Prospects for Economic Development in Berlin

The Berlin economy is currently undergoing fundamental structural changes, a process that began with the German unification in 1990 and has evidently not yet come to an end. Its most striking manifestation is a drastic decline in employment and output in manufacturing industry and an increase in the number of jobs in service industries, whereby the decline in industry has proved more pronounced and the rise in service employment weaker than had been widely expected. There is no sign of fundamental change in this trend for the foreseeable future. The number of jobs in industry will continue to decline and this will be offset to some extent by service companies. Employment in construction industry will continue to expand slightly. In view of rising costs, the public sector will have to sharply cut the size of its workforce; a further decline in employment is thus likely here. These public-sector job losses are expected to total 30 000 jobs in the prognosis presented below. The forecast assumes that Gross Domestic Product (GDP) will grow by an annual average of 1.7% to the year 2010. Current demographic structures and trends suggest that the population of Berlin will stagnate; labour market participation rates are therefore expected to decline somewhat. Given this constellation, there will be scarcely any improvement in the unemployment situation even in the medium term.

Data base and method

Analysis of economic trends in Berlin still faces serious data-related problems. Although the standard statistical reports are now also available for the eastern part of the city, the data supplied by the official statistics on Berlin are in many cases incomplete. Following changes in the definitions used, current data on industry are not comparable with those of previous years; the figures on the construction industry are incomplete, as the activities of non-indigenous firms in Berlin are not covered consistently by the statistics; last but not least, services are not – and never have been – covered at an adequate level of disaggregation. The result of all this is that the official statistics can provide only a rough estimate of the origin of GNP in Berlin; there is no income-side calculation at all. Thus the risks associated with prognosis are greater than usual, simply in terms of the data available. On top of this comes the methodological problem that in the situation of fundamental transition in which Berlin currently finds itself, it is not possible to utilise prognosis techniques based on the extrapolation of stable development parameters. Finally, the small size of the region under consideration increases the risk of inaccuracy.

Consequently, the following attempt to sketch out the prospects for economic development in Berlin should not be seen as a prognosis in the traditional sense of the word, but rather as an attempt to make a "best guess" at the growth path that seems, at present, to be most plausible. This attempt is based on assumptions on the development of output and productivity at sectoral level that have been determined in the light of both macroeconomic trends and factors specific to Berlin. This forecast modifies earlier estimations by the DIW in the light of new, more highly differentiated data on output and employment in Berlin and east Germany.

The current situation

German unification fundamentally changed the framework of economic conditions for both parts of Berlin. Since then significant progress has been made in reconstructing the economy in east Berlin, although this process is far from being complete. Following massive transfers in support of both consumption and investment, industrial employment is approaching a level sustainable by virtue of market forces. Output and sales are rising. Employment has stabilised in the trade, construction and service sectors. Staffing levels are substantially too high in the public sector, however.

According to the Berlin State Statistics Office, GDP in east Berlin grew by 8% in 1994 on the previous year and by 5% in 1995. The rate of growth was thus slightly weaker than the average for the new federal states. In 1995 487 000 people were employed in the eastern part of the city, somewhat more than one-third of the total employment in the city. However, these employees generated only one-fifth of the city's total value added. Per employee east Berlin's GDP, at DM 58 000, was two-thirds of the level achieved in west Berlin.[1]

Initially the west Berlin economy profited greatly from the end of the division of the city. The additional demand stimulated output and sales to a greater extent even than in west Germany, and led to a substantial rise in employment, particularly in services. Between 1989

[1] The GDP figure for west Berlin contains, due to the major importance of the tobacco processing industry there, a disproportionate quantity of consumer taxes on cigarettes, which means that the figure is a significant exaggeration of actual economic strength.

Table 1
Employment in Berlin, 1991 and 1995

	1991			1995			1991 to 1995		
	Berlin	West Berlin	East Berlin	Berlin	West Berlin	East Berlin	Berlin	West Berlin	East Berlin
	in 000's						Annual average in %		
Agriculture and forestry	11.1	6.6	4.5	11.4	8.3	3.0	0.5	5.9	–9.6
Utilities, manufacturing and construction	482.5	303.2	179.4	371.0	250.1	121.0	–6.4	–4.7	–9.4
Energy and water supply	24.7	13.0	11.7	20.2	12.8	7.4	–4.9	–0.4	–10.8
Manufacturing industry	326.6	212.4	114.2	204.5	153.7	50.8	–11.	–7.8	–18.3
Construction	131.2	77.8	53.4	146.4	83.6	62.8	3.8	1.8	4.1
Trade and transport	339.5	208.1	131.4	289.1	199.2	89.9	–3.9	–1.1	–9.1
Service companies	375.3	248.5	126.7	423.8	290.6	133.2	3.1	4.0	1.3
Government, private households, non-profit organisations	458.8	271.8	187.0	417.0	277.3	139.7	–2.4	0.5	–7.0
Total employment	1667.3	1038.3	629.1	1512.3	1025.6	486.8	–2.4	–0.3	–6.2

