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Economic Legal Reforms as a Necessary Means for Eastern European Transition into the Twenty-First Century

I. Introduction

Communism was once a revolutionary concept.1 It offered the prospect of a “prosperous, just, and liberating society.”2 This new society promised to end material and psychological deprivation as well as solve the fundamental economic and political struggles of a modern world.3 Communism represented the blueprint for civilized progress.4 No longer would private ownership exploit, enslave, and dominate the working class.5 Collective ownership promised the way of the future.6 More than one-third of the world embraced some version of this philosophy.7 Yet, what once was touted as the great experiment that would sweep the globe barely exists today.8

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1. See Paul B. Stephan III, The Fall—Understanding the Collapse of the Soviet System, 29 SUFFOLK U. L. REV. 17 (1995). The term “communism” first appeared among revolutionary groups in Paris during the 1830s. See THE OXFORD COMPANION TO POLITICS OF THE WORLD 165 (1993) [hereinafter POLITICS OF THE WORLD]. The word combined two meanings: (1) a political movement focused on overthrowing capitalist society on behalf of the working class; and (2) an outline of society under working class rule. See id. The first definition of communism represented an extreme form of socialism, more violent in its pursuit of abolishing private property. See id.
2. Stephan, supra note 1, at 17.
3. See id.
4. See id.
5. See id.
6. See id.
7. See id.
While fundamental changes have taken place in Eastern Europe that affect the global political, economic, social, and legal climate, successful transformation will not occur overnight. The ability of Eastern Europe to make a successful transition to market economies and democracy will depend in large part upon the new legal systems put into place. A "complete metamorphosis" of the law must embrace a capitalist system involving "the sanctity of private property, freedom of entrepreneurial activity, freedom of contract, [and] equality of all actors in the marketplace." Such new laws involve a total reversal of the principles of a communist past. Unfortunately, communism leaves behind an incredible legacy with which these newly emerging Eastern European countries must contend.

The purpose of this article is to showcase the changing legal systems in post-communist countries, specifically in the economic and business realms. The necessity for new legal systems must be recognized as crucial to this region's successful transition to democratic and free market economies. It is useful initially to briefly highlight what comprises Eastern Europe and its history during the denouncement of communism. Part II serves this purpose. Part III discusses the necessity and complexity of legal reform in the region. This section reviews the unprecedented legal, social, and economic changes as they are affected by the communist legacy. Part IV is the focal point of the article, reviewing the areas of privatization, banking, and bankruptcy. Part V briefly touches on other areas of needed economic legal reform. Part VI concludes the article with an eye towards where Eastern Europe has been and where the region is going in the twenty-first century.

II. Eastern Europe: Breaking Free From Communism

A. What Is Eastern Europe?

William Echikson, an author experienced in the affairs of Eastern Europe, states that "Eastern Europe, after all, is a misnomer." Despite the West's desire to
package this region, its peoples, and its problems, the truth remains that Eastern Europe was never a monolithic block.\textsuperscript{15} Eastern Europe is comprised of many different nationalities, different histories, and different traditions.\textsuperscript{16} Parts of the region are also referred to as Central Europe.\textsuperscript{17} This title is less a "geographic entity than an intellectual construct."\textsuperscript{18} The Soviet communist experiment failed to extinguish these vast differences.\textsuperscript{19} This led to the exciting and sometimes frightening present day situation in which the peoples of this region are beginning to unearth their unique national identities.\textsuperscript{20} Despite the many significant differences, many commentators suggest that the former Soviet empire can be dealt with as a whole.\textsuperscript{21}

Perhaps the most unifying characteristic is that all of these countries face similar problems in learning to function after communism.\textsuperscript{22} The transition from a centrally planned economy, as well as the switch from a single-party political regime, continues to be a daunting task.\textsuperscript{23} Social and economic chaos are two results brought about by the defeat of communism.\textsuperscript{24} A system that once promoted egalitarian ideals now experiences the reality of outright inequality.\textsuperscript{25} The ideals, politics, and economics

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15. See Osiatynski, \textit{supra} note 14, at 845.
16. \textit{Id}. A listing of the countries usually considered to be part of Eastern Europe can be separated into three categories: (1) former republics of Yugoslavia; (2) former members of the Soviet Union's Council for Mutual Economic Assistance (COMECON); and (3) former republics of the Soviet Union. See John J.A. Burke, \textit{The Economic Basis of Law as Demonstrated by the Reformation of NIS Legal Systems}, 18 LOY. L.A. INT'L & COMP. L.J. 207, 208 n.1 (1996). Former republics of Yugoslavia included Bosnia-Herzegovina, Croatia, Macedonia, and Slovenia. Yugoslavia currently is composed of Serbia and Montenegro. The former members of COMECON are Bulgaria, Cuba, Czechoslovakia, German Democratic Republic, Hungary, Mongolia, Poland, Romania, and the U.S.S.R. The former republics of the Soviet Union are Armenia, Azerbaijan, Belorussia, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldovia, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan. See \textit{id}. While this listing is not exhaustive, it does provide a manageable breakdown of a majority of the countries undergoing transition. In addition, while these countries are in no way enacting the exact same political, economic, and legal systems, they are all moving toward a democracy and free market economy, thus making their grouping advantageous for study. See \textit{id}.
17. See \textit{Politics of the World, supra} note 1, at 119.
18. \textit{Id}.
22. See \textit{id}.
25. See Osiatynski, \textit{supra} note 14, at 845. Much of the optimism and excitement that precipitated the "quiet revolutions" of such countries as Bulgaria, Hungary, and Poland in 1989 and 1990 has been squelched by the present reality of social and economic inequality. Mark N. Salvo, Comment, \textit{Constitutional Law and Sustainable Development in Central Europe: Are We There Yet?}, 5 \textit{S.C. Env'tl. L.J.} 141 (1997). Political upheaval is often the result of such inequality. See \textit{id}.}

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of Eastern Europe are not the only areas experiencing change. Such transformation requires a change in the legal systems of these countries as well.\textsuperscript{26} The economic success of these countries, in fact, is dependent upon the ability of the legal system to encourage and further economic reforms.\textsuperscript{27} Since the old legal institutions were based on dictatorship and a central economy, such systems are in many ways obsolete.\textsuperscript{28} The post-communist world known as Eastern Europe must establish a system based on constitutionalism and the rule of law.\textsuperscript{29}

B. 1989: THE AUTUMN OF PEOPLES

Beginning in 1989, the fall of communism in Eastern Europe occurred so swiftly that some analogize it to the 1848 Springtime of Peoples.\textsuperscript{30} Both waves of revolutions carry monumental significance, as one marked the beginning of an era, and the other, the end.\textsuperscript{31} In 1990 for example, the Polish people revealed how deeply this revolutionary wave would sweep, as eighty percent of the nation’s citizens voted against the old regime during the presidential elections.\textsuperscript{32} It is evident that the most visible changes took place in the realm of politics. Osiatynski states it best when he says, ‘'[i]t was as if frozen societies began to make up for lost time.'’\textsuperscript{33} In Poland, for example, new parties sprung up almost daily, over one hundred in all.\textsuperscript{34}

Beyond politics, the economic sphere in Eastern Europe began to experience vast changes as well. State-owned factories and enterprises began the process of privatization.\textsuperscript{35} In such countries as the Czech and Slovak Republic, Hungary, and Poland, property confiscated as many as forty-five years ago began to be returned to its original owners.\textsuperscript{36} While privatization is a necessary vehicle with which to transcend post-communist countries to market economies, such a process is complex and slow, often limited by social factors.\textsuperscript{37}

\begin{footnotes}
\item[26.]
See Burke, supra note 16, at 208.
\item[27.]
See Coco, supra note 24, at 171.
\item[28.]
See Burke, supra note 16, at 208.
\item[29.]
See id.
\item[30.]
See Osiatynski, supra note 14, at 824. The 1848 Springtime of the Peoples was the first revolution against capitalism. In 1989, the world witnessed the first revolution for capitalism in this region of the world. See id.
\item[31.]
See id.
\item[32.]
See id. Due to depressed conditions in many countries, the initial euphoria over the promises of democratic change has worn thin, causing some disenfranchised voters. See Salvo, supra note 25, at 141 n.1. Polish voters in a November 19, 1995 election provide an example. See id. Disenfranchised voters did not elect incumbent Lech Walesa as president, but rather communist Aleksander Kwasniewski. See id.
\item[33.]
Osiatynski, supra note 14, at 824. The Eastern European revolutions all occurred very quickly—over the course of a few months. See POLITICS OF THE WORLD, supra note 1, at 226.
\item[34.]
See Osiatynski, supra note 14, at 824.
\item[35.]
See id. Privatization means shifting property and ownership rights from one entity to another. See POLITICS OF THE WORLD, supra note 1, at 744.
\item[36.]
See Osiatynski, supra note 14, at 824.
\item[37.]
See Coco, supra note 24, at 171.
\end{footnotes}
While economics and politics play such a large role in modern society, in many ways the most telling changes occurred within the minds of the East European peoples. Almost overnight, people's beliefs in communism began to change. No longer were such tenets as economic security and a right to work worth the struggle. Eastern Europe would now have to engorge itself with capitalist ideals once forbidden and unknown. While people in post-communist countries embraced the change to democracy and a free market economy, deeper common intellect and social values so completely tied to a centrally-planned economy would prove difficult to change. Famed economist Milton Friedman theorized that pervasive belief systems would pose more of a barrier to a successful move toward a market economy than any purely economic obstacles.

Despite the amazingly swift and revolutionary changes taking place, Eastern Europe was not generally marked by extreme violence and turmoil. There were relatively few shootings or demonstrations, and monuments of the communist era remained standing. The breaking down of the Berlin Wall is perhaps the most vivid memory of the Western world, and it was a joyful and peaceful event. Since these changes were not precipitated by a loaded gun and an army of tanks, it is often difficult to perceive the sheer depth of change in Eastern Europe.

C. WHY DID COMMUNISM FALL?

Knowing that such profound changes have taken their course in Eastern Europe, the next logical question becomes how such changes came about. There is neither a simple nor a single answer to this question. Some experts on the region cite the economic failure of communism. Others also cite those nations that struggled to win freedom before the communist machine was ready to let go. Another reason given for the fall of communism is the reign of Gorbachev, with such policies as

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38. See Osiatynski, supra note 14, at 824.
39. See id.
40. See Greenspan, supra note 9, at 2 n.3.
41. See id.
42. See Osiatynski, supra note 14, at 825.
43. See id.
44. On August 13, 1961, the Berlin Wall was raised to stop the massive migration of East Germans to the West. See Greenspan, supra note 9, at 1 n.1. Attempts to cross the wall often ended in death, making the wall an infamous "symbol of Stalinist oppression" as well as a symbol of the fragmentation of Europe and Germany after World War II. Id. This symbol of the Iron Curtain finally came down on November 9, 1989. See id. at 1.
45. See Osiatynski, supra note 14, at 825.
46. See id. at 827.
47. See id. Certain authors pinpoint the Solidarity movement in Poland in 1980 as the beginning of the demise of communism. See ECHIKSON, supra note 14, at 11. Others push this beginning earlier to 1979, with the visit of Pope John Paul II to Poland. See POLICS OF THE WORLD, supra note 1, at 707.
perestroika and glasnost as well as the overall message that Moscow would not intervene to protect the status quo of communism abroad. Still other commentators suggest it was the moral and economic pressure from the West that prevented communist hard-liners from using force against any signs of change. Yet another reason—often overlooked—is the dynamic of change within the communist party itself. In many ways, communist elites lost confidence in themselves, their legitimacy, and their right to rule using whatever means necessary.

