The Reform Zeal of the New German Government Is Fading

Before the federal election in February 2025, the CDU/CSU gave the impression that they wanted to tackle reforms more resolutely in order to revive the ailing economy. In this publication, we had described the promise in these parties' election platforms to fully abolish the solidarity surcharge as a litmus test of their determination to reform. By now, any uncertainty has been dispelled.

The new federal government, which is tantamount to a 'GroKo 3.0', will not completely abolish the solidarity surcharge and will instead continue it as a tax on the rich. Any equity investor can easily see this for themselves when they receive a dividend statement from a German listed company.

More important still is the broader path for the future that the new government has laid out. It is clear that both CDU/CSU and SPD are reluctant to swiftly implement the necessary reforms. Instead, massive debt is being taken on to stimulate the economy through dramatically higher government spending and public investment. Meanwhile, an additional ministry is being established, and the number of public-sector employees is rising steadily—just like tax revenues.

Equity markets have demonstrated a keen instinct for the growth prospects that are emerging from these developments. The economy will benefit significantly from the government troughs now filled to the brim with borrowed funds. It is hardly surprising, then, that the German stock market is being buoyed by the announced spending spree. After all, the very nature and strength of financial markets lie in their ability to anticipate future real economic and political trends. Accordingly, the anticipation of the coming flood of public money is palpable on the Frankfurt exchange. Less certain is whether all this spending will actually deliver the hoped-for results for the economy and citizens. A look at the past counsels skepticism. The presumptuous and market-distorting state-directed allocation of investment capital has in recent years led to massive squandering of public wealth. One need only think of the enormous subsidies for so-called "green steel," or of failed ventures like battery manufacturer Northvolt or semiconductor plants planned by Intel and Wolfspeed, to name just a few high-profile examples.

Anyone who still remembers the 1990s will recall the term "unreformability." Back then, it referred to the so-called "Rhenish capitalism," which under Chancellor Helmut Kohl increasingly manifested in a bloated state sector at the expense of private initiative and personal responsibility. It ultimately took an entirely new government, which itself squandered two years getting started, before Chancellor Gerhard Schröder finally broke through the reform backlog of decades with the Agenda 2010 program. Today, no comparable appetite for reform is in evidence. Instead, policymakers in Berlin seem intent on sidestepping the need for reform altogether by leaning on the crutch of public debt. Without substantially improving Germany's structural conditions as a business location, most of these subsidies (such as tax breaks for expensive electric vehicles) will likely end up being captured opportunistically. However, the result of February's federal election has also shown that the public does not perceive any urgent need for far-reaching reform.

Sincerely yours,

Fund managers and co-investors

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