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1 Introduction

Communist rule lasted almost forty years in East Germany. It is therefore not surprising that those who did not experience it themselves, wonder what effect it had and still has on people's minds and deeds.

Alesina and Fuchs-Schündeln (2007) (henceforth AF) have recently made an honourable attempt to uncover the possible reasons underlying differences in West and East German preferences towards state social policies. In their extensive empirical work they claim to have shown that communist governments planted the seeds of love for government redistribution deep into the minds and hearts of East Germans. Moreover, the data seem to indicate that it will need 20 or so more years before any visible adjustment towards West German preferences will take place.

In this comment, I will argue that AF's measure of communist influence is misleading, due to the lack of identification. The remainder of the note is organized as follows: I next recall the basic arguments of AF and then highlight its fundamental problem. In the second part I provide an alternative explanation and introduce some more data for supporting my arguments.

2 The identification problem

2.1 The underlying question of economic policy

Economics usually deals with optimal choice under given preferences and certain other state variables. At the same time, economists are well aware of the fact that preferences are also subject to change. In that sense, there can be good and bad preferences even

though economists commonly abstain from moral judgements. In the current context bad preferences are those implanted by many years of communist rule, especially since they allegedly entail the individuals' desire for an interventionist state. Market-oriented economist would argue that this might be a dangerous love affair which might further cloud the prospects of transformation economies like East Germany. In addition, since communism has vanished it would only be a matter of time before the preferences would switch back to "normal". In such a situation, the denial and neglect of the the wishes for a interventionist state appear acceptable.

On the other hand, if the preferences were genuine such as for example the Scandinavian citizens' support for a large social welfare system, similar denial could hardly be justified and a negative long-run impact on East German utility and hence welfare would result. Taken together, AF's intention to single out communist influence is fully justified.

2.2 A control group

According to AF, a historic experiment holds the key to answer the research question. This experiment is the introduction of a market-oriented government in the West of Germany as compared to a communist regime in the East. They regard these events an "exogenous shock" (p. 1507) to the process generating Germans' preferences. And indeed, exogenous it was. Having been defeated by the Allies and being morally bancrupt, it was not for the Germans to decide their fate after WWII. AF note that up until 1945 the political and economic system in East and West Germany had been the same for more than seventy years. Therefore, this experiment appears to be the perfect tool for analyzing the effect of a regime change on the preferences of people involuntarily being subjected to the change.

The basic idea is simple and can conviently be sketched as a preference generating func-

tion. Let us call $P_t^{()}$ the preferences of West (P_t^W) and East (P_t^E) Germans respectively. Then, according to AF (p. 1508, 1509) $P_t^{()}$ can be understood as a function of individual economic situation, transfer payments received (individually and collectively), degree of altruism, and "living under a specific system [that leads] to adaptation of preferences"[1]:

$$(1) \quad P_{i,t}^{()} = aX_{i,t}^{()} + b\Xi_t^{()}$$

where $X_{i,t}$ is a vector which collects the first three factors and Ξ_t is the process of interest. The coefficient vectors a and b measure the impact on the preferences. The value of $\Xi_t^{()}$ represents the accumulated effects of living under communist rule, or more generally, the cultural experiences made in the past up until today. AF can control for X in their estimations by a long list of socio-economic measures. Hence, any effect unaccounted for is attributable to the cultural heritage. Let us therefore have a second look at Ξ_t.

$$(2) \quad \Xi_t^{()} = \sum_{i=-\infty}^{t} \beta^i \xi_{t-i}^{()}$$

It consists of the sum of all (discounted) past cultural "shocks" $\xi_t^{()}$ to the nation and hence, the current value of $\Xi_t^{()}$ thus represents the whole cultural heritage of a nation. Now, the difference of preferences between East and West Germans can be calculated as

$$(3) \quad P_{i,t}^W - P_{i,t}^E = a(X_{i,t}^W - X_{i,t}^E) + b(\Xi_t^W - \Xi_t^E)$$

