LETTER FROM
BERLIN

Bundestag Bombshell

"We are back on track," claims Friedrich Merz.

BY KLAUS C. ENGELEN

The day after Germany elected its tenth chancellor on May 6, 2025, the front-page headline in *Handelsblatt* hailed "Friedrich, the Second."

For the first time ever, a candidate for chancellor of Germany was unable to reach the required majority in the 630-seat Bundestag in the first round of voting. As candidate of the Union parties and the Social Democrats, Friedrich Merz received only 310 votes. A second round of voting was needed. After breathtaking negotiations among the democratic center parties, a same-day unprecedented second secret round of voting was scheduled. There was a historic sigh of relief later in the afternoon when Julia Klöckner, president of the Bundestag, announced that with 325 votes, Merz had been elected chancellor.

Under the heading "Bundestag bombshell," *The Economist* warned that "Friedrich Merz becomes Germany's chancellor—after a painful defeat. He needed an embarrassing second round of parliamentary voting to clinch it."

A SHAKY START AND UNPRECEDENTED CHALLENGES

For Merz, after half a year struggling with a caretaker government and disappointing snap election results for the democratic center parties, especially the Social Democrats led by then-Chancellor Olaf Scholz, there was good news on April 9, 2025, when the CDU/CSU and SPD presented a coalition government deal.

When Merz was asked by *Deutsche Welle's* political editor Michaela Kuefner what his message to new U.S. President Donald Trump would be, Merz responded, "The key message to Donald Trump is Germany is back on track. Germany will fulfill the obligations in terms of defense. And Germany is willing to strengthen their own competitiveness and that is not just Germany, that is Europe."

The day after the election, Radio Free Europe reported Merz saying in a televised discussion: "'For me, the absolute priority will be to strengthen Europe as quickly as possible so that, step by step, we can really achieve independence from the USA' in defense matters." Merz added, "I'm very curious to see how we head toward the NATO summit at the end of June—whether we will still be talking about NATO in its current form or whether we will have to establish an

Klaus C. Engelen is a contributing editor for both Handelsblatt *and* TIE.

THE INTERNATIONAL ECONOMY
THE MAGAZINE OF INTERNATIONAL ECONOMIC POLICY
220 I Street, N.E., Suite 200
Washington, D.C. 20002
www.international-economy.com
editor@international-economy.com

independent European defense capability much more quickly."

Referring to remarks made by billionaire Elon Musk in favor of the far-right Alternative for Germany party prior to the election, Merz continued, "The interventions from Washington were no less dramatic and drastic and ultimately outrageous than the interventions we have seen from Moscow. We are under such massive pressure from two sides that my absolute priority now really is to create unity in Europe."

MERZ TRIES TO DE-DRAMATIZE

In a major *Handelsblatt* interview, Merz discussed how he would deal with Trump's global trade war threats.

Countering Trump's "Day of Liberation" announced on April 2—global tariff hikes for 190 countries and territories—for Merz "talking about alternatives is another way to avoid talking about this dispute," notes *Eurointelligence.*

"It is what Friedrich Merz did in his interview with *Handelsblatt,* where he tried to de-dramatize the stand-off: there is still potential for a trade deal with the United States,

"There is no sense of urgency about the viability of the German economic model in a global environment where there are no more countries left willing and able to absorb Germany's savings surpluses."

Germany could buy a bit more gas from the United States, and if that does not work, there are other trading partners with whom the European Union could get into business."

Eurointelligence concluded: "So more deals with Canada, Mexico, India, Japan, South Korea, the entire Southeast Pacific region, all the way to Australia and New Zealand? Also the Mercosur deal, which France opposes for domestic reasons, and which may remain blocked by Argentina. Merz is also advocating paying more attention to the African continent, seeking out new strategic alliances there. The interview suggests that Merz has accepted the new era and now wants the EU is to redefine its priorities and partners, insisting on seeking opportunities rather than responding to threats."

Facing the worst global trade war since the U.S. Smoot-Hawley Act in 1930 put tariffs on more than 20,000 products, the German chancellor can draw on his exceptionally long and broad experience with Americans.

Merz formerly served as chair of the supervisory board of BlackRock Germany and as head of the Atlantik-Brücke, the private non-profit association to promote German-American understanding.

U.S.-EU trade imbalances are at record levels. The observers at *Eurointelligence* point out: "The latest trade and current account data show an increase in Europe's balance against the rest of the world, and a very strong increase in the trade surplus against the United States. These data will reinforce the U.S. views that the trading relationship will need to be rebalanced by force—either through a revaluation of the euro, or through tariffs. A sudden revaluation could constitute a shock to the EU for which EU governments and the European institutions appear ill-prepared. … The U.S. Trade Representative records the bilateral trade deficit for the last year at a record of $236 billion."

