

The Renaissance of the Big Cities – and the Opportunities for Berlin

For decades Germany's big cities and major agglomerations have experienced a less favourable economic development than the other regions, but towards the mid-1990s a change in the trend became evident. From 1998 to 2002 employment in the major cities grew at a much stronger rate than on average for Germany as a whole. Munich, Cologne and Frankfurt am Main showed by far the greatest dynamic, with growth rates between 8% and 10%, but in Germany's biggest city, Berlin, employment fell by 2.5%. The main driving force of urban growth comes from services that are offered above regional level, such as financial services and consultancy, the media and tourism, all of which are growing many times as fast as the economy as a whole. Their preferred locations are still urban centres, and their concentration in the big cities is tending to grow even more.

In contrast to its poor record in employment as a whole Berlin is displaying a particular dynamic in a number of service sectors: information technology, advertising, the media and tourism. This is mainly due to Berlin's great cultural and science capacities. Networking of officially supported and commercial activities will continue to play a central role in the future development of traded services in Berlin. Thus, in view of its precarious financial situation Berlin needs to adopt a strategy for culture and science that, despite inevitable cuts in total public spending, will achieve the maximum possible synergy effects and stimulate growth in private sector traded services.

Historical background

The settlement structure and the geographical division of labour in the economically developed countries are largely the result of industrialisation. After the Second World War the cities at first continued to grow,¹ with population and employment rising faster than in the rural regions, and more strongly than in the surroundings of the cities. In the 1960s the concentration in urban centres – urbanisation – gave way to a tendency to greater geographical spread, particularly within the densely populated areas. The growing migration to the

¹ D. Boustedt: 'Die Entwicklung deutscher Stadtregionen', in: *Archiv für Kommunalwissenschaften*, vol. 2, 1966, pp. 179-202.

outer fringes – sub-urbanisation – caused the population and employment to rise less strongly in the inner cities than in the surrounding areas. However, many agglomerations (inner city areas and their hinterland) did still have higher growth rates than the less densely populated areas.

This changed in the 1970s, when the growth in population and employment slackened markedly everywhere. Most of the big cities suffered population losses, and the agglomerations also lost weight compared with the other areas. Terms like 'de-urbanisation' were coined for this decline in urban concentration, while in research and political discussion the development was often regarded as the start of a secular deconcentration process, in the course of which the big cities would experience a dramatic decline.² And although these expectations were not fulfilled, as time went on the percentage of total employment in the big cities and the urban areas did continue to fall. There was a temporary slackening of deconcentration in the 1980s, but in the early 1990s geographical structural change away from the urban centres gathered pace again.³ In West Germany the share of the agglomerations in total employment fell from 48.7% to 47.1% between 1980 and 1995.⁴ The core cities' share fell from 23.8% to 21.8%, while that of the surrounding areas rose by 0.4%.⁵

Clear gains in employment for the big cities

A fundamental change in the development of the geographical division of labour occurred towards the mid-

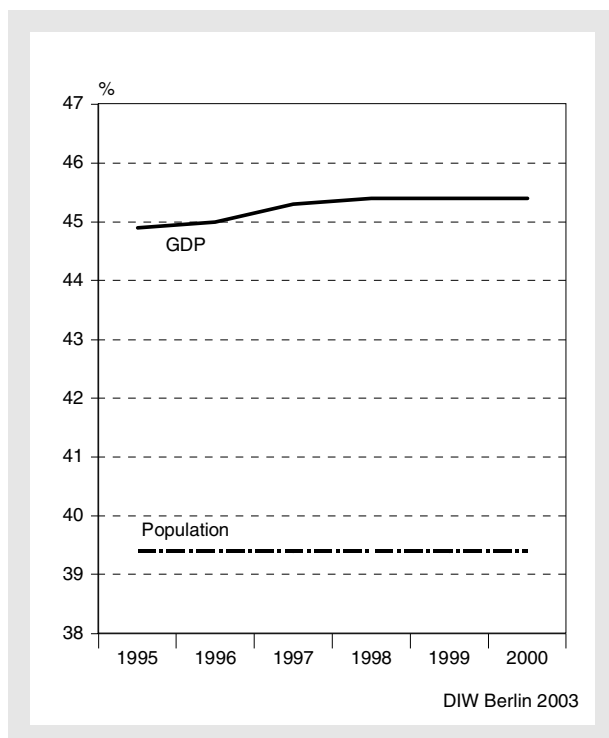
² Cf. e.g. P.G. Hall and D. G. Hay: 'Growth Centres in the European Urban System', London 1980.

