

Long-Term Effects of Socialism and Transformation on Self-Employment in East Germany

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Summary

The rigorous anti-entrepreneurial policies that prevailed during the communist regime did not leave any long-term negative effects on the level of self-employment in East Germany. On the contrary, self-employment in East Germany is higher today than in the West. Our analysis suggests that the current differences in self-employment between East and West Germany are primarily the result of the shock transformation that significantly overcompensated the negative effect of four decades of anti-entrepreneurial ideology and policies. It is noteworthy that the higher East German self-employment rates cannot be explained by the undoubtedly high level of start-ups out of necessity.

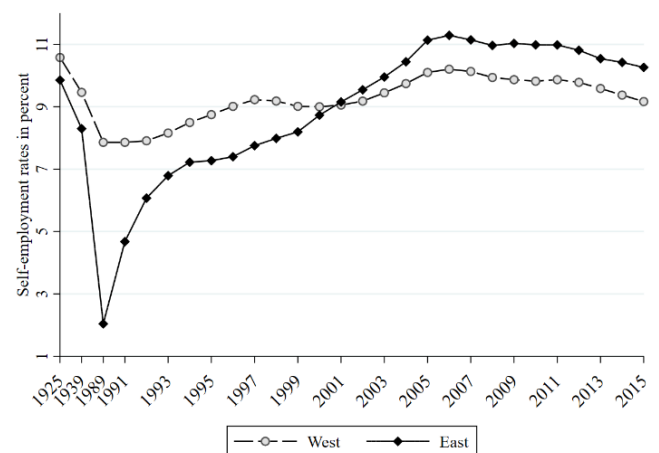
The negative effects of socialism on entrepreneurship have been sufficiently discussed in the literature (Fritsch et al. 2022). In addition to rigorous expropriations and collectivisation campaigns, widespread communist indoctrination aimed at suppressing value priorities such as individualism and striving for autonomy that are fundamental to the emergence of entrepreneurial thinking. How has self-employment developed in East Germany since the collapse of the communist state, the GDR ('German Democratic Republic')? Can a long-term negative GDR effect be identified? Answers to these questions can help to develop tailor-made recommendations for policies to promote entrepreneurship in East Germany.

The Long-Term Development of Self-Employment in East and West Germany

In order to determine the effect of 40 years of communism on self-employment in the territory of the former GDR, it is useful to compare it with West Germany. Figure 1 shows the shares of self-employed persons in the respective labour force (self-employment rate) in East and West Germany between 1925 and 1939 (before World War II), at the end of the GDR period in 1989, and after German reunification between 1991 and 2014.

Before German division, the level of self-employment in East Germany was somewhat lower than in West Germany. A comparison of self-employment rates at the end of the GDR period in 1989 clearly shows the effects of the anti-entrepreneurial policies. While the self-employment rate in West Germany was 8.9 %, it was only 1.8 % in East Germany.

Figure 1: Self-employment rates in East- and West Germany 1925-2015 (in percent)



Own presentation. For data sources see Fritsch, Greve and Wyrwich (2022). Berlin is not included because after 1990, data for this region cannot be clearly assigned to either East or West.

After German unification in 1990, there was a rapid increase in self-employment in East Germany. It is worth noting that the self-employment rate in East Germany already reached the West German level in the year 2002 and has been significantly higher in the East since then. The rapid East-West convergence and the subsequent higher shares of self-employed persons in East Germany can hardly be explained by socialist legacies, lower availability of capital, or the differences in mentality that are often rumoured.

It is much more likely that the development of self-employment in East Germany since reunification has been shaped by the transformation process. There are two main reasons for this. First, in the early 1990s, a relatively large number of companies were founded because of necessity (necessity entrepreneurship),

for example, due to actual or anticipated unemployment. Most of these start-ups took place in the service sector, because the capital required here is generally much lower than for a start-up in manufacturing. Second, the privatisation of the GDR economy in the manufacturing sector led to the emergence of comparatively small-scale structures that persisted over time due to low competitiveness and consequently low growth. Against this background, one may expect that the share of self-employed persons in the East German manufacturing sector is higher than in West Germany. The low capital endowments of East German founders may, however, suggest a comparatively lower level of self-employment in the manufacturing sector.

In order to show the role of these two factors, we distinguish in a further step of analysis between self-employed persons in the services sector and in manufacturing (including construction). Figure 2 shows the development of self-employment rates in these two sectors in Eastern Germany compared with the level in West Germany. Here, the corresponding values for West Germany are indicated by the zero line.

Figure 2: Self-employment rates in manufacturing and services in East Germany compared to West Germany



Own presentation. For data sources see Fritsch, Greve and Wyrwich (2022).

The figure makes it clear that the higher self-employment rate in East Germany since the early 2000s is largely due to developments in manufacturing. In contrast, the level of self-employment in the East German service sector is roughly the same as in West Germany. This shows that the higher level of self-employment in East Germany can hardly be attributed to widespread necessity start-ups in services.

Furthermore, it follows from the sector-specific analysis that the higher level of self-employment in East German manufacturing is not solely due to a short-term start-up boom in the construction sector at the beginning of the 1990s. Rather, the development primarily reflects the dominance of small and medium-sized businesses in the East German manufacturing sector. The findings are stable when regional differences such as outward migration and population density are accounted for in the analysis.

What support is actually needed

Since the beginning of the 2000s, the level of self-employment in East Germany has exceeded that in West Germany. This suggests that the negative GDR effect on entrepreneurship, which has been documented in various studies, has been significantly overcompensated by other factors. Policymakers should, therefore, not focus primarily on activating the East German population to think and act entrepreneurially. There is hardly any need for action here that can be justified by the negative long-term consequences of socialism. The low economic success of East German companies, which is reflected in weak growth and often lower survival rates, points primarily to qualitative deficiencies in managerial skills, which may be seen as a late consequence of socialism. This raises the question of how policy could effectively counteract such deficits.

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