Never will a complete and final list be prepared concerning the reasons why communism fell. This is true in large part because of the sheer complexity and diversity of the region of the world that communism once held tightly in its grip.

III. The Necessity and Complexity of Legal Reform

In the western world, it is difficult to perceive how very different legal systems of post-communist and socialist countries once were. In such countries, the legal systems were based on socialist and communist goals. In this sense, such systems were used as political instruments of the government. The law was not used to provide predictable rules of behavior, but instead to function as an agent in promoting the goals of communism and socialism. For these reasons, legal systems in Eastern Europe are not well suited to an open market economy.

48. The term "perestroika" is synonymous with the word "restructuring" and may be defined as a "deep, revolutionary renewal of all aspects of the life of Soviet society, providing socialism with the most modern forms of organization, and disclosing to the fullest extent possible its merits in all respects: economic, sociopolitical and ideological." \textit{Politics of the World, supra} note 1, at 693. While perestroika has been used by many Soviet leaders including Stalin, it is most closely associated with Gorbachev's reforms. See id. Glasnost reflected Gorbachev's belief in a more open and free flow of information. See id. at 694. Gorbachev believed that without greater understanding about the true state of Soviet affairs, the Soviet people would not be willing to follow the reforms outlined by perestroika. See id.


50. See id.


52. See id. at 828; see also Ash, \textit{supra} note 49, at 140-42. In reference to Eastern Europe in 1989, Ash cites DeTocqueville, who once characterized the most significant element of a revolution as "the ruling elite's loss of belief in its own right to rule." \textit{Id.} at 142.


54. See id.

55. See id.

A. Lawmaking on a Grand Scale

Beginning in 1991, Eastern Europe began the unprecedented effort of lawmaking on a grand scale. Almost overnight, former communist countries had to disassemble their political, economic, and legal institutions, which were based on centrally-planned economies, to erect market-based democracies. Large sections of these countries' legal systems were now obsolete. The legislatures, however, were not simply free to form law and policy, as an "author is free to write a novel." Post-communist actors have been and continue to be constrained by history and the economy.

Seven decades of communist rule left most legal systems ill-prepared for the changes needed immediately after the 1991 and 1992 revolutions. In Russia, for example, almost no law existed in areas of contract, property, and tort. Thus, many new laws throughout the region had to be created to fill the "legal voids."

Many of the new legal codes in Eastern Europe are described as "professorenrecht" (the law of the professors), as most were formulated by law professors. Beyond full-scale codes, many of the new laws are simply individual laws. Despite the implementation of new laws, various old-guard laws remained in place. In Russia, for example, old Soviet laws remained on the books from 1991 to 1993, unless alternative laws had been adopted. Even when new laws were instituted, many countries, like Russia, did not repeal or amend old laws, but only adopted new laws to be read in conjunction with the pre-transition-period laws. To complicate matters further, the new laws often originate from different sources and may provide overlapping and contradictory coverage. Besides presidential decrees and legislative efforts, other sources of law include such entities as administrative agencies.

57. See Burke, supra note 16, at 207.
58. See Thompson, supra note 13, at 864-65; see also Burke, supra note 16, at 207. See generally Greenspan, supra note 9, at 8.
59. See Burke, supra note 16, at 208.
60. Id.
61. See id. Communist legacies for Poland include an international debt of $40 billion (U.S.), rampant corruption, overwhelming government mismanagement, and unusually high mortality and morbidity rates due to everything from environmental hazards to alcoholism. See Politics of the World, supra note 1, at 707.
62. See Thompson, supra note 13, at 868.
63. See id.
64. Id.
65. Osakwe, supra note 11, at 1415.
66. See Thompson, supra note 13, at 865 n.5.
67. See Coco, supra note 24, at 173.
68. See id.
69. See id.
70. See Thompson, supra note 13, at 866.
While some new laws and decrees pass quickly, many are often premature and experience slow implementation. While some new laws and decrees pass quickly, many are often premature and experience slow implementation. Other reforms are often "incomplete, partial, and inconsistent." Practicing law in Eastern Europe involves an environment of a "learn as you go" nature. The situations in these countries reveal that law is used as the vehicle to enact legislatively established policies. Economics shape the vast legislative efforts in Eastern Europe because restructuring the economy and promoting better standards of living assume top priority. Thus, many of the new laws enacted during the transition phase in these countries deal specifically with economic issues. In this sense, it can be said that industrialized countries use legal systems to enable economic policies. While an economic system is not the exclusive purpose for a legal system, such systems do complement a country's chosen economic system by "setting rules of conduct for market actors."

B. THE HUMAN FACTOR IN IMPLEMENTING NEW LEGAL SYSTEMS

While many of the new legal systems were concocted almost overnight, implementation, acceptance, and legitimacy will take time. Even eight years after the break from communism, many laws have not permeated the legal consciousness of the people in this region. In Russia, for example, the Civil Code "functions like a potted plant in a society which refuses to accept the rule of law as a social value. [T]he code decorates and brightens its surrounding environment, but is not biologically rooted in the ecological system into which it is transplanted."

In establishing a working legal system, one factor crucial to the recipe is the "human dimension of reform." A country's ability to make a successful transition out of communism, no matter how well-conceived and written the plan is in theory, is contingent in large part on the people. Much of the success

74. See Burke, supra note 16, at 208.
75. See id.
76. See id. Estonia provides a good example of the theory that the majority of laws enacted in post-communist countries are of an economic nature. See id. at 212.
77. See id. at 208.
78. Id. at 210.
79. See Osakwe, supra note 11, at 1418.
80. Id. at 1419.
82. See id.
depends on the judgment and skills of the people who will establish and implement the new legal systems. This involves having qualified accountants, auditors, and marketing specialists. Eastern European countries also need highly qualified attorneys and judges to aid in the development of a modernized market economy.

On a more basic level, the mass population of Eastern Europe must be considered. An understanding of the expectations and processes of a market economy must be instilled in younger generations in order to begin passing on a fuller and more intuitive understanding of capitalism to future generations. This process will take time. As for older generations, they arrive out of a communist legacy in which there was "little tolerance for individual accomplishment, business activities, or entrepreneurship." The older generations are very influential actors in determining the success of transformation. Unfortunately, an "ingrained popular cynicism towards governmental authorities" continues to exist in most countries. For these reasons, the communist legacy makes it hard to establish the rule of law. Recent economic troubles further compound the problem of popular acceptance of transition economies and politics.

As a result of the problems with the human dimension of reform, the law on the books still varies greatly from the law in practice in most Eastern European countries. A mature legal culture does not yet fully exist in the region. Mikhail Smolensky, of the Russian Stolichnii Bank in Moscow, describes the current atmosphere in Russia as one where "there is no respect for the law, no culture of law, no judicial system." Smolensky adds that before this new culture can exist, the interim is one in which a lawless atmosphere abounds and where "bribery is the grease of commerce." With such words, the Russian banker seems to understand the human factor at stake in transition. "The quality of democracy depends heavily on the quality of the democrats," concludes Smolensky.

83. See id. at 438-39.
84. See Greenspan, supra note 9, at 9.
86. See Greenspan, supra note 9, at 12.
87. See id.
89. Coco, supra note 24, at 172-73. See also Puffer & McCarthy, supra note 88, at 1287.
90. See Boylan, supra note 72, at 1327.
91. See Coco, supra note 24, at 174.
92. See Osakwe, supra note 11, at 1419.
93. See id.
95. Id.
96. Id. at 358.
C. EASTERN EUROPE AND THE GLOBAL ENVIRONMENT

It is important to review what has been done in these "growing" legal systems since their emancipation. It is also important to grasp the future direction of change. Post-communist countries provide a rich laboratory for observing legal reforms on a wide basis, and for lending insight into how the rest of the world will be able to interact with these newly formed market economies. Eastern European states must have legal systems that are compatible with other industrialized nations. A solid legal structure can establish confidence from creditors and investors affecting trade and foreign investment.

It must be noted that the West has impacted the legal transformation of Eastern Europe in numerous ways. Such influences involve everything from configuring international project financing, drafting new laws, and establishing a legal infrastructure to assist transition. While helpful, and arguably necessary, Western influence raises the concern of the "transplantability of Western social and political institutions and postcommunist state building." Western legal systems involve autonomic sets of rules that are separate from, but impacted by, social standards. In this sense, the legal system maintains an independent role in forming culture. As a result, Western cultures usually have "internalized a sense of law." In addition, an institutional legal framework endures to strengthen a culture based on the rule of law.

IV. Transitional Economies and Democracies Through Legal Reform

A. PRIVATIZATION LAWS: A PRECURSOR TO ALL OTHER LEGAL REFORMS

While most legal minds would agree that all areas of the law need to be revamped in post-communist countries, much economic analysis tends to focus on

97. Rubin, supra note 56, at 2. Such immense changes have taken place over the past eight years since the fall of communism, that "[a]lmost everything one can say about [a] country is false and true at the same time." Patricia A. McCoy, Levers of Law Reform: Public Goods and Russian Banking, 30 CORNELL INT'L L.J. 45, 49 n.4 (1997) (quoting John Maynard Keynes). It is, however, possible and useful to research how post-communist governments are enacting such drastic changes in their legal systems on a more general level. See Burke, supra note 16, at 207. It is useful to compare laws and philosophies with other industrialized nations. See id. at 218. Such comparison also enables greater predictability as to what is in store for these countries. See Rubin, supra note 56, at 2.

98. See Rubin, supra note 56, at 2.
99. See generally Burke, supra note 16, at 207; Greenspan, supra note 9.
100. See Burke, supra note 16, at 218.
101. See id.
102. See Chua, supra note 20, at 4.
103. See id.
104. Id. at 5.
105. See Coco, supra note 24, at 171-72.
106. See id. at 172.
107. Id.
108. See id.
property law, specifically the process of privatization. Reformers battle an old resource allocation system, based on politics and social policy that created huge inefficiencies. Producers were dependent upon the government for money; the people were dependent on the government for its system of "cradle-to-grave" social benefits. The challenge is to convert to a system based on efficient resource allocation resonating in a competitive marketplace—shifting assets and resources from uncompetitive entities to competitive ones. The word "privatization" defines this complex transformation process. Unfortunately, the process of privatization often involves great economic hardship. Also, political and social tensions arise because of the redistribution of income, wealth, and power. It is often difficult for reformers to garner massive public support to vigorously carry out such a process. Privatization is not a swift process and can only succeed after much sacrifice.

