

On-line Appendix to: “Good bye Lenin (or not?): The effect of Communism on people’s preferences”

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1 Aggregate transfers

Gross transfers into East Germany amounted to around 101 billion Euro in 2002 (Lehmann et al., 2005). Most of these transfers come as a part of the federal legislation already in place in Germany before reunification, and are therefore not special transfers to East Germany, but transfers from richer states or the federal government to poorer states. Subtracting federal tax revenues collected in the East from the gross transfers, one arrives at net transfers of 67 billion Euro in 2002 (Lehmann et al., 2005). Lehmann et al. (2005) do not report the transfers on the level of the states, but their reported numbers of transfers into the East can serve as a reference point to validate our calculations.

We build a gross transfer measure that adds up three subcomponents of the transfers for any state in West and East. The first subcomponent includes the payments from the German regional transfer system (*Länderfinanzausgleich*), also incorporating special payments by the federal government to poorer states (*Bundesergänzungszuweisungen*) and the special investment subsidies for the East (*Investitionsförderungsgesetz Aufbau Ost*). The calculation of this subcomponent is described in further detail in subsection 1.1. The second transfer measure calculates the net transfers to any state within the social security system (see subsection 1.2). The last transfer measure, described in subsection 1.3, incorporates federal investment subsidy programs that are not specific to East Germany. To calculate net transfers, we subtract tax payments of every state to the federal government from the gross transfer measure.

While our total transfer measure almost adds up to the one provided by Lehmann et al. (2005), namely 98 billion Euros vs. 101 billion Euros, the numbers for the different subcomponents diverge from the ones reported in Lehmann et al. (2005). However, we want to point out that, if the true number per state is a linear transformation of our measure, then the results for the estimates of interest would be unchanged. In a robustness check, we include the three subcomponents separately as controls. It is even more likely that the true transfers per state are a linear transformation of the calculated numbers within each subcategory (see also footnote 33). The three transfer subcomponents are highly positively correlated (with a correlation coefficient between 0.68 and 0.8). Moreover, the gross transfer measure is highly negatively correlated with tax payments to the federal government, with a correlation coefficient of -0.83.

1.1 German regional transfer system

Realizing the different economic powers of the states, the need for a financial equalization scheme was written down in the West German constitution in 1949. In 1993, federal and state governments reformed the system to administer massive monetary flows into the new eastern German states. The new system (*Solidarpakt I*) was established in 1995, and scheduled to expire at the end of 2004.

In response to the still significant economic needs of the eastern German states, the federal and state governments negotiated an extension of the system (*Solidarpakt II*) in 2001, which started to become effective in 2005 and is scheduled to expire at the end of 2019.

The financial equalization scheme between the federal government and the states (*Länderfinanzausgleich*) comprises a horizontal and a vertical component. In the horizontal component, the financial needs and financial resources of any given state are determined via specific formulas. Based on these calculations, it is decided whether a given state should receive extra financial resources, or should share its resources with other states. The financial flows between the states in this step sum up to zero. In the subsequent vertical component, certain states receive additional financial resources from the federal government (*Bundesergänzungszuweisungen*). On top of that, since 1995 the eastern German states have received special support from the federal government based on the “Law for the Promotion of Investment in Eastern Germany” (*Investitionsförderungsgesetz Aufbau Ost*).¹ Last, the debt of the East German government was taken over by the western German states. This led to annual interest and amortization payments by only the Western states (*Fonds Deutsche Einheit*).² Most of the information used to build this transfer measure comes from the Bundesministerium der Finanzen.³ This subcomponent of the transfers sums up to 15 billion Euro in 2002 for the East, compared to 17 billion Euro reported in Lehmann et al. (2005).

There is one additional transfer measure that should be added to these numbers, which Lehmann et al. (2005) report to sum up to 10 billion Euros. In a first step of the equalization scheme, the receipts from value added taxes are divided between the states. 75 percent of the receipts are divided based on the number of inhabitants, while 25 percent of the receipts are divided according to a formula that takes the financial needs of the states into account. Hence, this procedure leads to implicit flows between states. Unfortunately, we were not able to obtain the amounts of these implicit transfers on the level of the states. However, it is likely that adding these amounts would result in a linear transformation of our measure, since the applied formulas are very similar.

1.2 Net transfers through the social security system

The fairly generous West German social security system was adopted in the East right after reunification. Thus, the social security system is a uniform German-wide system. The system provides indirect West-East transfers, since the gap between contributions and payments is larger in the East than in the West. We calculate these indirect transfers by subtracting social security contributions made by the inhabitants of any state from the social security payments received by inhabitants of that state. The source of these numbers are the national accounts of the states (*Volkswirtschaftliche Gesamtrechnung der Länder*). This component adds up to 76 billion Euros for the Eastern states in 2002, compared to 55 billion Euros reported in Lehmann et al. (2005). We have no good explanation for this discrepancy.

1.3 Transfers through investment subsidy programs

Last, there exist several investment subsidy programs, financed and organized through the European Recovery Program, the state-owned bank *Kreditanstalt für Wiederaufbau*, or directly through the federal government as part of the federal government’s special infrastructure programs (*Gemeinschaftsaufgabe Verbesserung der regionalen Wirtschaftsstruktur*).⁴ These programs apply to eastern

¹Since 2002, these flows have become part of the *Bundesergänzungszuweisungen*, and hence they have only been added in 1997.

²Note that the regression results are unchanged when we omit the *Fonds Deutsche Einheit* in calculating the transfers.

³Bundesministerium der Finanzen: *Bund-Länder Finanzbeziehungen auf der Grundlage der geltenden Finanzverfassungsordnung*, Ausgabe 2005.

⁴Specifically, we capture subsidies through the following programs: *Städtebauförderung*, *ERP Regionalprogramm*, *ERP Existenzgründungsprogramm*, *ERP Eigenkapitalhilfeprogramm*, *ERP Innovationsprogramm*, *ERP Umweltpro-*

as well as western states. We have information on the average subsidies per state for the period 1999 to 2003 (Bundesamt für Bauwesen und Raumordnung, INKAR 2005), and calculate an annual subsidy by dividing these figures through 5. Thus, there is no time-series variation in our information concerning these subsidies. This component adds up to 7 billion Euros for the Eastern states, compared to 18 billion Euros reported in Lehmann et al. (2005). The list of programs captured in Lehmann et al. (2005) is longer than the list of programs for which we could find data on the state level.

gramm, GRW gewerbliche Wirtschaft, GRW Fremdenverkehr, GRW Infrastruktur, KfW Infrastrukturprogramm, KfW Innovationsprogramm, KfW Mittelstandsprogramm, Gemeinschaftsaufgabe Hochschulbau, KuM-Förderung.