

Are Older Cohorts the Winners of East Germany's Transition? Skill Investment, Selection Bias and Changes in Relative Wages and Welfare

Christina Gathmann*
University of Chicago

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Abstract

The distributional effects of economic transition have been of central concern to policymakers and researchers of the reform process. This paper analyzes a dimension that has received very little attention in the transition literature: the changes in relative wages and welfare across cohorts. For East Germany, we find that wage growth is actually highest for older cohorts and decline monotonically toward the young. We analyze two mechanisms to explain this puzzle: investments in on-the-job training by the young and selective withdrawal from the labor market by older cohorts. We outline a simple overlapping generations model and derive its implications for relative wages and regional wage convergence after unification. Preliminary findings show that older East Germans have gained substantially from the transition in terms of welfare despite modest wage losses in the labor market. Results from voting behavior support these conclusions. In sharp contrast to Russia, Poland or the Czech Republic, we find that young people in East Germany are more likely than older cohorts to vote for the former socialist party.

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