By definition, privatization sounds simple. "Formally, privatization is an orderly and legally sanctioned transfer of . . . property." However, the property to be transferred is almost all property that once belonged to "the people" indivisibly. Thus, the details and organization of such transformation into private entities become mind boggling. In contrast to other non-Eastern European countries, privatization is not simply the transfer of ownership from state to private

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112. See Balfour & Crise, supra note 110, at 85; see also Coco, supra note 24, at 169.
113. See Balfour & Crise, supra note 110, at 85. Privatization may be defined as a "process of socio-economic transformation of the foundation of socialist-centralized economies by means of transferring state assets and state enterprises to the private sector and thereby resulting in fundamental changes in ownership relationships in the spheres of production and distribution of material welfare." Klaudt, supra note 85, at 305 n.8. This definition, however, does not discredit the existence of state property. See Andrei A. Baev, Is There a Niche for the State in Corporate Governance? Securitization of State-Owned Enterprises and New Forms of State Ownership, 18 HOUS. J. INT'L L. 1, 2 (1995). Privatization is usually thought of as the opposite of nationalization. See id. As such, privatization is usually considered a capitalist notion, while nationalization is considered a socialist mechanism. See id. In reality, nationalization and privatization are merely opposites on a continuum of property rights. See id. at 3.
114. See Balfour & Crise, supra note 110, at 85.
115. See Mencinger, supra note 111, at 34.
116. See Balfour & Crise, supra note 110, at 85.
117. See id; see also Helmut Gerlach, Bankruptcy in the Czech Republic, Hungary, and Poland and Section 304 of the United States Bankruptcy Code, Proceedings Ancillary to Foreign Bankruptcy Proceedings, 22 MD. J. INT'L L. & TRADE 81, 86 (1998).
118. Mencinger, supra note 111, at 34.
119. Id. Around the world, privatization involves a difficult, lengthy, and detailed process that is "as politically sensitive as it is technically complicated." POLITICS OF THE WORLD, supra note 1, at 745. Privatization may be especially difficult when the division between public and private entities is affected by regional, ethnic, and religious complications. See id.
Instead, privatization is a process by which the concept of property ownership in its most basic form is reintroduced to Eastern European societies. Often, the success of privatization in a newly emerging democratic country is used to measure the overall progress of establishing a market economy. Because privatization removes assets from the state and puts them in the private sector, such a measure underscores the success of transition out from under state control. It is important to note that privatization actually encompasses a wide range of policy initiatives. Some of these basic initiatives include: (1) the restoration of property to dispossessed former owners; (2) the sale or lease of small entities such as shops and cafes; (3) the sale of large industrial entities; (4) the sale of land; and (5) the sale of domestic residences such as apartments and houses. Progress occurs in each area separately and does not necessarily transfer to success in all areas. Numerous specific policy goals are also pursued in connection with privatization. Unfortunately, not all of these goals are compatible or consistent. Skeptics suggest that privatization is one way in which the old communist elite is maintaining positions of wealth and power. Political assets can be gained by vast releases of public resources. Obviously, no single privatization scheme can achieve all policy goals and remain completely free of misconduct. Reformers may use different types of privatization to achieve different policy objectives. Difficult decisions concerning which goals to pursue must be made. Compromise is a necessary element in this process.

To achieve success, privatization demands a tailored legal and political structure to serve as the "skeleton of a market economy." The institutional elements

121. See id. Private property is one of the fundamental building blocks of a free market economy. See Gerlach, supra note 117, at 85.
123. See id.
124. See id.
126. See Rutland, supra note 122, at 5. See generally Klaudt, supra note 85.
127. See Rutland, supra note 122, at 8 (for a listing of specific goals see page 9). See generally Prosser, supra note 120, at 215.
128. See Rutland, supra note 122, at 9.
129. See id.; Klaudt, supra note 85, at 303 n.2; see also Heller, supra note 125, at 624.
130. See Rutland, supra note 122, at 9.
131. See id.
132. See id. Other reforms are often used in conjunction with privatization such as public enterprise rehabilitation, restructuring, or commercialization, streamlined enterprise-government relations, and market-based pricing criteria. See POLITICS OF THE WORLD, supra note 1, at 743.
133. See Rutland, supra note 122, at 9.
134. See id.
135. Balfour & Crise, supra note 110, at 87.
must be in place; otherwise, the foundation of the economy will be unstable. The government of each country must take an active and affirmative role in dismantling inefficient companies, finding new owners, and shifting assets. Often this involves decisions between competing interest groups on social and political levels. Economists and legal scholars suggest that new institutions and measures of reform established by these governments need to focus on creating an overall atmosphere of easy "entry and exit of resources." Such an atmosphere encourages efficient entities and discourages inefficient entities. Certain economic areas of the law, as will be discussed shortly, promote this desired atmosphere in post-communist countries, thus allowing the various methods of privatization a chance to succeed. Also needed in this mix is a stable political climate.

1. Private Property: Building Block of a Free Market Economy

Property law is currently one of the most confounding and controversial areas of law, largely because of the magnitude of vested interests. Under communism, the legal concept of real estate did not exist—the state owned all land for the people indivisibly. In a manner once only written about in university textbooks, Eastern Europe has encountered the most difficult job of defining real property rights and ensuring conditions of a free, fair, and competitive marketplace. Property law, and more specifically property rights, help to ensure that

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136. See id. The goal of reform is to provide a legal system and infrastructure that ensures individual freedom and advancement. See Thornton, supra note 8, at 848. Privatization is not simply the removal of government and the introduction of pure laissez-faire rules. See Prosser, supra note 120, at 234.
137. See Rutland, supra note 122, at 7; see also Heller, supra note 125, at 629-30; see generally Coco, supra note 24, at 169-70.
138. See Rutland, supra note 122, at 7.
139. Balfour & Crise, supra note 110, at 87.
142. See Balfour & Crise, supra note 110, at 87.
144. See Heller, supra note 125, at 627. As a result, land markets did not exist, which means that no legal tools such as land registries exist in Eastern Europe. See id. at 628.
145. See Klaudt, supra note 85, at 304.
146. See Gray, supra note 143, at 295. In Russia, for example, property ownership is distorted in favor of a small handful of economic players. See Kathryn Hendley, The Spillover Effects of Privatization on Russian Legal Culture, 5 TRANSNAT'L L. & CONTEMP. PROBS. 39, 46 (1995). Those fortunate enough have reaped unbelievable profits. See id. The numbers of impoverished, however, are far greater. Id. There does exist a middle ground in which a Russian middle class could evolve. See id. As the Russian middle class grows and assumes property rights, they will increasingly demand
resources are used efficiently.\textsuperscript{147} A well-instituted legal system that guarantees protection and enforcement of property rights can raise investor confidence.\textsuperscript{148} With such confidence, owners will then set out to maximize the productive use of their property.\textsuperscript{149} This translates into a more efficient economy on a grand scale.\textsuperscript{150} To maintain and spread owner confidence, legal protections and rules regarding property must apply to all different types of property,\textsuperscript{151} including real property, movable property, and intellectual property.\textsuperscript{152} Different countries have instituted multifarious privatization schemes.\textsuperscript{153} Three main methods of privatization are recognized: (1) voucher; (2) joint venture; and (3) liquidation.\textsuperscript{154} Countries also use different variations and combinations of these methods.\textsuperscript{155} Under the voucher system, the state distributes ownership shares in public entities to its citizens.\textsuperscript{156} The joint venture system usually involves the pairing of a foreign-owned company with a state-owned entity.\textsuperscript{157} Using the liquidation system, the productive assets of state-owned entities are sold to the highest bidder, while the remaining assets are scrapped.\textsuperscript{158} Combining the various methods can result in the transformation of many different-sized state entities.

clear and enforceable laws and regulations providing property protections and guarantees. \textit{See id.} at 47. The more immediate source of the demand for protection, however, are the small handful of those whose interests are presently at stake. \textit{See id.} Interestingly, at this stage the demand is "not for laws per se, but for a basic level of stability . . . allow[ing] them to make rational choices when planning for the future." \textit{Id.} Such an environment demands a stable regulatory scheme. \textit{See id.} (this is especially true in regard to taxation).

147. \textit{See Balfour & Crise, supra} note 110, at 87.

148. \textit{See id.} at 87-88. Property rights are rules of the game that can be defined by legislation, administrative rules, or informal customs. \textit{See Thornton, supra} note 8, at 849. Such rules regulate how competition for valuable resources may take place. \textit{See id.} Owner and investor confidence is especially important in the context of foreign investors. \textit{See Balfour & Crise, supra} note 110, at 88. Russian law now includes a formal right to compensation for expropriation. \textit{See Heller, supra} note 125, at 641 n.101. Unfortunately, these provisions are underdeveloped. \textit{Id.} Often foreigners require a more stable and protected atmosphere than even domestic investors. \textit{See Balfour & Crise, supra} note 110, at 88. Foreigners are reluctant to invest large sums of money unless they can mitigate some risks through legal rights and protections. \textit{See id.} Hungary, for example, has the most business-friendly laws in all of Eastern Europe. \textit{See Klau, supra} note 85, at 319. As a result, Hungary has experienced a flood of foreign investment. \textit{See id.}

149. \textit{See Balfour & Crise, supra} note 110, at 88. If property is unprotected because of absent or unclear property rights, the individual incentive to own such property decreases. \textit{See Thornton, supra} note 8, at 849.

150. \textit{See Balfour & Crise, supra} note 110, at 88.

151. \textit{See id.}

152. \textit{See id.} Private ownership of real property is far less disputed politically and more entrenched in the Eastern European mindset. \textit{See Heller, supra} note 125, at 638 n.86 (referring specifically to Russian law).

153. \textit{See Balfour & Crise, supra} note 110, at 86.

154. \textit{See id; Coco, supra} note 24, at 174.

155. \textit{See Balfour & Crise, supra} note 110, at 86.

156. \textit{See id.}

157. \textit{See id.} In Russia, for example, while foreign investors may take part in voucher auctions through intermediaries, they normally choose to participate in Russian privatization in the form of joint ventures. \textit{See Peck, supra} note 140, at 34.

158. \textit{See Balfour & Crise, supra} note 110, at 86; \textit{see also Coco, supra} note 24, at 179-80.
The major controversy regarding privatization involves the speed at which such reform should take place. Some argue in favor of a rapid and immediate privatization, referred to as the "big bang" method. Others argue for a more modest paced transition from state to privately held property.

Since the revolutionary break with communism, all countries have undergone painful sacrifices, usually only to find themselves with reduced standards of living, reduced production, increased unemployment, and a worsened distribution of income. All Eastern European countries once declared uncompromising loyalty and faith in building a capitalist market. Each country made a staunch commitment to ensure full-scale privatization of state-owned property. While knowing this would be a complex and difficult period, perhaps none truly recognized or comprehended how devastating the transition would prove to be for some.

Entering 1999, most post-communist countries have had only modest success in the realm of privatization. Few countries, if any, have completely transformed major portions of their economies. Difficulties have arisen, especially in the realm of industrial privatization, but some countries have met with success in the privatization of smaller-sized entities. This grouping includes such entities as retail operations and public service entities. Unfortunately though, many

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159. See Rubin, supra note 56, at 1; Gerlach, supra note 117, at 86 (refers to the two different approaches as fast-track privatization and moderate-track privatization).

160. Rubin, supra note 56, at 2. The term "big bang" is often used to mean "shock therapy." Robert B. Seidman et al., Big Bang v. Gradual Change: Macro-Economic Changes from Centralized to Market Economies: Big Bangs and Decision-Making: What Went Wrong?, 13 B.U. INT'L L.J. 435, 436 n.1 (1995). Poland was the first post-communist country to employ the big bang approach. See id. at 437. Poland is somewhat unique in that private ownership—in a limited sense—did exist in the country under communism. See Gerlach, supra note 117, at 88-89. The Czech Republic provides another example of fast-track privatization. See id. at 86-87. Most other post-communist countries followed Poland's lead. See Rubin, supra note 56, at 436. Unfortunately, the radical reforms were not as successful as hoped. See id. at 437. All of Eastern Europe found itself in a severe recession, and inflation continues to be a problem. See id.

