

**Dangerous Liaisons: Dual Transitions and
Institutional Transfer in Eastern Germany**

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The transition from a communist state to a politically democratic and economically liberal nation is often a very dangerous and tumultuous path. Following the collapse of a socialist regime, nations throughout history have been confronted with the monumental task of how to best restructure their entire political, social, and economic frameworks to support those consistent with democratic institutions. In an attempt to consolidate both economic liberalization and political democratization, states will often undertake a strategy of simultaneous dual transition, which has traditionally been regarded as a very dangerous and risky strategy (Armijo, et al., 1994: 162). This dilemma was especially exemplified through the case of regime collapse in Eastern Europe. Even as mass mobilizations and gradual political reform heralded the demise of authoritarian rule in the Soviet bloc, the post-communist transition legacies of countries such as Yugoslavia stood as a current and frightening reminder of the dangers involved in liberalizing both politics and economics (Bunce, 1999: 66). Scholars and policy experts often cautioned states planning to instigate political and economic reform via dual transition (Prezeworski, 1991: 139). Considering these warning signs, policy makers initially championed a more neoliberal ideology, calling for the immediate opening of markets and the adoption of capitalist blueprints from the west. In response, neo-statist scholars criticized this neoliberal transformation because of its inability to actually transform societies, not just markets (Sachs, 1993: 6). Yet despite all the initial calls for action, one reality remains painfully clear: Without the initial presence of either liberal markets or democratic political infrastructure, post-communists states are often forced to embark on a long and agonizing path towards democratization.

Considering these two schools of political and economic thought, I intend to show that, despite the burdens and challenges associated with socialist legacies, the institutional adaptation approach provides the solution for how to institute successful market reform in post-communist societies. As the debate surrounding democratic transitions in post-communist states has evolved, recent theories suggest that certain exceptions exist to the previous assertion that all democratic dual transitions are tumultuous. The notion of institutional transfer as a means of consolidating political democratization and economic liberalization has been suggested as an alternative hypothesis to explain why, in hindsight, the transition to free market society can be more seamless than initially believed (Habermas, 1990).

In this paper, I present the case of institutional transfer in eastern Germany through a theoretical framework that draws on various approaches in democratization and path-dependency theory. I argue that, in the case of eastern Germany, both structural preconditions and elite agency played critical roles in the collapse of the GDR and the subsequent democratization and institutional transformation of the former communist states. My analysis will specifically focus on how the singular way in which political reform, democratic consolidation, and economic liberalization were subsumed by Germany's unification process demonstrates a powerful exception to the otherwise well-established rule that *simultaneous* dual transitions are dangerous. I argue that the preexisting structural framework of the East German states provided a viable framework in which West German elites could facilitate a democratic transition, thus forging the political and economic institutions of East and West. In this respect, the willingness of the East German states to conform to institutional transfer provided a viable foundation

upon which the West German government could implement, enforce, and legitimize its democratization reforms. It was indeed the adoption of political and economic institutions from the West that provided a new and surprisingly adaptable framework for eastern Germany's transformation of its economic and political institutions, and, moreover, allowed for a successful synergy of East and West Germany.

In order to analyze the successes of institutional transfer in the case of East Germany, a thorough understanding of the problems of post-communist societies and why they collapse is essential. It is these same problems that pose hurdles to political democratization and economic liberalization projects following regime collapse. All of these regimes shared certain institutional commonalities that, throughout the 1980s, caused rifts within the ruling party, empowered mass movements in society, and hampered economic performance. During the early stages of regime collapse, Poland and Hungary were exposed as vulnerable because they, as Yugoslavia had done, liberalized politics with disastrous economic performance (Bunce, 1999: 75). This led to increased levels of civil unrest that, in turn, proved a crucial factor in regime transition. Dissent spread throughout the rest of the Soviet bloc as the majority of countries belonging to it experienced nearly identical political and economic problems. The precedent had been set in Hungary and Poland, and combined with Gorbachev's reforms from Moscow, signaled the seemingly inevitable decline of the bloc.