1) Domestic concept (i.e. residents and non-residents).
Sources: Berlin State Statistics Office; DIW estimates.

and 1992 employment in west Berlin rose by 131 000. Once the unification-induced boom came to an end, however, output and employment declined: as early as 1992 GDP and employment began to fall. In 1995 1 026 000 persons were in employment in west Berlin (annual average).

Yet the decline was not merely cyclical in nature, but also reflected the need for structural adjustment within the west Berlin economy. Industry there had been dominated by highly subsidised manufacturing companies that are nowadays scarcely ever located in major conurbations and high-wage areas. The permanent subsidisation also meant that firms did not always react to market changes. The abrupt end to subsidies on sales, rising land prices within the city and the expanding supply of commercial sites outside west Berlin induced a growing number of industrial firms to abandon, wholly or partially, their production in west Berlin. In some cases productive plant and employment were relocated in the eastern half of the city or in the environs, other firms left the region entirely or, due to lack of profitability, closed altogether. Since 1991 employment and value added in manufacturing industry have declined by 28% and 20% respectively.

Banks, insurance companies and other producer-oriented service branches on the other hand had only very limited scope for development prior to unification due to the unfavourable structure of west Berlin industry, the isolation from its hinterland and the large distance to supraregional sales markets. Since unification such branches have experienced substantial growth. By 1995 employment had increased by 17% value added by more than 10%.

The overall economic situation of Berlin remains unsatisfactory. In 1995 Berlin's economic growth performance was actually the worst of all Germany's fifteen federal states. This was reflected not least in rising unemployment. The annual average unemployment figure in 1995 was 14% in west and 12% in east Berlin.

The signs – bankruptcies, planned plant closures etc. – are that the structural change in the Berlin economy is far from over. Yet it is difficult to foresee its pace and magnitude over the coming years, as a number of factors central to any prognosis remain largely imponderable. These include the scope for growth in the German economy as a whole, the pace of economic reconstruction in the new federal states and ongoing political and economic developments in central and eastern Europe.

A number of important regionally specific conditions are now clear, though. The planned fusion between the states of Berlin and Brandenburg will not take place and the decision to move the seat of government to Berlin is to be implemented by the year 2000.

Prospects for development

The framework of conditions

The assumptions for the framework of macroeconomic conditions for the prognosis were made in line with the results of other currently available studies. It is expected that the city will benefit from economic integration within the European Union (EU). To a greater extent than previously the changes in eastern Europe will also exert a determining influence on developments in Berlin. It is assumed that over the medium term economic cooperation with partners there will increase.

Changes in work organisation will occur due to the new technical opportunities and pressure to cut costs. Greater spatial decentralisation and an increase in the degree of autonomy enjoyed by individual corporate divisions are expected. This gives firms greater scope in deciding where to locate production. The importance of industrial jobs will decline, that of services in the broadest sense will increase. This is particularly true of major conurbations. Finally, there will be an increase in working time flexibility and in part-time work.

Between 1980 and 1990 the annual average rate of growth in west Germany was 2.2%; in the previous decade 2.7%. Based on current DIW scenarios of macroeconomic trends it is assumed here that annual average economic growth of 1.3% will be achieved in west Germany to the year 2010, an assumption that, given the current weakness of growth does not appear excessively pessimistic.

In eastern Germany GDP grew rapidly until 1994. Even so, by 1994 labour productivity had reached just 44% of the west German level. Since then the pace of the catching-up process has slowed markedly, and it remains doubtful whether it will pick up significantly once more before the end of the decade. Accordingly, here too the lower variant for economic growth in east Germany from the DIW scenarios – 3.6% – is taken as a basis for the prognosis.

