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25 years of economic and social union – proving the strength of Germany's social market economy[1]

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Under the terms of a treaty between the Federal Republic of Germany and the GDR, the two countries entered a currency, economic and social union on 1st July 1990. Since then, living conditions in eastern Germany have largely risen to match those of the more economically powerful West. Those central problems that remain – relatively high levels of unemployment, depopulation and lack of innovation – are also evident in other structurally weak regions. The challenge for the future is to use established regional development schemes and federal fiscal redistribution arrangements to balance out the disadvantages even further and to continue to improve eastern Germany's economic attractiveness by promoting investment and innovation.

Incomes broadly equalised

Recently, available annual income per capita in eastern Germany reached a nominal EUR 17,700, equivalent to 84 % of the level in the western part of the country. In some towns and districts just outside Berlin, in Saxony and in south-west Thuringia, available income per inhabitant is now higher than in the structurally weak area of north-west Lower Saxony or parts of the Ruhrgebiet.

In 2014, productivity in eastern Germany (GDP per person in employment) was just under 77 % of the western level. These lower productivity levels are largely due to the East's different industry structure. At 17.5 % of gross value added, the sector with the highest levels of productivity – manufacturing – is much less commonly represented in the East than in the West.

Lower productivity levels are also due to the fact that the East's business and industry structure is less conducive to innovation. New products or new production methods were launched by just 24 % of east German SMEs between 2011 and 2013, meaning that the SME innovator rate in the East was a good five percentage points lower than its western equivalent.

Dynamic investment development

High levels of investment were a key ingredient in eastern Germany's dynamic development after the fall of Communism. Given the extent to which the East needed to catch up and the comprehensive investment assistance available, investment activity flourished in the 1990s. Since 1991, companies, local authorities and private house builders have invested a total of EUR 1.6 trillion in eastern Germany.

Regional disparities at conventional level

A comparison with other major industrialised nations shows that those regional differences that remain can now be regarded as "normal" (Figure). When it comes to productivity, regional inequality in Germany is now no more than half the average for the G7 countries as a whole. Seen from a historical perspective, regional differences in economic performance have returned to levels that were common in the mid-1920s during the Weimar Republic – well before the Second World War and the division of Germany.

Strength and weaknesses

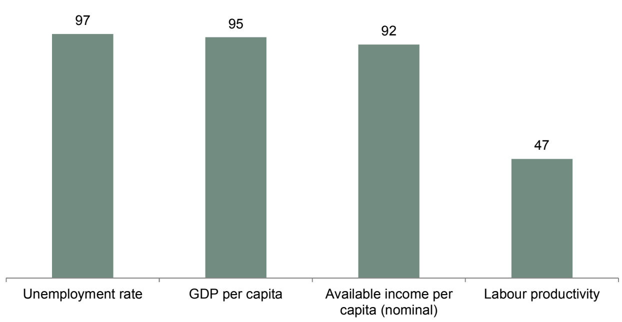
High levels of investment activity after reunification led to a rapid formation of a competitive capital stock. This has proved to be one of eastern Germany's strengths. Major infrastructure deficits have largely been eradicated. Another of the East's strengths is the size of its well-educated labour force potential.

The relatively low number of large corporations is often cited as one of the most serious disadvantages affecting the East. Given that large corporations are more likely to engage in research and development, the amount spent on R&D in the East relative to the region's GDP is barely half that of western Germany.

Demographic change is the greatest potential threat to the economic progress the region has made. All forecasts suggest that population ageing and contraction will hit the East much harder than the West in the decades to come. ■

Figure: German regional differences not out of the ordinary by international standards

German heterogeneity from an international perspective (G7 average inequality measure=100; values below 100 indicate lower inequality)



Source: OECD, own calculations

[1] See Focus on Economics No. 73, September 2014, for a more in-depth analysis. Indicators in this issue have been updated, where available.