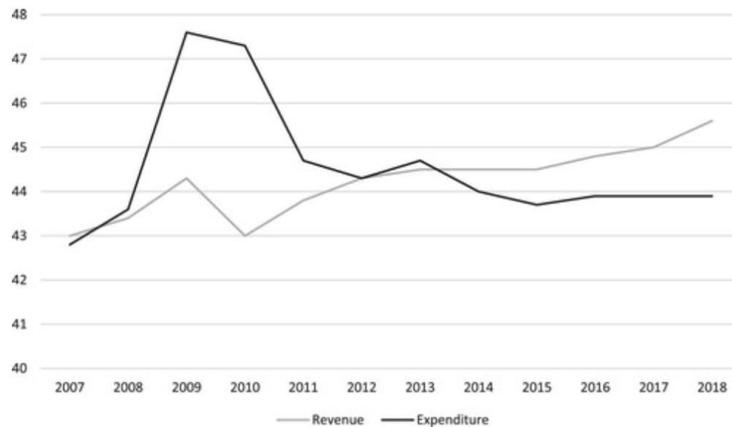


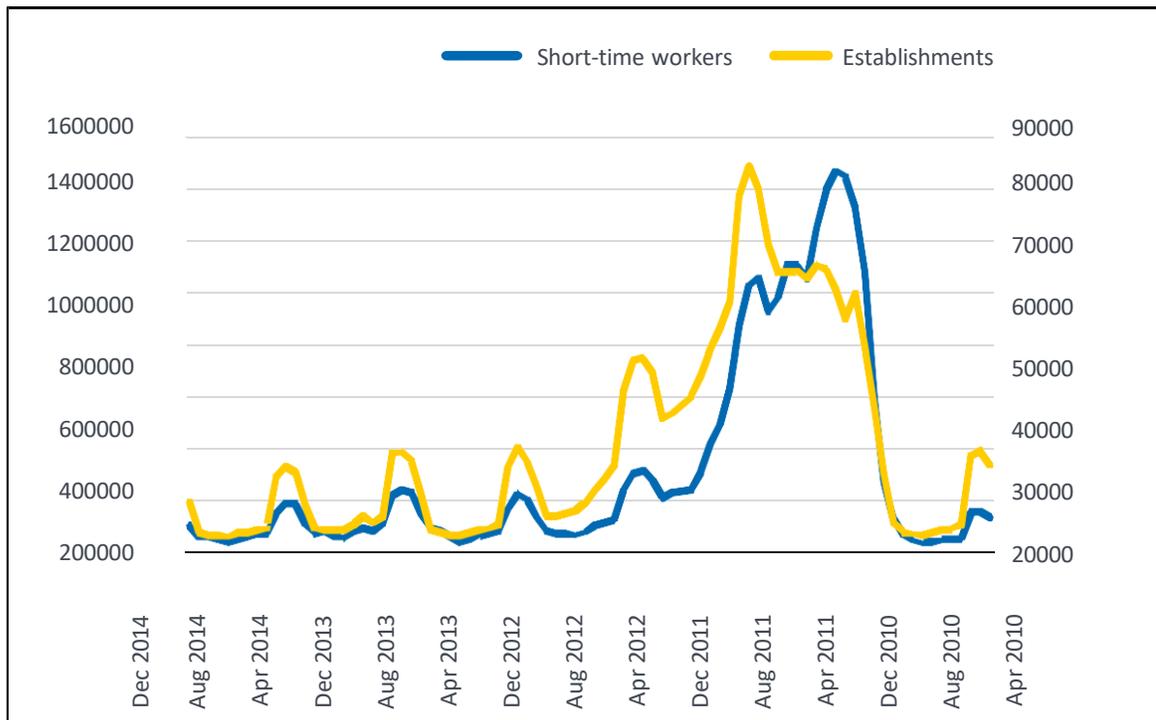
Fig 2: Public Spending and Revenue (% of GDP) from 2007 to 2018. Source: Eurostat.

Labour market measures include improved placement of workers threatened by joblessness, short-term working allowance, i.e, extending how long workers could receive support while working fewer hours, the government helped prevent mass unemployment and allowed companies to keep skilled workers until the economy improved. Tax reliefs for companies, private households and newly bought cars to encourage consumption. Investment measures such as giving the KfW (Kreditanstalt für Wiederaufbau) more leeway for granting loans to SMEs and municipalities for infrastructure development. Additional investments were made for buildings with energy-efficient renovation, transport and for improving regional economic structure.