The situation in Erich Honecker's East Germany was distinctly different. With high levels of regime unity and a strong commitment to the repression of its opposition, a collapse of the German Democratic Republic was not certain from the outset. The East German regime was widely recognized as one that was unusually immune to calls for

economic and political liberalization, and also occupied a frontline position in the cold war and, thus, center stage in Soviet foreign policy (Bunce, 1999: 69). These factors, combined with mass mobilization society, did not set a positive precedent for political and economic liberalization projects in East Germany. Yet contrary to all these warning signs, regime collapse in East Germany is regarded today as a peaceful, successful transition from a command to a market society. The crucial explanatory factor is institutional transfer.

Explaining Transitions in Post-Communist Polities

With the fall of the Soviet Iron Curtain and the resulting collapse of its East Central European communist regimes, post-socialist countries were faced with the enormous task of how to implement new political rights, transform property rights, and situate their economies in the rapidly expanding sphere of the global market economy. For many scholars of post-socialism, defining the project of political and economic transformation is of the utmost importance. Directly following widespread regime collapse, neoliberal scholars looked solely to the future of post-communist regimes, and also assumed a form of a priori knowledge of capitalism. If the ultimate goal solely encompasses the institutional transition from socialism to market, then all that is required is a firm implementation and imitation of the blueprint of Western capitalism.

Arguments backing the strength of open markets and criticizing the establishment of the omnipotent state in East Central Europe are perhaps most strongly voiced in a work by political economists Jacek Kochanowitz, Alice Amsden, and Lance Taylor, entitled *The Market Meets Its Match*. In their introduction, the authors argue that the

underlying causes for inhibited economic growth in Germany stem from “a dogged determination to stick with a fixed set of economic policies that pays little attention to the shape, form, and substance of the region’s existing economic institutions and ignores the realities of constructive government intervention...” (Kochanowitz et al, 1994). These scholars evidence a notable degree of antipathy towards the state and, in favor of the power of the free market, calling for greater levels of deregulation. Yet this begs the question, how it is possible to strengthen the market without first or simultaneously strengthening the state? This question requires a reconsideration of the classic neoliberal model. The key lies within the reformative power of institutional transfer and the benefits inherent to a path-dependent approach.

The free market solution in East Central Europe that was implemented in the beginning of the 1990s proved, to the dismay of neoliberals, largely erroneous. Instead, the best possible approach for these post-communist regimes, as laid out in *Postsocialist Pathways*, is derived from a path-dependent model that, while influenced by past legacies, suggests the possibility for the recombination of network properties of assets and liabilities in the form of “deliberative associations”.¹ In answering the puzzle of simultaneously stimulating economic development and democratic transformation, the authors contest that “successful economic restructuring to create self-sustaining growth and self-maintaining social peace can be achieved neither by a transformative state nor by the self-generating market but through the transformative politics of deliberative association” (Stark and Bruszt, 1998: 111). Deliberative associations emphasize the role of the mediatory function of political institutions that serve as the intermediaries between

¹ This term was coined by Stark and Bruszt. Deliberative associations are “associative (with identifiable network properties) and they are deliberative (with identifiable discursive properties)” (Stark and Bruszt, 1998: 111)

state and society. Negotiation between actors of competing evaluative principles can help to contribute to economic development by securing broader support and raising awareness about economic reform. Such practices that recognize the network of properties of liabilities and initiate discourse between parties with varying interests and potentially competing ideologies can be referred to as a deliberative association (Stark and Bruszt, 1998). In this manner, political and economic actors associated with institutional networks of the previous regime should be provided conditions in which they can rework network properties of assets and liabilities to promote simultaneous economic reform and democratization. Especially in the case of Eastern Germany, institutional reform and the restructuring of liabilities and assets was achieved through deliberative associations within the FDR and former GDR.

As is in the case of German unification, West Germany was capable of establishing successful state institutions with distinct capacity and cohesiveness to support the successful democratization and liberal marketization of the East German states. Transformation in Eastern Germany did not hinge solely upon the implementation of the West German capitalism blueprint. Rather, the institutions from the west were *adapted* in an effort to promote the most seamless institutional transformation possible. Scholars have also highlighted other reasons for why the transition to democracy in East Germany appeared so seamless, including the presence of common communist institutions, generally low levels of economic crisis before transition, and strong effects of demonstration (Gill, 2000 and Przeworski, 1991). Yet, as I intend to show through my research, no one of these variables can account for success throughout the entire East European bloc. In observing distinct levels of variation in the democratization of Eastern

Europe circa 1990, only the singular phenomena of institutional transfer can account for the triumph of the creation of a whole, united Germany.