Since AF can control for X the key for isolating the communist effect is the difference $(\Xi_t^W - \Xi_t^E)$. In contrast to other cross-country comparison East and West Germans share a common history and, therefore, AF claim differences in individual preferences cannot be attributed to differences in cultural heritage. However, zooming in on Ξ_t tells us another

[1] For simplicity, I do not assume that shocks have a different effect, depending on being West or East German, hence there are no superscripts on the coefficients.

story: East and West Germans only share a common history up unitl 1949 (or 1945).[2] Since then, Ξ^W and Ξ^E differ from one another:

$$(4) \quad (\Xi_t^W - \Xi_t^E) = \begin{cases} 0, & t < 1949, \text{ and } t > 1990 \\ \beta^i \sum_{i=1949}^{t} (\xi_{t-i}^{(W)} - \xi_{t-i}^{(E)}), & \text{else} \end{cases}$$

The preference generating model used for estimating a and b thus reads

$$(5) \quad P_{i,t}^W - P_{i,t}^E = a(X_{i,t}^W - X_{i,t}^E) + b \sum_{i=1949}^{t} \beta^i (\xi_{t-i}^{(W)} - \xi_{t-i}^{(E)})$$

The specific East German heritage and thus communism's trace in individuals is represented by $\sum_{i=1949}^{t} \beta^i \xi_{t-i}^{(E)}$. Obviously, b *does not* identify the impact of communism, even if we assume that from 1991 onwards both parts of the country started to become culturally indistinguishable from one another again (see section 3 for a discussion).

In the words of AF, however, identification is achieved since West Germans "constitute a meaningful control group" (p. 1507). One may therefore ask, what the special features of a control group are.

The term control group is best understood by referring to medicine where new drug therapies are tested (phase III) by providing equally ill patients with either the new drug, or a placebo (with neither the doctor nor the patient knowing who gets what). The group of people who obtains the placebo is called control group, since their reaction allows to control the unique effect of the drug. In our context this raises the question: Where is the placebo?

2.2.1 Where is the placebo?

For the West Germans to be regarded a control group, we need to establish that they did not receive any treatment. No treatment in (5) is obtained for $\xi_t^{(W)} = 0, t > 1948$.

[2] AF count 45 years. I would count 40 years, since communist power properly consolidatet after the foundation of the East German state in 1949.

In economic (and political) terms, this would imply that West Germany developed as if WWII marked the end of West Germany's cultural history. Only in this case would the shock AF refer to really have been a one way issue. Otherwise, two shocks would have occured and identification would get a lot more complicated.

In short, identification would be achieved if nothing had happened in West Germany. However, to think that "no treatment" is a fair reflection of West Germany's economic and political development after 1948 is to ignore actual events. The East German government tended to do so, but what about the three million people who migrated from East to West between 1945 and 1961?

As far as I can see most economic historians would think otherwise. Especially the reforms introduced by Ludwig Erhard and approved by the Western Allies are widely considered as a key to understanding the long lasting economic boom and fast recovery of the West German economy (see table 1 below). Liberalization was one of the cornerstones of these reforms. After the war, membership in trade unions and in trade associations became a matter of individual decision. Cartels were declared illegal whereas they used to enjoy legal protection. The West German government no longer engaged in endeavours such as running holiday services ("Kraft durch Freude"), forced labour, and so on and so forth. Even though the retreat from the Third Reich's state interventionism may not have been perfect (see e.g. Ritschl, 2005) it is hard to accept that it would not have been significant.

Taken together, there are enough arguments in favor of regarding the West Germans after WWII as a treatment group, but not as a control group. The effects of these treatments on, for example, preferences, are yet to be quantified which puts the identification problem back on the agenda.

3 Identification reloaded

In this section I introduce some more data and tell yet another plausible story of the sluggish preference adaptation process. I argue that the estimates of AF are well suited to measure the role macroeconomic and political settings play for the formation of preferences.

