



Debt-Fueled Dreams of German Greatness: Where Does the Plan of Friedrich Merz Lead?

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April 2, 2025

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Germany is currently undergoing a period of rapid political change. After years of fiscal conservatism and aversion to militarization, the German government now looks set to throw away these post-1945 norms. But what does it hope to gain? And have they thought through the consequences? From the outside looking in, Germany appears to be reacting to events that they did not expect in a panic—a recipe for disaster, especially when the reactions are as deep and profound as what is currently going on in Germany. Germany’s current path could put the country at deep risk. They may come out the other side with little in the way of a military, a plethora of misallocated public money, and collapsing trust in German institutions on the part of the public.

The Shift Away from the Christian Democrats’ Fiscal Conservatism

If the failure of the German traffic light coalition at the end of 2024 had to be boiled down to one culprit, the prime suspect would be money: The coalition was doomed to fail after the German Constitutional Court ordered the coalition to transfer €60 billion in COVID-19 emergency funds to other budget areas. Due to the *Schuldenbremse* (debt brake) enshrined in the Basic Law for the Federal Republic of Germany, financing the federal budget with loans was impossible. As the government could not agree on either a reform or a new special fund—even though Germany had already been relying on special funds for years—no leeway remained to do anything substantive. Friedrich Merz must have taken notes. Even though the debt brake was the idea of his own party, the CDU, when it was still led by Angela Merkel, Merz rejected both a quick debt brake reform and a new special fund in his election campaign, saying that regaining competitiveness and fostering growth through tax breaks are necessary steps before reform is possible.

After his election victory, this quickly changed, partly because a coalition government with the SPD party, which was in favor of a reform, required compromises, and partly because the realization was

that Germany cannot react to current geopolitical events without funds. This is precisely the reasoning Merz now uses to explain his change of tune on the need for reform and a new special fund. But the change is huge: from a policy of no new debt to a €500 billion special infrastructure fund for the next 10 years and a reformed debt brake when it comes to defense spending. For comparison, the average annual federal budget is also around €500 billion. The situation is akin to “only Nixon could go to China”—in this case, only Merz and the CDU could reform the debt brake.

The price of this U-turn is high. Merz [angered](#) many within his own party for “betraying” Merkel’s legacy so openly, as well as other centrist parties with his aggressive negotiating style. Even though there were [hardly any dissenters](#) on the vote on March 18, his grip on power is brittle. At the same time, the resulting proposal is as vague as it is full of compromises, something that was basically unavoidable given the two-thirds majority needed for the proposal to pass in both the old [Bundestag](#) and the [Bundesrat](#). Initially, the reform was presented as the first agreement between the CDU/CSU alliance and the SPD in their exploratory coalition talks, but to achieve the required two-thirds majority to pass the reform, the *Grüne* (Green) party also had to be wooed.

In the end, the compromise proposal for the €500 billion fund included stipulations that €100 billion go to the states to ensure that the reform passes in the *Bundesrat*, where state representatives sit, and another €100 billion go into the existing Climate and Transformation Fund as per the request of the Greens. But what this funding will be spent on is mostly a mystery—infrastructure is a very broad term, after all. In some sense, the agreement is very similar to the program presented in the exploratory paper of the CDU/CSU-SPD coalition negotiations, which can be summarized as “promising everything to everyone.” Basically promises to all major party [are present](#), including new subsidies, increases to the minimal wage, and tax cuts. At the same time, although economists and business associations are happy about the spending plans of the Merz government, there are also accusations that structural problems are not being addressed and that it is merely an example of “[senseless subsidies and clientelist politics](#).” In the end, the only real goal for now seems to be to have money to spend.

