

Germany: Fostering regional development in times of structural change

Category: Germany

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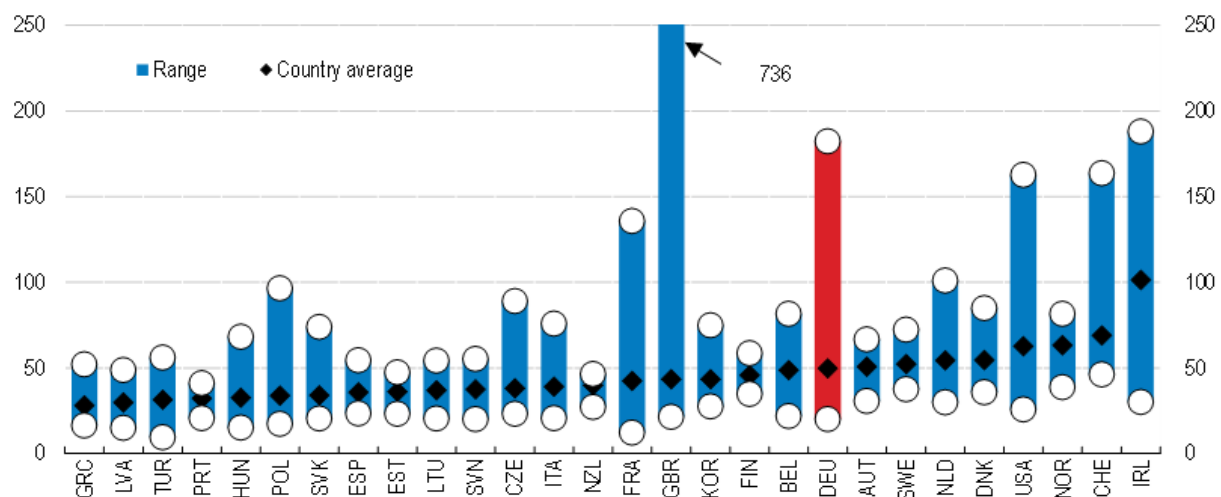
By Robert Grundke, Enes Sunel

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Germany is a highly decentralised federal country with significant regional disparities (Figure 1). This is partly related to the German reunification, as the transition from central planning to a market economy implied major structural changes with high economic and social adjustment costs in the East. Moreover, structural change related to globalisation and technological change have also strongly affected some Western regions. Although economic disparities, especially between the eastern and western Länder, have narrowed substantially since the 2000s (BMWK, 2024), the green, digital and demographic transitions risk widening existing gaps.

Figure 1. Regional disparities remain large

GDP per capita in districts, thousand USD 2015 constant prices PPPs, 2021



Note: "Districts" refer to TL3 regions (Kreise for Germany). Country coverage is limited by the availability of regional data at TL3 level. Country averages are weighted by population across districts.
Source: OECD Regional Statistics database.

How can Germany foster regional development in times of structural change? The **2025 Economic Survey of Germany** identifies five priorities:

1. Better coordinate conditional federal grants and industrial policies with place-based policies

Large inter-governmental transfers, including conditional grants to support urban development, transport, digital or research infrastructure, are used to balance living standards across the regions, but most of these funds are not well coordinated and not allocated to the regions with the greatest needs. In contrast, place-based policies have a much smaller funding size, but use a regional development index for allocating funds. Better coordination of these conditional grants with place-based programmes and EU cohesion funds and the wider use of the regional development index for allocating funding could improve targeting and raise spending efficiency. This is particularly important as a recently created infrastructure fund will allocate EUR 100 billion over the next 12 years to support public investment in the Laender and municipalities. Moreover, simplifying and harmonising funding applications by expanding the one-stop shop, *Foerderzentrale Deutschland*, to cover more federal, EU, and Laender programmes

would reduce administrative burdens and help municipalities with limited administrative capacities to access funding more easily.

2. Compensate municipalities for future federal legislative changes affecting municipal budgets

A municipal infrastructure backlog has hindered public investments in education, transport and utilities, and reduced public service quality, challenging the ability of regions to address structural change (Figure 2). Rigid expenditures set by other government levels, such as federally legislated social benefits, limit funds for municipal long-term infrastructure investments. While federal transfers and increased VAT shares provide some relief, these do not fully cover municipal social spending. If federal legislative changes increase municipal costs, municipalities should receive a higher share of VAT or joint tax revenues such as personal income tax while ensuring that grants from Laender through municipal equalisation systems are not reduced in exchange. Evaluating the impact of federal tax reforms on municipalities is key to maintain local public service provision and ensure stable and sufficient funding for municipalities.