3.1 History repeating itself

According to AF, in October 1990

> the economic and political system of the West was transferred to the East.
>
> (p. 1510)

If this statement is true, it implies that the West German institutional framework has been introduced twice in German history. The first time after the war in West Germany and the second time in the years following 1990 in East Germany.[3]

Using equation (5) we may state this assumption as:

$$\begin{aligned} \sum_{i=1949}^{t} \beta^i \xi_{t-i}^{(W)} &= \sum_{i=1990}^{t} \beta^i \xi_{t-i}^{(E)} \\ \xi_{t|t>1990}^{(E)} &= \xi_{t|t>1948}^{(W)} = \xi \end{aligned} \tag{6}$$

If assumption (6) holds, we should expect that over time (after 45 years at latest) the difference between East and West is only due to cummunist rule in the past and vanishes for $\beta < 1$. If, however, assumption (6) does not hold, we may use the approach of AF to gauge the role of the cultural experiences under which preferences form. Let us therefore first collect the factors $(\xi_t^{()})$ which most likely influence the adaptation of new rules of a

[3] Karl Marx has remarked history repeats itself twice: First as a tragedy, and second as a farce.

game: political conditions at the time of the shock and economic performance under the new regime.

Given that the same shock occured twice, the only major difference remaining after accounting for politics and economics are the forty years of communism. To turn the argument around: if one were able to show that the other two factors were similar, all differences could be attributed to communism.

3.1.1 Political situation

With respect to the political situation at the time of the shock, we can observe the following constallation:

West Germany. In West Germany (I write West Germany even though the same applies to the whole of Germany at that time) the political elites as well as their political programs had suffered military and moral bankcruptcy. Therefore, any foreign rule, especially those of the victorious Allies enjoyed in principle high credibility. This is not to say that foreign rule was immediately welcomed on all accounts; it says, however, that there was no reason to expect it to be short lived. In addition to this, the joint anti-Soviet and anti-communist mood of the Germans and the Western coalition provided a fertile ground for the new system. Consequently, the new German government and state were built according to the Allie's blueprint and slowly West Germany became an independent, recognized member of the international community. It is noteworthy that a credible German-only alternative did not exist. There was no "natural" German authority left for running the country independently since, generally speaking, the former elites were either corrupted, killed, or driven out of the country by the Nazis.

East Germany. The political setting in East Germany at the time of the (second)

shock could hardly be more different. While in 1990 German unification took place one year earlier East Germans emancipated themselves from Soviet and communist rule. On September 18 the then head of the government resigned and by November 7 the whole government followed. In the weeks after a new government was formed, now including former opposition groups. In March 1990 the first democratic elections were held. In contrast to Germany 40 years earlier, there was no "natural" need for foreign rule since by 1990 the authorities running the country were morally and politically fully credible. This situation changed, however, in October 1990 when the transfer of the West German political and economic system began. In essence, it introduced a variant of foreign rule. The new system (yet not its introduction, see below) was exogenous to the East Germans and so were the majority of those ruling.[4] Arguably, the adaptation of the West German system was equivalent to again loosing (the second time after 1945) souvereignity and the right of self-rule at large. It appears fair to doubt that this situation created an all-positive attitudes towards West German habits. Nevertheless, the East Germans were very much in favour of unification despite the high political price – loss of self-rule – to be paid. First, unification was considered a supreme national value, and second the prospects of fast economic catch-up appeared too attractive to resist. It seems therefore fair to say that the details of the new system were not as much approved by the East Germans as was the principle of introducing significant economic and political reforms.

[4] In 2000 the Government of the Federal state of Brandenburg put the share of senior civil servants with West German background to no less than 70 percent. The new elites were recruited in the West in all fields, including science and culture as AF's list of acknowledgments impressively reflects.