WORST SPD RESULT IN MORE THAN A CENTURY

Merz, 69, came out a winner of the snap election on February 23 as leader of the center-right CDU/CSU alliance with 28.5 percent of the vote.

New German Chancellor **Friedrich Merz:** *"Germany is back on track. Germany will fulfill the obligations in terms of defense. And Germany is willing to strengthen their own competitiveness and that is not just Germany, that is Europe."*

He had been expected to finish with a vote share in the upper 30 percent range.

For months, reported *Politico,* Merz "has positioned himself as a kind of antidote to Scholz's left-leaning coalition, hammering the government over its policies on migration and the economy. That strategy paid off, making them the dominant force in German politics once again." The SPD

"Klingbeil is on the rise."

suffered its worst national election result in more than one hundred years.

After the catastrophic SPD results were in, Chancellor Olaf Scholz, who had blocked letting Defense Minister Boris Pistorius, as the most-liked politician at the time, run as SPD's chancellor candidate in the snap elections, was finished politically. Scholz announced that he would not serve in a future government.

The irony of the snap election is that SPD co-head Lars Klingbeil, despite the election disaster, was able rather quickly to secure his power in the party and drive a hard bargain in the coalition negotiations. As the new vice chancellor and finance minister, comments *Der Spiegel,* "Klingbeil is on the rise."

"The far-right Alternative for Germany was in some ways the biggest winner of the night, recording double its 2021 result. The party's relentless focus on immigration, economic grievances, and Russia-friendly positions struck a nerve with disillusioned voters, particularly in the East, where it has cemented itself as the strongest party," notes *Politico.*

The AfD got 20.8 percent, far ahead of the Social Democrats with 16.4 percent. This might have been a sort of punishment for the outgoing Scholz, who was blamed for not doing enough to contain the immigration crisis and who allowed the break-up of the traffic-light coalition when dismissing his finance minister from the Free Democratic Party.

The Greens came out much weaker than in the 2021 election with 11.6 percent, and Die Linke was surprisingly strong with 8.8 percent. That the populist left, Russia-friendly Sahra Wagenknecht Alliance (BSW) with 4.98 percent did not get into the Bundestag was a relief for the center parties. With only 4.3 percent, the Free Democrats, who had held 91 seats after the 2021 federal elections, also could not get back in the new Bundestag. FDP party head Christian Lindner was dismissed as finance minister in the fight over loosening the debt brake.

THE COALITION DEAL

On February 28, the leaders of the CDU/CSU and SPD, along with working groups and legions of party member experts, started work on a coalition agreement as a basis for the next four years of governing the country.

On April 9, Merz, Markus Söder of the CSU, and SPD co-leaders Lars Klingbeil and Saskia Esken presented the joint coalition agreement under the motto "reform and invest."

The veteran observers of *Eurointelligence* seem not much impressed after examining the 146-page coalition agreement. "The main question of interest to us is whether this new agreement has a policy to reverse Germany's economic decline. If it does, it certainly is not obvious from the coalition agreement."

The debt brake "is good news for Germany and for Europe. German debt will rise, but remain sustainable."

Eurointelligence finds it noteworthy, for instance, that there is a "complete absence of income tax cuts except for the low-wage categories. The reason is that the CDU prevailed on some projects, like a pension for mothers, a plan that is political popular, but also very expensive, a cut in VAT for restaurants, and the restoration of a diesel subsidy for farmers. The SPD prevailed on the continuation of large social welfare payments."

The coalition agreement is "a document of a remarkable complacency, one that could have been written ten years ago. There is no sense of urgency about the viability of the German economic model in a global environment where there are no more countries left willing and able to absorb Germany's savings surpluses."

In conclusion, notes *Eurointelligence,* "CDU/CSU and SPD agreed a coalition deal that promises lots of subsidies, marginal incentives for investment, and some business tax cuts but not before 2028, coming in small installments over several years."

The Bavarian Christian Social Union approved the coalition agreement through a board decision. The CDU voted to approve the coalition deal at a small party convention on April 28, with Merz expected to be elected as chancellor in the Bundestag on May 6. The roughly 358,000 SPD members voted to approve the coalition deal a day later, despite leaders of the SPD's youth wing, Jusos, representing about 12 percent of party members, urging its members to vote against the coalition deal.

MODERNIZING THE OLD DEBT BRAKE

The disappointing snap election results for the three democratic centrist parties posed a challenge of historic dimensions.

First, with the AfD doubling its vote share and Die Linke stronger, both parties in the next Bundestag would be able to block any reform of the debt brake. Since the newly elected Bundestag was set to convene by March 25, there was a strategic urgency to use the two-thirds supermajority still available in case the Greens—headed into the opposition—remained willing to vote with the coalition parties under Merz as incoming chancellor.

Second, if a new CDU/CSU/SPD coalition were able to get the Greens on board, a two-thirds majority of the outgoing Bundestag and Bundesrat needed to reform the debt brake in the *Grundgesetz* (Basic Law) could be achieved.

