



# The shadows of the socialist past: Lack of self-reliance hinders entrepreneurship

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## ABSTRACT

We provide empirical evidence that the experience of a socialist regime leads to a lack of self-reliance by comparing East and West Germans conditional on regional differences in current economic development. This meaningful lack of self-reliance persists after the regime's breakdown and hinders the development of an entrepreneurial spirit, which might hamper the transition process. Since East Germany adopted the formal institutions of a market economy quasi overnight when reunifying with West Germany, we avoid simultaneity issues regarding current institutions and preferences. Further tentative evidence suggests that the socialist regime also affected the composition of the East German population by inducing selective migration before the construction of the Berlin Wall in 1961.

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## 1. Introduction

Countries in Central and Eastern Europe (CEE) have experienced dramatic changes in the last decades. After the Eastern Bloc collapsed, most of the currently existing states gradually adopted the rules of Western market economies, which triggered a dynamic catch-up process enabling CEE economies to modernize and grow. [McMillan and Woodruff \(2002\)](#) or [Estrin et al. \(2006\)](#) argue that, in the transition from a socialist regime to a market economy, entrepreneurs are the main actors of change while existing firms are less well placed to be the engine of structural transformation because they are outcomes of the planning system themselves.<sup>1</sup> According to [Schumpeter \(1912\)](#), the adopted institutions of a free market economy should unleash human inspiration and breed creative entrepreneurs who come up with new ideas leading to innovation and growth. Yet, “without a widespread individualistic mentality, free markets reveal only a fraction of their progressive power” ([Caplan, 1996](#)). Certainly, this vital individualistic mentality, most importantly self-reliance, is best learned by constant practice.

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<sup>1</sup> For further discussions of entrepreneurship in the post-socialist transition economies, see [Acs and Audretsch \(1993\)](#), [Bergmann and Sternberg \(2007\)](#), [Earle and Sakova \(2000\)](#), [Hanley \(2000\)](#), [Johnson and Loveman \(1995\)](#), or [Smallbone and Welter \(2001\)](#).

Most likely, the experience of more than 40 years of central planning not only heavily affected the economic structures in CEE countries but also crowded out productive self-reliance and redirected creativity into rent-seeking activities, which eventually led to the systems' economic collapse (cf. Baumol, 1990; Murphy et al., 1993; Hillman, 1994). Preferences developed over several decades of socialist education and socialization in a centrally planned economy do presumably not change overnight after the regime's breakdown.<sup>2</sup> Consequently, a lack of self-reliance may still be present today and may have dampening effects on these countries' growth paths. However, the legacy of the socialist past is often difficult to pin down empirically since institutions change only slowly and therefore, a lack of self-reliant preferences might also be an outcome of still rather market unfriendly current institutions in CEE countries.

In this paper, we exploit the German reunification as an ideal setup where, in contrast to other socialist countries, the German Democratic Republic (GDR) adopted the institutions of a market economy quasi overnight when joining the Federal Republic of Germany (FRG). We can thus rule out simultaneity issues, i.e., current market-unfriendly institutions affecting individuals' preferences and vice versa. This gives us the chance of analyzing whether we still find shadows of the socialist past, i.e., persistent differences in preferences for self-reliance between East and West Germans, and investigating the extent to which a potential persistent lack in self-reliant preferences negatively affects entrepreneurship and could thus hamper the transition process.

Our analysis shows that East Germans (born and) living in the regions of the former socialist GDR are indeed less self-reliant than their West German counterparts who have always lived in the free market economy of the democratic FRG. These shadows of the past loom large and are not explained by individual characteristics or by differences in economic development between East and West Germany alone. To assess whether the analyzed preference differences affect individuals' entrepreneurial spirit, we test the impact of self-reliance in the context of an occupational choice equation (cf. Kihlstrom and Laffont, 1979). We find that self-reliance is indeed positively associated with the likelihood of being an entrepreneur. This association is particularly strong when looking at entrepreneurs with employees as compared to self-employed individuals who do not employ further employees. In this way, the shadows of the socialist past, i.e., a lack in self-reliance, hinder entrepreneurship and might thus slow down the transition process. Our finding can also cast light on results from the Global Entrepreneurship Monitor country report for Germany in 2000 (Sternberg et al., 2000). While experts evaluate the entrepreneurial prospects in East Germany even better than in West Germany, this feeling is not prevalent in the overall East German population. Our empirical analysis suggests that a lack of self-reliance bred by the socialist regime might at least partly be responsible for this puzzle.<sup>3</sup>

We are interested in persistent differences in self-reliant preferences between East and West Germans and whether a lack in self-reliance could negatively affect productive entrepreneurship and thus hamper the transition process. Thus, we do not focus on the question how exactly the socialist regime of the GDR shaped individual preferences. Nevertheless, we want to investigate one indirect channel through which the socialist regime could have had an effect on the distribution of individual preferences which has so far been neglected in the economic literature. Nearly 3 million individuals fled from the Russian occupational zone (which would later become the GDR) in the time span ranging from the end of World War II to the construction of the Berlin Wall in 1961. With communism looming, one could well imagine that individuals that escaped the Russian occupational zone were more self-reliant and had stronger preferences for independence than the average East German. Consequently, the average person who remained in East Germany likely was less self-reliant than the average West German already before the full treatment with the socialist regime actually set in. We provide some first pieces of evidence for this indirect channel.

The remainder of the paper proceeds as follows. Section 2 introduces our data. Section 3 provides evidence for the persistent differences in self-reliance between East and West Germans. Section 4 investigates the association between self-reliant preferences and entrepreneurship. Section 5 discusses the indirect channel, i.e., out-migration before the Berlin Wall was constructed in 1961, through which the socialist regime could have had an impact on the East German population even before this regime was entirely established. Section 6 concludes.

## 2. Data on self-reliance and entrepreneurship

The German General Social Survey (ALLBUS) is a valuable data source for our research project. The data set is based on biennial, representative surveys of the German population conducted through personal interviews. ALLBUS covers a wide range of topics pivotal to empirical research in the social sciences. A core set of questions is asked in every wave of the survey, with various sets of additional questions complementing the survey in different years.<sup>4</sup> Since we are interested in the occupational choices of interviewees, we retain only entrepreneurs and employed workers in our sample and exclude non-working, unemployed or retired individuals. For entrepreneurs, we can observe whether the entrepreneur is merely "self-employed" without employees or whether the entrepreneur employs any workers. In a first step, we do not further exploit this information and count every self-employed respondent as entrepreneur; however, later in this paper, we will distinguish between these different kinds of entrepreneurs. In order

<sup>2</sup> Kornai (1992) describes how socialist regimes deliberately manipulated the preferences in an intense way unthinkable in an individualistic society. The aggregate effect of this manipulation is shown for example by Alesina and Fuchs-Schuendeln (2007) redistributive preferences, by Rainer and Siedler (2009) for trust, and by Bauernschuster and Rainer (2012) for sex role attitudes.

<sup>3</sup> This would also be in line with the findings of Runst (forthcoming), who investigates differences in cultural and psychological traits between East and West Germany and assess their influence on entrepreneurship.

<sup>4</sup> Terwey et al. (2007) provide detailed information on the ALLBUS surveys in general and present all variables available in the cumulated data set from 1980 until 2006.

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