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## A different look at Lenin's legacy: Social capital and risk taking in the Two Germanies

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### ABSTRACT

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What are the long-term effects of Communism on economically relevant notions such as social trust, fairness, and scope of cooperation? To answer this question, we study the post-unification trajectory of convergence between East and West German individuals with regard to trust, cooperation, and risk. Our hypotheses are derived from a model of German unification that incorporates individual responses both to incentives and to values inherited from earlier generations as recently suggested in the literature. Using two waves of balanced panel data, we find that despite twenty years of unification East Germans are still characterized by a persistent level of social distrust. In comparison to West Germans, they are less inclined to see others as cooperative. East Germans are also found to have been more risk loving than West Germans. However, risk attitudes fully converged recently. *Journal of Comparative Economics* xxx (xx) (2013) xxx–xxx. University of Bamberg, Feldkirchenstr. 21, D-96052 Bamberg, Germany; Institute for Empirical Research in Economics, University of Leipzig, Grimmaische Str. 12, D-04109 Leipzig, Germany.

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### 1. Introduction

On August 13th 1961, more or less random historical circumstances led to the building of the Berlin Wall, dividing Germany for four decades into two separate countries. Five decades after this historic event and two decades after the other even more unexpected historic break, German unification, the question is not only whether the period of division (1961–1990) has effects lasting to the present but also whether it is possible to identify *why* it has long-term effects. Today, the first part of this question is a stylized fact: According to Boltho et al. (1997), East German GDP per capita amounted to 120% of West German GDP per capita before 1936. It fell back to 60% between 1948 and the peaceful revolution of 1989. The share dropped to its post-war all-time low of 31% in 1991. After a steady rise following unification, it stagnates at a level of roughly 65% since the second half of the 1990s. Less “hard data” based series on happiness or life satisfaction show very similar patterns (Frijters et al., 2004a; Frijters et al., 2004b). A seminal study combining life satisfaction and economic conditions in the context of German unification is Easterlin and Plagnol (2008).

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Yet, to explain the hitherto realized result of limited convergence is an open issue. Potential channels include institutions, culture, knowledge and technology, and movements between multiple equilibria. For a general overview of channels of path dependency see Putnam (1993) and Nunn (2009).<sup>1</sup> In this study, we make an attempt to empirically identify long-term cultural discrepancies in economically relevant notions resulting from the division of Germany and to assess their explanatory potential for limited social convergence. The latter is done by giving the generational passing of cultural traits model by Tabellini (2008a) a new dimension by extending it to a two societies convergence scenario.

Our study contributes to a recently established strand of mostly empirical literature (Alesina and Fuchs-Schündeln, 2007; Brosig-Koch et al., 2011; Buch and Toubal, 2009; Burchardi and Hassan, 2011; Burda, 2006; Fuchs-Schündeln and Izem, 2012; Redding and Sturm, 2008; Süßmuth et al., 2010; Uhlig, 2006)<sup>2</sup> that addresses the long-lasting effects of Communism on economically relevant notions twenty years after the collapse of the Soviet system. More than two decades after the fall of the wall it is now possible to study economic behavior of individuals who spent most of their childhood in unified Germany. We focus on the persistence of gaps in “deep parameters” (i.e. factors relevant for social capital formation) that has recently gained increasing attention in the literature (Brosig-Koch et al., 2011; Burchardi and Hassan, 2011). Our empirical strategy widely follows Alesina and Fuchs-Schündeln (2007) who analyze individuals’ policy preferences such as attitudes towards income redistribution or pro-state provision of services that could as well be provided by private forces. In the context of German unification, Rainer and Siedler (2009) is the first study to investigate trust which has been shown to impact on a variety of economic outcomes (Knack and Keefer, 1997; Alesina and La Ferrara, 2002; Slemrod and Katuscak, 2005). Their findings suggest that some ten years after unification, East Germans still have the same levels of social distrust as shortly after the fall of the wall. However, Rainer and Siedler (2009) is a cross-sectional study, implying that all information about dynamic dependence in behavior, which is particularly important in the political transition context stressing inertia and persistence, is lost. Balanced panel data like the ones that we are mainly relying on here are required to identify the dependence between past and current behavior by tracking subjects (Cameron and Trivedi, 2005). Our contribution in this regard, that is, to the “persistent gap” hypothesis, lies in combining the approved empirical strategy by Alesina and Fuchs-Schündeln (2007) with the idea of Rainer and Siedler (2009) to examine whether the democratic experience of East Germans leads to an erosion of distrust. Beyond that, we analyze how inert this process actually is in translating into enhanced cooperativeness. Another fundamental notion that is sometimes seen as prerequisite for trust and altruistic cooperation, is fairness. At the individual level, it has for example been shown that selfish or greedy intentions destroy altruistic cooperation almost completely, whereas sanctions perceived as fair leave altruism intact (Fehr and Rockenbach, 2003). By now, there are only very few studies that empirically study fairness at the societal level (see, e.g., Zak and Fakhra, 2005). To our knowledge, none of them analyzes the notion of fairness in the context of the German unification process.

We add to this literature (i) by examining the East–West trust gradient for the first time using panel data from the German Socio-Economic Panel, which allows accounting for intra-personal correlation over time, (ii) by analyzing the effects on individuals’ risk attitudes and their persistence as well as (iii) by studying the differences in the perception of others being fair and helpful and their persistence over time. Some basic hypotheses are derived from a model of German unification that incorporates individual responses both to incentives and to values inherited from earlier generations as recently suggested by Tabellini (2008a).

Our results indicate that despite almost twenty years of unification, East Germans show a lower level of social trust, which is only slowly converging to the West German level in the second decade of the unification process. This finding is in line with predictions from our unification extension of Tabellini (2008a), and it holds controlling for a wide range of socio-demographic and contextual characteristics as well as across various estimation approaches. In contrast, West Germans show a quantitatively small downward tendency in terms of broadly measured social trust amounting to about one fifth of the significant East–West gap in the second decade of the unification process. With regard to testing the model synthesizing incentives and inherited value systems, these results lend support to the passing of cultural traits across generations and for cooperation being sustained by values and reputation. Extrapolating our results, full convergence in social trust will take approximately one more decade. For fairness and cooperativeness, we find (yet) no statistically significant trajectory of convergence to extrapolate.

Contrary to common belief, we also find East Germans to have been more risk loving than their West German counterparts at the beginning of the last decade which again holds for an ample range of robustness checks. In contrast to trust, fairness, and cooperativeness, however, risk attitudes clearly fully converged in the “Two Germanies” to the more risk averse attitude prevalent among West German individuals.

Finally, we use a counterfactual placebo effects strategy to show that our findings are not resulting from differences in mentality or local environments but are a product from socialization due to the Communist system.

<sup>1</sup> Putnam (1993) sees three main routes of explanation for the prevailing North–South dichotomy in modern Italy: institutional design, socioeconomic determinants, and sociocultural factors. Empirically, he rules out the first two channels and finds differences in “social capital” at the heart of the economic and political gap: The northern way of life installed since about 1000 AD nurtured a system of cooperation and trust that grew into strong civic-mindedness. In contrast, the oppressive nature of Norman rule and the catholic church kept citizens of the South in a state of dependence which led to a widespread social feeling of distrust.

<sup>2</sup> While Redding and Sturm (2008) rely on the division of Germany as central source of exogenous variation, our focus is on German unification and re-integration.

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