

2000

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### Recommended Citation

John B. Attanasio, *Interconnection of Legal/Constitutional Reform and Economic Reform - Success*, 34 INT'L L. 201 (2000)  
<https://scholar.smu.edu/til/vol34/iss1/16>

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# Interconnection of Legal/Constitutional Reform and Economic Reform—Success?

JOHN B. ATTANASIO\*

One evening, Boris Yeltsin was at home relaxing when he got a telephone call from the mayor of Vladivostok, on the Pacific Coast. Mayor Sergei cried, "Boris Nicolaivich, Boris Nicolaivich, the people of Vladivostok want to secede." Yeltsin replied, "Not you too Sergei, I thought you were loyal to Mother Russia." Mayor Sergei replied, "No, you don't understand, we only want to secede for fifteen minutes for symbolic reasons; then we will rejoin the Russian republic." Yeltsin bellowed suspiciously, "Only for fifteen minutes, Sergei?" Sergei answered, "Yes, I will call you in fifteen minutes to rejoin Mother Russia." Yeltsin commanded, "Well, all right, but you will call back in fifteen minutes."

Five minutes pass, ten minutes pass, fifteen minutes pass, twenty minutes pass, twenty-five minutes pass, an hour passes. Yeltsin cannot stand the tension any longer and calls Vladivostok. After a number of rings, someone answers the phone and Yeltsin asks who this is. The person answers in a happy, excited voice: "I am Anatoly the janitor." Yeltsin—who can barely hear over the shouts of joy in the background—asks: "What is going on there and where is Mayor Sergei?" Anatoly replies: "Sixty minutes ago we seceded from Russia; fifty minutes ago, we surrendered to Japan."

The anecdote probably is no longer considered funny in Russia, as nine years ago, an earlier version of the story was popular that was premised on Estonia seceding from the Soviet Union and surrendering to Germany. Despite elections and some new institutions,<sup>1</sup> the formation of the new Russian State did little to establish the idea of the constitutional democracy in the Russian psyche. After all, the state was technically formed by the secession of Russia from the Soviet Union, which effectively allowed Boris Yeltsin to seize power from Gorbachev.<sup>2</sup> I am not suggesting that the Soviet Union could or should have remained

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1. Some institutions, such as the Constitutional Court, were new; others, such as the Supreme Court, were not.

2. Russia's succession was part of a process of succession that the Baltic republic sparked. Gorbachev resisted this step and eventually began grudgingly to discuss allowing it for a few republics. Yeltsin placed Russia in the center of the process as a means of gaining power.

together, but the way in which Russia became an independent state was cynical and followed virtually no process at all.

Any account of law in Russia must reckon with what some now—eight years later—call a failed state. Now the republics, Krays and Oblasts of Russia, seek to secede. Even short of secession, the republics are refusing to obey the federal government or even pay taxes.<sup>3</sup> A few years ago, General, now Governor, Aleksandr Lebed, even laid claim to the nuclear weapons in his province.<sup>4</sup>

Understanding the federal structure in terms of legal or political fault lines and power lines is key to understanding the difficulty of economic regulation. For years, some regions have asserted control over their own territory, including the natural resources thereon. For example, a few years ago, De Beers thought it had made a deal to market Soviet diamonds at a time when the Soviet Union desperately needed hard currency.<sup>5</sup> The Soviets and the Russians approved, but the Tartars stopped the deal.

Yeltsin has courted regional leaders. He has been fashioning treaties with them for some time. On April 19, 1999, he told a group of governors that they may be given even more independence.<sup>6</sup> He also suggested that regions take a more active role in foreign policy. Undoubtedly, this helped garner their support to block his impeachment last spring.<sup>7</sup>

Breakdowns in national and regional governments have prompted some commentators to label Russia a “failed state.”<sup>8</sup> I do not yet accept this description and there are some bright spots, such as the Constitutional Court. However, the center has certainly been losing authority for at least ten years. In August, Mr. Yeltsin appointed Vladimir Putin, a career KGB officer, to be his new prime minister. Under Prime Minister Putin, Russia has been flexing its military muscle toward Dagestan and now even Chechnya.<sup>9</sup> Whether Mr. Putin can reverse these centrifugal forces, driving various constituent units moving away from the center, remains to be seen.

