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## **KCM Management Insight: Germany's Parliament Votes to Amend Basic Law, Easing Fiscal Restrictions**

***Germany is facing increased financial pressure as it strengthens its defense and modernizes infrastructure amid shifting global security dynamics and urgent infrastructure upscaling needs.***

The February 23 parliamentary elections saw CDU/CSU reclaim the top position (28.6%), while AfD surged to second place (20.8%), reflecting growing dissatisfaction. The ruling SPD dropped to third (16.4%), the Greens (11.6%) saw slight losses, and the FDP lost. The Left Party (8.8%) and the new far-left BSW (4.97%) also gained ground, though the BSW missed the 5% hurdle to enter the Bundestag, same as FDP who ended up with 4.3%.

With these two not making it to the parliament, the new seating allocation in the Bundestag will be as follows: 208 seats for CDU/CSU (33.0% of the total 630 seats); 152 seats for the AfD (24.1%); SPD 120 seats (19.0%); Green Party 85 seats (13.5%); Left Wing Party 64 seats (10.2%) and Electoral Union of South Schleswig (SSW) who have a special right to have a seat even missing the 5% hurdle 1 seat (0.2%)

In response to urgent national security and infrastructure needs, both houses of parliament passed an amendment to the Basic Law on March 18 and 21. The key provisions include:

- **Defense Spending:** Exempting defense expenditures exceeding 1% of GDP from the constitutional debt brake to strengthen military capabilities amid evolving geopolitical risks.
- **Infrastructure Investment:** A €500 billion special fund to modernize transportation, energy, healthcare, education, digitalization, and long-term care over 10 years, with €100 billion allocated to climate initiatives.
- **State Fiscal Flexibility:** Allowing state governments to take on debt up to 0.35% of GDP, easing previous restrictions..

### **Differing Views on Fiscal Impact:**

Supporters argue that these measures will boost security, enhance the infrastructure and excrete economic growth. Some economists predict that €50 billion in annual infrastructure investment could raise GDP by 1.2%. Engineers highlight the urgency of modernizing deteriorating infrastructure after years of underinvestment. Others argue that Germany's current debt levels remain low by G7 standards, making strategic borrowing justifiable.

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Critics, however, raise concerns about the fund's long-term fiscal impact, arguing that financial injections alone won't solve structural inefficiencies. Some warn that rising debt levels could increase financial strain, while the vague definition of "infrastructure" leaves room for uncertainty in allocation. Since the fund's announcement, German bond yields have climbed from 2.4 levels pre-plan announcement to 2.8 levels post parliament decision, signaling investor caution.

While infrastructure and defense investments are seen as crucial for Germany's future resilience, effective implementation and fiscal discipline will be key to balancing economic growth with financial stability.

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