Consequences of the New €500 Billion Special Fund

The question is whether the German economy can handle this level of spending. Germany is famously a low-debt economy, so it is assumed that it can bear this burden. The country had a debt-

to-GDP ratio of [around 62 percent](#) in 2023. Hardliners, of which there are many in Germany, say that this is already in violation of the [Maastricht Criteria](#), which set a limit of 60 percent for the public debt ratio of eurozone member states, but it seems likely that their concerns will be dismissed. The debt-to-GDP ratio could now rise to [around 82 percent](#), around the EU average. Those advocating fiscal prudence in Europe, who until now were often either German or associated with German institutions, have seen their power greatly diminished since they lost the battles around the European Central Bank bailouts of the PIIGS countries—Portugal, Italy, Ireland, Greece, and Spain—during the eurozone crisis. The Merz government looks set to finally kill their influence at home and put another nail in the coffin of Angela Merkel’s legacy. This is already being celebrated by their opponents, who have long associated German fiscal prudence [with stodgy conservatism](#).

There is no doubt that debt levels and debt sustainability matter in the long run. But the economic debate in Europe seems to have gone off the rails in recent years. Advocates of lax fiscal policies did not historically advocate for these policies for their own sake. Keynesian economists typically make the case that the government should run debt-financed spending when there is high unemployment or slack in the economy—usually in the event of a recession or a depression. Indeed, in the debates around fiscal prudence in Europe during the crisis years, the Keynesians said that the high unemployment could be solved by increasing deficit spending.

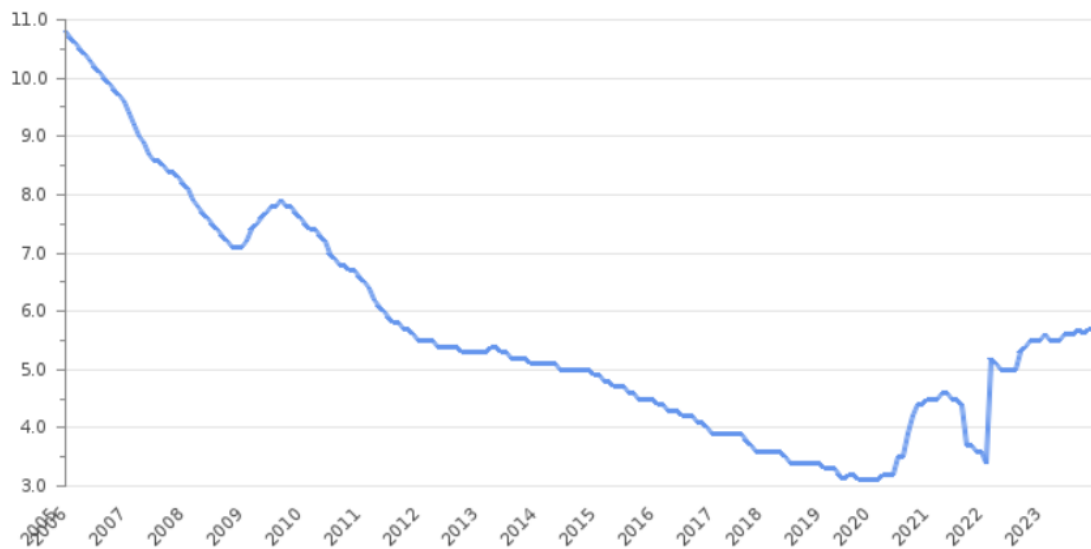
It appears that they have since started to view deficit spending as a weapon in what seems to be an ideological war. Colombia Law School Professor Katherine Pistor, for example, argues that Germany abandoning fiscal prudence is necessary for “an anti-fascist economic policy.” She is drawing on the work of University of Massachusetts Professor Isabella Weber, who argues that “to defeat the far right, we must adopt an anti-fascist economic policy” and that massive debt-financed spending is needed to stop the “[extremist visions of parties like Alternative für Deutschland](#).” Although this is not the only reason for higher spending, Weber’s ideas [have been picked up](#) by the German press and used to sell higher spending to left-leaning parties. The perceived crisis of military readiness has been embraced by people convinced that extremely large government expenditure will enable the defeat of what they consider “far right” parties in elections.