³ On the development in Germany see E. Irmen and A. Blach: 'Räumlicher Strukturwandel, Konzentration, Dekonzentration, Dispersion', in: *Informationen zur Raumordnung*, vol. 7/8, 1994, p. 445 ff.; F.-J. Bade and A. Niebuhr: 'Zur Stabilität des räumlichen Strukturwandels', in: *Jahrbuch für Regionalwissenschaft*, no. 19, 1999, p. 131 ff.

⁴ Agglomerations are basically defined according to the concept used by the Federal Office for Building and Area Planning; however, special consideration is only given here to the *big* agglomerations, that is, where the core city has more than 500 000 inhabitants. The Hanover region is not included because the relevant data for 2002 does not allow any differentiation between the core city and the surrounding area.

⁵ To enable the most recent data to be used the geographical division of labour is analysed here solely by the indicator 'Number of employees paying statutory social insurance contributions'. In relation to this figure the cities have lost weight in recent decades. But if *qualitative aspects* are also taken into account, e.g. the structure of employment and the level of incomes, the cities have lost very much less ground; cf. e.g. Kurt Geppert: 'Zur wirtschaftlichen Entwicklung in westdeutschen Ballungsräumen', in: *Wochenbericht des DIW Berlin*, no. 42/96; A. Haas and J. Möller: 'Qualifizierungstrends und regionale Disparitäten', in: *Mitteilungen aus der Arbeitsmarkt- und Berufsforschung*, vol. 2, 2002, p. 139 ff.

Figure 1
Share of Agglomerations in Total EU
GDP and Population, 1995 to 2000



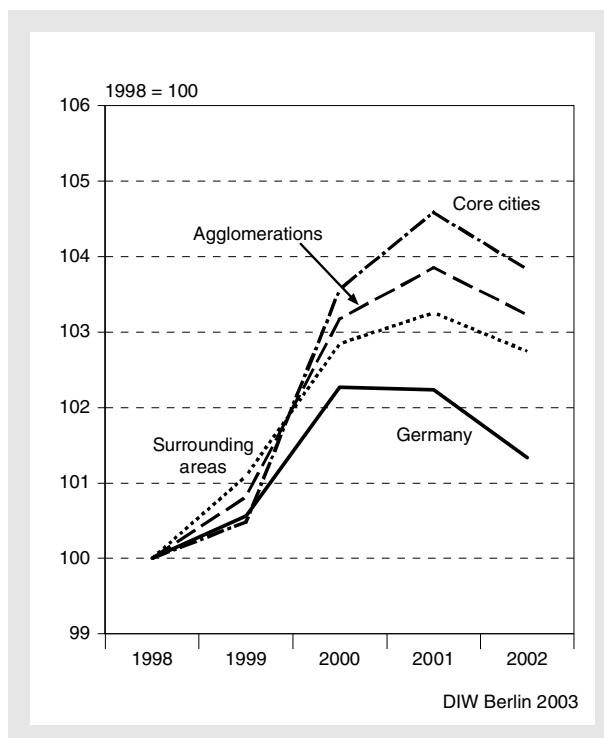
Agglomerations are delimited on the basis of NUTS 3 regions. Included are regions with core cities of more than 500 000 inhabitants. Neighbouring cities with fewer than 500 000 inhabitants were combined to form an urban core with more than 500 000 inhabitants.
Sources: REGIO Database; DIW Berlin.