However, as the economic growth looked bleak, the federal government in Germany introduced another package in order to combat the Recession induced by the Global Financial Crisis in 2009. This package also includes the investment measures in public facilities, broadband network, measures in labour market and employment, measures of tax relief and credit facilities and loan guarantees. The important highlight of this package is the introduction of the debt brake policy that obliges Germany's national and state

governments to balance their budgets with a strict limit on new debt. The federal government also enacted the law to remove red tape from SMEs to increase competitiveness and promote growth. This was followed by the investment in renewable energy and improvement of tax provisions to ensure economic growth.

These developments have led to a renewed interest in the “German labour market miracle” and, specifically, the reasons behind it, the economic policies adopted and the tri-partite interplay of Federal Government, unions and employers. These policies helped the German Economy to ensure that the number of workers and companies who benefit from these short-time working schemes to increase throughout the crisis. The graph below shows the utilization of short-term work in Germany. We can see that the beneficiaries of the short-term work are high from April, 2009 to August, 2011. This shows that the firms showed interest in introducing the short-term working schemes rather than following the policy of “hiring and firing” and reducing costs by massive layoffs of their employees.



Source: BA (2015c).

Through this, we can see that Germany was able to reap the benefits of these schemes completely only after 2010 and 2011. There is also an assumption that the positive

expectations of these measures have helped to boost the consumer as well as corporate's trust and to increase demand in the economy.

### **Fiscal Consolidation**

The federal government introduced this package to control its deficit, which had been rising since the Global Financial Crisis. The government deficit increased from 1.6% of GDP in 2006 to 5% of GDP in 2010. The package aimed to reduce the structural deficit by €32 billion by 2014. It followed a frontloaded approach, with 60% of the adjustments scheduled for 2011–2012, reflecting the government's intention to signal fiscal credibility early in the recovery phase.

The consolidation package combined both expenditure cuts and revenue enhancements, with the primary aim of reducing government spending. It had a nuanced macroeconomic impact on the German economy. In the short run, the expenditure cuts reduced the disposable income of liquidity-constrained households, leading to a decline in aggregate demand. However, in the long run, these measures demonstrated positive supply-side effects, such as increasing labour supply and reducing real wages, which in turn enhanced economic efficiency. Fiscal consolidation also contributed to the further increase in Germany's current account surplus.

### **Black Zero (Schwarze Null)**

From 2014 onwards, Germany's fiscal policy was further tightened through the adoption of the "Schwarze Null" (Black Zero) policy, aimed at maintaining balanced budgets with net-zero borrowings. Then-Finance Minister Wolfgang Schäuble stated in one of his speeches that the government would continue to reduce new indebtedness in the 2014 budget. He described it as Germany's essential contribution to fulfilling the obligations of the European Stability and Growth Pact, and viewed it not only as an instrument of fiscal prudence but also as a moral commitment to future generations.

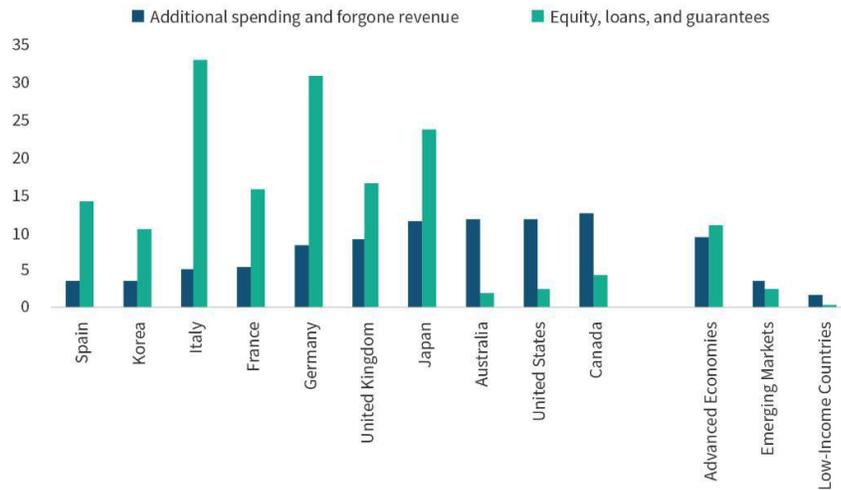
This policy enabled Germany to achieve balanced budgets year after year from 2014 to 2019. However, it is important to note that achieving a fiscal surplus without using it for future investment and choosing instead to pay down debt or offer short-term relief can be seen as a failure of national fiscal policy. Germany diminished its fiscal capacity to respond effectively in an era of increasing economic uncertainty and rapid change. It failed to invest adequately in critical infrastructure, particularly in renewable energy, digitization, housing and education.