In my research, I will examine variables that are rooted in the theory of deliberative associations and institutional transfer. These variables enabled the seamless transfer of liberal and democratic West German institutions to the formerly communist East German states, while avoiding the pitfalls generally associated with dual political and economic transitions. These variables specifically account for the success of the democratization model in East Germany. My dependent variable of institutional transfer leads to this measure of success by creating conditions through which East Germany can rework, restructure, and reorganize its institutions. Regime transfer negotiations are the initial focus of political transition to democracy, as they varied in all cases of East European democratization. Its success can be measured by the role and status of the old political elites within the new regime. Economic privatization is also crucial for facilitating transition from a command to a market economy, and can be measured by the level of action taken by West Germany to privatize business and industry in the East. Lastly, a thorough examination of social partnership between East and West evidences the success of achieving integration and reunification of the German states through the means of institutional transfer.

Cases

Regime Transfer

In considering the political institutional transition that occurred in eastern Germany, a careful examination of the collapse of the GDR and SED is necessary for understanding the new political structures that arose post-unification in the East German states. Negotiations between East and West Germany prior to the collapse of the Berlin Wall were relatively infrequent considering the GDR's deep commitment to the communist ideal. The SED's oppressive secret police of East Germany, the *Staatssicherheit* (State Security), was widely regarded as one of the most effective and oppressive intelligence agencies of its time, and was often employed to isolate threats to the communist ideal and keep other oppositional forces at bay. The GDR and SED firmly rejected the social, political and economic philosophies of its western counterparts, and certainly stifled movements towards capitalism and democracy within its own territories. Holding steadfast to their political creed, the GDR rejected negotiation, as it was most often associated with reform – a counterproductive force to the communist ideal. The total regime collapse and velvet revolution in the GDR was partially due to this inflexibility in the political elites' refusal to engage in negotiation and establish measurements of progressive reform. Effective on October 2, 1990, the contract signed by the sovereign governments of the FDR and GDR solidified the official disbanding of the GDR as per international law. The East German government was thereby also forced to concede elections, allowing for the infiltration by West German political elites to assume command (Dale, 2006: 10). While it may have appeared on the surface as though East German political elites had suddenly lost the will to rule and simply surrendered

power to the West, some evidence to the contrary suggests that certain aspects of the transition process allowed for the extraction and transfer of some of Eastern Germany's "old red socks"² into the new democratic order.

While all instances of post-communist transitions in East Central Europe involved eventual and total regime collapse, political transformation specifically in Eastern Germany was also marked by "the establishment of transitory power arrangements in which opposition forces acquired varying degrees of access to the official political process" (Dale, 2006: 8, qtd. in Ekiert, 1991: 287). Contrary to popular belief, the GDR's political power was not surrendered under the threat of popular protest, but was rather passed on to more progressive political reformists, the majority of which whom had previously held important senior positions within the former East German regime. Therefore, the political transformation of East German democratization exemplifies a case of "transition through extraction."³ A clear distinction between the downfall of the East German regimes and the collapse of the political elite who governed them must be made in this particular analysis of East Germany's democratization process.

I would argue that the transition was due in large part to the unequivocal restructuring of East Germany's political elite in response to a universal call for progress and change in Europe. Already in the years preceding 1989, the first indicators of instability for the political and especially economic future of the socialist regime were apparent. As the GDR suffered from declining economic competitiveness and an increasing dependency on West Germany for debt financing, the initial seeds for

² Yoder (1999). This term is used frequently throughout the literature to refer to old GDR political elites who, following the regime collapse, were appointed to various political positions in a unified Germany.

