

Compromise reforms amid Germany's economic stagnation

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On 2 July, Germany's federal government agreed on a long-anticipated reform package entitled the Programme for Economic Recovery and Employment. The package comprises 34 measures aimed at stabilising the social security system, reducing the tax burden for some taxpayers, strengthening the competitiveness of Germany's key industries, cutting bureaucracy and making the labour market more flexible. At this stage, the package has yet to be enacted into law. However, the governing coalition's political agreement effectively guarantees its gradual implementation.

One of the package's most important elements is the commitment to implement, by the end of 2026, the recommendations of the Pensions Commission, which were published in the second half of June. These include linking the statutory retirement age to increases in life expectancy. According to media estimates, this would gradually raise the retirement age to 70 by 2091. The recommendations also call for the introduction of a mandatory funded pension pillar. Another key proposal is income tax reform that would primarily benefit families with children. For a household with two children and a combined annual gross income of €60,000, the tax relief would amount to more than €600 per year from 2028 onwards. The tax cuts would be financed through higher taxes on top earners.

The proposed reforms respond to slowing economic growth and the declining competitiveness of German industry. The package will now be translated into draft legislation and, after the summer recess, the reforms will be introduced to parliament in stages. The proposals form part of the broader reform agenda pursued by the CDU/CSU–SPD government. However, their scope has been limited by the coalition partners' differing political priorities and concerns over the social costs of more far-reaching reforms, which could benefit the poll-leading Alternative for Germany (AfD).

Commentary

- **The package is a response to Germany's deteriorating economic situation and the growing pressure this has placed on the government.** In the spring, the government lowered its 2026 GDP growth forecast by 0.8 percentage points to 0.5%, citing the negative effects of the war in Iran, including higher energy prices, weaker competitiveness and declining exports to the United States and China. The industrial sector has been particularly affected. According to an EY analysis, employment in German industry was 2.3% lower at the end of the first quarter of 2026 than a year earlier, with a total of 341,500 jobs lost since 2019. In this context, the reform package is intended primarily to address structural barriers by removing some reporting

requirements for businesses and partially liberalising the labour market. Experts and business representatives have welcomed the overall direction of the reforms, while maintaining that the package remains too limited in scope.

- **The package strengthens the CDU/CSU–SPD government and demonstrates its capacity to reach compromises.** After last year's delays and coalition disputes, it shows that the government remains capable of advancing its reform agenda. In March, the Bundestag adopted social benefit reform, and changes to the healthcare system are currently being finalised. These reforms aim to limit upward pressure on social security contributions in the face of a deteriorating demographic outlook. The new package complements the government's earlier measures and reflects a strategy of gradual, phased reforms rather than broad, comprehensive reform packages.
- **The selective and compromise-driven nature of the package highlights the government's limited room for manoeuvre, reflecting the coalition partners' differing policy priorities.** The package has drawn criticism for reopening the debate on social benefits shortly after the adoption of the citizens' benefit reform (see: ['Waiting for reforms: the future of the German welfare state'](#)). It has also been criticised for focusing on socially contentious measures that are unlikely to improve the economic situation significantly, such as abolishing the possibility of obtaining sick leave following a telephone consultation. The government's cautious approach to more far-reaching reforms reflects both the policy differences between the Christian Democrats and the Social Democrats and the coalition's low public approval, with only 13% of respondents satisfied with the federal government's performance. It is also driven by concerns that unsuccessful reforms could further increase support for the AfD. According to an ARD Infratest dimap poll conducted in July, support for the CDU/CSU stands at 22%, compared with 12% for the SPD and 27% for the AfD.
- **The widest gap between the government's promises and the package's contents is in the areas of public finances and taxation.** The document contains no concrete proposals to consolidate the strained federal budget, while the planned income tax reform is less focused on low- and middle-income earners than promised in the coalition agreement of spring 2025. Instead, it primarily benefits families with children. Critics also argue that the planned tax increases amount to a political manoeuvre, as the tax scale will in any case be adjusted this autumn to account for so-called fiscal drag, whereby inflation-driven increases in nominal wages push taxpayers into higher tax brackets even though their purchasing power declines. As a result, some of the planned tax relief is likely to overlap with this adjustment, limiting its overall effect on taxpayers. At the same time, the reform's cost to the federal budget will remain relatively modest.