1990s. The process of decentralisation, which had continued for decades, came to a stop, and in recent years it has actually been reversed. From 1995 to 2000 the large urban agglomerations of the EU increased their share in total gross domestic product (GDP) and kept their population share (cf. figure 1). In Germany employment in the big agglomerations rose from 1998 to 2002 much more strongly than in the rest of the country (cf. figure 2). Even more remarkable is that the core cities, which for a long time were the clear losers in geographical structural change, showed the most positive development.⁶

The big cities probably profited most from the ballooning of the New Economy; at least, the growth in employment in 2000 and 2001 suggests this. But the New Economy alone will not explain the improvement in the position of the cities, for in 2002, long after a more sober assessment of the Internet economy had become

⁶ Owing to changes in the regulations on employment for a few hours a week the number of part-time workers paying statutory social insurance contributions rose markedly during the period considered here. However, that does not affect the conclusions in this study.

Figure 2
The Development of Employment in
Agglomerations in Germany,¹ 1998 to 2002



¹ Agglomerations whose core cities have more than 500 000 inhabitants. The Hanover region is not included because the data for 2002 does not permit differentiation between the core city and the surrounding area.
Sources: Statistics on employees paying statutory social insurance contributions; DIW Berlin calculations.

established, the old geographical patterns of development did not simply reinstate themselves. The fall in employment in 2002 from 2001 was stronger in many of the big cities than in their surrounding areas, but for the cities as a whole it was much weaker than in the other parts of Germany.

It may seem too early to talk of a new urban revival, in view of the short period under review here and our restriction to employment as an indicator.⁷ But the data presented here does suggest that the urban centres in Germany are in the process of stabilising and building up their position in the geographical division of labour. However, there are very big individual differences. Three groups of cities with more than 500 000 inhabitants can be identified (cf. figure 3):

- In Hamburg, Düsseldorf, Cologne, Frankfurt am Main, Stuttgart and Munich employment expanded

⁷ The term 'new urban revival' was originally used for the temporary economic revival of the cities in the United States in the 1980s; cf. W.H. Frey: 'The New Urban Revival in the United States', in: *Urban Studies*, vol. 4/5, 1995, pp. 741-774.

strongly from 1998 to 2002. Within this group Cologne, Frankfurt and Munich stand out as by far the most dynamic centres.

- Bremen and the three Ruhr cities, Dortmund, Essen and Duisburg, were close to the national average in their employment trend.⁸
- Berlin is the only major German city in which employment clearly fell from 1998 to 2002.

Traded services drive urban growth

In view of the changing geographical development trend two questions in particular arise:

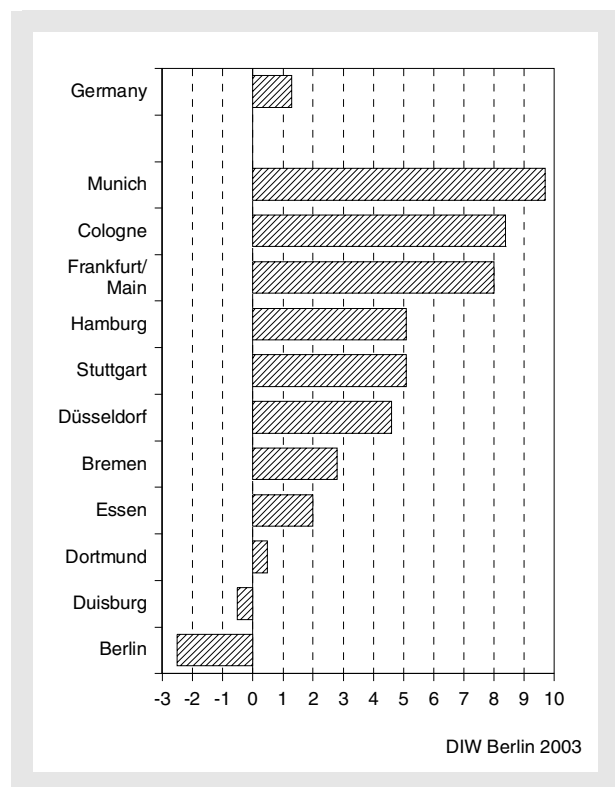
- What general economic changes will explain the renaissance of the big cities?
- What specific factors will explain why Berlin, by far the biggest German city, is not participating in this trend?

The current growth processes in the big cities, not only in Germany, can be shown particularly clearly with reference to the 'theory of the export basis'.⁹ According to this approach, which was developed as early as the 1950s, the economic importance of a city or region is determined by its ability to attract and retain demand from outside its region.¹⁰ The more strongly the regional export surplus grows the greater is regional growth.