³ Dale examines the schism between scholars who deem East Germany's transition to democracy as exemplifying either "regime collapse" or "transition through extraction".

democratization in the East German states had already been planted. Dale asserts that the presence of “a more or less resentful admiration for aspects of Western capitalism had long prevailed amongst East German officials and industrialists” (Dale, 2006: 13). These essential preconditions and popular mass movements present in the late 1980s forced the old regime’s political figures to align themselves with Europe’s changing political and economic environments. By 1989 it was clear that, for the GDR elite, preserving East Germany’s political structure and communist ideal was no longer a top priority. They positioned themselves in such a way that, in the event of a political transformation, they could be seamlessly extricated from the former regime and re-implemented as influential political, social, and economic figures within the new one.

The political ideologies of GDR and communist elites collapsed in East Germany and throughout East Central Europe communist-bloc. Yet in their wake stood a rickety but nonetheless intact organizational political framework to be utilized by West Germany for the implementation of its democratization projects. These findings are significant in the assessment of the extent to which former regime structures affected the transparency and success of democratization projects in Eastern Europe. The decision of the former communist elites to strategically align themselves with impending political reconstruction helped to preserve an administration of political elites in East Germany who had no qualms with abandoning their former communist ideologies and were solely motivated to return to positions of political authority through the transformative process of democratization. Moreover, their actions did not lend themselves to either neoliberalist or neostatist reform in eastern Germany, but rather increased the level of political transparency through more seamless institutional transition.

Pre-unification Economic Reforms

In the months preceding German unification, various economic reform efforts were carried out under the leadership of the leader of the SED at the time, Hans Modrow. Although it was not yet official, the impending reality of regime collapse forced SED to take action and implement stringent economic reforms. One way to assess the success of these reforms is to measure the degree to which firms can function independently of one another. By the time unification was imminent, the center had reduced the number of orientation coefficients from twelve down to five. These included goods actually sold, final products for citizenry, exports, net earnings, and net earnings taxes (Bryson and Melzer, 1991: 116). Although not yet under democratic rule, the final months of the old communist East German regime indicate a gradual movement towards decentralizing policies in preparing East Germany for the presence of an open market economy. Here we see another instance of actions taken to promote fluid institutional transfer. By implementing reforms before actual unification and establishing an economic framework geared towards the direction of a free market economy, East Germany took very intentional measures to help its citizens and the West German institutions of the FRG allow for the most seamless economic transition possible.

The establishment of an independent central bank was also high on the list of priorities for Modrow's administration. These banks were established to authorize and approve the founding of commercial banks in a two-tiered banking system (Bryson and Melzer, 1991: 120). The intention was that these banks would be able to economically strengthen the East German state by allowing them the opportunity to manage their own credit financing independently of the state. Although this reform was miniscule

compared to the highly developed, regulatory environment for monetary and credit policy in West Germany, movements toward economic reform were nevertheless taken to anticipate the coming of liberal economic markets in a united Germany. The economic reforms initiated under Modrow were by no means breathtaking from a western perspective. Yet considering the GDR's weighty communist past, these reforms were the first steps in East Germany's socialist history to progress towards an open market economy. It was at this time that East Germans realized that abandoning the old socialist economic order would be critical in achieving economic development and sustainable growth in a united Germany based off of the Western model. Although the SED's banking reforms paled in comparison to the monetary and credit policies of the West German government, their motions towards economic restructuring displayed yet another example of the former regime's commitment to ensure successful, transparent regime transformation.

Economic Convergence Through Monetary Union

Along with economic convergence and reunification, a movement towards a monetary union was also instituted by the West German government. To the citizens of the East, this was a sign that West Germany was serious about economic integrations between the two lands, and intended to give them good prospects for an economic future. It was also adapted as a measure to keep large groups of eastern Germans from migrating to the West post-unification. For an independent, capitalist East Germany, a currency reunion also aimed to stave off fears of inflation and severe shifts in price levels. Perhaps the most promising aspect of a monetary union for the East German states was that it now

suddenly provided the tools to replace the stagnant and decrepit planned economy of the GDR with the western model of a free market, liberal economy.

Initially, economic convergence was the cause for some unrest and concern in East Germany. Massive levels of high unemployment were worrisome to many, but this was inevitable due to the decline of socialism and economic restructuring in the old communist-bloc. To the credit of the FDR, however, the levels of unemployment that resulted from economic convergence were smaller than the levels of disguised (unproductive) unemployment in the former East German communist regime (Bryson and Melzer, 1991: 139). While this process revealed some initial economic instabilities, East Germans were now also able to rely on social protections offered by West Germany's social democracy, namely in the form of social insurance and welfare policies (Köves, 1992). The marketization of the East German states also opened up many new industries and job sectors, particularly in the realm of private enterprise.