This could be a recipe for political disaster. Experts in Germany are already warning that the massive German spending program will be rushed and generate enormous amounts of potentially scandalous misdirected spending. The Greens, in fact, only supported the reform if had stipulations

that the special fund could only be used for new projects, fearing the government would use it for politically motivated projects—but again, it is still incredibly vague. Germans are not used to watching their money spent on dubious projects, and scandals could further erode the German public's high trust in the government and public institutions. There is a need for massive spending in certain areas, which makes the misuse of funds even more dangerous: Railway infrastructure and the *Deutsche Bahn* are massively underfunded and need around [€150 billion of the fund according](#) to the company's own estimates, while modernizing bridges, schools, and energy grids—the latter being one of the main aims of the €100 billion reserved for states—could quickly [add up](#) and bleed the special fund dry in a shorter period of time than the stated ten years.

It is also worth considering the economic effects. Germany's economy has just gone through its highest period of inflation in decades, and German citizens are [more pessimistic](#) about their standards of living than at any other point since the 2008 crisis. Dumping enormous amounts of money into the economy risks sparking more inflation if the spending increase is larger than the potential to produce more goods. German bond yields are climbing at the fastest rate since reunification in 1990, signaling that the markets expect an [uptick in German inflation](#). Strangely, the country's typically prudent [central bank is signaling its support](#) for these policies regardless of the inflationary implications.

The easiest way to conceptualize whether there is “slack” in an economy is by looking at unemployment. In theory, if unemployment is high, any additional spending can be used to hire people. The classic example of this is a Keynesian spending package that hires the unemployed to clean up graffiti: Since the only resource needed to clean graffiti is human labor, such spending can be justified if there is unemployment. When we look at German unemployment numbers, we see that they are currently above pre-pandemic levels. Unemployment is almost twice as high today than at the beginning of 2020.



UNEMPLOYMENT RATE IN GERMANY BY CHANCELLORS

Figure 1. Unemployment Rate in Germany by Chancellors. Source: take-profit.org.

Prima facie these numbers could be used to make the case that higher fiscal expenditure is justified. There are currently nearly [three million people unemployed](#) in Germany. In theory, assuming that half of these individuals are ready to work, the unemployment rate could fall back to the levels in early 2020. Over ten years, the €500 billion spending package could enable €33,400 to be spent on each unemployed person annually. For context, the [average gross German salary](#) is €49,300, and current average social welfare payments to the unemployed are around €18,000 a year, so Merz's spending package would roughly double the spending power of the unemployed if it managed to create jobs for them.

However, the situation in Germany is more complicated than this. It is unclear how much of the money earmarked for defense spending will actually go toward direct spending on the military, as some of the funds will be used for "dual use" infrastructure. But even if hundreds of billions of euros were spent on military equipment, there would have to be sufficient "slack" in the manufacturing sector to produce the goods needed for the new German military. Yet the [unemployment](#) in Germany appears to be generated by the deindustrialization of the country due to the high energy costs associated with the war in Ukraine, alongside other structural issues such as a lack of high-

skilled workers and high salaries. In every month since May 2023, industrial production has declined on a year-on-year basis - almost two years of poor performance compared to previous years.