Traditionally, the production of goods is seen as the regional export base. That is to assume that goods (material goods) are sold mainly outside the region, while services are provided for local needs. The historical urbanisation process, and the loss of importance for the big cities since the 1970s, with the decline in industrial mass production that was concentrated in the cities, largely suggest that industry is the explanation for regional change.

However, processes of change in industry can hardly explain the present renaissance of the big cities. The production of goods is still declining in direct economic importance in all the big cities. The reason for the break in the trend in regional development patterns is rather to be sought in the expansion and diversification of the urban export base. Increasingly, services are also being traded at national and even international level. This applies firstly to large sections of the financial sector

Figure 3
The Development of Employment in Big German Cities,¹ 1998 to 2002



¹ Cities with more than 500 000 inhabitants; Hanover is not included because no data is available for that city for 2002
Sources: Statistics on employees paying statutory social insurance contributions; DIW Berlin calculations.

and to consultancy, which is primarily directed to the needs of other companies for intermediate products. But a growing tendency to national orientation is evident in certain services that are designed for end-demand from households as well. They include the media sector and large parts of the cultural sector and hotels and catering, in connection with tourism.¹¹ In the financial sector in particular, and in the media, Internet-supported business models are also driving the new supra-regional orientation.

Employment has been rising fast in finance, consultancy, tourism and the media as a whole in recent years.

⁸ According to the data available up to 2001 Hanover should be included in this group of less dynamic cities.

⁹ Cf. N. Buck, I. Gordon, F. Hall, M. Harloe and M. Kleinman: 'Working Capital: Life and Labour in Contemporary London', London 2002.

¹⁰ Cf. R.B. Andrews: 'Mechanics of Urban Economic Base: Historical Development of the Base Concept', in: *Land Economics*, vol. 28, 1953, p. 100

¹¹ Cf. M. Gornig and E. von Einem: 'Charakteristika einer dienstleistungsorientierten Exportbasis', in: H.-J. Bullinger and F. Stille (eds.): 'Dienstleistungsheadquarter Deutschland', Wiesbaden 2000, pp. 49-73. Specifically the following economic sectors have been included here: banks, insurance, other financial services, corporate and legal consultancy, software firms, engineering and architects' offices, advertising agencies, business organisations, publishers, TV companies, film producers, news agencies, opera houses, theatres, artists, hotels, guest houses and restaurants.

Growth in these traded services reached 15% in Germany from 1998 to 2002 – compared with a mere 1.3% rise in total employment.

The cities that profited particularly from this structural change are those where these sectors are most strongly represented, such as Munich, Cologne and Frankfurt. Hamburg, Düsseldorf and Stuttgart also have clearly higher shares of employment in traded services than the other big German cities, and, as a consequence, also show a better employment trend (cf. figure 4).

As a whole, the geographical concentration of services designed for sale outside the region is still increasing in the fast-growing cities. Munich, Frankfurt, Stuttgart, Cologne, Düsseldorf and Hamburg were able to increase their employment in all traded services by a good 20% from 1998 to 2002, while the growth rates were one quarter lower on the national average and in the other big cities.

The intense growth of most of the big German cities in recent years is largely due to their outstanding position and dynamic in traded services. The big city milieu, with the many possibilities for contact and exchange it

offers, evidently provides particularly favourable conditions for companies in these sectors. However, Berlin falls far behind the west German growth centres in the dynamic of its traded services. With growth of just under 15% in employment between 1998 and 2002 Berlin just achieved the growth rate for Germany as a whole.