The success of the stability policy was offset by its unwillingness to pursue structural reforms. In subsequent years, fiscal and budgetary policy shifted focus from long-term development to the distribution of short-term benefits. While many other countries implemented tax cuts and introduced measures to stimulate investment, Germany refrained from undertaking such initiatives for over a decade following the 2008 crisis. As a result, Germany lagged behind other EU countries in Digital infrastructure and broadband coverage.

### **Triggers for changes in the Fiscal Policy; Covid-19**

At the time of the crisis, the German economy was fragile, with aging infrastructure, rigid fiscal policy, and weak public investment. The German economy was seriously affected by the pandemic, as it showed its inability to respond quickly to the impending crisis. Germany, which was committed to the idea of fiscal austerity, temporarily suspended the policy of the debt brake and prepared to spend heavily in response to the crisis. Berlin's response was swift and focused on immediate grant assistance to the economy. The federal cabinet adopted a “supplementary budget and economic stabilization fund.” The supplementary budget included £122 billion (\$144.5 billion) in additional spending and £33.5 billion (\$40 billion) in tax relief. Most of the spending went to immediate grant assistance for SMEs, welfare payments, additional funding for hospitals and doctors, and the expansion of the wage subsidy program (Kurzarbeitergeld).

### Discretionary Covid-19 Fiscal Response (Percent of GDP)



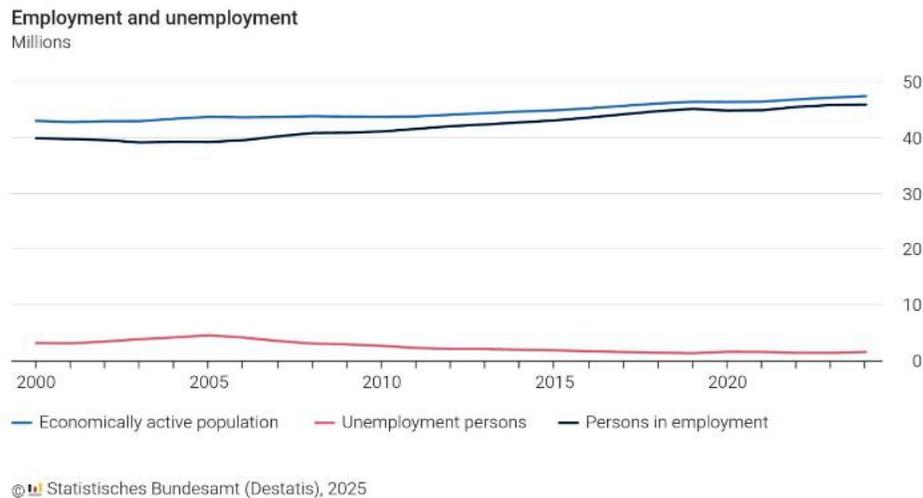
Source: International Monetary Fund, data through September 11, 2020.

CSIS | ECONOMICS PROGRAM

The Covid-19 pandemic caused private consumption, net exports, and working hours to fall. Aggregate output and capital investment declined because of the rise in production costs and labor prices. Due to the rise in import prices, the cost of intermediate goods also increased, which in turn raised production costs. The manufacturing sector was seriously affected by the pandemic due to supply chain disruptions caused by lockdowns across the world. The manufacturing sector also witnessed a reduction in capital investment due to increased production costs and falling demand, which led to high default rates. The fiscal package, while it could not completely prevent the damage caused by the pandemic, helped to reduce its negative impact by stabilizing consumption and reducing labor costs throughout 2021. The most effective measure that the federal government can take in the longer run is to increase public capital investment. It helps foster output through an increase in aggregate demand, as investment goods are bought by the government from the private sector.

As public investment increases the public capital stock, it in turn positively affects private-sector productivity and helps to increase private investment demand. We can observe that Germany had to depend primarily on fiscal policy, as there was limited room to cut interest rates during the crisis. The German government provided a strong commitment to

maintaining fiscal support during the pandemic. As a result, the German labor market remained relatively stable compared to other G7 countries. This was mainly because of the short-term work subsidy program (Kurzarbeit), through which the government managed to prevent large-scale layoffs by helping employers reduce wage hours.



