



Religious heterogeneity and fiscal policy: Evidence from German reunification



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ABSTRACT

Theoretical work based on social identity theory predicts that population diversity undermines redistributive public policies. This article tests this proposition exploiting an exogenous shock in diversity due to Germany's reunification. In contrast to previous work on ethno-linguistic or racial heterogeneity, we specifically analyze religious diversity, which is an increasingly relevant social cleavage in many countries. Our main results corroborate that increasing religious diversity leads to a change in fiscal policies in Bavarian municipalities over the 1983–2005 period. Moreover, we find some evidence of declining individual-level local identification over the post-reunification period, which suggests that the observed fiscal effects are indeed linked to the theoretical mechanism of individuals' social identification. Finally, we highlight an important mediating role for the democratic process, since the observed fiscal effects strengthen considerably following Bavarian municipalities' first local elections after the reunification migration wave (March 1996) and a legal change allowing local referenda on public policies (October 1995).

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“What is the use of the best welfare state, when the Cossacks come”

(“Was nützt der schönste Sozialstaat, wenn die Kosaken kommen”)

Franz Josef Strauss (Bavarian state minister 1978–88).

1. Introduction

Immigrants often differ from the native population of the region where they settle in terms of race, ethnicity, language or religion. Consequently, substantive migration flows tend to alter the composition of a jurisdiction's population and increase its heterogeneity. While such diversity can bring important benefits (Hong and Page, 2004), it may also undermine redistributive public policies. Alesina et al. (1999) and Alesina and Ferrara (2000), for instance, build on social identity theory (Tajfel et al., 1986) to argue that individuals are likely to be more altruistic toward those with whom they share a common 'identity'. As a result, a community may provide more redistributive public goods when diversity

is lower because “social closeness increases the value attached to other people's well-being” (Ashworth et al., 2002, p. 32).¹

Previous empirical work evaluating this prediction looks at racial, linguistic and, especially, ethnic diversity (Ashworth et al., 2002; Alesina et al., 1999; Habyarimana et al., 2007; Dahlberg et al., 2012; Jofre-Monseny et al., 2016; for a review, see Stichnoth and Straeten, 2013). In contrast, we focus on religious diversity.² As such, we gain new insights into the potential consequences of the increased religious diversity in many countries, regions, and localities. Indeed, our analysis of the comparatively proximate Catholic and Protestant beliefs (see below) might reflect a lower bound for studies involving more disparate religions.

¹ Glaeser's (2005) work on the origins of hateful narratives in the practice of politics suggests that political entrepreneurs may play an important role in this story. They might demonize certain prospective recipients of welfare by highlighting sources of social cleavage separating 'them' from 'us', and thereby undermine support for redistribution to such groups. Where Glaeser (2005) emphasizes political entrepreneurs' 'supply side' contributions to divisive discourse, our focus is nearer the 'demand side' attitudes among voters (which might make such discourse electorally advantageous).

² This links our work to scholarship exploring the relation between religion and economic outcomes—see Fernandez et al. (2001); Acemoglu et al. (2001); Sala-i Martin et al. (2004); McCleary and Barro (2006); Arrunada (2010); and Durlauf et al. (2012).

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Clearly, socio-demographic heterogeneity is generally not independent from local fiscal policies since such policies may influence migrants' location decisions (Fiva, 2009; Jofre-Monseny et al., 2016; Tiebout, 1956). This creates a crucial endogeneity concern. We therefore rely on the exceptional event of Germany's reunification in 1989/1990 to develop our identification strategy. First, German reunification—which triggered sudden and substantial immigration into western Germany—happened quickly and was widely unanticipated (Alesina and Fuchs-Schuendlen, 2007; Burchardi and Hassan, 2013; Frijters et al., 2004, 2005; Fuchs-Schuendeln and Schuendeln, 2005). Hence, the reunification migration shock can reasonably be treated as exogenous. Second, the religious composition of the immigrants differed substantially from that of the native population in the West German state of Bavaria. This divergence can be exploited via a difference-in-differences (DD) estimation approach since—as we will show in more detail below—post-reunification immigration particularly strongly affected the religious composition of predominantly Catholic or predominantly Protestant Bavarian municipalities, but had a more limited effect in religiously heterogeneous municipalities.³ Third, as post-reunification immigration was largely concentrated in larger (than average) municipalities, we can furthermore compare large and small towns to assess whether migration and changing diversity are directly driving our results.