Berlin: a fall in employment but success with many traded services

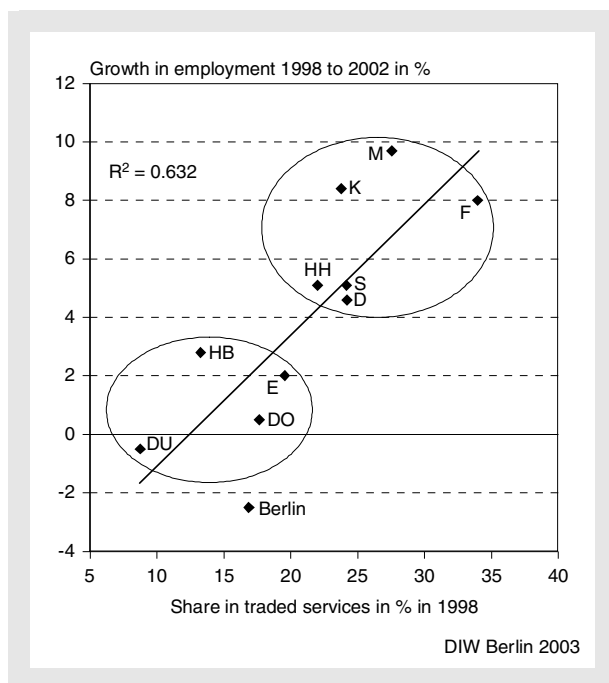
The development in individual branches of traded services, however, shows that a consideration of total employment in this sector is not enough, particularly for a classification of the development in the German capital. The average of 15% growth for Berlin conceals strong polarisation between individual types of services (cf. table).

Firstly, contrary to the general trend Berlin registered a particularly poor development in employment in some branches of traded services from 1998 to 2002. Employment in both banks and insurance companies in the capital fell by around 10%, while such growth centres as Frankfurt and Munich achieved further notable growth. The situation is similar for technical consultancy (engineering), where employment fell by nearly 5% in Berlin, while the national trend was up by just under 4%. The capital is also lowest on the scale for development in the cultural sector. Certainly, these activities are still concentrating strongly in Berlin, but it was only possible to maintain the 1998 level of employment. In the big cities that were successful altogether employment rose by 20% on average.

For many traded services, on the other hand, Berlin is one of the most dynamic locations in Germany. It heads the growth hierarchy of big cities for advertising, business organisations and the film and television industry. Gains of nearly 95% since 1998 in advertising and a good 40% in the film and the television industry as well as in business organisations are unequalled anywhere else in Germany. Berlin is also well above the average for Germany and the other big cities in information technology (data processing, software), hotels and other tourist accommodation, and publishing. With growth rates in employment of a good 85% in software firms, more than 22% for hotels and just under 15% for publishing, the dynamic of Berlin's development leaves most of the other big cities behind.

To illustrate how Berlin is catching up in at least some central areas of traded services, figure 5 shows the shares in employment for the capital in the total figures for big cities for data processing, advertising, business

Figure 4
Shares of Traded Services¹ and Growth in Employment in Big German Cities,² 1998 to 2002



¹ Here traded services include financial services, consultancy, tourist services and the media/culture. The regression is significant at the 1% level. — ² Cities with more than 500 000 inhabitants. Hanover is not included because no data is available for that city for 2002.

Sources: Statistics on employees paying statutory social insurance contributions; DIW Berlin calculations.

Table
**The Development of Employment
in Traded Services, 1998 to 2002**
Big cities with more than 500 000 inhabitants; % change

Economic sector	Big cities			Germany
	With great dynamic	With little dynamic	Berlin	
Financial services	10.0	4.3	-7.9	2.7
Banks	11.6	0.1	-9.3	0.4
Insurance companies	9.2	12.1	-11.5	7.5
Other financial services	2.4	10.7	6.3	10.6
Consultancy	33.6	22.8	24.3	24.4
Law/business	41.7	24.2	27.9	26.7
Engineering	4.2	0.4	-4.8	3.7
Information technology	68.4	57.8	86.1	67.3
Advertising	41.8	58.6	94.4	46.7
Business organisations	-0.4	4.8	42.0	2.4
Tourism	15.9	19.2	20.3	14.3
Hotels	9.7	9.2	22.6	7.5
Catering	18.2	21.9	19.5	17.6
The media/culture	13.5	5.5	16.4	11.9
Publishing	6.9	8.9	14.6	5.3
Film, TV, radio	17.8	5.6	41.6	27.9
Culture	21.4	0.8	0.7	9.9
Total	20.2	15.5	15.1	14.9
Memo item: All economic sectors	7.0	1.4	-2.5	1.3

Sources: Statistics on employees paying statutory social insurance contributions; DIW Berlin calculations.

organisations, hotels, publishing and the film and television industries from 1998 to 2002. We see that Berlin achieved its biggest development leap in 1999 and 2000. The catching-up tempo has slackened slightly most recently, but in 2001 and 2002 Berlin was able to increase its employment shares noticeably in the film and television industries, advertising, business organisations and publishing. Only in information technology and hotels did the city again lose some of the previous year's gains.