3.1.2 The economies after the shocks

The economic performances after the shock were strikingly different in West and East Germany (see table 1). While West Germany experienced a long lasting boom of no less than 20 years, East Germany faced and faces a lengthy period of economic stagnation. West Germany soon ran out of labor after the shock despite the huge East-West migration and hired Italian and Turkish labor for its fast expanding industry. The opposite happened in East Germany after the shock. Employment fell sharply and it took several years for the East German industrial sector to achieve the output level of the pre-shock era. Without continued migration from East to West current unemployment figures would be much higher still. Therefore, it does not come as a surprise that East Germans value their income prospects much lower than their West German counterparts even when employed. The likelihood to obtain a new job once unemployed is rated lower when unemployment is high among peers. Thus AF's finding (p. 1521) that East Germans favour state interventionism more in comparison to their West German counterparts even if currently employed is fully understandable.

There is a potential short-cut to save AF's argument, namely by assuming that the adverse political and economic circumstances are also a result of East German attitudes. However, to my knowledge, this argument has not yet taken center stage in any explanation of the East German economy's difficulties to take off. Among the more prominent reasons discussed are the initial exchange rate shock and poor privatisation strategy (Sinn and Sinn, 1992), improper labor market structures (Burda, 2006; Uhlig, 2006), and the West-East transfer system (Snower, 2006).

The comparison of the economic conditions under which preferences formed leaves the impression that the shock once served as a sweet drug, while it was a very bitter pill on

the occasion of German unification. Nothing is as successful as success and that is why the same shock may have led to two very different outcomes. In short, there is not much support for assumption (6).

3.2 Endogeneity

Having said that East Germans were in favor of unification despite all the difficulties mentioned before raises yet another problem. This problem is better known as endogeneity bias. As AF stated:

> In order to analyze these questions empirically, one needs an exogenous shock to the regime; (p. 1507)

Looking at a simplified regression version of equation (1) reveals the dilemma

$$P_{i,t} = c_0 + c_1 I_{i\in \mathrm{E}} + aX^W_{i,t} I_{i\in \mathrm{W}} + aX^E_{i,t} I_{i\in \mathrm{E}} + b\xi^{(W)}_{t=1949} I_{i\in \mathrm{W}} + b\xi^{(E)}_{t=1990} I_{i\in \mathrm{E}} + b\xi^{(E)}_{t=1949} I_{i\in \mathrm{E}} \tag{7}$$

where, for simplicity, all the relevant past has been assigned to the three shocks: Erhard-shock in West Germany in 1949, Soviet shock in East Germany in 1949 and the Erhard shock occurring a second time in Germany in the East in 1990. The indicator variables $I_{i\in \mathrm{W}}$ assume the value 1 if the individual on the left hand side is from the West and $I_{i\in \mathrm{E}} = 1$ if the individual is from the East. In this regression, c_1 ought to measure the effect of communism on East Germans' preferences under the assumption $\xi^{(W)}_{t=1949} = \xi^{(E)}_{t=1949}$ and noticing that $\xi^{(E)}_{t=1949} I_{i\in \mathrm{E}}$ is not observable in practice and hence not included in the regression either.

Estimating the preference generating function in equation (7) would require the right hand side to be exogenous to the left hand side, but not vice versa (Engle and Hendry, 1993; Engle, Hendry and Richard, 1983). While there is no problem with this assumption with

respect to $\xi^{(W)}_{t=1949}$ and $\xi^{(E)}_{t=1949}$, the situation is totally different with respect to $\xi^{(W)}_{t=1990}$. In 1990 it was not an external power that simply took over East Germany. The introduction of West German economic institutions followed the active rejection of communist power and elections that were won by the Chrsitian Democrats (CDU), the party which promised fast re-unification. Hence, the second Erhard shock is also a result of East German preferences and not only one of its determinants.

Secondly, there is certainly also a feedback from the 1949 Erhard shock to the East German preferences since East Germans explicitly and implicitly referred to West Germany's economic success following the 1949 introduction of Western rule. Using this more realistic view on the actual events makes estimation of equation (7) infeasible and sheds serious doubt on the solution presented by AF.

Taken together, AF's method does not take into account the endogeneity of the economic reforms started in 1990. Neither does it account for the fact that the desire for economic reforms has also been a result of West Germany's economic success after 1949.