161. See Rubin, supra note 56, at 2. Hungary was the only country in Eastern Europe to employ an incrementalist policy. See Seidman, supra note 160, at 436 n.2 (incrementalism is also referred to as piecemeal social engineering or gradualism). Incrementalism in most respects met with the same results as shock therapy, resulting in high inflation and recession. See id. at 438-40, 442. For specifics on Hungarian privatization, see Gerlach, supra note 117, at 87-88.

162. See Mencinger, supra note 111, at 34. Privatization to a large extent determines society's economic winners and losers. See Klautz, supra note 85, at 327. Under communism, unemployment was unheard of prior to 1989. See id. at 328. Modern unemployment is generally caused by the closing or privatization of large state-owned enterprises. See id. The private sector is not yet capable of absorbing these workers. See id.

163. See Mencinger, supra note 111, at 34.

164. See id.

165. See id.

166. See Rutland, supra note 122, at 5.

167. See id. at 7. Reasons for the sluggish transformation include: (1) the ambiguity of new rights; (2) local government corruption; and (3) the lack of a legal infrastructure. See Heller, supra note 125, at 623.

168. See Rutland, supra note 122, at 7.

169. See id.
stores still remain empty, the entrepreneurial promise of “transition from Marx to markets” unfulfilled.\textsuperscript{170} Not all privatization efforts have been a failure; the Czech Republic, East Germany, Russia, and the Slovak Republic have made significant advances.\textsuperscript{171} These are the only countries that have instituted a legitimate degree of industrial privatization.\textsuperscript{172}

In trying to eradicate inefficient entities once owned by the state, politicians in Eastern Europe walk a fine line between desperately needing foreign investment and being criticized for selling off national resources at “fire sale” prices.\textsuperscript{173} Foreign investors often require major control in their investments and also often focus only on those industries and entities with the most potential, leaving domestic investors and entrepreneurs with whatever is left.\textsuperscript{174} Any effort to limit foreign investment, however, leaves only the very limited domestic market to pick up the slack. A delicate balance must be struck between these two constituencies.\textsuperscript{175}

Another problem is that of trying to balance the goals of efficiency and social equity.\textsuperscript{176} While it is often best if control of an entity is concentrated in a small group, outsiders often accuse such groups of being the old party officials who are now beneficiaries in a new system of corruption.\textsuperscript{177} The very structure of the privatization process gives tremendous control to politicians who are not free from conflicts of interest.\textsuperscript{178} Thus, ensuring fairness in the process is very difficult, especially when the mere perception of unfairness by the citizenry can cause difficulties.

2. Case Study: Russia

The Russian government launched a massive privatization program in July of 1992 with the Program for Deepening the Economic Reform in the Russian Federation.\textsuperscript{179} The document alone is roughly 280 pages, discussing the basic goals of Russian privatization: (1) liberalization and stabilization of the monetary

\textsuperscript{170} Heller, supra note 125, at 622-23. Many stores remain empty because title to the land is unclear or the property is still occupied by defunct state-run entities. See id. at 634.

\textsuperscript{171} See Rutland, supra note 122, at 8. The Russians, for example, implemented privatization reforms at a pace rarely matched by other Russian reforms. See Peck, supra note 140, at 22.

\textsuperscript{172} See Rutland, supra note 122, at 8.

\textsuperscript{173} Id. at 10.

\textsuperscript{174} See id.

\textsuperscript{175} See id.

\textsuperscript{176} See id.

\textsuperscript{177} See id. Preferences for existing managers and workers in privatization schemes across Eastern Europe have been criticized by the populace. See Prosser, supra note 120, at 230. Businesses transferred to management without any system of centralized control resulted in many transfers at “artificially reduced prices” to the benefit of former managers and workers. Id. Such practices outraged many citizens and discredited the privatization process to an extent. See id.

\textsuperscript{178} See Heller, supra note 125, at 624.

\textsuperscript{179} See Georgi G. Angelov, Legal Framework of Privatization in Russia, 2 MINN. J. GLOBAL TRADE 207 (1993). Russian politics dictated the speed with which Russian privatization occurred. See Peck, supra note 140, at 22. The director of privatization, Deputy Prime Minister Anatoly Chubais, cited the failed coup attempt in August of 1992 as the impetus for large-scale privatization. See id.; see also Coco, supra note 24, at 175 (citing Angelov, supra).
system; (2) institutional changes regarding state-owned entities; (3) structural changes; (4) foreign investment policy changes; and (5) social policy changes.\textsuperscript{180} Twenty-five thousand large firms were ordered by the government to transform themselves into joint-stock companies.\textsuperscript{181} This conversion, also known as "denationalization," was to begin the process of transforming state-owned entities into newly formed companies independent of the state.\textsuperscript{182} Each company was required to devise a plan for share distribution.\textsuperscript{183}

Russian law makers enacted the Russian Law on Privatization of State and Municipal Enterprises (RLP) to guide parts of the process and to aid in implementation.\textsuperscript{184} Months later, the government issued 148 million vouchers\textsuperscript{185} to the people of Russia, each worth the nominal value of 10,000 rubles.\textsuperscript{186} Auctions then took place in which people could either choose to use their vouchers for shares or sell them for cash.\textsuperscript{187} The equivalent dollar price for the average voucher was ten dollars.\textsuperscript{188}

In order to pass these privatization laws, the laws were altered somewhat in favor of worker ownership.\textsuperscript{189} Companies undergoing share distribution were

\begin{footnotesize}
\begin{enumerate}
\item See Angelov, supra note 179, at 207.
\item See Rutland, supra note 122, at 13. To account for the vast range of sizes of state entities, the program divided all entities into three different groups. See Angelov, supra note 179, at 213.
\item Angelov, supra note 179, at 210.
\item See Rutland, supra note 122, at 13. Because the privatization process was highly decentralized, approval of entity share distribution plans occurred almost automatically. See Peck, supra note 140, at 23.
\item See Angelov, supra note 179, at 210; see also Coco, supra note 24, at 175-76. The RLP called for an initial three-year program of privatization. See Angelov, supra note 179, at 210. The law outlined those sectors crucial to society in which the state would maintain limited control. See id. at 212.
\item While the amounts of the individual vouchers are rather nominal, such a vast system does have its advantages. See Angelov, supra note 179, at 219. Each of the millions of Russian citizen is given an "equal start" under the new economy. See id. The hope is that such involvement will encourage the development of an extensive middle class and help compensate for a lack of savings by the people. See id. The voucher system is not without its drawbacks, in that vouchers may simply replace ambiguous state ownership with ambiguous and widespread citizen ownership. See id. In this sense, the people still have little control over management issues. See id. Lastly, voucher systems can be manipulated for fraudulent purposes. See id.
\item See Rutland, supra note 122, at 13; Coco, supra note 24, at 178 n.42 (10,000 rubles is the rough equivalent of $25). See also Peck, supra note 140, at 26.
\item See Rutland, supra note 122, at 13. The Yeltsin government wanted to make the results of privatization irreversible. See Peck, supra note 140, at 23. The government wished to create national pride in stock ownership. See id. Those citizens opting to sell their vouchers may have sold them to one of the 500-plus investment funds established for this purpose. See id. at 26. Investment funds acquired one-sixth of all vouchers. See id. Investment funds are, however, limited by law to owning no more than fifteen percent of any one company. See id. at 34. Vouchers were very popular because of their instant profit potential as evidenced by trading on the Moscow Commodity Exchange. See id.
\item See Rutland, supra note 122, at 13. Because Russians received vouchers virtually for free, and since no imbedded notion of private property existed, critics worried that the majority of Russians would not know what to do with their vouchers. See Ratinov, supra note 71, at 1773.
\item See Rutland, supra note 122, at 14. The Russian government instituted three options, entitled variants, for enterprise committees to choose from in establishing a share distribution plan. See Peck, supra note 140, at 25. Variant I involved larger entities being reorganized as corporations in which
\end{enumerate}
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allowed to reserve fifty-one percent of their shares to sell to its workers and managers. Between seventy-five and eighty percent of companies decided to take part in the worker buy-out option program.

The laws also created a Russian Property Fund to house any state shares in privatized companies. The fund generally held twenty percent of the shares in each company, leaving roughly twenty-nine percent to auction off to the general public. Unfortunately, such a breakup of the percentages provided little incentive for companies to sell shares and risk losing insider control. As a result, managers aggressively sought shares from their workers. Russian reformers began to worry that not enough shares were being made available to cover the number of vouchers issued. Pressure was exerted on companies to continue to sell shares. To monitor such massive transformation, Russia developed a two-tier agency regulation system.

In June of 1994 the voucher program was terminated. Over 24,000 companies had been converted into joint-stock entities, and over 11,000 voucher auctions workers would receive twenty-five percent of the corporation's shares. See id. Roughly twenty percent of Russian enterprises have chosen Variant I. See id. Variant III, in contrast, involved mostly management ownership of shares based on performance criteria. See id. at 26. Russian enterprises have seldom used Variant III. See id. See also Coco, supra note 24, at 176-78 for specifics regarding Variants I and III.

190. See Rutland, supra note 122, at 14. Variant II, as stated, allows insiders a great amount of control by reserving fifty-one percent of the entity's shares for purchase by management and workers. See Peck, supra note 140, at 25. In addition, by combining vouchers, managers and workers could buy the fifty-one percent holding without any cash outlay. See id. at 26. Because of such benefits, it comes as no surprise that Variant II was the most widely chosen option. See id.; see also Coco, supra note 24, at 177 (detailed specifics regarding Variant II).

191. See Rutland, supra note 122, at 14; Peck, supra note 140, at 26.

192. See Rutland, supra note 122, at 14. One tool used to maintain government control is that which is referred to as a "golden share." Prosser, supra note 120, at 219. The golden share is a share owned by the state in a privatized entity so as to give the entity some breathing room by removing the threat of a hostile takeover. See id. In this way, the state can maintain a degree of control over an industry it deems to be of strategic importance to the country, such as telecommunications, energy, or transportation. See id. at 218; see also Baev, supra note 113, at 20-24, 38-39.


194. See Rutland, supra note 122, at 14.

195. See id. Managers and employees exert a great deal of political power through strong lobbies. See Peck, supra note 140, at 23. These two groups were in many ways considered the two most-needed supporters for privatization reforms to pass. See id. at 24. While some criticize the manager-worker stronghold, the long-term results of such a coalition may benefit and further the implementation of a market economy. See id. at 31. If, and it seems likely, managers will continue to increase ownership and control over their businesses, such managers may eventually become majority owners. See id. As such, managers will increasingly focus on profit maximization, which is exactly what a market economy demands. See id.

196. See Rutland, supra note 122, at 14. Russian officials also worried about enterprises dominated by management and workers. See Peck, supra note 140, at 24.

197. See Rutland, supra note 122, at 14.

198. See Angelov, supra note 179, at 212.

199. See Rutland, supra note 122, at 14.
had taken place. In total, nearly 100,000 state-owned entities changed ownership form, with approximately 12,500 turning into private entities. Even after this extensive voucher system, roughly forty percent of the larger state-owned entities continued under state control. Smaller-sized entity conversions met with greater success, seventy-three percent being transferred.

Shortly after the termination of the voucher system, Russian reformers implemented a second round of privatization schemes. Many suggest this phase of privatization caused the truly fundamental changes necessary for radical transition. The main purpose of these laws was to sell the residual share holdings of the government from the first strands of privatization and raise much needed capital for the government budget. Cash auctions and investment tenders were the two main vehicles used to achieve this end. The Russian government aimed to raise $1.9 billion in 1995 alone, but fell short of this goal.