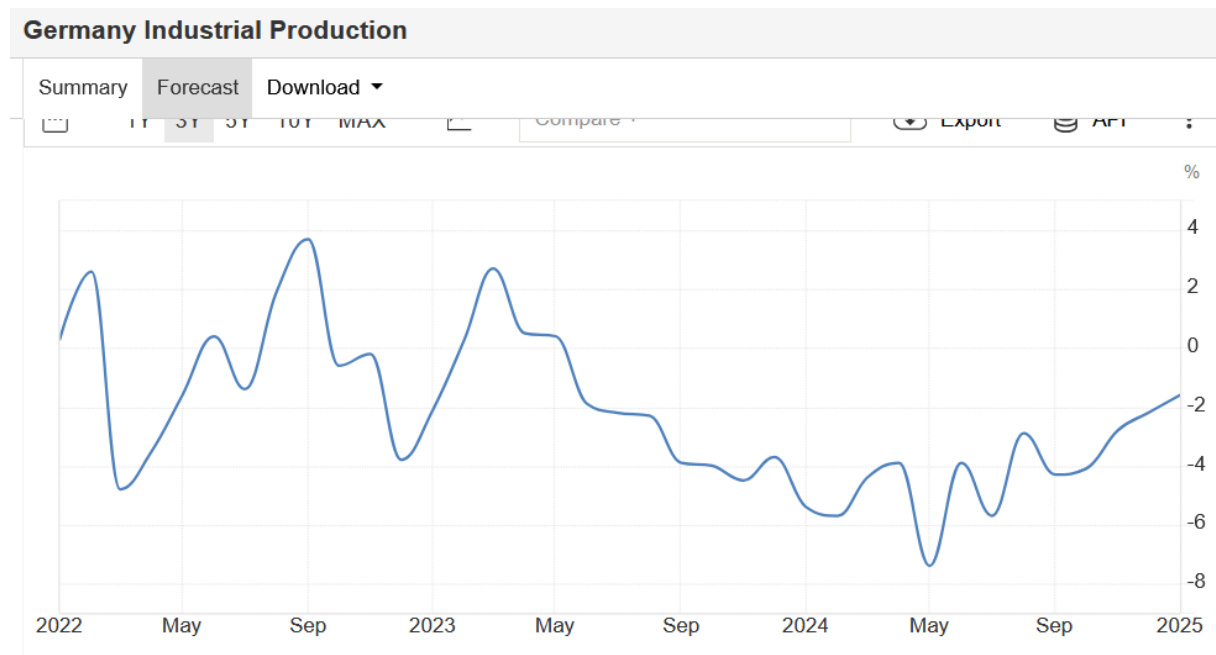


Figure 2. German Industrial Production on a Year-on-Year Basis. Source: Trading Economics.

Merz's package is likely to be spent on things that are not directly military-related, though, because there are serious supply constraints on what can be produced by the German military-industrial complex. In 2024, the largest German arms manufacturer, Rheinmetall, [saw revenues of €9.8 billion](#). This means that to meet the demands of, say, €200 billion spent on new armaments, the country would need access to twenty years of Rheinmetall's full output, while €100 billion would require a full ten years of full output. The price of the goods sought could also inflate, meaning that Germany could get a small amount of increasingly overpriced military equipment. The demand that producing even this equipment puts on the manufacturing sector, meanwhile, could lead to a spike in inflation in the rest of the economy.

Unlimited Spending to Rebuild the German Military?

Besides the €500 billion special fund, the proposal also encompasses a reform to the debt brake. Defense spending above one percent of GDP—[approximately €44 billion](#)—will no longer be subject to it and can be financed through additional borrowing. Considering that Germany already spends more than one percent of its GDP on defense, this could allow unlimited spending through loans, specifically government-issued bonds, without triggering an excessive deficit procedure given the [new direction](#) of the von der Leyen II European Commission.

The previous *Bundeswehr* (German Army) special fund amounting to €100 billion made it possible for Germany to surpass the soon-to-be-outdated 2 percent defense spending target of NATO in 2024 with [2.12 percent](#) in defense spending. Over time, the reform will likely enable the country to meet the new NATO target too, which is expected to be 3.5 percent of GDP—for Germany, that would mean [close to €150 billion](#) spent on defense every year. Certain infrastructure investments, however, will likely be categorized as military-related in order to meet this goal. Defense spending only accounts for [€52 billion](#) in the “normal” federal budget. This is important, because it means that Germany is not budgeting for long-term sustainability and instead depending on loans to meet NATO targets. There are plans to increase the normal defense budget to [€80 billion](#) a year by 2028, but that will likely be insufficient to meet the new requirements. Furthermore, the €100 billion fund set up in 2022 was planned to last until 2027, but 82 percent of the funds have already been [used](#). Loans cannot be a substitute for yearly budgets.

The *Bundeswehr* is badly in need of funds. When Olaf Scholz announced the €100 billion special fund in 2022 in his *Zeitenwende* (historic turning point) speech, the army was already a shadow of its former self. As of [2024](#), the problems include the short supply of manpower, limited amount of working equipment, and almost total lack of combat readiness. The phrase thrown around back in 2022 was that the army was “[empty](#),” and even as recently as last year, some held the opinion that the *Bundeswehr* could “still defend Augsburg with this [level of preparedness], but not Munich and Berlin.” How the German army got to this place is the usual post-cold war story: austerity measures, suspension of all forms of conscription, and the belief that, at best, the army will not be needed anymore or, at worst, U.S. soldiers stationed in Germany would provide a suitable deterrent.