As we can see in the picture, the German economy did not face the problem of mass layoffs due to the timely actions taken by the government to protect jobs. There were no significant changes in the unemployment rate during the pandemic, as we can see in the graph that the red line does not show any large increase. The unemployment rate increased, but only by a small percentage. We can see that the unemployment rate in Germany remained largely stable. The German fiscal stimulus focused on long-term recovery by channeling investment into sustainability, digital infrastructure, and green energy to strengthen the resilience of the economy. In conclusion, Germany's response to the covid-19 shows its shift from fiscal austerity. By temporarily suspending the debt brake, Germany managed to deal with the covid-19 crisis. However, as they were recovering from the pandemic, the German economy faced another crisis in the form of the Russia-Ukraine war, which brought in the energy crisis and the need to increase the defense spending as a new problem to the fiscal prudent German economy.

## **Russia-Ukraine War and the Energy Crisis**

Russia's war on Ukraine since February, 2022 has not only resulted in the tragic loss to human lives, but has also triggered the energy crisis and inflation, especially in Europe's largest economy. This war marked a significant turning point in Germany's energy policy. Germany imports all of its natural gas, and prior to the war, 35% of it came from Russia. This dependence was an important part of Germany's energy transition plan. As a result, Western sanctions on Russian oil and gas caused energy prices in Germany to rise sharply. This crisis has exposed the risks of Germany's heavy dependence on Russian oil and natural gas.

Germany's reliance on Russian oil and natural gas has steadily increased throughout its period of steady growth especially since 2012. And the liberalization of its energy market made cheap Russian gas, a favorable energy source. Additionally, German leadership viewed natural gas as a “transition fuel” between coal and renewable energy, a carbon-neutral energy source, as well as a means of fostering better ties between the European Union and Russia. Germany ignored the advice of the European Commission to diversify its gas supply. Now, the Western embargo on Russian oil and natural gas led Germany to cut Russian imports. This also led Russia to cut supply from the Nord stream. This caused the gas prices to rise by 10% in fall 2022. This caused the full-blown energy crisis that affected the households, industries and the economy.

To maintain its economic stability Germany temporarily reactivated coal-fired power plants. It also led Germany to extend the use of nuclear power, which it previously decided to phase out by 2022. These geopolitical changes have led Germany to accelerate the adoption of renewable energy and develop robust energy solutions to ensure long term energy security.

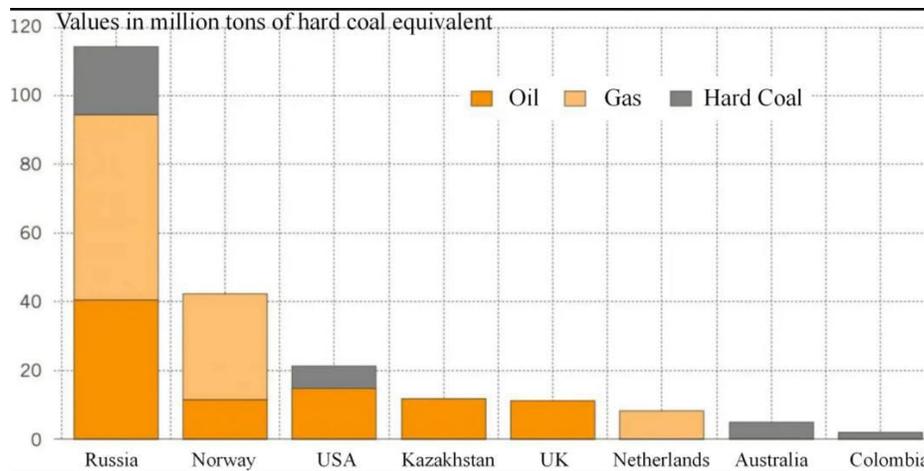


Fig 6: Energy raw material suppliers to Germany before Russia-Ukraine war.

Source: World Energy Council.