As previously noted, Russian privatization, when compared to most of its neighboring countries, met with substantial success. Private citizens now controlled methods of production on an unprecedented level. Privatization snowballed to include most sectors of the economy and has resulted in a rebirth of Russian private property. The boom in new enterprises resulted in over forty million Russian shareholders—an unheard of number by Russian standards. Such successes resulted despite pessimistic predictions.

Problems still arose and continue to plague efforts today. For example, unlike in the Czech Republic, Russia was not able to implement a computerized voucher

200. See id.
201. See Ratinov, supra note 71, at 1772.
202. See Rutland, supra note 122, at 14; see also Baev, supra note 113, at 15, 32.
203. See Rutland, supra note 122, at 14. These smaller entities were handled on a separate privatization scheme and were bought in large part by past employees for nominal prices. See id. See also Heller, supra note 125, at 648 n.128.
205. See Ratinov, supra note 71, at 1772.
206. See Lieberman & Veimetra, supra note 204, at 738. Many of the residual share holdings of the government are in the communications, defense, energy, mass media, and transportation sectors. See Peck, supra note 140, at 36.
207. See Lieberman & Veimetra, supra note 204, at 738.
208. See id. The Russian Government is in dire need of additional funds. The Chairman of the Duma Economic Policy Committee, Sergei Glazyev, lamented about the financial state of affairs of his country, saying "we have no money for health or education but we are giving away shares in Russian oil companies. It's crazy." Peck, supra note 140, at 36.
209. See generally Rutland, supra note 122, at 5-9. Some commentators suggest that over fifty percent of state-owned entities had been converted into private ownership through the voucher program in just two short years. See Lieberman & Veimetra, supra note 204, at 737.
210. See Thompson, supra note 13, at 868.
211. See id.; Ratinov, supra note 71, at 1772 n.2.
212. See Ratinov, supra note 71, at 1773.
This made it impossible to create a national bidding system, which opens the door to possible regional manipulations. In addition, the worker buy-out option, while positive in some respects, excluded many investors from taking part in meaningful management. This option was often used to generate income while retaining core control of the entity. Thus, Russian companies did not change hands as much as expected or desired. As a result, Russian privatization is considered inequitable, as the law and system of insider preferences have "largely been a victory for enterprise insiders and the industrial lobby." Many Russians have become greatly disillusioned by the process.

In summary, skeptics suggest that privatization has had only a slight impact on the macroeconomic problems facing Russia. The system did not necessarily stop resource allocation to inefficient entities, nor did it mandate corporate restructuring. At present, Russia finds itself in the midst of an "incomplete reform." Competition for assets is still underway, and the process of privatization is by no means complete. Despite such difficulties and failures, successes must be acknowledged. To its credit and benefit, Russia has successfully dismantled a good portion of its old administrative organs and aggressively begun the conver-

213. See Rutland, supra note 122, at 15. For general information regarding Hungarian privatization, see Gerlach, supra note 117, at 87.
214. See Rutland, supra note 122, at 15.
215. See id. In addition to the absence of meaningful control, outside investors, often characterized as minority shareholders, rarely receive dividends. See Peck, supra note 140, at 32. Russian businesses rarely pay out dividends to stockholders, instead choosing to use the money to increase worker wages and managerial salaries. See id. Minority stockholders are without securities laws to protect their interests. See id. at 33. In addition to having few legal rights, minority stockholders are rumored to have been bullied and threatened at meetings to comply with majority interests. See id. The result of such terrible treatment of minority stockholders is reduced interest by outsiders to invest in businesses with such reputations. See id.
216. See Rutland, supra note 122, at 15.
217. See id. It is sometimes difficult to track enterprise ownership as enterprises are not required to report the distribution of shares. See Peck, supra note 140, at 26.
218. Coco, supra note 24, at 181.
219. See id.
220. See Rutland, supra note 122, at 15.
221. See id.
222. Thornton, supra note 8, at 847.
223. See id. Russian privatization is not complete, as Russian businesses continue to encounter major restructuring difficulties. See Peck, supra note 140, at 27. Restructuring involves the process in which the outputs of Russian businesses are "brought in line with the demands of a market economy." Id. Currently, there is an enormous mismatch between output and demand. See id. Unfortunately, an economy that once centered around military and heavy industry production (the legacy of the Communist planned economy) is neither easily nor quickly restructured and brought into balance. See id. One reason for the retarded rate of restructuring is the reluctance of old as well as newly formed businesses to reduce their work forces. See id. at 29. Historically and socially, it is difficult to lay off workers. See id.
224. See Thornton, supra note 8, at 847; see also Peck, supra note 140, at 36.
ECONOMIC LEGAL REFORMS FOR EASTERN EUROPEAN TRANSITION

B. ECONOMIC REFORM: BANKING TO BANKRUPTCY

Certainly the transition from communism to capitalism and democracy requires unprecedented changes in all areas of the law. In fact, many areas did not even exist under communism, as capitalist notions such as competition and profit maximization held no meaning in the popular psyche. Regarding the business and economic realm, two areas of law prove to be especially important for transition—banking and bankruptcy.

Banking laws are the first crucial subject for post-communist economic reform. Before the revolutions of 1991 and 1992, the banking sectors in this region served at the behest of the state, usually subsidizing inefficient and failing entities. New banking schemes must embrace capitalist ideals and become independent systems supporting efficient market actors. The second area needing reform is that of bankruptcy. In theory and practice, bankruptcy is a newborn concept in Eastern Europe—because communism had no need for such a process.

As post-communist countries continue to struggle with transition, economic law reforms, especially in the areas of banking and bankruptcy, become most important. Interestingly, banking and bankruptcy represent two opposites on a business spectrum. One side represents new growth and financial support, while the other side represents the end of inefficient and unsuccessful ventures. An in-depth review of both areas of legal reform is necessary to highlight their importance in transition.

1. Banking Laws

A country's economic and financial stability depends greatly upon its banking system. Such a banking system requires a reliable monetary system and a stable banking structure. In order to make the transition to a market economy, the banking structure relies on a bank's ability to serve as a financial intermediary between creditors and debtors, its ability to encourage payments between newly emerging financial actors, and its ability to supply the maximum capital necessary to finance infrastructure improvements and investments needed in order for these

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225. See Thornton, supra note 8, at 847.
226. See id. Other areas of the law reinforce Russian privatization efforts. The Russian Civil Code of 1994 provides one such example. See Osakwe, supra note 11, at 1421. The Code "treats private property as one of the cornerstones of a market economy, and proceeds to give a ringing endorsement to the concept of private ownership." Id.
228. See id.
countries to compete globally. Post-communist countries will experience legal instability if: (1) gaps in the law are not filled; (2) a poor reporting system is not streamlined; and (3) the existing complex bureaucracy is not exterminated.

Even today, most post-communist banking systems remain underdeveloped. Despite the slow progress, most countries indicate a willingness to continue to reform their inefficient systems.

In a free market economy, stability and efficiency usually require the creation of a central bank to guide a commercial banking system. Such a system involves numerous branch banks, which keep the nation’s wealth, create lending, and control inflation through the interest rate. Independent management is another aspect of a central bank system. Many post-communist countries not only look to foreign models for guidance, but in many cases have direct involvement from foreign advisors.

In instituting new banking systems, post-communist countries have employed two basic models, that of the United States and that of the Federal Republic of Germany. The German approach, which many commentators suggest is used more frequently, involves the creation of universal banks. Such banks render a broad range of services including taking deposits, making loans, underwriting securities issues, performing mutual fund transactions, making investment recommendations, dealing in collectible coins and precious metals, and facilitating real estate sales.

Bulgaria, the Czech Republic, Poland, and Romania have followed

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230. See Pullen, supra note 227, at 161 n.11.
232. See Pullen, supra note 227, at 162.
233. See id. The willingness to convert to market economies can also be seen by the various organizations that exist to aid in the transition. See Linarelli, supra note 231, at 376. The European Bank for Reconstruction and Development (EBRD) is one such organization. See id.
234. See Pullen, supra note 227, at 162. Eastern European banking systems in general were very primitive. Under communist central planning, the extent of the domestic banking system was little more than a single bank used to house people’s savings. See Greenspan, supra note 9, at 11.
235. See Pullen, supra note 227, at 162.
236. See id.
237. See id. at 164. One example of such foreign advice is the U.S. Federal Reserve’s involvement in Russia. See id. Along with a few major commercial U.S. banks, the Federal Reserve founded an advisory group named the Russian-American Bankers Forum. See id.
238. See Horton, supra note 229, at 684.
239. See id.
the German model. Most of Europe follows this model in one way or another. The U.S. model divides commercial banking functions and investment banking functions between entities. Hungary has chosen to follow the U.S. model. Both the German and U.S. models have proponents and critics. Eight years after initial integration of the new banking systems, both models continue to experience new problems mixed with occasional successes.

Since the German model is more pervasive in new banking systems in post-communist countries, it is useful to outline the benefits and drawbacks associated with this model. The first benefit associated with the German universal model is the increased stability banks gain when they diversify their lines of business. A second benefit is increased efficiency due to economies of scale and scope. This means that many skills in banking apply across the board to different areas, making it efficient for one firm to service all needs under one roof. Supporters of a universal banking model cite a third benefit, that of reduced regulatory costs. Since all banks provide the same services, both the banks and the regulators only have to consider one set of rules. A fourth benefit created by the German model is that such a system can increase the likelihood of finding alternative private solutions to individual businesses' economic needs, the lender bank having an interest in the ailing business. Such an interest might cause the lender

241. See Horton, supra note 229, at 684. One of the reasons for this model's appeal is the geographical proximity of the Eastern European region to the Federal Republic of Germany. See id. A second reason for this model's appeal is the strength and rapid accession of this model during the early nineteenth century. See id. at 685.

242. See id. European countries such as France, Italy, Switzerland, and the United Kingdom all allow some version of universal banking as advanced by the German model. See id. at 686 n.8. For specifics on German and U.K. banking systems, see Bill Shaw & John R. Rowlett, Reforming the U.S. Banking System: Lessons from Abroad, 19 N.C. J. INT'L L. & COM. REG. 91, 111-17 (1993).


244. See Horton, supra note 229, at 684.

245. See generally id. at 683.

246. See id. at 686. See also Gruson & Schneider, supra note 240, at 340, 343-44. See id. at 340 n.2 for limits on activities in which banks may engage. Critics warn that investment banking is demonstrably much riskier than commercial banking, a fact that calls into question the stability of such banks. See generally POLITICS OF THE WORLD, supra note 1, at 302-04.

247. See Horton, supra note 229, at 687.

248. See id. at 688. Critics suggest that the universal model is not the only model to achieve economies of scale. See id. Banks of different specialties can simply associate with one another in a type of "narrow banking." Id. (quoting Robert E. Litan, Commentary, 19 BROOK. J. INT'L L. 229, 230 (1993)).

249. See id.; see also Gruson & Schneider, supra note 240, at 344. See generally Gerhard Wegen, Transnational Financial Services—Current Challenges for an Integrated Europe, 60 FORDHAM L. REV. 91, 93 (1992) (different types of regulations).


251. See Horton, supra note 229, at 688.

252. See id.
to be more flexible in allowing longer adjustment periods than a disinterested third party lender. A final benefit offered by the German model is its ability to increase banks' incentives to monitor management in businesses in which they retain equity.