3.3 What's left

The analysis leads to the following conclusion: there are many reasons for the differences in taste for state interventionism between East and West Germany. Among them are the political setup and the economic performance after the shock. Communism may add to these factors, it is impossible, however, to correctly weigh its relative importance. The basic claim made by AF that they can assess the effect of Communism on individual preferences therefore remains an open issue.

Relating back to the underlying policy question, one would have to account for the possibility that East German pereferences are not simply a result of communist indoctrination

but a reflection of a basic desire. Therefore, instead of blaming East Germans for having the "wrong" tastes, alternatives to the current practice of simply applying West German solutions to East Germany have to be seriously considered. Scandinavian countries may be potential archetypes to look at. They seem to be very successful on all accounts, economic prosperity, provision of political freedom, and state guarantees for well-being.

As the bottom line of the whole discussion we should certainly accept that people simply differ in their tastes and preferences. Instead of bothering with a potential need for re-education the focus should clearly be prosperity of the country. A successful economic policy will be appreciated by all members of the society irrespective of whether or not they individually prefer state intervention.

4 Summary

Communism may have had a considerable effect on East Germans' preferences, we just do not know. The identification scheme suggested by AF rests on very weak assumptions. In particular, they proclaim to assess the impact of a single shock while there occured in fact two. The effect of the shock 'Communism' can therefore not be identified since the simultaneous 'Erhard' shock remains unaccounted for.

Comparing the effect of a single shock that occured twice offers the possibility of approximating the impact of different basic conditions for the virtue of this shock. If it was possible to show that all conditions except communism were the same, or favorable to the outcome (reduced attitude for state interventionism) we could be sure that any differences between East and West Germans are attributable to communist rule. The plain facts indicate that the relevant basic conditions were totally different and all very likely

worked against the favorable outcome. Therefore, there is again no way of quantifying communist education.

Table 1: Economic performance indicators after the market reform shocks

yrs. after	yty GDP (%)		yty unempl. (%)		unempl. rate (%)		yty un. rate (%)	
the shock	W	E	W	E	W	E	W	E
1	n.a.	n.a.	n.a.	n.a.	11.0	10.2	n.a.	n.a.
2	8.83	7.7	-8.3	27.2	10.4	14.4	-5.5	41.2
3	9.21	11.9	-3.6	-0.8	9.5	15.4	-8.7	6.9
4	8.78	11.4	-9.7	0.2	8.4	15.7	-11.6	1.9
5	7.7	4.5	-5.4	-6.8	7.6	14.8	-9.5	-5.7
6	12.01	3.2	-23.9	11.3	5.6	16.6	-26.3	12.2
7	7.58	1.6	-18.4	14.8	4.4	19.1	-21.4	15.1
8	5.93	0.4	-14.9	1.0	3.7	19.2	-15.9	0.5
9	4.35	2.6	1.3	-2.2	3.7	18.7	0.0	-2.6
10	7.79	1.3	-29.3	0.9	2.6	18.6	-29.7	-0.5
11	8.44	-0.3	-49.9	1.5	1.3	18.8	-50.0	1.1
12	4.61	0.7	-33.2	2.0	0.8	19.2	-38.5	2.1
13	4.68	0.2	-14.6	3.9	0.7	20.1	-12.5	4.7
14	2.82	1.5	20.1	-1.5	0.8	20.1	-14.3	0.0
15	6.64	-0.1	-8.9	1.0	0.8	20.6	0.0	2.5

The years of the shocks are 1949 (West Germany, W) and 1990 (East Germany, E) respectively. 'yty' is short for year-to-year rate of change (in ercentage points), GDP abbreviates gross domestic product, 'unempl.' and 'un.' stand for unemployment.

Sources. West German GDP: Bundesbank online data base (code JJ500j), East German GDP: Arbeitsgruppe VGR of the federal states, Sachverständigenrat zur Begutachtiung der gesamtwirtschaftlichen Entwicklung (Council of economic advisors), annual report 2007, Unemployment: GENESIS online data base of the Federal statistical office (web source: http://www.destatis.de, download 8 November 2007) and Federal labor office, monthly report Dezember 2005. Own calculations.

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