Our main results indicate that municipalities which were religiously homogeneous prior to reunification record significantly slower growth in public expenditures following the migration shock (compared to ex ante religiously diverse municipalities). Importantly, this finding is strongest among larger municipalities, which saw more immigration. It is reflected in lower outlays on public utilities, public order, administration and, crucially, social welfare (including adult education programs and child care provisions). Interestingly, this change in fiscal policies in Bavarian municipalities closely relates to a shift in Bavarian natives' identification with their town of residence and its residents following the migration wave. Particularly, the post-reunification inflow of predominantly non-Catholic immigrants led Catholics in Bavaria to lose their feeling of 'common identity' with their fellow inhabitants at the local level to a substantially greater degree than other Bavarians. This provides some suggestive evidence that individuals' lower altruism toward those with whom they do not share a common 'identity' underlies the observed negative heterogeneity–redistribution relation (Alesina et al., 1999; Alesina and Ferrara, 2000). Finally, and interestingly, our observed fiscal effects first arise around 1993 and gain particular traction after 1996. This timing appears to reflect an important mediating role for the democratic process, as it coincides with Bavarian municipalities' first local elections after the reunification migration wave (March 1996) and a legal change allowing local referenda on public policies (October 1995).

2. Data and descriptive statistics

We have built a panel dataset covering all 2031 municipalities in Bavaria for the years from 1983 to 2005.⁴ Municipalities constitute the lowest of the four German governmental tiers, and have wide-ranging spending responsibilities. These include welfare services (such as child care provision and education), cultural events,

³ From a more practical viewpoint, Bavaria also has local-level fiscal information available from 1983 onward, thus covering the period before and after the fall of the Berlin Wall.

⁴ Throughout the analysis, we exclude cities with populations over 100000 inhabitants as these may differ fundamentally in their susceptibility to heterogeneity effects in terms of social identification. Auxiliary regressions using survey-based data on individuals' social identification support this supposition.

Table 1
Descriptive statistics on religious diversity.

Variable	Mean	Std. dev	Median	Min	Max
Number of inhabitants	4105	4595	2521	186	51440
Herfindahl Index	0.741	0.143	0.769	0.369	0.976
Share of Catholics	0.745	0.265	0.862	0.035	0.988
Share of Protestants	0.215	0.260	0.096	0.006	0.962

Notes: This table presents key descriptive statistics on the towns in the analysis. We highlight the mean, standard deviation, and median as well as min and max of all variables. The first row gives an indication of town sizes. In the following rows, we provide information on the religious diversity within the municipalities prior to reunification via the share of Catholics, Protestants and the Herfindahl–Hirschman Index (using the share of all religious denominations including non-religious). Data on religious denominations derive from the 1987 census. Source: Own calculations.

sports and recreational facilities, and local infrastructure investments. Furthermore, they often supervise local public firms (e.g., water, sewage, and energy supply) and administer spending allocated from higher tiers. Local government revenues mainly derive from three sources: allocated grants, taxes and fees. Among the taxes, municipalities are free to set three local tax rates independently: the property tax A on agricultural land, the property tax B on all other property and the local trade (business) tax. Revenues from these three taxes jointly account for about 50% of local tax revenues. The remaining tax revenues predominantly derive from municipalities' share of VAT revenues and income taxation. Descriptive statistics with respect to these fiscal outcome data are provided in Table 7 in the appendix. The underlying data derive from the state statistical office in Bavaria.⁵

We restrict attention to the southern (West) German state of Bavaria for three reasons. First, Bavaria shares a border with the former East Germany, and therefore saw massive net immigration following reunification by East Germans and individuals with German ancestry from the former Soviet Bloc (henceforth 'ethnic Germans'; note that this category does not include East Germans). Fig. 1 shows that, while population growth was limited before 1989, the average municipality in Bavaria grew about 10% in the period 1989–1995 (upper panel of Fig. 1). While ethnic Germans—though not East Germans—were subject to a placement program at the level of the *Regierungsbezirk* (a purely administrative government level just below the state), no constraints were imposed on immigrants' location choices at the municipal level. Consequently, much of this population increase was concentrated in larger (than average) municipalities. The lower-left panel of Fig. 1 shows that municipalities below 4000 inhabitants saw little to no population growth, whereas larger municipalities in the lower-right panel of Fig. 1 saw substantial growth (about 18% between 1989 and 1995).⁶

Second, the religious composition of the immigrants was very different from that of native Bavarians (which was remarkably stable between the 1840 census and the fall of the Berlin Wall; *Datenverarbeitung*, 2008, 113). Bavaria's religious composition around the time of reunification is illustrated in Table 1. Using information on the shares of religious denominations in each Bavarian municipality in the 1987 census (the most recent census before reunification), we display the Herfindahl–Hirschman Index (HHI) based on the shares of all religious denominations (including

⁵ All data are publicly available at <https://www.statistik.bayern.de/regionalstatistik/index.php>.

⁶ The threshold of 4000 inhabitants was chosen to fall between two administrative cut-offs at which population size induces an increase in council size (i.e. 3000 and 5000 inhabitants). Although this avoids our inferences being affected by such administrative shifts (Eggers et al., 2016), our results are robust to alternative choices of the population threshold.

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