There were some attempts even before 2022 to bring the *Bundeswehr* out of its sorry state and have at least 203,000 active soldiers—the bare minimum—in the army, but the [number has stagnated](#) around 181,000 soldiers, with the only achievement being that the downward trend that began in

1990 was stopped. According to Carsten Breuer, the Inspector General of the German Army, the end goal of rearmament is [460,000 well-equipped soldiers](#), active and reservist combined, which will clearly be impossible without some form of conscription. The CDU—and interestingly, the AfD—was toyed with the idea of conscription in their [party programs](#) for the 2025 *Bundestag* elections. Even other parties, like the SPD, support the “Swedish” model, whereby young men must complete a questionnaire about their health, fitness, and education and declare whether they support conscription.

Underlining the efforts to boost the army’s manpower is important because it demonstrates that not everything is a question of money. While the government will receive a blank check to develop defense capabilities, simply throwing money at the problem will not solve it, especially if it is still as unclear where exactly that money can go as it is with the infrastructure fund. A more recent example highlights both this issue and other general problems with the *Bundeswehr*. Following the Russian invasion of Ukraine, one of Olaf Scholz’s goals was the creation of the 10th Panzer Division—nicknamed “the Chancellor’s Division” after [the great military promises](#) of the outgoing chancellor—to protect the eastern flank of NATO. It was supposed to be ready for combat by January 1, 2025, yet despite being a prestige project, how (not) combat-ready the division is has been kept secret. Additionally, German officers have little combat experience on average, and the whole military apparatus is still unfamiliar with the rapidly developing pace of drone warfare. In the same interview in which he gave the 460,000-soldier figure, Carsten Breuer had to admit that they do not have the capabilities to counter a mass drone attack.

The picture is grim. Perhaps a better conceptual framework would be to consider the situation if Germany did not have a functioning army before 2022 and only just started building it three years ago with the first special fund. Indeed, the *Zeitenwende* is called a turning point for a reason, since Germany had to reformulate its defense, security, and foreign policy strategy from among [the ashes of its failed liberal policies](#). Knowing that, the current deficiencies are more understandable, but it also means that the German army is not going to be a valuable tool for foreign policy in the short to medium term—as a security guarantee for Ukraine, for example. This is clearly illustrated by the country being unable to set up a single new brigade in [Lithuania](#) as per a mutual defense plan. Money will have to be spent on equipment, intelligence gathering capabilities, and infrastructure, as well as innovation, doctrinal studies, and personnel.

Only in roughly five more years can we expect the German army to be a real force capable of defending Germany, much less Europe. All this underlines the simple fact that money alone is not sufficient to create a serious military. Military leadership all over Europe has become accustomed to underlining financial needs to civilian leaders—as with any government bureaucracy, the military bureaucracy always wants more funding, not less. Military leaders do not seem to explain to civilian leaders, however, that simply spending money is not sufficient to generate a powerful media. It looks like Germany is going to learn this lesson the hard way.

***Zeitenwende* in Defense Policy, *Epochenbruch* in Foreign Policy?**

Nonetheless, the debt brake reform serves as a potential means to properly rearm Germany and boost the European defense industry. In contrast to the plans three years ago, there is a strong “buy European” element complemented by the recent Commission announcement that the €150 billion EU defense fund [will exclude](#) American, British, and Turkish military equipment. In many cases, this will mean ordering from [German companies](#) such as Rheinmetall or Thyssenkrupp, while fighter jets can be requested from Airbus—perhaps even to the detriment of [already-signed deals](#) to buy American F-35 fighter jets. Rheinmetall expects an imminent ramp-up of orders and recently suggested that it could even rebuild soon-to-be-closed Volkswagen plants like the one in Osnabrück to produce military equipment. Joint EU arms purchases are on the table as well.