Critics of the German model cite three main drawbacks in addition to those mentioned in the footnotes. As already hinted, a universal banking system involves increased risks associated with securities underwriting and other non-traditional services that make these already fragile banking systems even more unstable. Another negative aspect involves decreased competition in the marketplace for financial services. A final drawback extends from the fact that the universal system promotes a tight network of banks and businesses, a situation in which insider trading may be too seductive to resist.

Roughly a decade after emerging out of the chaos of communism, many Eastern European banking systems still face basic challenges. Many banks in the region are still unable to adequately, if at all, allocate credit and turn a profit. Some of the regions' banking systems are not yet even functioning at a minimum level. Commentators suggest that by lending to inefficient state-owned entities, such countries as the Czech Republic, Hungary, and even Poland retard their rates of transition to market economies, endangering these newly emerging states.

Even in 1999, Eastern European banking faces enormous problems in establishing

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253. See id. at 689. Faultfinders suggest that this scheme sets up the potential for "throw[ing] good money after bad." Id.


255. See Horton, supra note 229, at 690. Proponents of the German model do not find this mixture dangerous. See Rubin, Discretion and its Discontents, supra note 250, at 1324.

256. See Horton, supra note 229, at 691.

257. See id. See Freis, supra note 254, at 30-31, for examples of German problems regarding insider trading. Antitrust laws may be able to address some of these concerns. See Horton, supra note 229, at 691. See generally Bernard Black & Reinier Kraakman, A Self-Enforcing Model of Corporate Law, 109 HARV. L. REV. 1911, 1913-14 (1996).

258. Prior to the revolutions beginning in 1989, Eastern European countries were very interconnected. See POLITICS OF THE WORLD, supra note 1, at 120. Given this history, the economic failures felt by each country during the transition only reinforced and multiplied the region's troubles as a whole. See id.

259. See Horton, supra note 229, at 702 (citing Mark M. Nelson, East Europe's Banks Remain State-Run, Despite Grand Plans for Privatizations, WALL ST. J., Nov. 8, 1994, at A18 (quoting Karla Brom, financial services specialist, Institute for EastWest Studies, Prague)).

260. See id.

261. See id. at 703. To their benefit, such countries as Czechoslovakia, Hungary, and Poland have instituted numerous banking laws in line with the European community's directives. See Wegen, supra note 249, at 95.
viable and competitive systems. Obviously, it is very difficult to create new financial systems from scratch.

a. Case Study: Russia

Russia, like most other countries in the region, still teeters between "economic transformation and civil strife." Although haphazardly, real incomes are finally rising, and both inflation and unemployment are finally falling. Unfortunately, much of the progress is both too late and too little. Such progress is also by no means complete. Having undergone painful market reforms, and with the future looking much the same, Russia faces such citizen upheaval as was evidenced by the near victory of a communist slate during the 1996 summer elections. Russia's economic and political stability remains questionable. This uneasy atmosphere in Russia prompts the question of whether commercial law reforms, intended to instill market discipline in Russia, were too late. Surprisingly, both "big bang" theorists, as well as gradualists, agree that it would have been impossible for market-oriented laws to be merely "adopted off-the-rack from Western legal codes," thus ensuring a quicker implementation.

The Russian Federation under perestroika had enacted major reforms (including bank privatization legislation) even before the fall of communism. The 1990 legislation, however, had very little impact on the banking system. Such laws are cited as failing to stop self-dealing among bank directors and sharehold-

262. See Horton, supra note 229, at 703.
264. McCoy, supra note 97, at 45.
265. See id.
266. See id.
267. See id. See generally Greenspan, supra note 9.
268. See McCoy, supra note 97, at 45.
269. See id. It is vital for post-communist countries to establish stable economies because this is closely intertwined with political stability. See Linarelli, supra note 231, at 374.
270. See McCoy, supra note 97, at 45. It has been difficult for post-communist countries like Russia to switch to a mindset in which financial losses translate into penalties. See id. at 46 n.1. To achieve this end, measures such as legally-mandated loan underwriting standards, interest rate deregulation, restrictions on insider loans, and collateral forfeiture laws should be enacted. See id.
271. Id. at 45-46. Russia is unique in that its people lived under communist rule for the longest time and therefore have the least entrepreneurial heritage or experience. See id.; see also Greenspan, supra note 9, at 11-12. Surprisingly, public opinion polls in Russia reveal a high acceptance of democratic ideals and values for a society that has no history of political democracy. See Politics of the World, supra note 1, at 805. However, the Russian people still exhibit a low level of attachment to political pluralism. See id.
272. See McCoy, supra note 97, at 45.
273. See id. For the history of Russian banking, see Peter Y. Malychev, Practitioner's Perspective: Applications by Russian Banks to Establish Representative Offices in the United States, 9 Transnat'l Law. 159, 208-13 (1996).

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This atmosphere captures the Russian philosophy toward finance under communism, which was that banks operated merely to subsidize state priorities regardless of their productive value. Thus, a major challenge in the transition to a capitalist system of banking has been to establish a system that redirects resources to their optimum use. To do this requires extreme alterations of expectations. Fortunately, the situation, while not perfect, has changed drastically, and new legislation has been drafted and implemented to revamp and redirect the Russian banking system. While these new laws have not been without opponents, banking reforms have survived so far.

In summation, the major reforms of 1990 tried to overhaul the entire Russian banking system by attempting to create a two-tier competitive banking system. Much like in the United States, under this system a central bank focuses on regulating the interest rate and overall credit extension, while lower-level commercial banks handle the loan and deposit transactions. No matter how well written, such reforms are likely to encounter major implementation problems. After the fall of communism in 1992, Russia again looked to its banking system

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274. See McCoy, supra note 97, at 45.
275. See id.; see also Greenspan, supra note 9, at 11.
276. See McCoy, supra note 97, at 45.
277. See id. at 47. This challenge is similar to those faced in the attempt to privatize such institutions. See generally Balfour & Crise, supra note 110, at 85.
278. See McCoy, supra note 97, at 47. Under communism, expectations were that the government would always subsidize businesses, no matter what their financial condition, in the name of the public good. See id. This expectation is completely opposite to the free market tenet that businesses should not receive credit unless they have the ability to repay their loans. See id.
279. See id. at 46. New legislation has begun to address such problems as: (1) conflicts of interests; (2) closing down failed banks caused by rampant acceptance of delinquent loans; and (3) carefree loan subsidies to former state-owned entities. See id. at 47. For additional ideas on reform, see Paul Anawalt, Russia's Sberbank and a Fresh Look at the Glass-Steagall Act, 14 BERKELEY J. INT'L L. 344, 345 (1996).
280. In 1990, when bank privatization legislation was enacted, prices were still controlled and the banking constituents saw no gain for them by halting subsidies. See McCoy, supra note 97, at 48. Insolvent state-owned entities could not qualify for credit under the new laws, and solvent entities did not know how to compete for funds under the new system, rather than the old system of lobbying the government for funds. See id. Thus, the general consensus was against market-based financing and in favor of subsidies. See id. The fall of communism did not change the constituency mindset easily, and many opposed the reforms. See id. Slowly and gradually, the new reforms were embraced. See id. at 47.
281. See Inna Vysman, Note, The New Banking Legislation in Russia: Theoretical Adequacy, Practical Difficulties, and Potential Solutions, 62 FORDHAM L. REV. 265 (1993) (Vysman clearly details the newly established Russian banking system. Vysman also discusses the theoretical, practical, and potential problems and solutions for Russian banking. While these materials are beyond the scope of this article, they are excellent for more in-depth study). See also Malyshev, supra note 273, at 212-13.
282. See Vysman, supra note 281, at 265. One difference between the U.S. and Russian banking systems is the fact that Russia has only a national banking system as opposed to the United States, which has a co-existent national and state banking system. See id. at 265 n.1. See generally Shaw & Rowlett, supra note 242, at 92, 111.
283. See Vysman, supra note 281, at 265.
as a crucial component in making a successful transition to a free market economy.\textsuperscript{284} The legal foundation of the old communist banking system was very weak in that it did not restrict itself by legal rules.\textsuperscript{285} To change this history, the new democratic Russia set about to reform the radical Central Bank Law and Commercial Banking Law enacted in 1990.\textsuperscript{286}

The new Russian legislation has two primary goals: (1) to institute a truly independent central bank; and (2) to give this bank the ability to supervise and regulate lower-level commercial banks as well as to carry out monetary and loan policy.\textsuperscript{287} The goal concerning central bank independence is especially noteworthy since this is the first time the central bank is independent from the executive government's control.\textsuperscript{288} This radical departure from old laws safeguards the positions of top bankers against political shifts and influence.\textsuperscript{289}

Also noteworthy is the fact that the new banking laws distinctively define the role of the Central Bank in Russia not as a fiscal agent of the government.\textsuperscript{290} The new laws expressly prohibit the Central Bank from financing any government debt.\textsuperscript{291} Under communism, the bank simply printed new money to cover the deficit.\textsuperscript{292} At least in theory, the new banking laws create an independent Central Bank.\textsuperscript{293}

Despite the seemingly strong provisions stated above, ensuring that the Central Bank is independent requires such measures as creating its own monetary and

\textsuperscript{284} See id. Russian businesses today demand even further changes in banking laws. See Malyshev, supra note 273, at 161.

\textsuperscript{285} See Vysman, supra note 281, at 265.

\textsuperscript{286} See id.; see also Malyshev, supra note 273, at 161-62.

\textsuperscript{287} See Vysman, supra note 281, at 266.

\textsuperscript{288} See id. This independence is the first of its kind since the creation of a state bank in Russia over 130 years ago. See id.; see also Malyshev, supra note 273, at 161-62 (discussing the achievements of the new regulatory framework established by the Central Bank of Russia). The law states that the Central Bank of Russia is accountable to the Russian Supreme Soviet, but not the executive and administrative entities of the government. See Vysman, supra note 281, at 266 (Central Bank Law, art. 1). Under communism, the entity that served as the central bank acted as a subordinate entity. See id. The new laws call for the nomination of the central bank chairman to be named by the Supreme Soviet, as opposed to members of the executive branch. See id. (Central Bank Law, art. 37). The new law was tested when the provisional government dismissed the government, particularly the Central Bank Chairman, after a 1991 coup. See id. at 267. This action was determined to be illegal and the Chairman was eventually reinstated. See id. See generally POLITICS OF THE WORLD, supra note 1, at 804-05.

\textsuperscript{289} See Vysman, supra note 281, at 267

\textsuperscript{290} See id. (Central Bank Law, art. 17). Before such laws, the Central Bank financed the government's budget deficit directly through zero-percent interest rates, with no collateral requirements and no payment schedule. See id.

\textsuperscript{291} See id. The new laws set a maximum debt limit for certain agencies of the government. See id. (Central Bank Law, art. 17). In the case of the Ministry of Finance, a previous abuser of the Bank, the entity can only obtain loans on the same general terms as other debtors. See id.; see also Malyshev, supra note 273, at 161.

\textsuperscript{292} See Vysman, supra note 281, at 267.

\textsuperscript{293} See id.
credit-issuing policies. To create a regulatory scheme, Russian legislators next focused on the regulatory relationship between the Central Bank and the lower commercial banks.