Berlin's development conditions

Because of its particular situation the city will almost certainly have to struggle with serious adjustment difficulties even after the turn of the century. Not until towards the end of the projection period will it be able to utilise additional growth potential. Specifically, the following conditions need to be taken into account:

- Berlin is located at the edge of the large west European sales markets. Consequently, rapid access to west European centres is an essential precondition for the international competitiveness of the region. It is assumed that rapid progress will continue to be made in improving the transport infrastructure.
- Berlin is developing into an important nodal point for trade and transport. This is partly due to the accession of Finland and Sweden to the EU and the *rapprochement* of the east European countries to the EU.
- In future the city will be able to utilise to a greater extent than previously its highly diversified endowment with scientific and research institutes to intensify cooperation between academe and business. A start has been made on improving the networking between these innovation potentials. On the other hand it is evident that in the longer term the city plans to reduce its high education capacity.
- As the seat of German government, Berlin's "political capital" will increase. This will offer both the city and its environs a development impulse. It is unlikely that government will move to Berlin before the end of the millennium. The direct employment effects of the move are minor, not least due to the planned relocation of federal institutions currently still located in Berlin. The indirect effects are more significant. Embassies, party offices and interest groups will come to Berlin and thus contribute to the expansion of the service sector. Last but not least, the city will increase in importance in the eyes of the rest of the world and thus become more attractive to potential investors as a production location.
- The number of inhabitants in the city is forecast to grow only slightly. A substantial deficit – over the medium term – resulting from natural demographic development is only just offset by immigration. Most of this immigration will continue to consist of the poor and refugees. In this constellation the potential labour force will decline slightly.

Sectoral development prospects

Private services will remain one of the expansionary sectors of the Berlin economy. This is particularly true of primarily consumption-oriented services, such as hotels and catering. The media sector is also expected to improve its position. The growth prospects are also favourable, however, for largely producer-oriented services, particularly software, marketing, advertising, management and legal consultancy, engineering services, leasing, training, trade fairs and congresses. Other reasons for the increase in service employment are the outsourcing of services by industrial firms and the privatisation of government services.

Yet two factors need to be considered in estimating the growth prospects of service industries. Firstly, the growth of producer-oriented services depends on the demand from industrial firms located in the region. It tends to be firms' headquarters that demand such services. Yet the relatively weak presence of corporate headquarters in Berlin is unlikely to change fundamentally in the short term. Secondly, a stable polycentric structure has developed in west Germany with regard to the leading supraregional services, with specific local specialisations. It is unlikely that Berlin will be able – in the short term at least – to specialise on supraregional services that are already well established elsewhere.

Another sector whose prospects in the region are favourable is the construction industry. Large-scale investment projects have already been completed or are currently under construction, however. It is not to be expected, therefore, that the already buoyant construction activity will continue to expand significantly. Rather, here too the growth trajectory is expected to flatten out.[2]

The public sector in Berlin suffers from excessive staffing levels, which must be reduced. This is true of both district and city administrations. There is unlikely to be any significant increase in the number of federal government employees, as the influx of government civil servants will be offset by the departure of government employees and those working in subordinate offices. On the other hand there will almost certainly be a marked expansion in areas such as interest groups and collective organisations. International organisations will also intensify their presence in Berlin, not least due to its new role as capital.

There has been a sharp increase in the number of large retail trade outlets located in the environs of the city. Such large-scale outlets outside the city will continue to increase in importance, creating difficulties for retail traders within the city boundaries. Wholesale

Table 2
Employment in Berlin 1995, 2000, 2005 and 2010
in thousands

	1995	2000	2005	2010
Agriculture and forestry	11.4	10.5	9.5	9.0
Utilities, manufacturing and construction	371.0	351.5	333.0	316.0
Energy and water supply	20.2	19.5	18.0	16.0
Manufacturing industry	204.5	177.0	160.0	145.0
Construction	146.4	155.0	155.0	155.0
Trade and transport	289.1	285.0	280.0	275.0
Service companies	423.8	445.0	472.5	500.0
Government, private households, non-profit organisations	417.0	400.0	390.0	380.0
Total employment	1512.3	1492.0	1485.0	1480.0

1) Domestic concept.
Sources: Berlin State Statistics Office; DIW estimates.

Table 3
Employment in Berlin 1995, 2000, 2005 and 2010
annual average change in %

	1995	2000	2005	2010
Agriculture and forestry	–1.5	–2.0	–1.1	–1.5
Utilities, manufacturing and construction	–1.1	–1.1	–1.0	–1.1
Energy and water supply	–0.7	–1.6	–2.3	–1.5
Manufacturing industry	–2.9	–2.0	–2.0	–2.3
Construction	1.2	0.0	0.0	0.4
Trade and transport	–0.3	–0.4	–0.4	–0.3
Service companies	1.0	1.2	1.1	1.1
Government, private households, non-profit organisations	–0.8	–0.5	–0.5	–0.6
Total employment	–0.3	–0.1	–0.1	–0.1

1) Domestic concept.
Sources: Berlin State Statistics Office; DIW estimates.