3. Use the recent update of property values to better link property taxation to market values and raise municipal revenue

As local business taxes, which strongly fluctuate with the business cycle, are the major revenue source for municipalities, financial planning is complicated, particularly for bigger infrastructure projects. Revenue from taxes on immovable property could provide more stable revenue streams but they are low compared to other OECD countries. Such revenues have stagnated as a share of GDP since the 1990s, although land prices have more than doubled and real

estate prices have increased by about 80% during the last 10 years. The recent update of property values should be used to raise revenue from property taxes, while introducing a national minimum tax rate to help avoid detrimental tax competition. To support cash-poor but asset-rich households, tax deferrals could be introduced provided that the unpaid tax is settled when the property is sold or inherited.

4. Raise local administrative capacities by improving cooperation and bundling tasks across municipalities

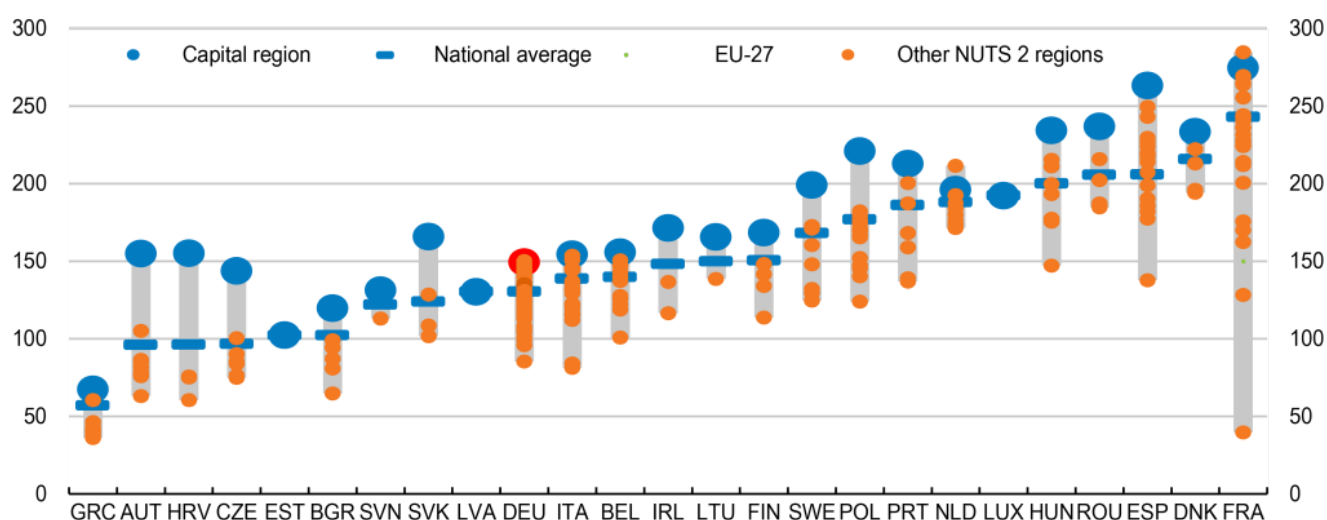
The large number of small municipalities implies high unit costs of public service delivery, while labour shortages are high. Limited administrative capacities have contributed to the large investment backlog and complicate the application for and management of conditional grants from other levels of government or the EU. If territorial reforms or mandatory cooperation are not feasible, inter-municipal associations could facilitate cooperation between smaller municipalities, as already applied in areas such as waste management, public transport or tourism. Capacity-building initiatives and financial incentives could support the take up of such initiatives. In addition, bundling tasks or transferring some tasks, which can be fully digitalised and do not require close local counselling, to other levels of government can help reduce pressure on administrative capacities at the local level.

5. Expand access to high-performance network connectivity to all regions

Germany's business R&D spending is above the OECD average, but investment in knowledge-based capital is low, hindering the adoption of digital technologies. Slow average download speeds are a key reason (Figure 3). According to the OECD Broadband Statistics, only around 11% of all fixed broadband subscriptions were fibre-based compared to around 42% in the

average OECD country at the end of 2023. To remove connectivity bottlenecks for fibre access it is key to foster competition by facilitating infrastructure sharing. This should be accompanied by further simplifying and accelerating planning and approval procedures and establishing national standards for low-cost roll out technologies.

Figure 3. Internet download speeds are slow in many German regions



Note: The range indicates regional variation at the NUTS2 level (Regierungsbezirk for Germany).

Source: European Commission (2024)

For more information, please refer to the **Economic Snapshot of Germany**.

References

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The United Kingdom: Stronger growth needs significant productivity improvements across regions

Category: United Kingdom

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Raising productivity requires more investment, re-and up-skilling to facilitate worker's relocation and better use of existing skills to address shortages.