Under the new laws, commercial banks must obtain a license from the Central Bank. This license lists the types of services each bank may provide. The Central Bank has the right to revoke these licenses when commercial banks act improperly. Any Russian citizen or even foreigner may establish a commercial bank, assuming all requirements are met. Foreigners must meet a few additional requirements, but such openness is a first in Russia. Lastly, the new laws prescribe certain requirements that all commercial banks must meet, such as capital requirements and statutory reserves.

While the Central Bank takes an active role in the affairs of commercial banks, it is prohibited from getting too involved in the day-to-day exercises of the commercial banks. Despite this prohibition, the Central Bank maintains enough power over commercial banks to ensure that the laws of the new Russia and its economic goals are being carried out properly.

2. Bankruptcy Laws

Under communism, the government owned everything and planned the operations of almost every economic player. The centralized economy guaranteed an "artificially stable economy." For example, banks were subsidized when not making profits. Such consistency lent a false sense of stability and expectation for both enterprises and the public as a whole. Statistically, the health of

294. See id.
295. See id. at 268; see also Malyshev, supra note 273, at 212-13.
296. See Vysman, supra note 281, at 268 (Central Bank Law, art. 23 and Commercial Banking Law, art. 11).
297. See id. Allowing only certain services at commercial banks follows most Western banking systems. See id. This provision is especially reminiscent of Swiss banking laws. Id. (referencing PETER NOBEL, RULES OF CONDUCT FOR SWISS BANKS, IN TRENDS AND FORCES IN INTERNATIONAL BANKING LAW 83, 87 (Boston University ed., 1990)).
298. See id. at 269.
299. See id. at 268 (Commercial Banking Law, art. 13).
300. See id. Additional requirements are placed on foreign entities to ensure that the Bank's articles of incorporation do not run counter to any Russian laws and that there are sufficient financial resources to fund the endeavor. See id. at 268.
301. See id. at 270 (Central Bank Law, art. 24 and Commercial Banking Law, art. 24). For an example of U.S. capital reserves, see Shaw & Rowlett, supra note 242, at 101-05.
302. See Vysman, supra note 281, at 270 (Central Bank Law, art. 22).
303. See id. at 269.
305. Id; Gerlach, supra note 117, at 83-84.
306. See Kim, supra note 304, at 1043.
307. See id.
the economy was grossly distorted. Centralization produced two very distinct results: (1) full employment; and (2) the absence of bankruptcies.

Since business under communism was not profit driven, and because the state would always subsidize any losses, economic players were not financially disciplined. Basic market principles such as competition and profit maximization were ignored. After the revolutions, transition meant that these economies would not only enjoy positive aspects of a market economy, but also the pitfalls and rigors of such a system. In this system, it is natural to have winners and losers.

a. Development of Bankruptcy Laws

A modern bankruptcy system should achieve seven main purposes. It should: (1) provide a mechanism to deal with failed entities; (2) provide for the equitable and predictable treatment of creditors; (3) maximize asset recovery; (4) provide practical opportunities for reorganization in an appropriate case where creditor interests and social needs are better met by maintaining the debtor in operation than by liquidating said debtor; (5) give the honest debtor an opportunity for a fresh economic start after financial failure; (6) pressure inefficient and insolvent entities to voluntarily reallocate resources; and (7) further privatization efforts through liquidation. In order for such goals to be met and for bankruptcy laws to truly take hold, post-communist countries must develop and sustain newly born market economies and commercial legal systems. A significant aspect of establishing a market economy depends in large part upon a solid legal framework that encompasses the rights of the players as well as a structure in which transactions can occur. While government policies and the development of financial

308. See Gerlach, supra note 117, at 84.
309. See Kim, supra note 304, at 1044; Gerlach, supra note 117, at 84. See generally B.W. Roelvink, Security Interest in the Czech Republic, in The Revival of Private Law in Central and Eastern Europe: Essays in Honor of F.J.M. Feldbrugge 564-65 (George Ginsburgs et al. eds., 1996).
310. See Gerlach, supra note 117, at 84; Kim, supra note 304, at 1044.
311. See Kim, supra note 304, at 1044; Gerlach, supra note 117, at 84. Under a capitalist system, scarce resources are used in the manner most efficient—resulting in the insolvency of inefficient entities. See id. at 85.
312. See Kim, supra note 304, at 1045.
313. See id. at 1046.
315. See Bufford, supra note 314, at 463. See generally Gerlach, supra note 117, at 85.
316. See Bufford, supra note 314, at 462.
institutions are important, it is the legal system that will provide the cornerstone for a sustainable market economy. 317

Ironically, even young and immature bankruptcy laws can aid in the implementation and establishment of a sustainable market economy. 318 Some commentators go so far as to argue that if post-communist transitions are to succeed, bankruptcy law restructuring is just as critical and necessary as laws regarding banking regulation and securities. 319 Bankruptcy, in this sense, is considered the "final market corrective." 320

The basic civil law in post-communist countries is based on civil codes, which are in large part modeled after the French and German codes. 321 In addition to codes, the legal system must also include laws of specific subject areas, bankruptcy being one of these. 322 While bankruptcy law is only one among a varied list, it is in this realm that a commercial system for post-communist countries gains its momentum. 323 Bankruptcy law leads the transition in many ways because of its close connection to privatization as a means beyond a market in which numerous businesses are already insolvent. 324

Privatization is one of the first steps toward establishing a market economy. 325 No voluntary buying or selling can occur until the general public has the right to own and exercise control over its own property. 326 Bankruptcy law helps to restructure markets. 327 It does so by "taking assets from insolvent or near-insolvent ('nonviable') enterprises and funneling the assets to profit-making enterprises." 328 Additional steps are required in establishing a market economy, since a capitalist infrastructure is necessary, 329 but it is perhaps in the privatization process of state-owned enterprises that bankruptcy law may play its most important role. 330

317. See id. at 463. The former legal systems of Eastern Europe must be replaced by "'laws appropriate to the requirements of a state based on the rule of law and those of a market economy.' " Klaudt, supra note 85, at 317 (for a definition of rule of law, see Hendley, supra note 146, at 41)).

318. See Bufford, supra note 314, at 463; Gerlach, supra note 117, at 89-90. See generally Klaudt, supra note 85, at 307 n.18.

319. See Kim, supra note 304, at 1047.


321. See Bufford, supra note 314, at 463 n.22.

322. See id. at 463.

323. See id. For an example of Czech laws, see Roelvink, supra note 309, at 564-65.

324. See Bufford, supra note 314, at 463.

325. See Kim, supra note 304, at 1045.

326. See id.

327. See id. Under communism, failure was impossible, thus making the emergence of bankruptcy a forced restructuring of the market. See Gerlach, supra note 117, at 89. See also Scott Horton, The Death of Communism and Bankruptcy Reorganization, 1994 ABI J. Lexis 2645, col. 1.

328. Kim, supra note 304, at 1045.

329. See id.

330. See Bufford, supra note 314, at 464. It must be noted that the method of privatization used by each country in Eastern Europe greatly affects the specific bankruptcy laws implemented in each country. See Gerlach, supra note 117, at 91.
Post-communist countries are implementing bankruptcy laws at a rapid pace, due to the highly technical and complex nature of this area of the law. The intermingling of legal and economic consequences of these laws are best left to attorneys. Most elected officials are not attorneys, and therefore simply do not understand technicalities of these laws. Thus, these laws are often neutral political issues. Along these same lines, "bankruptcy is a system of law that has no existing vested interests of substantial consequence . . . so that changing the bankruptcy law does not step on very many toes of substantial players in the present legal or economic structure." Another reason for rapid development in this area is that bankruptcy laws can often be revised and revamped without having to change previous bodies of law. In most instances, it is not necessary to create new institutions to administer these laws.

Domestic circumstances are not the only impetus behind rapidly developing bankruptcy laws in post-communist countries; there exists substantial international pressure as well. International lending institutions such as the International Monetary Fund (IMF) and the World Bank often condition loans on bankruptcy reform. Other international influences include the United States Agency for International Development (USAID), which has sponsored valuable programs on bankruptcy law creation and reform in post-communist countries. These programs attempt to educate local judges about how to administer bankruptcy laws and about basic accounting and business practices so as to render appropriate decisions in regard to business reorganizations.

331. See Bufford, supra note 314, at 464. For an example of Russian bankruptcy laws specifically, see Horton, The Death of Communism, supra note 327, col. 5.
332. See Bufford, supra note 314, at 464.
333. See id.
334. See id. This is a general statement that ignores the possibility that certain elected officials might raise some questions concerning state-owned entities. Id.
335. Id.
336. See id. German bankruptcy laws have proven to be a useful resource for much of Eastern Europe. See Gerlach, supra note 117, at 90.
337. See Bufford, supra note 314, at 464.
338. See id. Western advisors consider bankruptcy laws a vital component of transition. See Gerlach, supra note 117, at 90.
339. See Bufford, supra note 314, at 464. See also Klaudt, supra note 85, at 344-48. The IMF has developed a complex system of procedures and conditions placed on countries who wish to receive monetary aid. See Politics of the World, supra note 1, at 449.
340. See Bufford, supra note 314, at 465. The USAID administers roughly one-third of the U.S. foreign aid budget. See id. at 465 n.28.
341. See id. at 465. In 1993, the USAID program evolved out of a grant to Deloitte & Touche, L.L.P. See id. at 465 n.29. The firm was charged with three projects: (1) to report on the existing bankruptcy laws in post-communist countries (ten countries in the initial phase, consisting of Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Macedonia, Poland, Romania, Slovakia, and Slovenia); (2) to present a summary of the current laws to each country with respect to the entire region; and (3) to conduct week-long judicial training sessions in each country on bankruptcy law (the sessions were required to have small student to teacher ratios). See id.
342. See id. at 465.
b. Use of Bankruptcy Laws

While the development of bankruptcy law has been rapid, this does not translate into the its widespread use in post-communist countries. Research from 1996 reveals that bankruptcies were just beginning to be filed, with most of these filings involuntary.

Some of the more successful transition economies—countries like the Czech Republic, Hungary, and Poland—have met with some success regarding the implementation of bankruptcy codes. In the Czech Republic, for example, the number of creditor-initiated bankruptcies has dramatically increased. By 1994, over 1,592 bankruptcy petitions were filed. In Hungary, laws were once weighted so much in favor of bankruptcy that in 1992, 14,000 bankruptcy petitions were filed.

Despite the success of a handful of countries, much of the Eastern European region still faces numerous problems in bankruptcy implementation; for example, financial responsibility for bankrupt state-owned entities is difficult to divide and assign. Commentators suggest that the economies in these countries still lack incentives to force insolvent businesses to file for bankruptcy, with the threat of financial failure not yet real in the minds of managers and owners. Culture, and a history where short-term liquidity and long-term profitability played no role, both account for this skewed business mindset in an open market economy.

The limited use of bankruptcy disturbs some western advisors. It is assumed by many that the nonuse of bankruptcy law translates into a poor transition economy. Understandably, many commentators disagree and cite other, more gradual, restructuring mechanisms. This second camp explains that an environ-

343. See id. In Russia, for example, some reasons why bankruptcy law has not been widely used include: (1) cultural resistance and fears about bankruptcy; (2) no fundamental basis of property and commercial law; (3) a reluctance to go to court; and (4) the fear of social and political consequences. See Sidney B. Brooks, A New Insolvency for Russia, 1995 ABI J. LEXIS 22, col. 3.

344. See Bufford, supra note 314, at 465.

345. See id.

346. See Gerlach, supra note 117, at 83. For specific details on the individual bankruptcy codes of the Czech Republic, Hungary, and Poland, see id. at 92-106.

