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## Explaining the low labor productivity in East Germany – A spatial analysis

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## ABSTRACT

**Fuchs-Schündeln, Nicola, and Izem, Rima**—Explaining the low labor productivity in East Germany – A spatial analysis

This paper sheds light on the transferability of human capital in periods of dramatic structural change by analyzing the unique event of German reunification. We explore whether the comparatively low labor productivity in East Germany after reunification is caused by the depreciation of human capital at reunification, or by unfavorable job characteristics. East German workers should have been hit harder by reunification the more specific human capital was. Treating both human capital and job characteristics as unobservables, we derive their relative importance in explaining the low labor productivity by estimating a spatial structural model that predicts commuting behavior across the former East–West border and the resulting regional unemployment rates. The identification of the model is based on the slope of the unemployment rate across the former border. The results indicate that East and West German skills are very similar, while job characteristics differ significantly between East and West in the sample period 1998–2004. Hence, they suggest that a significant part of the human capital accumulated in the East before 1990 was transferable. *Journal of Comparative Economics* 40 (1) (2012) 1–21. Goethe University Frankfurt, Germany; Food and Drug Administration, United States.

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## 1. Introduction

German reunification provides a unique opportunity to study the transferability of human capital in a period of severe structural changes. According to traditional measures of human capital, like years of schooling or further education, the East German population was better educated at reunification than was the West German population. If human capital is very general and transferable, e.g. mostly consisting of general problem-solving, language or mathematical skills, the East German population should have fared very well in the new West German labor market. However, the content of education and on the job training might have differed substantially between both countries, and a lot of either job-, industry-, occupation-, or technology-specific human capital should thus have depreciated at reunification.<sup>1</sup>

The analysis of this paper answers questions of broad policy importance. How easily is human capital transferred from an obsolete industry to the next? What is the relationship between depressed and booming regions? German reunification provides a unique opportunity to study these questions. In contrast to other possible case studies, e.g. the car industry in Michigan, or a comparison of Northern and Southern Italy, the German case offers three unique advantages: first and

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E-mail addresses: [fuchs@wiwi.uni-frankfurt.de](mailto:fuchs@wiwi.uni-frankfurt.de) (N. Fuchs-Schündeln), [rima\\_izem@yahoo.fr](mailto:rima_izem@yahoo.fr) (R. Izem).<sup>1</sup> The distinction between general skills and skills specific to a firm or occupation dates back at least to Becker (1964) and Mincer (1974). Chari and Hopenhayn (1991) and Violante (2002), analyze the effect of vintage specific human capital on the diffusion of new technologies and wage inequality, respectively.

## Mean Unemployment Rate

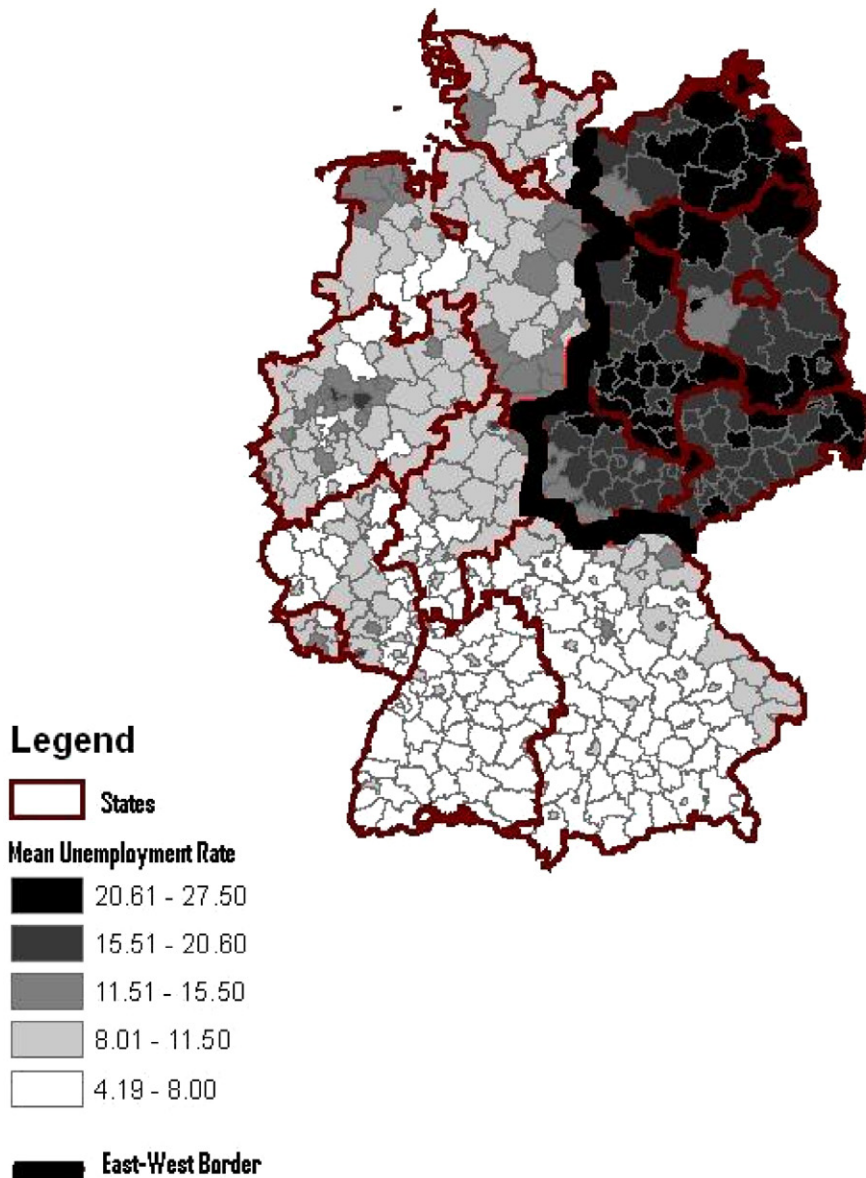


Fig. 1. Mean unemployment rates in German counties, 1998–2004. Data source: Institute for Employment Research.

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