Another basic lesson of the Russian legal structure is the pervasiveness of corruption. In a 1990 article in the *Moscow News*, a Russian economist warned that the only business using hard currency in its business dealings was the Russian Mafia. Consequently, they were the only ones accumulating hard currency. Most other Russian businesses dealt in rubles, which have lost over ninety-nine percent of their value during this decade. To give you some idea, in 1990, the ruble traded at 1.66 rubles to the dollar at the official business rate, at 5.6 to the dollar at the special official tourist rate, and at between sixteen and thirty to the dollar at the then black market rate.<sup>10</sup> Nine years later, the ruble trades at between 24,000 to

3. See Vladimir Shpak, *Russian Regions Refuse to Pay Taxes*, *Moscow News*, Oct. 1, 1998, at 1.

4. See *Lebed Offers Kirienko Nuclear Headache*, 2 RFE/RL Newsline 142 (July 27, 1998) <<http://rferl.org/newsline/1998/07/270798.html>>.

5. See *State Seeks to Alter De Beers Contract*, *Moscow Times*, May 29, 1993, at 11.

6. See *Yeltsin Tells Regions to Take More Power*, 3 RFE/RL Newsline 76 (Apr. 20, 1999) <<http://rferl.org/newsline/1999/04/200499.html>>.

7. See *Yeltsin Wins More Support from Regional Leaders*, 3 RFE/RL Newsline 71 (Apr. 14, 1999) <<http://rferl.org/newsline/1999/04/140499.html>>.

8. See generally Eric Schmitt, *Debate over Russia*, *N.Y. Times*, Sept. 26, 1999, at 20; see also Henry J. Richardson III, “Failed States,” *Self Determination, and Preventative Diplomacy: Colonialist Nostalgia and Democratic Expectations*, 10 *TEMP. INT’L & COMP. L. J.* 1 (1996).

9. See Vladimir Yemelyanenko, *Aushev Blames War on Moscow*, *Moscow News*, Aug. 25, 1999, at 32.

10. See Elisabeth Rubinfiem, *Soviet Public Stands By, Baffled as Reforms Are Imposed Bit by Bit*, *WALL ST. J.*, Nov. 5, 1990, at A11.

27,000 rubles to one dollar.<sup>11</sup> The big plunge came in August of 1998, when both the ruble and the Russian stock market went into a free fall during the global financial crisis.<sup>12</sup> Obviously, those who traded in dollars, marks and other hard currencies made huge amounts. As some were predicting, those who traded in hard currencies in 1990—notably the Russian mafia—would eventually become the bankers of Russia.<sup>13</sup> Accordingly, the Mafia came to play an extremely prominent role in the economy, along with former officials in the Soviet government.

I do not want to suggest that a lack of respect for law is a new phenomenon attributable solely to the Mafia. After all, the Soviet Union was very much a lawless state. It was built on Marxist and really Leninist ideology, which reduced all law to power. The state was premised on the notion that to attain the romanticized, utopian world of the true Communist society, the end always justified the means. Neither process nor substantive law had much value in this project. Russians only knew Communism. There was no political culture of democracy or especially of the rule of law. In a recent article, noble laureate in economics Douglass North talked about the importance of political culture to establishing the rule of law.<sup>14</sup>

For Marx, law was power—an ideology used by the state to suppress the masses.<sup>15</sup> At best, it was an interim means on the road to a utopian, stateless society.<sup>16</sup> This view contrasts sharply with a Madisonian view of law as principled checks on the baser instincts of human nature, ensuring some degree of liberty and fairness in a world where utopia was unachievable.<sup>17</sup> Because the Communists retained power for over seventy years, Russian society lacked the memory of any notion of the rule of law or of what free markets meant. Indeed, these notions really never existed in the Russian psyche, except in a stilted way toward the end of the czars.<sup>18</sup>

The Communist ideology also taught that capitalists were really crooks. Many in Russia have embraced this characterization by behaving as though the best capitalist is the best crook. One often sees this behavior played out in Russian businessmen's focus on short-run profits, even if this destroys long-term relationships.<sup>19</sup> This short-sighted approach has even dominated the Russian government's relationships with the IMF and other creditors.<sup>20</sup>

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11. See *Foreign Currency Exchange Rates*, WALL ST. J., Dec. 16, 1999, at C19 (Ruble traded at 26.9 rubles to the dollar). Beginning on January 1, 1998, the Russian government lobbed off three zeros from the ruble to dollar exchange rate. See *Russia to Redenominates Ruble*, in *Sign of Stability*, WALL ST. J., Aug. 5, 1997, at A15.