Germany also diversified its energy imports to substitute its dependence on Russia. As a result, Crude oil imports fell from 87.4 million tons in 2022 to 72.6 million tons in 2023, with Norway, the U.S., Kazakhstan, and the UK, emerging as largest suppliers by collectively supplying nearly 60% of the total imports. Meanwhile, domestic crude oil production declined by 4.5% to 1.8 million tons, and domestic sales of petroleum products dropped by 6.2%. Natural gas consumption also decreased by 7.0%. The German energy transition requires a large-scale investment and expansion of renewable energy, along with the integration of flexible energy storage technologies to ensure grid stability. According to the German government's targets, by 2030, over 80% of the country's electricity will be sourced from renewable energy, with total generation reaching 600 TWh. These steps show us a significant shift in Germany's energy policy, shifting from its reliance on cheap Russian gas to building a resilient and diversified energy system.

The war also showed the loopholes in Germany's military preparedness. In response, Chancellor Olaf Scholz announced a €100-billion special fund for the military and promised that 2% of GDP would be invested into defense, in line with the NATO target. He termed it as a "turning point" both in history and German defense policy. Germany also emerged as one of the largest military-aid contributors to Germany. The energy crisis and supply chain disruptions caused the industrial growth to slow down due to high production costs and caused a decrease in production. Higher energy costs also led to a fall in

household consumption. Germany's economy has been facing the repercussions of these crises and has been sluggishly fluctuating on the edge of a technical recession, defined as two consecutive quarters of gross domestic product declines. The national GDP has been alternating between expansion and contraction in each quarter throughout 2023 and 2024. The country is facing a wide range of issues, including infrastructure problems, a struggling housebuilding sector and pressure on some of the industries that have historically strongly contributed to its growth, such as automobiles. Together, these problems created the momentum for a paradigm shift in fiscal strategy.

### **Germany's Fiscal Reforms**

In March 2025, Germany began its fiscal reforms. Its chancellor, Friedrich Merz, announced a transformative fiscal policy shift marking a change from its traditional fiscal conservatism. Merz along with other political leaders announced plans to reform the longstanding fiscal pillar of the German economy- the debt brake. The proposed measures of the federal government include significant changes to budgetary rules, relaxation of debt brake rules and the establishment of the special infrastructure fund. However, this was not the beginning of Germany's fiscal reforms, but rather a continuation of them since the government's announcement in 2022, when it introduced the €100 billion special fund. However, this special fund is expected to be depleted by 2027.

### **Important features of the fiscal reforms**

**Relaxation of the Debt brake:** Germany's constitutional fiscal rule of “debt brake”, which allowed only 0.35% of GDP as structural deficit is set to be eased. More specifically, this is meant to exempt defense spending over 1% of GDP from the “debt brake”. The main aim of these measures is to free the defense spending from these strict debt limitations, so that they can bolster military capabilities through increased borrowing. This move comes from the changing security scenario in Europe and need for increased defense spending in view of the changing geopolitical alliances. This move is widely considered as a push to reach the NATO target of 2% of GDP. NATO countries now decided to invest 5% of their

economic output in defense in the medium term, of which 3.5% is to be traditional military spending, the rest is to go into infrastructure. Finance minister Klingbeil wants to achieve this goal as quickly as possible. According to his plans, the German defense budget will gradually increase to more than double by 2029, reaching €152.8 billion to meet the 3.5% target. Germany must be “capable of deterrence and defense”, Klingbeil said.

**€500 billion Infrastructure Fund:** An important element of the fiscal overhaul is the creation of a €500 billion infrastructure fund for the federal government, states and municipalities, which is equivalent to approximately 11.6% of Germany's GDP in 2024. This fund remains one of the largest fiscal stimulus packages in the recent history of Germany. This fund is designed to be used over the next decade to finance the improvements in infrastructure and stimulating growth. The federal states and the municipalities that have been struggling with the financial deficit for years are provided with roughly €100 billion of the infrastructure fund. These funds would be used to develop civil infrastructure such as education, public protection, education, energy, transport, healthcare and science infrastructure in addition to hospital investments and digitalization.

**Increased Fiscal Flexibility for Federal States:** The proposed reforms now allow the federal states and municipalities to run small deficits moving away from the previous rule of fiscal mandate of maintaining balanced budgets. This proposal would extend the deficit allowance of the German states to 0.35% of GDP, which at present must run balanced budgets. This move helps to double the borrowing cap of the government to 0.7% of GDP per year. This change aims to provide the regions with greater fiscal power so that they are capable of funding their local needs and are able to invest in critical infrastructure projects. The proposed changes to the debt brake also marked a major shift from the CDU-CSU's election campaign, during which the parties proclaimed that they want to stick with the Angela Merkel-era rule. Merz eventually suggested he may be open to some reform.