Conclusions

Taking traded services as a whole, Berlin did not achieve above-average dynamic in development. So in

contrast to other big German cities it was not able to make up the losses in industry with gains in services.¹²

Berlin has not been able to improve its position in the big areas of finance, technical consultancy and legal and business consultancy. Evidently spatial structures in these sectors are too fixed for any fundamental changes to be expected in the foreseeable future. The cities that are traditionally in the lead here, Frankfurt and Munich, are each growing faster in their special fields than the other big cities. Much thus suggests that the geographical concentration of competences, communications and infrastructures in these fields also give the established locations the advantage in opening up future growth potentials.

However, Berlin is a particularly attractive location for many services. In most of these cases it is not yet the economic centre, but the dynamic of the development indicates that these branches are becoming increasingly concentrated in the capital. Berlin has clearly improved its position in the competition between the major cities for information technology, advertising and the media.

Berlin's chances of taking over more supra-regional functions in the services sector do not lie in attracting or copying established fields of business that are highly concentrated in other cities. Berlin needs to identify at an early stage gaps and niches in traded services that are not yet so strongly bound to a particular region, establish a market position and then build on it.¹³ Evidently it offers particularly attractive location conditions for information technology, advertising, business organisations, the media and tourism. Particularly in the link between advertising, the various sectors of the media and parts of information technology an integrated production cluster appears to be developing in Berlin. There are big potentials here in networking and synergy effects with the public areas of culture and science, that are particularly well developed in Berlin.¹⁴ Berlin thus has obvious location advantages in the regional competition for the above private sector services.

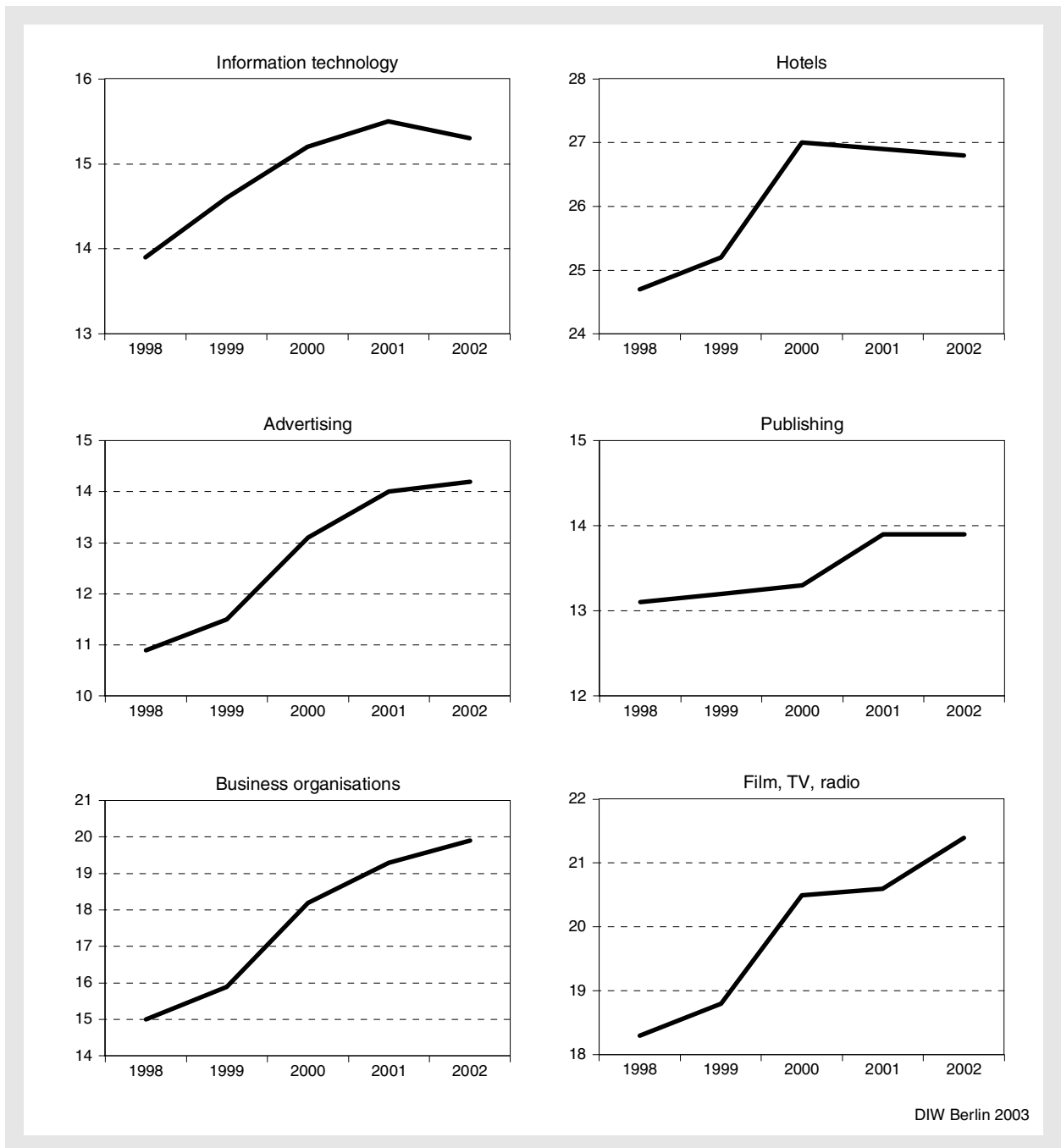
The official expenditure on culture and science is an undoubted drain on Berlin's financial resources. This creates a dilemma for the Berlin Senate. If the big eco-