[2] Data on the current level of output in the construction industry are, however, highly uncertain, as the output of non-local firms in the city is covered only inadequately by the statistics.

trade, on the other hand, is expected to expand in the wake of the increase in super-regional trade.

The prospects for manufacturing industry within the city remain relatively unfavourable. In the western half of the city, the decline in the number of manufacturing jobs due to relocation or closure has not yet come to an end, although there are some initial signs of structural improvements: an increase in the number of service jobs located within industrial firms. The systemic transformation within industry in the eastern half of the city is by and large complete. The employment level is not yet stable, however. On the other hand there is evidence that non-local large concerns are intensifying their commitment and are planning to develop their internal services substantially. The increase in the number of jobs with high skill requirements in central corporate divisions must be seen against the losses in direct production due to rationalisation and relocation, however. To judge by experiences so far, it is initially unlikely that large numbers of new firms will set up in the city. Thus the decline in industrial employment will continue. Manufacturing output, by contrast, is again expected to expand in the light of the relatively favourable prospect for certain branches, in particular road and rail vehicles and the chemical industry.

Under the above conditions economic output in Berlin will increase slightly more strongly than in the German economy as a whole. For the period 1995 to 2000, annual average GDP growth of 1.5% is assumed. Allowing for sectoral productivity trends, an employment level of just under 1.5 million would be expected on this basis. During the following five years the economy will grow at a similar pace, while employment remains virtually constant. The rate of economic growth will accelerate to 2.0% by the year 2010. This will be accompanied by a marked change in the structure of employment in the city. Manufacturing industry will provide about one-tenth of the available jobs, slightly less than the construction industry. More than one-third of all employees will be active in the service sector.

In the longer term economic relations between Berlin and its environs will intensify. It is not possible to quantify the extent of commuting to be expected in future, however. On the pattern of other large cities, though, the volume of commuter flows in both directions is expected to continue rising.

On this basis slightly more than 1.48 million jobs are expected in Berlin for the year 2010. The size of the city population is not expected to change significantly to the year 2000, subsequently increasing slightly, largely due to foreign immigrants. There will be only a slight decline in the size of the labour force. Under such conditions unemployment will remain high into the next millennium.

Conclusion

Taking a realistic view of the framework of conditions and on the basis of a critical evaluation of the various influencing factors, the prospects for economic development in Berlin over the medium term are not particularly favourable. The erosion of the manufacturing base will continue. It is still unclear at what level the process will come to a standstill. The results of the above calculations – around 160 000 industrial jobs left in ten years and a slight rise in output – can therefore, strictly speaking, only be seen as a "model". They rely centrally on the assumption that the city quickly manages to realise the expected growth potentials.

Although the growth opportunities for the local construction industry are better, they are no longer particularly good. Although a number of large-scale public investment projects, particularly in the transport infrastructure, still have to be completed, government will be forced to make cuts in other areas – primarily, it seems, in support for housing construction. Moreover, the experience of recent years has shown that the effects of investment boom on employment and income for the region are less substantial than widely assumed.

In the medium term the often expected increase in the importance of service functions in the city is bound to occur. There is doubt, however, whether this can offset the loss of jobs in other areas. Given the prospects for industry in Berlin, a more favourable development than that assumed here, does not appear very likely.

Last but not least, government is unable to make a major contribution to stabilising employment. Shortage of public funds necessitates a cut in public sector employment – which compared with other regions is far too high – although the failure of the fusion Berlin and Brandenburg means that a certain number of functions that would otherwise have been superfluous will remain in the city.

All in all, the Berlin economy is likely to close the gap on the growth path of the German economy once more. This should not be allowed to hide the fact, however, that output per employee in Berlin as a whole is currently by far the lowest of the "old" federal states of west Germany – although markedly higher than in any of the east German federal states. The slightly higher growth assumed here for the Berlin economy will do nothing to change this fact, even in the medium term.

The removal of the seat of government to Berlin will make an important contribution to the improvement in the economic situation in the city. Manufacturing industry will benefit least of all from this, however, as the function as capital is no longer of any relevance as a locational factor for industrial production. What is required are additional positive impulses, such as could emanate from continued economic recovery in the nearby east European countries.

In the analysis presented above, economic growth is not expected to accelerate until after the year 2000. For economic policy makers in Berlin this means that they face the difficult task of setting a course for the future during a transition phase and in the face of scarce resources.

Alexander Eickelpasch and Ingo Pfeiffer