This will reduce German reliance on American equipment—at the moment, [70 percent of weapons](#) bought by Germany come from the United States. It must be noted, however, that it is a fever dream to imagine a Europe not dependent on America for the foreseeable future. The German-manufactured Taurus long-range missiles, for example, rely on U.S. manufacturers because of their [American-made engine](#). Furthermore, while there is discussion over France or the UK extending their nuclear umbrella to cover Germany, their capabilities are currently insufficient to serve as a proper deterrent, for [many reasons](#). There is also a reliance on Patriot missile systems for air defense. In essence, there is currently no existing substitute to the United States when it comes to the defense of Europe, so the Americans are here to stay.

Yet the wheels are turning, at least for Friedrich Merz. For him, this is not merely a *Zeitenwende* but rather an *Epochenbruch* (epochal shift). He is bound to be more active on the international stage than his predecessor, Olaf Scholz, and is already suggesting to lead Europe in the creation of a [European](#)

[defense community](#). His reasoning is that he no longer trusts the U.S. [to protect Europe](#) if push comes to shove. Merz's rhetoric could even be called anti-NATO at this point, as he [publicly questioned](#) whether NATO will still exist in its current form by June in his post-election speech. The soon-to-be chancellor's opinions on Ukraine are also quite hawkish—he advocates for a “peace through strength” approach supporting Ukraine with continued funding, weapons, and sanctions to achieve what he sees as a just peace. The debt brake reform allows military aid for “[countries attacked in violation of international law](#)” to be financed by loans.

Merz did not, however, go as far as to suggest that Germany could send peacekeeping forces to Ukraine, saying that it is “[too early to think about it](#).” But if the Trump administration expects Europe to keep the peace in Ukraine, it cannot be avoided, and Europe will need to have a force capable of serving as a real deterrent, which seems doubtful without U.S. involvement. Merz's aspirations to take a center place on the world stage may not come to fruition either. European leaders like Kaja Kallas have gone out of their way to [insult the Chinese](#), for example, and many world leaders no longer take European leaders seriously.

The big question is whether this sentiment is a farce—merely politicking—or real. Some have called the *Zeitenwende* an illusion, pointing out that Scholz had already promised to take on the responsibility of European security, but his efforts were not nearly enough. Realists would explain that perhaps this was logical. According to [realist thinking](#), when facing aggression, a state has a choice between balancing or buck-passing—pushing responsibility onto allies closer to the immediate danger in order to avoid the cost of confrontation. Germany's decision to buck-pass until now was rooted in four factors: a favorable geographical position surrounded by allies, a military doctrine favoring defense (as is the case in Ukraine), powerful allies able to guarantee security, and the burden of financial costs. Given these factors, Germany did not need to take responsibility in 2022 under the Biden administration.

This changed with the Trump administration. Their adamancy that Europe should share the burden unleashed a spending spree in Europe. Paradoxically, European leaders like Merz claim that rearmament is, in some sense, done in opposition to the United States because of its perceived unreliability. Deteriorating relations between EU countries and the U.S. could bring about calls for the European Defense Community and real military capacity-building. It does not matter anymore who is responsible for the deterioration in relations. The European public has made up its mind, and

the European elite truly seems to believe that they are fighting against American injustice and the looming danger that the U.S. will not protect them. If this is true, Germany no longer has powerful allies able to guarantee security, and Friedrich Merz is likely to make a real effort to take the responsibility for the security of Europe and move from buck-passing to balancing. Whether this will be successful is the big question. The first challenge is for Europe to reliably participate in upholding a future ceasefire between Ukraine and Russia.

The continent is suffering from a severe competitiveness crisis. Although recent reforms and defense spending plans aim to build a strong Europe, there may not be enough manufacturing capacity or „slack“ in the economy to handle these levels of spending. Reforms to limits on borrowing debt, such as the German debt brake reform, could lead to unrestricted borrowing. The German defense and military industry, like others, however, is having structural issues and needs more than just money thrown at the problem. While European leaders like Friedrich Merz call for a *Zeitenwende*, it is unclear how successful they can be in the face of the new Trump administration in the United States. Germany’s current path could put it at risk of drifting away from being a world-leading manufacturing powerhouse toward becoming a country with only limited military strength, high levels of debt, and a significant amount of misallocated public funds.