¹² For a more detailed analysis of the economic situation in Berlin and the development in the 1990s see Karl Brenke, Kurt Geppert, Rainer Hopf, Ingo Pfeiffer, Katharina C. Spiess, Dieter Vesper and Gert G. Wagner: 'Bausteine für die Zukunft Berlins', in: *Wochenbericht des DIW Berlin*, no. 10/2002.

¹³ M. Gornig and H. Häussermann: 'Berlin: Economic and Spatial Change', in: *European Urban and Regional Studies*, vol. 4, 2002, pp. 331-341.

¹⁴ There are also interdependencies of this nature between the information sciences, information technology and the new media, and between facilities in the humanities, advertising and business organisations in Berlin. Similar links are evident between tourism and culture.

Figure 5
 Berlin's Shares in Employment in Selected Traded Services in Big Cities
 with more than 500 000 Inhabitants, 1998 to 2002



Sources: Statistics on employees paying statutory social insurance contributions; DIW Berlin calculations.

conomic potentials in traded services are to be exploited for Berlin, success in regional competition can only be expected in those branches that are dependent on culture and science. However, every additional euro for these branches makes the necessary consolidation of the

state budget more difficult, or it increases the pressure to economise, which is already great, in other policy areas. Hence it seems that Berlin needs to work out a specific development strategy for culture and science that will achieve the greatest possible synergy effects

Is Berlin undervalued as a business location?

The qualities of the big German cities as business locations are frequently compared in news and business magazines.¹ In these ranking studies Berlin is usually well down the scale for hard location factors, but it is regarded as having considerable advantages in soft factors such as leisure value and cost of living compared with the other big cities.

It is often said now that Berlin offers clear competitive advantages over the expensive south German cities owing to the low prices for property in the capital. However, cost advantages of this nature on investments in Berlin could only be realised if the other production costs and sales expectations operated independently of the location. Individual business constellations of this kind will always be found, but as a whole they are probably less significant. Rather, it is to be expected that the regional differences in property prices reflect the totality of all the external regional effects. This would also be compatible with the longer term empirical findings on the regional differences in property prices in the old federal states. Hence, although the trend in property price differentials between Bremen and Munich is stable, a shift in business activities from the expensive location in south Germany to the less expensive city in the north is not evident.