## **Sectoral Allocation of the Fiscal Expansion**

**Transformation of the Energy Sector:** A significant portion of the infrastructure fund will be invested in the energy sector to help Germany reach climate neutrality by 2045. €100 billion has already been allocated for energy transition and climate protection including funding renewable energy systems, storage technologies, smart grids, and electricity network expansion. These steps show Germany's commitment to scaling up renewable power generation and European climate targets.

**Defense Industry:** The government's decision to allow defense spending outside the borrowing limits is expected to lead to big investments in the military. This will directly help defense companies and other related industries.

**Infrastructure and Construction:** The €500 billion infrastructure fund is meant to improve Germany's infrastructure. This will create many opportunities for construction companies and businesses linked to the sector.

**Telecommunications and Digital Infrastructure:** Germany has been slow in building fast internet and 5G networks, which has affected its economic growth and digital progress. This fund will help to expand fiber-optic networks across the country, increase 5G coverage to improve internet speed and access, and support smart city projects that use AI for better urban planning.

**Automotive and Electric Vehicles (EVs):** Germany's car industry is changing quickly, moving toward electric and digital vehicles. The €500 billion fund will help by adding more EV charging stations across the country, investing in battery factories and research, and giving support for EV production and related infrastructure.

**Industry and Private sector investment:** The German government in June approved a €46 billion tax relief package to support companies and revive its sluggish economy from this year through 2029. This package is the first in a series of expected measures from

Germany's new government to boost the economy. The German government also introduced a €4 billion subsidy plan aimed at energy-intensive industries. This initiative is intended to support sectors such as chemicals, metals, glass, plastics, and paper from the adverse effects of persistently high electricity prices. These industries, which are foundational to Germany's export-driven economy, have faced mounting pressure due to the combined impact of the energy crisis and the costs associated with decarbonization. The proposed subsidies would reduce power prices for these sectors.

### Market Reactions and Investor sentiment

The announcement of the fiscal reforms has caused a profound impact in the financial markets.

**Equity markets:** The equity markets have shown huge gains amid the anticipation of the economic stimulus especially the sectors that would directly benefit from the increased government spending. The German stocks experienced a significant rally after the announcement. The DAX index surged over 3%, reflecting the investor's confidence in the fiscal stimulus announced by the federal government. The rally in Germany's DAX following the announcement took the index's year-to-date gain to over 16%, making it one of the best-performing stock markets in the world in 2025 (YTD as at 17 March 2025). The leaders of the rally were cyclical, infrastructure and defence related industries.



Source: Simply Ethical

**Currency Markets:** The euro became stronger, going up by 0.5% against the dollar after the announcement. So far this year, the euro has gone up by more than 5% compared to the US dollar. This rise in value shows that there is more confidence in the eurozone’s economic outlook because of Germany’s large government spending plans.



Source: Simply Ethical

**Bond Markets:** German government bond yields went up, with the 10-year yield rising to 2.93%. Even though Germany’s AAA credit rating is not under any immediate threat, this increase shows that markets expect higher growth and inflation in the future because of the government’s spending plans. The rise in bond yields shows that markets are adjusting to the expected increase in government borrowing. While higher yields mean Germany will have to pay more to borrow money, they also show that investors still trust Germany’s ability to handle and repay its debt.

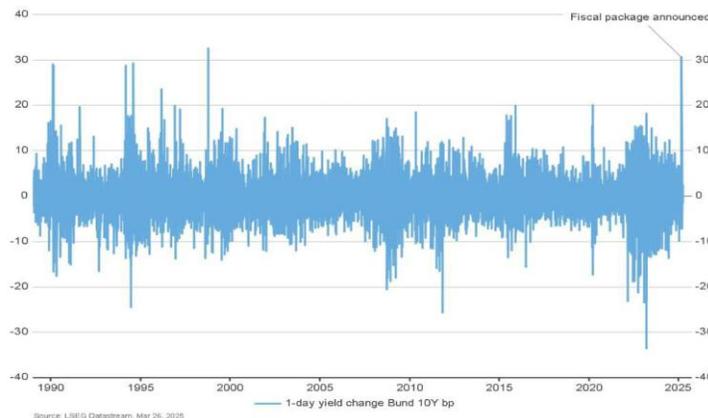


Fig 9: German government bond yields surged after announcement of the fiscal reform.

Source: LSEG Datastream.