Privatization Reforms

Many of the reforms under the Modrow association called for the transformation of publicly owned means of production to more private forms geared towards an open market economy. An official trustee commission, the famed *Treuhandanstalt* ("trust fund"), was established to oversee the disposition of public assets and enterprises (Bryson and Melzer, 1991: 120). This massive state holding entity took charge of nearly 12,000 formerly state-run companies that were severely oversized and overmanned, a common affliction of post-communist enterprises, and converted them into private enterprises modeled on West German corporate legal frameworks (Stark and Bruszt, 1998; Schäfer and Ghaussy, 1993). Its guiding mission was to privatize previously state-owned

enterprises, to distribute them, and to sell them or temporarily fund them if there was a chance they might survive. This action of swift privatization on behalf of the *Treuhandanstalt* was itself not a move to deliberately promote economic reorganization, but was rather aimed at providing the valuable resource that would allow for economic transformation, namely the accumulation of West German capital.

The Treuhand was given the great responsibility of finding the necessary resources to achieve such a massive level of privatization. Despite a lack of inter-firm and inter-organizational networks that had collapsed at the first signs of a market economy, Treuhand constantly shifted its goals and tasks in its unyielding effort to reorganize the assets and liabilities of firms that had previously been state-owned enterprises. Through this process of administrative reform during uncertain times, the Treuhand adapted into a set of deliberative institutions that included actors such as regional governments, trade unions, and employers' associations (Seibel, 1993: 360). As Treuhand took on this new role within the framework of deliberative institutions, it slowly began to establish ties between social network and the policy networks in which they functioned. Through its networking interactions, Treuhand effectively became a significant importance as the middleman between the West German government of the FDR and that of the East German states. The political and social networking of the Treuhand exemplifies one example of how the strong economic and political structures from the West allowed for a successful transition of property rights for East German states.

Among the instances of regime rebuilding that proceeded following the collapse of communist satellite states, the economic and political reform in the former GDR was

the only instance where a decimated political administration and weak networks were suddenly absorbed by a country with strong markets and a well-established democratic political structure. The only true economic crisis endured by East Germany was that which followed the collapse of the GDR. The events triggered sudden economic convergence (*Wirtschafts und Währungsunion*) that was made official on the day of economic unification, July 1 1990 (Offe, 1997: 165). While these events ultimately paved the way for successful institutional reform, immediate impacts were felt in East Germany's export and domestic markets. Although the GDR had officially dissolved, the deeply entrenched roots of its state-planned economic past remained. Such an immediate blow to eastern Germany's infant market economy made for a highly attractive political and economic environment in which to implement neo-statist ideals. Yet the FDR had no intentions of implementing such wide-sweeping, centralized programs. Rather, rapid privatization aimed to promote the spontaneous and massive inflow of West German capital, which would ultimately provide the catalyst for the transformation of the East German states.

These reforms and social protections that were extended to East Germans gave them a concrete sense of direction on their path towards democratization and marketization. This sense of direction generated the collective notion of the values and goals that the new regime must pursue with high priority, namely a social market economy and a liberal democracy within the institutional framework of strong federalism (Offe, 1997: 185). The discontinuity of East Germany's political and economic institutions resulted in institutional reform from the West that led to adjustments in habits, expectations, and socioeconomic attitudes in the East. Next I turn to the dominant

political and economic models exemplified by the FDR, and examine the extent to which the West German model of strong social democracy and social market economy were implemented in the East German states by means of institutional transformation.