As the *Financial Times* noted, "During the campaign Merz insisted he was committed to the debt brake—which limits government borrowing and keeps the structural deficit at 0.35 percent of GDP—while not ruling out discussions over how to amend it."

The "balanced budget amendment," also known as the debt brake or *Schuldenbremse,* is a fiscal rule enacted in 2009 during Chancellor Angela Merkel's first term.

In the most spectacular Bundestag session in recent history, parliamentary group leaders Katharina Dröge and Britta Hasselmann of the Greens taught chancellor-in-waiting Merz a lesson he will never forget. Both opposed giving Merz any help from the Greens, accusing Merz's conservatives of a U-turn on debt brake reform.

As reported by *Deutsche Welle,* Hasselmann told the Bundestag, "The conditions today are no different than they were in October 2024 … Everyone knew that this country urgently needed investment. The Greens and the SPD had campaigned together for this. We asked you to accompany us on this path."

Hasselmann continued, "You said: 'There is no need for this in our country.' After all, we don't have a revenue problem, but a spending problem. How deeply you have defamed my colleagues. Defamed them for their ideas and for their struggle to ensure that we invest in this country."

Citing an investment backlog in municipalities, railways, and climate protection, Hasselmann told Merz and the CDU, "You categorically rejected all of this—and mostly with such arrogance and populism that it made one sick."

These highly emotional broadsides in the Bundestag in front of millions of television onlookers helped the Greens when they eventually opted to negotiate and vote as patriots with the CDU/CSU and SPD on March 18 to reform the debt brake. The amendment included a second special fund of over €500 billion for infrastructure, and exempted defense spending over 1 percent of GDP. The Bundestag voted 513 to 207 and the Bundesrat 53 to 16 in favor.

The first challenge to the balanced budget amendment had been Chancellor Scholz's €100 billion fund to rearm the Bundeswehr after his historic February 2022 *Zeitenwende* speech in reaction to Russia's Ukraine invasion.

The Greens got €100 billion for climate projects and were able to force the CDU/CSU and SPD to accept the important principal of "additionality" for disbursements to block the substitutions of regular budget funds.

GERMANY'S BILLION-EURO DEBT MIRACLE

Three SPD veteran party comrades in high office, realizing the huge financial needs of any new German government, worked in secrecy to put together a debt plan unprecedented in size.

The Social Democrats were able to bring into the new coalition government the billion-euro package that loosens borrowing limits and allows new investments in defense, infrastructure, and climate.

In an earlier *Handelsblatt* piece on March 20, journalist Julian Olk reported how Jakob von Weizsäcker of the SPD, who had served previously in the Berlin finance ministry, got economists Moritz Schularick of the Kiel Institute, Michael Hüther of the Institute of the German Economy, and Jens Südekum from Heinrich Heine University Düsseldorf to draft a new, more realistic debt authorization plan in view of Germany's huge military and infrastructure finance needs for coping with a totally changed economic and geopolitical world. The SPD had signaled that taking on large debts for defense would require a similar large debt authorization for infrastructure. In their first outline, the economists agreed on the need for €400 billion additional debt for defense and €500 billion additional debt for infrastructure financing. When Clemens Fuest, head of the Ifo Institute, joined the group, their debt reform recommendations got even more acceptance.

The Greens came out much weaker.

When Merz, as chancellor-in-waiting and under growing pressure for the first time, mentioned the need for a larger debt authorization in the Bundestag, he referred to the paper written by the four outstanding economists. This helped to legitimize his stunning change of mind on the debt brake issue.

"How the SPD outsmarted the CDU with the financial package" headlines the April 10 *Handelsblatt* article by Martin Greive and Jan Hildebrand. They point out, "*Handelsblatt* research and internal documents show who the real authors of the gigantic debt authorization package are and how cleverly the SPD, in the exploratory negotiation rounds, was able to change the CDU's opinions." It continues, "The Merz-Söder CDU/CSU was almost totally unprepared as to the huge fiscal requirements that the incoming Merz coalition government was facing."

Based on their research, "the outgoing finance minister Jörg Kukies, a veteran Goldman Sachs investment banker, and the Scholz chancellery's state secretary Steffen Meyer could claim the copyright of the finance package."

And what does the German debt brake reform mean for Europe? On March 31, economist Jeromin Zettelmeyer from the Bruegel think tank posted, "This is good news for Germany and for Europe. German debt will rise, but remain sustainable. Assuming nominal growth of 2.5–3 percent and longer-term military spending of 3–3.5 percent of GDP, it should converge at around 100 percent of GDP. Europe will benefit from demand effects, higher German defense capability (helping to deter Putin), and reduced emissions. Real interest rates in the euro area could also rise, and may have risen by about 30 basis points. This is bad for government borrowing costs, but creates room for the European Central Bank to cut interest rates in a downturn." ◆