347. See id. at 92 (see Bankruptcy and Composition Act).

348. See id. at 92 n.74.

349. See id. at 97.

350. See id.

351. See id. Since employment is already at especially high levels in Eastern Europe, closing down more businesses would create even higher levels of unemployment, making the option of bankruptcy not terribly popular from a social standpoint. See Klaudt, supra note 85, at 303-04.

352. See Bufford, supra note 314, at 465. To a lesser extent, this comment also applies to the attitudes of creditors. See Gerlach, supra note 117, at 90.

353. See Bufford, supra note 314, at 465.

354. See Kim, supra note 304, at 1047.

355. See id. at 1048.

356. See id. Some mechanisms do exist that might render bankruptcy laws unnecessary. See id. at 1069. Restructuring can take place through various domestic and foreign means. To avoid bankruptcy proceedings on the domestic front, post-communist countries have tried to improve credit-worthiness
ment conducive to capitalist behavior must exist before bankruptcy law can be used as a regular economic tool. Beyond Eastern Europe, as this region continues to evolve as a player in the global marketplace, transnational bankruptcies will become more of an issue. Finely-tuned bankruptcy codes in these countries can only increase global acceptance and economic well-being in the future.

V. Other Areas in Need of Legal Reform

While this article has discussed the crucial legal reforms being pursued in the banking and bankruptcy sectors, other areas of law—such as securities, foreign investment, tax, contract, property, and antitrust—require attention as well. Beyond the economic realm, areas such as criminal law also demand reform. Encompassing all legal reform is the issue of establishing the proper legal infrastructures in these countries. The existence of an independent, trusted, and much-used judiciary is one such institution. All of these elements must be in place if true reform is to occur in a successful manner. Reform is not a stagnant entity, but instead an ongoing process that requires constant revision and testing. Below is a brief discussion of contract and foreign investment laws as they tangentially relate to banking and bankruptcy.

A. Contract Law

There exists a great need to procure an efficient and reliable method of enforcing agreements in Eastern Europe. From an economic standpoint, formulating a working legal reform in this area is necessary if the newly embraced open market and contain inflation. See id. at 1069. To achieve these goals such countries can: (1) encourage lenders and borrowers to work out as much bad debt as possible, and if impossible, cut out or recapitalize such debt through established public entities; (2) centralize government aid to select state owned entities to prepare them for privatization (in this sense some industry sectors may be wholly exempt from bankruptcy options); and (3) initiate "pre-privatization," which involves restructuring and reworking the balance sheets of larger state-owned entities that had been distorted under communism. Id. at 1069-71. It is assumed that such mechanisms outside of bankruptcy gradually can help establish capitalist behavior. See id. at 1071. New "informal codes of behavior" must be advanced to help government, investors, managers, and the general citizenry learn "to utilize assets in the most efficient way and steer these assets towards profit-generating entities." Id. Foreign investment has been another tool outside of bankruptcy. See id. at 1072. Such investment provides ready capital and impetus in restructuring the private sector. Id.

357. See id. at 1047. See generally Bufford, supra note 314, at 462-64. 358. See Gerlach, supra note 117, at 104-05 (analyzing of harmonization of cross-border bankruptcy proceedings). 359. See generally Mike Cormaney, RICO in Russia: Effective Control of Organized Crime or Another Empty Promise?, 7 TRANSNAT'L L. & CONTEMP. PROBS. 261 (1997); Heller, supra note 125, at 643-45. 360. See generally Boylan, supra note 72. 361. See Rubin, supra note 56, at 1. See also Greenspan, supra note 9, at 8-10; Kathryn Hendley, The Role of Law in the Russian Economic Transition: Coping With the Unexpected in Contractual Relations, 14 WIS. INT'T L.J. 624 (1996).
economies in Eastern Europe are expected to succeed. Leading economic historian Douglass North professes that "[h]ow effectively agreements are enforced is the single most important determinant of economic performance." The positive aspect of contract law is that it is easier to reform than many other areas because the contracting parties are engaged in a positive sum game. While parties to a contract are not exempt from disputes, it is important that they at least began their union peacefully and with similar interests. Both usually maintain an interest to resolve the dispute quickly and efficiently. Much debate abounds on how post-communist countries should draft their new contract laws. What influences should be taken into account? While the details are worked out over time, it is necessary to understand that business will take place before a succinct and final contract law is formed and implemented in these emerging democratic countries. In truth, these economies are moving forward regardless. As privatization continues, more transactions will find themselves under the newly developed scope of contract law. In many contract cases, the law may be unnecessary. Such may be the case if private parties learn to use self-enforcing contract mechanisms. Alternative

362. See Rubin, supra note 56, at 1. While contract laws, specifically such bodies of law as the Uniform Commercial Code (U.C.C.), are not new to Eastern Europeans per se (prior to the modern revolution, Russian academics narrowly studied the U.C.C. for dealings in international affairs), only recently has there been the practical need to study such bodies of law. See Alexander S. Komarov, The Uniform Commercial Code: A Russian Point of View, 29 Loy. L. A. L. Rev. 1085 (1996). 363. Rubin, supra note 56, at 3 (quoting Douglass North, Institutions, Ideology and Economic Performance, 11 Cato J. 477, 481 (1991) (reviewing the benefits of both informal agreement-enforcing mechanisms and formal legal mechanisms to this end)). See also Komarov, supra note 362, at 1089. 364. See Rubin, supra note 56, at 3. 365. See id. at 4. 366. See id. 367. See id. at 5. See generally Komarov, supra note 362, at 1085-89. Still, all businesspersons desire better contract laws, because unlike in the West where a signed contract has the force of law and is usually backed by force, a contract in Eastern Europe usually means nothing more than someone's autograph. See Greenspan, supra note 9, at 9. 368. See Rubin, supra note 56, at 5. Contract rights enforcement is easier and more valuable when property rights are clearly defined. See id. This can prove difficult in countries where public ownership was the norm and private rights were non-existent. See id. While more recent laws have been enacted regarding contracts specifically, questions still remain as to whether courts of Eastern European countries function to enforce contracts and if businesspeople really rely on such tools. See Karen Halverson, Resolving Economic Disputes in Russia's Market Economy, 18 Mich. J. Int'l L. 59 (1996). 369. See Rubin, supra note 56, at 4. 370. See id. Unfortunately though, parties to contracts are not always able to provide for all contingencies. See Thomas F. Miceli, Economics of the Law 71 (1997). As a result, occasions will arise when one party to the contract "no longer values performance" under the contract as written, but provision was made in advance for this eventuality. Id. See generally Neil F. O'Donnell & Kirill Y. Ratnikov, Dispute Resolution in the Commercial Law Tribunals of the Russian Federation: Law and Practice, 22 N.C. J. Int'l L. & Com. Reg. 795 (1997).
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dispute resolution mechanisms also can limit the use of sparse judicial system resources in these countries.371

B. FOREIGN INVESTMENT LAWS

Despite the slow speed of reform and problems encountered during transition, the transformation of former communist countries will prove to be a success for both the East and West.372 In Eastern Europe, the global economy finds a wealth of resources in new people and new natural resources.373 The investment opportunities are unlimited.374

Foreign direct investment functions as a crucial stimulant in post-communist economies.375 The legal systems of these countries can have a fundamental role in either encouraging or discouraging outside investment.376 Under communism, foreign investment was illegal in most countries.377 Eastern Europe was in essence cut off from the global economy. Since the fall of communism, post-communist countries have radically changed their policies, opening wide the doors to foreign investment.378 Since 1989, foreign investment has risen from negligible amounts to almost $10 billion by 1993.379 Commentators estimate that the Russian Federation alone has the potential to bring in over $75 billion in foreign investment.380

372. See Greenspan, supra note 9, at 14.
373. See id.
374. See id.
376. See id.
377. See id. at 3.
378. See id.; see also David F. Black, So You Want to Invest in Russia? A Legislative Analysis of the Foreign Investment Climate in Russia, 5 MINN. J. GLOBAL TRADE 123 (1996). Foreign investment constitutes more than capital outlay alone. See id. Foreign investment also means the entry of foreign technology, which proves most beneficial in the newly emerging market economies of Eastern Europe. See id.
379. See Gray & Jarosz, Law and Regulation, supra note 375, at 3. To aid greater foreign investment, countries such as the United States team up with such countries as Russia to form organizations that promote and guarantee investments between the countries. See Black, supra note 378, at 137. Even countries such as Bulgaria, which has had an incredibly difficult transition period, are not without foreign investment potential. See David A. Levy, Bulgarian Trade and Investment: A Realistic Assessment, 27 CASE W. RES. J. INT' L L. 203, 244 (1995); Youlian Simidjiyski, A Comparative Study of the Bulgarian Law on Foreign Investment and the Foreign Investment Laws of Hungary, Poland, and the Czech Republic Through the Prism of the World Bank Guidelines for Treatment of Foreign Investment, 9 FLA. J. INT'L L. 277, 278 (1994).
380. See Gray & Jarosz, Law and Regulation, supra note 375, at 6. Russia is especially targeted for foreign investment because of the country's enormous reserves of raw materials and extremely educated and cheap workforce. See Black, supra note 378, at 123; see also O'Donnell & Ratnikov, supra note 370, at 795.
Despite the rather positive numbers, the level of foreign investment is only a small percentage of what is needed. Some countries in the region have recently been undergoing depressed economic conditions considered worse than those of the United States during the Great Depression of 1928. Legal reform has played a tremendous role in turning around and jump-starting these economies. Foreign investment laws have also been supplemented by reforms in business law, bankruptcy law, and tax law.

Regarding foreign investment laws in general, four topics claim priority: (1) repatriation of profits; (2) tools for entry of investments; (3) expropriation; and (4) arbitration mechanisms. The legal treatment of these four topics is most likely to influence a foreign investor’s decision on whether to invest. Above all, foreign investors seek confidence in the laws of a country, needing acknowledgment that their investments will be protected and recognized. In sum, post-communist countries must continue to send strong signals to foreign investors through legal reforms that reveal Eastern Europe’s desire to be a global business partner.

VI. Conclusion

Never before has lawmaking been done on such a grand scale as in Eastern Europe over the past eight or nine years. The ability of post-communist countries to make a successful transition to market economies and democracy will depend in large part on the new legal systems put into place. A solid market economy depends upon a solid legal framework that addresses the rights of the players and the structure in which transactions can occur. All of Eastern Europe must continue to dismantle old political, economic, and legal institutions based on bankrupt, centrally-planned economies.

The old legal systems are now obsolete, as they were used only as political instruments of communist governments. The new legal systems must be established based on constitutionalism and the rule of law, offering predictable rules of behavior that apply to all participants equally. Law reformers do not, however,
have the luxury of a blank page upon which to write new laws. The constraints of history and economic reality serve as boundaries. Nevertheless, legal systems can establish a skeleton upon which to build a functioning market economy. Crucial to transition are such areas of the law as privatization, banking, and bankruptcy. Foreign investment and contract law reform are also vital in the business realm.

Since the break with communism, most Eastern European countries have instituted new and reformed laws in these areas. While some have met with greater success than others, roughly all still remain committed to some variation of a market economy. Stability and efficiency will hopefully come with time. Until then, the region unfortunately continues to teeter between economic transformation and civil strife. No matter how well new laws and modifications are written, implementation and consistency will continue to plague these transformations. These countries have great potential if only they can successfully evolve out of their broken communist pasts.