The FDR Model: Social Partnership and the Social Market Economy

When referring to the success of the West German model of democracy and social market economy, I employ the definition of “social partnership” as given by Lowell Turner in the introduction of his book *Fighting for Partnership: Labor and Politics in a Unified Germany*. In examining German institutions of negotiation, Turner focuses on a critical area of east-west relations, which is situated at the heart of democracy and the liberal market. The notion of “social partnership,” he argues, can be defined as “a method of market regulation in which strongly organized business and labor (the “social partners”) negotiate comprehensive agreements that frame the political economy from top to bottom” (Turner, 1998: 18). In the study of social partnership and the social market economy, the institutions compose the independent variables that shape the outcome and direction of democratization and marketization reform projects. The success of transformational reform, at least in the case of East Germany, is based on pre-existing economic and political structures of the old regime. Most importantly, however, it is the actors themselves that are the harbingers of change and facilitators of institutional adaptation between the new regime and the old. In the particular case of German unification, this took the form of policy negotiations, comprehensive industry-level bargaining, and codetermination between East and West. These elements, crucial to the notion of social partnership, were present in the institutional transfer from West to East Germany. Coupled with the FDR’s social market economy, a model of “social

capitalism” was erected in a modern, unified Germany (Turner, 1998). As Turner points out, this model of social partnership had been crucial for the export-oriented led growth of Western Germany following the end of World War Two, and has proven to play a key role in the negotiations of institutional transfer that transformed the political milieu and social markets in Eastern Germany.

The strong presence of social partnership is individual to the case of institutional transfer between East and West Germany, as most other Eastern European post-communist regimes were neither provided with such models on how to reconstruct their political and economic institutions, nor were they directly absorbed by western regimes with well-established democratic and social market infrastructures. Unique to the case of German unification, I believe the strong role of social partnership and the West German model of “social capitalism” facilitated the simultaneous implementation of market liberalization and democratization projects in the East German states. When it came down to making critical economic decisions, the institutions of German social partnership provided the most flexible yet durable foundation for policy making and transparent institutional transfer, all of which helped to ease the burden of a very complicated transition towards marketization and democracy. These partnerships also allowed all actors and interests groups that were involved in the restructuring and transformation of eastern Germany to have a place at the negotiation table. On account of the power of social partnerships and deliberative associations, neither the neoliberals’ reliance on open liberal markets and blueprint capitalism from the west nor the neostatists’ faith in an omnipotent, autonomous state proved to be entirely viable solutions to the dilemma of institutional transfer in the post-communist East German states.

Conclusions

Ultimately, institutional transfer and political and economic convergence between East and West Germany succeeded due to the success of deliberative institutions, negotiated adjustments, strong social markets and partnerships, and the pre-existing frameworks and measures taken on behalf of the former communist regime. Although these were all achieved through the collective power of the liberal market and the democratic state, democratization and marketization in eastern Germany does not owe its entire success to either transformational entity. Rather, East Germans, both pre and post unification, utilized existing political, social, and economic structures and networks to facilitate a nearly transparent reconfiguration of its institutions.

Although initially plagued by economic difficulties and unmet expectations, the process of institutional transfer from West to East eventually provided a new and viable framework for the transformation of the eastern Germany's political regime to a democratic order, and the reconstruction of its planned economy to that of a social market economy. Democratic consolidation and market reform were encompassed within the greater context of Germany's unification process. Once united, West German's socially democratic institutions were transferred to and implemented in the East.

In the isolation of East Central European democratization and marketization projects, the success of institutional transfer in Eastern Germany was measured on a highly domestic and European level. Yet today we live in an age where communism has collapsed and the rapid growth of globalization and international markets has put economies and democracies world wide. In recent years, the world economy has changed rapidly, becoming much more international through the phenomenon of globalization.

Since the fall of the Iron Curtain, levels of democracy have risen worldwide, as markets and societies have become increasingly integrated on a global scale. In this highly globalized world, a new quality to the international division of labor has arisen, which has led to increased levels of competition and subjected labor markets to unprecedented international competition. Germany's welfare state and social market democracy should possess the means to facilitate continued economic and social modernization in the face of global competition.

Considering the case of East Germany, will its adopted form of social partnerships and social capitalism be capable of withstanding such mounting pressures, or will new political policies and economic reforms have to be implemented in order to confront the challenge? As we have seen, social partnership was integral to institutional transfer in East Germany, particularly due to its capability to adapt, flex, and reform to particularities of political and economic reconstruction. If the result of the crisis of German unification is any testament to the true success of social partnerships and deliberative associations in eastern Germany, then there is every reason to believe in their ability to confront the new political and economic challenges of modern times.

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