Bad Timing for a German Government Collapse

by Antonia Colibasanu - November 22, 2024

Germany – the political and economic heart of the European Union – is in the throes a major political crisis. Earlier this month, Chancellor Olaf Scholz fired Finance Minister Christian Lindner, the head of the Free Democratic Party, over their irreconcilable differences on how to manage Germany's poor economic performance. The move resulted in the breakdown of the governing coalition, which included Scholz's Social Democrats, the Greens and the FDP, and thus a government collapse.

Scholz has since announced preparations for a vote of confidence in the Bundestag, Germany's federal parliament, in December. If he fails to gain the required backing – as is expected – snap elections will likely be held in February.

It's no coincidence that political instability followed economic duress. The SPD and Greens have advocated higher public spending to encourage public consumption, protect jobs and provide relief to vulnerable groups, but the FDP has campaigned for budgetary discipline. The conflict between the two sides was ultimately what led to the coalition's dissolution and will likely be the primary focus of all parties in the incoming campaign season.

Opposition groups, particularly the Christian Democratic Union, headed by Friedrich Merz, have called for prompt elections to ease public anxiety and, it should be noted, to try to return to power. The CDU has long promoted economic conservatism, stressing balanced budgets and strict adherence to budgetary regulations. The "debt brake," a constitutional amendment passed in 2009, is the cornerstone of its economic strategy. In short, it restricts the federal government's structural deficit to 0.35 percent of gross domestic product. More recently, however, Merz has signaled a willingness to alter the debt brake. Though he continues to harp on budgetary restraint, he has suggested that changes could be made to support critical expenditures, notably on infrastructure and defense but not on consumption or welfare. Crucially, changing the debt brake would require a constitutional amendment requiring a two-thirds majority in both chambers of parliament – something that will almost certainly not happen if the CDU lacks a solid majority.

Still, that Merz – a potential candidate for the chancellorship – is talking about changes at all indicates a pragmatic approach to serious economic challenges. Recent data shows that Germany's economy will contract by 0.1 percent in 2024, which would mark the second consecutive year of economic decline. The European Commission forecast that Germany's economy will underperform in the eurozone until 2026, thanks to uncertainty in consumption and investment, poor external demand, especially from important trade partners, and a slow investment environment.

On Nov. 19, the Bundesbank noted that any additional trade tariffs imposed by the incoming U.S. government might further degrade Germany's economy, dependent as it is on exports. Indeed, Germany's economy is inextricably linked to Washington's, **making it especially susceptible to prospective U.S. tariffs on EU exports**. In 2023, Germany exported more than $172 billion worth of goods to the United States, accounting for roughly 10 percent of Germany's total exports. Meanwhile, the German Council of Economic Experts has updated its growth estimates, anticipating a 0.1 percent decrease in GDP in 2024 and moderate growth of 0.4 percent in 2025. The council identifies structural and cyclical issues, such as poor outside demand, skilled labor shortages and competition from China, as hindering economic performance.

It's possible that a snap election could help the economy, albeit in the short term. The collapse of the coalition government has highlighted deep divisions over fiscal policy, particularly between those who advocate increased public investment and those who prioritize fiscal restraint. If nothing else, an election could overcome these impasses by producing a clearer parliamentary majority or a more cohesive coalition. Without such ideological conflicts, the new government could move forward decisively on reform, especially if it has a renewed focus on economic policy. A new administration might, for example, adopt pro-investment policies to address Germany's aging infrastructure and support industries vital to long-term economic competitiveness.

Some problems won't be magically solved by a new government. The German business sector, for example, is grappling with uncertainty over the war in Ukraine. On Nov. 21, the German daily Frankfurter Allgemeine Zeitung wrote that the Bundeswehr has initiated efforts to engage with private companies to ensure they are prepared to operate during wartime scenarios. A central element of the Bundeswehr's strategy, detailed in the 1,000-page "Operationsplan Deutschland," is the identification and protection of critical infrastructure. Companies are being advised to secure their facilities and assets against potential attacks, with specific attention to those vital for maintaining public services and essential operations. This proactive approach is designed to mitigate risks and make sure key industries can continue to function under duress.

Then there is the issue of supply chains. The Bundeswehr has urged businesses to develop contingency plans to maintain operations even in the face of disruptions. The plans include diversifying suppliers, stockpiling essential materials and creating logistics networks that can adapt to wartime conditions. These measures aim to prevent cascading failures that could jeopardize broader economic stability. Moreover, companies are being encouraged to implement self-sufficiency measures so that they can still operate independently if external resources become unavailable. Recommendations include investing in backup energy solutions, such as diesel generators and wind turbines, and adopting technological solutions to minimize reliance on vulnerable systems.

The Bundeswehr's proactive collaboration with the private sector reflects an understanding that economic stability and national security are nearly the same thing. For German businesses, the collaboration underscores the need to address the immediate challenges posed by the war in Ukraine while also adopting long-term strategies to build resilience – particularly crucial for Germany given its central role in European production and supply chains.

In other words, the uncertainty within the German economy is compounded by Germany's, and the EU's, geopolitical challenges. There's never a good time for that to happen, but the timing is especially bad considering France's own domestic troubles have strained the usually reliable Franco-German leadership role in the EU. Their relationship has long been the driving force behind the EU's ability to respond decisively to challenges from within and without. From steering economic policy to shaping the bloc's foreign relations, their leadership is essential to EU strategic coherence.

The preoccupation of the EU's erstwhile leaders has left the bloc vulnerable at a time when decisive action is needed more than ever. Key challenges, such as recalibrating relations with **the U.S. under President-elect Donald Trump**, demand a unified European voice. Similarly, the growing threats posed by an assertive China and an increasingly aggressive Russia require coordinated diplomatic and economic strategies that are difficult to achieve without Franco-German alignment. Domestically, the EU is also contending with critical issues, including the energy transition, a migration crisis and rising inflation, all of which require comprehensive and unified policies. Without the leadership traditionally provided by Germany and France, the EU risks losing its ability to effectively address these challenges, further undermining its role as a global power – and its cohesion.

Author: Antonia Colibasanu
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