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**Article**

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# Transforming Berlin from a startup hub into an economically thriving metropolis

By Marcel Fratzscher, Martin Gornig, Ronny Freier, and Alexander S. Kritikos

After a long period of stagnation, Berlin achieved an economic turnaround—and today, the city is on a stable growth path. Economic performance, employment, and the population are increasing at above-average rates for the first time in years; as well, the city has regained fiscal space and unemployment is on the decline. All the same, Berlin's unemployment rate remains above the national average, and public debt is still extremely high; as well, the city is lagging behind when it comes to productivity, and thus to average wages and income levels. In fact, Berlin is the only European capital whose productivity situated below the respective national average.

To effect any major changes, the city will need to improve especially the growth conditions for young companies, bulk up the stock of potential workers with intermediate-level qualifications, and above all else, carry out the pending infrastructure upgrades. If this all plays out successfully, positive developments can be expected for Berlin in the coming decades.

Berlin's economy experienced uneven development in the years following reunification. When the Wall came down, euphoria swelled among the German people, and the future looked bright: the real estate market was booming. But disillusionment set in when it became clear that Berlin was not actually experiencing an economic recovery: instead, it was losing ground against the rest of the country in terms of economic performance.

After the turn of the millennium, however, many people—particularly young adults—began discovering Berlin, and more and more came to study, live, and work in the capital. In the context of the overall nationwide urban renaissance,

Germany's capital was now also able to attract new impulses for growth.<sup>1</sup> By 2005 the economic turnaround was complete, and from then on the federal capital's economic performance grew at above-average rates.

Increasingly, Berlin was topping the list of German metropolitan regions in terms of growth. Between 2005 and 2013, Berlin's GDP grew by nearly 30 percent—not only faster than the national average, but also stronger than that of virtually any other urban region in Germany (Figure 1). Even prosperous cities like Munich, Stuttgart, and Hamburg were outpaced by Berlin's dynamic, and by 2013 only Leipzig was exhibiting higher rates of growth. In the past two years as well, Berlin has continued to grow at significantly faster rates than have the other city-states, or even Germany as a whole.

The number of employed persons in Berlin increased by 290,000 between 2005 and 2015, which corresponds to a growth rate that exceeded the national average.<sup>2</sup> The past two years alone saw the addition of 70,000 new employees, or roughly 35,000 per year. These increases led to a drop in Berlin's unemployment rate, which fell from 19 percent in 2005 to less than 11 percent by 2015.

But because Berlin's potential labor force has also increased significantly, the unemployment rate has not decreased across the board. One reason is that in 2014—that is, even before the recent massive refugee influx—the

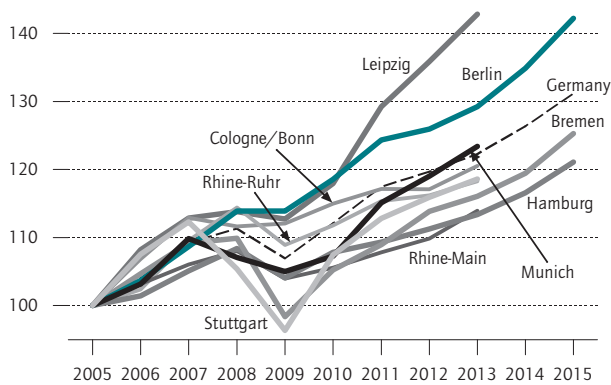
<sup>1</sup> Geppert, K. and M. Gornig (2010): More People, More Jobs: Urban Renaissance in Germany, Weekly Report 22, p. 173–181.

<sup>2</sup> For more on this topic, see the corresponding in this edition of the EB: Brenke, K. (2016): The Berlin labor market since 2005: strong employment growth yet unemployment remains high, incomes low. DIW Economic Bulletin 29+30.

Figure 1

**Gross domestic product in agglomerations**

Index 2005 = 100



Sources: National Accounts of the Länder, calculations of the DIW Berlin.

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From 2005 to 2015, Berlin's economic growth was well above the national average.

net immigration to Berlin from within Germany and beyond amounted to 55,000 people, more than five times as many as one decade earlier. Occupations for which intermediate-level skills are required have become more prevalent, and thus unemployment has dropped among such workers. Berlin's high unemployment rate, which is still higher than that of Germany as a whole, can thus be attributed to the increasing numbers of unemployed low-skilled workers.

Berlin's economic growth has gradually improved the city's budgetary situation; in some years, a share of the surpluses was directed into special assets used for covering investment requirements. There nevertheless remains an urgent need to catch up, since as part of the fiscal consolidation, Berlin was investing far too little over the course of years and instead living off the reserves. Berlin and its public companies are still investing relatively little in infrastructure<sup>3</sup>—just 807 euros per inhabitant—while in Hamburg, this figure stood at 1220 euros in 2014.