The external effects contained in land prices are not likely to change very much over time. If the actual price for land is subject to strong fluctuations over time the price relation for the external effect in a region that can be exploited by com-

panies will also change. In Berlin property prices have clearly fluctuated since reunification. It can be shown that the prices for one-family houses were far above the long-term price-earnings ratio for property of this kind between 1990 and 1995. At the end of the 1990s the price level dropped markedly, and it should now be well below the longer term trend in yield for property investment in Berlin.²

It is clear that Berlin was expensive as a location for business investment in the early 1990s, compared with its longer term yield potentials. This was due to the speculation boom after reunification. The counteracting effect on the exaggerated expectations of yield evident since 1995 should now really have caused the location to be undervalued. Accordingly this is a good time for companies to locate in Berlin, as expectations in relation to longer term earnings prospects should be favourable.

However, the stimulus to the Berlin economy from the currently relatively favourable relation between positive external effects and regional property prices should not be put too high, particularly because the relation between the present land price level and the longer term trend in yield potentials fluctuates considerably over time in other big cities as well (figure 6). Cities such as Munich, Stuttgart or Cologne also repeatedly go through phases when the existing location qualities can be exploited relatively favourably.

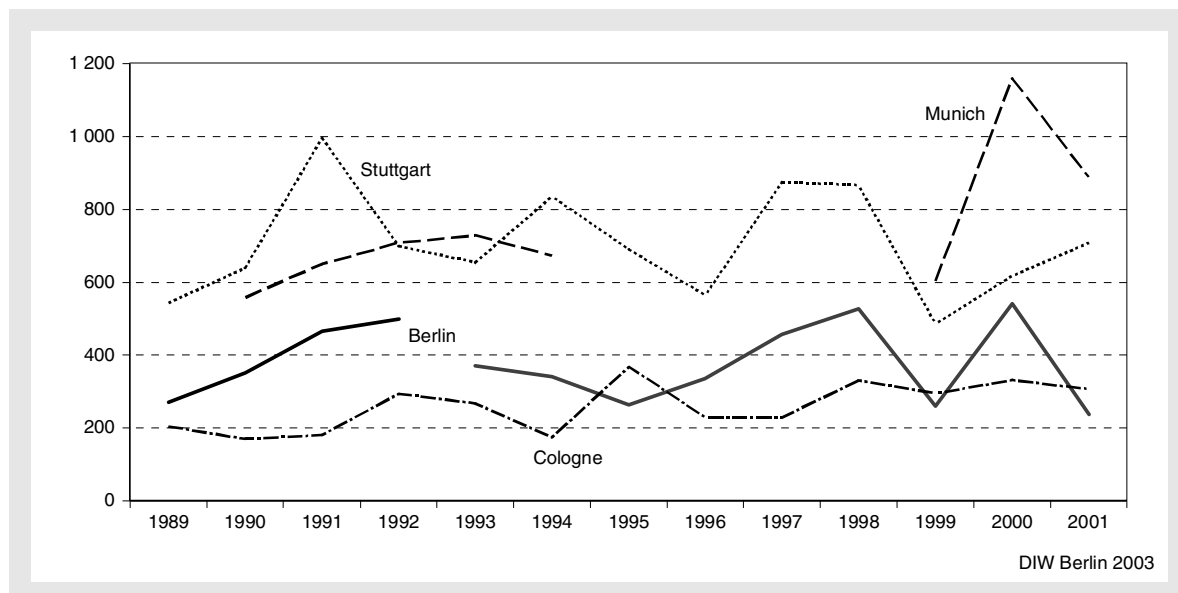
¹ E.g. the survey in M. Schönert: 'Städteranking und Imagebildung', in: *Monatsheft des BAW*, vol. 2, 2003, pp. 1-8.

² R. Schulz and A. Werwatz: 'A State Space Model for Berlin House Prices', Humboldt University, Berlin, Special Research Field 373, Discussion Paper 55, Berlin 2001.

Figure 6

Prices for Building Land in Selected Big Cities,¹ 1989 to 2001

In euros per square metre



¹ Prices for land developed for building. In Berlin from 1989 to 1992 only West Berlin. Sources: Federal Statistical Office; DIW Berlin calculations.

and stimulate growth in private sector services while reducing public spending as a whole. As well as focusing on the culture and science scene the strategy must also open up more sources of non-governmental funding for these activities.

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