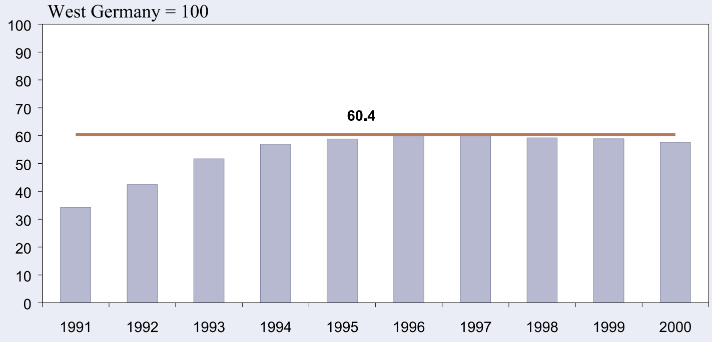
The East German Economy Stopped Catching Up

Relationship of East and West German Productivity

GDP per employable person



GDP in current prices, west Germany including west Berlin, east Germany including east Berlin.

Source: Databank of the Working Group "Income Accounts of the German States", data converted to the former GDR and FRG by the Ifo Institute.

The standard of living of east Germany is approaching that of the west. The average net income of an east German household already equals 80% of the west German level in nominal terms. This net income includes welfare payments, transfers to the unemployed and old age pensions. Because of lower goods prices and rents, in real terms this household has at least 90% of the west German net income at its disposal. The east German economy was modernised at a rapid pace; investment boomed during the 1990s. Whereas the share of investment in GDP amounted to 20% in west Germany, it was at least 40% in the east, peaking at 50% in 1994. This hides the fact, however, that the financial means available in east Germany by far exceed the output produced. Every third deutschmark which is spent in the east comes from the west. Public transfers amount to about 4.5% of west German GDP. And there is no end in sight.

Since 1997 the economies of eastern and western Germany have drifted apart as east German growth has fallen below that of the west. A comparison of east and west German states (excluding city states) shows that even in the boom year 2000 the eastern states grew by a meagre 1.1% whereas the western states achieved growth of 3.2%. As a result, relative output per employable person in the former GDR which in 1996 – according to a recent revision of the national accounts data of the federal states – had amounted to 60.4% of the west German level, declined further, to 57.6% in 2000 (see Figure). The latest unemployment figures also confirm that east German states do much worse than those in the west. Whereas unemployment in west Germany declined to 7.7%, it remained at 18.6% in the east.

It is the output side of the east German economy with its poor supply conditions which remains the main problem. The level of investment spending points to a major reason for lower productivity growth and the stoppage of the convergence process. Economic growth depends on capital accumulation. Capital is not only a factor of production as such, it also embodies technical knowledge. That is why in east Germany investment per capita should be higher than in the west over a considerable period of time. Although this has been the case during most of the 1990s – albeit with a declining trend in recent years – net investment has primarily gone into construction and not into machinery and equipment. Thus building investment per employable person at times exceeded the west German level by up to 80%, while equipment investment (per employable person) was higher than in west Germany only in 1995 and 1996 and has declined since to 88% in 1999. No wonder then that convergence is not proceeding at the aggregate level.

To be sure, economic catching-up is occurring in individual sectors. Thus, real gross value added in the manufacturing industry has increased by an average 6.6% p.a. since 1996 – and thus faster than in western Germany (including Berlin; 2.4% p.a.). The construction industry, however, is mired in deep crisis; its output shrank by an average 7.1% p.a. during the past four years (west Germany: – 0.7% p.a.). Even the tertiary sector grew more slowly in east Germany: an average increase of 2.6% p.a. since 1996 compares to growth of 3% in the west.

H.W.S.