## **Comparative Analysis: Germany and Its EU Peers**

While Germany's post-pandemic fiscal expansion marked a clear shift from its traditionally cautious approach, other EU countries like France, Italy, and Spain took different paths in both the scale and focus of their recovery strategies. Germany introduced measures worth about 8.4% of GDP, slightly more than France's 7.6% of GDP, but unlike France and Italy, who directed a large share of their spending towards household consumption and public services. Germany focused on industrial support, defense, and infrastructure investment. Italy and Spain, for example, prioritized long-term strategic recovery under the EU's Recovery and Resilience Facility (RRF), which helped them reach and surpass their pre-pandemic GDP levels by 2024, while Germany was still lagging behind with slower growth.

At the same time, Germany's stronger fiscal position and lower debt levels allowed it to pursue new investments without facing the same level of market skepticism as France, where political uncertainty and debt concerns led to rising borrowing costs and negative investor sentiment. Even as the Free Democratic Party (FDP) in Germany raised concerns about debt, investor reactions were relatively calm—suggesting greater trust in Germany's institutional stability. Overall, while all countries responded to shared economic shocks, Germany's approach reflected a more targeted, long-term strategy aimed at competitiveness and energy security, whereas many peers emphasized immediate relief and demand-side support.

## **Policy Implications and Recommendations**

Germany's recent move toward fiscal easing carries significant positive implications for the economy. Stepping away from the long-standing debt-brake policy has restored confidence among industries and investors, signaling that Europe's largest economy is ready to emerge from years of slow growth and its under-utilized capacity. Although this policy shift was announced much later than many hoped, it is a timely and necessary

response to low interest rates, persistent uncertainty, and the structural challenges made visible by the pandemic, the energy crisis, and shifting geopolitics. With strategic public investment in renewable energy, digital infrastructure, defence, housing, and transport, the federal government can stimulate growth, crowd in private capital, and tackle long-standing issues such as climate change, demographic pressures, and lagging digital connectivity.

However, Fiscal flexibility is not an end in itself. Public spending must remain transparent, efficient and must be targeted towards projects that expand Germany's productive capacity and support inclusive, sustainable development. Running deficits to finance long-term investment is not inherently problematic as public budgets are different from household budgets, but spending cannot be limitless. Rising interest costs underscore this reality: the Finance Ministry projects that annual debt-service payments will reach nearly €62 billion by 2029, consuming close to 10 percent of the federal budget. Moreover, the €100 billion special fund for the Bundeswehr, created in 2022, will be exhausted by 2027; defense spending will then return to the core budget, further tightening fiscal space. These pressures mean future savings or reprioritization within the regular budget may become necessary.

Balancing flexibility with discipline will therefore be crucial. Germany should keep focusing on targeted investment in renewable energy, digital connectivity, modern infrastructure, and public services—areas that raise long-term productivity and strengthen social cohesion—while accelerating the shift away from fossil fuels to ensure energy security. By blending conventional macroeconomic prudence with insights from Modern Monetary Theory, Germany can pursue growth without neglecting fiscal responsibility, set a precedent for sustainable, investment-led policy across the European Union, and build a stronger, greener, and more resilient economy.

## **Conclusion and The Way Forward**

Germany's fiscal policy has shifted from a stance of fiscal prudence to one of fiscal easing in response to the economic recession in the post-COVID-19 years. Decades of strict fiscal

discipline left Germany's public infrastructure and investment stagnant, making the economy more fragile over time. The COVID-19 pandemic, the Russia-Ukraine war, and the energy crisis severely impacted the German economy and exposed the limitations of fiscal conservatism and the lack of public investment pursued under the “black zero” policy. To address the effects of these crises, as well as the rising need for defense spending in a changing geopolitical environment, Germany has introduced reforms to the “debt brake.” These include exempting defence spending from the 1% GDP limit and proposing a €500 billion investment fund aimed at financing infrastructure projects such as roads, renewable energy, and digitalization over the coming years.

Moving forward, Germany's fiscal policy must prioritize long-term growth over short-term budgetary balance. Germany's focus should be on transforming its economy to foster sustainable development, improve the ease of doing business, and position itself as a more investment and infrastructure friendly country. In a decade marked by rapid technological advancement, Germany as the largest economy in the European Union should take the lead in strengthening civil infrastructure, upgrading public amenities, promoting digitalization of the public sector, and advancing its defense technology. By doing so, Germany can ensure resilience, competitiveness, and leadership within the EU and the global economy.

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