<sup>3</sup> For more on this topic, see the article in this issue by Freier, R. et al. (2016): Public investment in the Berlin state budget: education and transport are falling short. DIW Economic Bulletin 29+30.

Apart from tourism, Berlin's primary growth drivers include the cultural industry, the Internet economy, and research-intensive industries.<sup>4</sup> These developments can be traced back to the recent proliferation of new companies in Berlin, which has since become known as a hotbed for startups<sup>5</sup>: many businesses with innovative potential have emerged, transforming the city into an internationally recognized magnet for creatives. Helping these startups transition into fast-growing companies, however, has proven to be a challenge.

But the development process facilitated by startups and basic service providers also highlights a crucial problem in Berlin's growth patterns: its weak productivity. A sustainable increase in the per-capita economic output has not yet materialized. On the contrary, the productivity gap between Berlin and the national average has actually expanded somewhat since 2005, when Berlin's productivity was four percent below average; in 2014, this figure amounted to more than five percent. A convergence of this gap during the global financial crisis in 2009 was short-lived.

These factors all make for an unusual situation—internationally speaking—in which a national capital exhibits a lower economic performance than does the country as a whole. In each of the other EU countries, the capital region's productivity is well above the national average. In London, the difference amounts to 63 percent; in Paris to 35 percent; and in Warsaw, to 33 percent. Madrid and Rome exhibit rates that are at least eleven and six percent higher, respectively, than the national averages (Figure 2).

The main factors used to determine the level of productivity are the value-added shares of research-intensive industries and knowledge-intensive services, respectively, as well as the sizes of the companies themselves.<sup>6</sup> In all three parameters, Berlin continues to exhibit shortcomings, especially when it comes to the size of its local companies,

<sup>4</sup> Gornig, M. et al. (2012): *Datenanalyse zur Berliner Wirtschaft*. DIW Berlin – Politikberatung kompakt 62.

<sup>5</sup> For more on this topic, see the article in this issue by Kritikos, A. (2016): Berlin: a hub for startups but not (yet) for fast-growing companies. DIW Economic Bulletin 29+30.

<sup>6</sup> Gornig, M. et al. (2013): *Wirtschaftsentwicklung in Berlin: Szenario 2030*. DIW Berlin – Politikberatung kompakt 77.

which are significantly smaller than those of comparable regions. The absence of large corporate headquarters and major production sites in Berlin has primarily historical origins—that is, in the division of Germany and its consequences.

Nevertheless, it is entirely possible to establish large firms in Berlin. There is hope that the Brexit will have positive consequences for the German capital, since companies will need to relocate their London headquarters to other major cities in the EU. Experience has shown, however, that most companies—especially larger ones—only rarely relocate their headquarters when similarly important framework conditions change. To improve Berlin's productivity, and thus its income levels, it is therefore critical to facilitate the growth of companies that are already based in the city—and the pervasive startup culture has created ideal conditions for this.

By examining the three topics addressed in this edition of the Economic Bulletin—startups, the job market, and public investment—a number of strategies can be derived for improving the growth conditions for companies in Berlin.

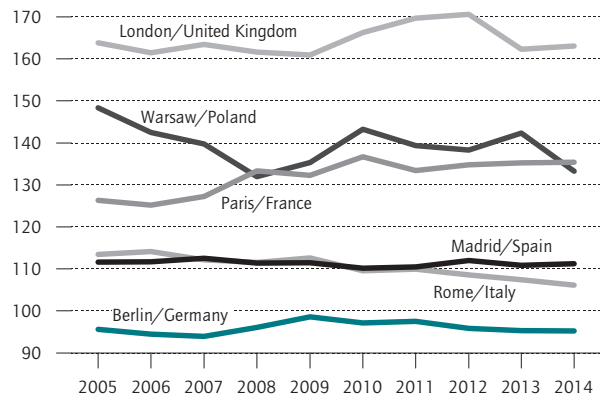
Even if the city is already doing a lot to support and make itself into a more attractive location for innovative startups, complementary measures are needed, especially when companies are transitioning from the startup phase to the growth phase. Such measures include the provision of high-quality commercial and industrial areas and the improvement of business-related administrative procedures in a service-oriented manner. These include the introduction of fast-track procedures and of electronic processes by the public administration.

There is also a need for action when it comes to providing startups and young companies with access to risk capital. Despite the strong increase in volumes granted in the recent past, Berlin companies run into difficulties when securing venture capital for their growth phases. This is especially true for companies specializing in business-to-business (B2B) transactions. In this case, it is about not only persuading the Federal Government and improving the regulatory requirements (such as those

Figure 2

**Gross domestic product per employee**

Relation between the capital and the nation,  
Relevant national average = 100



Sources: EUROSTAT, calculations of the DIW Berlin.

