The Impact of Public Employment: Evidence from Bonn

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Abstract
This paper evaluates the impact of public employment on private sector activity using the relocation of the German federal government from Berlin to Bonn in the wake of the Second World War as a source of exogenous variation. To guide our empirical analysis, we develop a simple economic geography model in which public sector employment in a city can crowd out private employment through higher wages and house prices, but also generates potential productivity and amenity spillovers. We show that after the relocation of the government, Bonn experienced a substantial increase in total employment and population relative to a control group of cities. However, this increase was almost exclusively driven by an increase in public employment, while private employment remained largely unchanged. We show how this finding can be explained by our model and provide several pieces of evidence for the mechanisms emphasised by the model.

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