© DIW Berlin 2016

With the exception of Berlin, European capitals' productivities exceed their respective national averages.

related to taxation as well as the protection of “minority investors”), but also improving the supply of venture capital in this segment through targeted collaborations (e.g. with the predominantly state-funded High-Tech Gründerfonds).

A starting point for the support (coaching) of fast-growing companies is an active location marketing, which applies especially to companies that are moving out of technology parks and seeking new locations. Monetary incentives for the district administrations, which coordinate the land use, could be offered to these fast-growing companies.

Apart from changing its administrative and financial factors, Berlin needs to be further developed as a location for research and higher education, particularly with regard to natural sciences and technology as well as IT. Special attention should also be given to facilitating networks with innovation-oriented startups and fast-growing companies. The planned collaboration in the case of *Stiftungsprofessuren* (endowed professorships) as part of the digital agenda can make a major contribution here.

In the medium term, the discrepancy between high public research and development spending and below-average private spending should be reduced.<sup>7</sup> An important step in this direction could be taken by establishing the research departments of large multinationals in Berlin. Although there has already been some success here, policy needs to make the recruitment of such establishments into a higher priority.

As well, Berlin's universities have only been offering dual degree programs to a limited extent. These programs could be increasingly used not only for providing the younger generation with a work-oriented academic education, but also for offering opportunities to employed workers who want to supplement their professional skills with additional academic qualifications—for example, through technical or craftsman training. A correspondingly more accessible and somewhat more practical university education could more effectively keep pace with the rapidly changing qualifications requirements.

From the perspective of fast-growing companies, another starting point lies in attracting professionals from within Germany and abroad. For example, regularly held and internationally oriented job fairs should be established through the recently developed *Talent* portal, because Berlin is one of Europe's largest and most attractive labor markets.

Overall, Berlin possesses a more highly skilled labor force than does any other state, or even other European capitals. But there are also significant weaknesses: these include not only the city's many low-skilled unemployed workers, but also the fact that companies are not offering nearly enough training opportunities. In school performance comparisons among all German states, Berlin regularly winds up at or near the bottom. As well, the proportion of young people who drop out of school is far above the national average.

What's needed is an education alliance for which employers would commit to providing sufficient apprenticeship

opportunities. In return, the Senate has agreed to make general education schools more performance- and career-oriented and resolve the large education investment backlog as quickly as possible. Although the special commission *Ausbildungsplatzsituation und Fachkräftesicherung* ("apprenticeship positions and securing skilled personnel") represents a step in the right direction, their objectives are too narrow to quickly eliminate the existing lack of training, and too vague when it comes to improving the quality of education in the schools.

Berlin's growth—specifically with regard to its economy—requires the modernization and expansion of infrastructure beyond the business world (which includes eliminating the above-mentioned education investment backlog). But residential infrastructure also plays a key role here, not least because cheap real estate is one of Berlin's major advantages as a business location. The increase in central Berlin's real estate costs cannot be effectively counteracted through pricing restrictions; what's needed is an increase in supply, which can be achieved through a greater densification, among other possibilities.<sup>8</sup> An improvement in the transport links between Berlin and Brandenburg could increase the surrounding area's appeal for residential and commercial usage, thus reducing the use conflicts of Berlin's real estate.

Berlin's increasing capital expenditure also needs to be addressed. There needs to be an improvements in management efficiency, which will catalyze the process of making resources available for investment. The recent demographic changes have necessitated a reorganization of Berlin's civil service, which in turn provides opportunities for policy restructuring. These should be taken advantage of.

For mobilizing investment resources for public infrastructure development, the establishment of further special funds is a viable option.<sup>9</sup> To accelerate the implementation of investment projects, however, an outsourced expansion plan—such as the one used by Hamburg for its school system—should be considered. Further efficiency gains in

<sup>7</sup> Geppert, K. and M. Gornig (2012): *Wettbewerb der Regionen – Berlin auf einem guten Weg*. In: *Städte und Regionen im Standortwettbewerb*. Hannover: Akademie für Raumforschung und Landesplanung, p. 142-162.

<sup>8</sup> Kholodilin, K. A. et al. (2016): *Die Mietprelsbremse wirkt bisher nicht*. DIW Wochenbericht 22, p. 491-499.

<sup>9</sup> Fratzscher, M. et al. (2015): *Overcoming weaknesses in municipal investment*. DIW Wochenbericht 43, S. 1019-1021.

infrastructure development can be made by improving the control capabilities and evaluation options, which in turn can be achieved through the abolition of cameralistics and the implementation of double-entry bookkeeping. As well, Berlin should exploit all funding opportunities to facilitate a rapid and extensive expansion of high-speed digital networks.

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If Berlin succeeds in carrying out the planned infrastructure upgrades, in improving the institutional framework conditions for fast-growing firms and in strengthening the labor supply United Kingdom apprenticeship training it will have many auspicious decades up ahead—even if it will likely be several years before the productivity and income levels can be raised sustainably.

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