12. See Jeanne Walen, *Ruble in Suspension as Economy Plummets*, MOSCOW TIMES, Aug. 28, 1998, available in LEXIS, News Library, Mostms File.

13. See *Banking in Russia; No Foreigners Need Apply*, ECONOMIST, Aug. 7, 1993, at 68.

14. See Douglass C. North, *The Historical Evolution of Politics*, 14 INT'L REV. L. & ECON. 381, 381–82 (1994).

15. See generally Ramond A. Belliotti, *The Legacy of Marxist Jurisprudence*, in *RADICAL PHILOSOPHY OF LAW: CONTEMPORARY CHALLENGES TO MAINSTREAM LEGAL THEORY AND PRACTICE* 1, 16–23 (David S. Caudill & Steven Jay Gold eds., 1995).

16. See *id.* at 21–23.

17. See generally THE FEDERALIST No. 51 (James Madison) ("If men were angels, no government would be necessary").

18. See Christopher T. Ruder, Comment, *Individual Economic Rights Under the New Russian Constitution: A Practical Framework for Competitive Capitalism or Mere Theoretical Exercise*, 39 ST. LOUIS U.L.J. 1429, 1434–35 (1995).

19. See Paul H. Rubin, *Growing a Legal System in the Post-Communist Economies*, 27 CORNELL INT'L L.J. 1, 32 (1994).

20. See Patricia A. McCoy, *Levers of Law Reform: Public Goods and Russian Banking*, 30 CORNELL INT'L L.J. 45, 106 (1997).

The Soviet Union was not bereft of any legal structures. It did have legal codes to handle, for example, tort and contract disputes, but all understood that any case that had political dimensions would receive telephone justice: a Communist Party or government official would simply call the judge and tell him who was going to win. Personal bureaucratic discretion ultimately controlled, and bribes and all sorts of other corruption were systemic. During the transition, even when laws were passed, little information existed about them, making them inaccessible even to lawyers, which made investors nervous. While the constitution protected private property,<sup>21</sup> government authorities still impaired it using such methods as confiscatory taxes.<sup>22</sup>

The West also exasperated problems in a number of ways. Notably, different countries attempted to have their own legal systems adopted, so that Russia emerged with a conglomeration of different principles. For example, the civil code blends Swiss, Italian, Dutch, American, French, German, and Soviet law.<sup>23</sup> Land sale is still prohibited.<sup>24</sup> Contracts can sometimes be made without consideration.<sup>25</sup> Administrative agencies sometimes fix prices and courts have considerable latitude to set aside contracts for unequal bargaining power.<sup>26</sup> Dispute resolution and even enforcement of contractual arrangements is problematic. Most lawsuits are strict nonpayment cases, and until 1998 enforcement powers were wholly inadequate in the commercial courts.<sup>27</sup> Russia has courts of general jurisdiction,<sup>28</sup> new courts of arbitration that deal with commercial matters including contracts,<sup>29</sup> and the constitutional court.<sup>30</sup> Jurisdiction lines between these various bodies are complex and unsettled. Even when the parties use private arbitrators, businesses must be very careful about enforcement, as a Russian court often must enforce the decision.<sup>31</sup> Moreover, some of these courts are throwbacks to the old system, whereas some are more reform-minded. Their outlooks can vary with the specific court and even with the particular judge. An even more basic question is whether a particular court is open for business. For several years now, many judges have not been paid wages, exacerbating corruption.

Unfortunately, the West is partly responsible for this calamity. The strategy of shock therapy, which involved abolishing the old structures and releasing prices on goods,<sup>32</sup> only fueled Russia's problem by destroying its institutions and sending the society into an economic nose-dive.<sup>33</sup> When Douglass North won the Nobel Prize in economics, he won for

21. See RUSS. CONST. pt. 1, ch. 2, art. 35(1).

22. See RUSS. CONST. pt. 1, ch. 2, art. 35(3). See generally Daniel McGrory, *Economic, Legal, and Political Dilemmas of Privatization in Russia: Civilizing the Russian Underground Economy: Requirements and Prospects For Establishing a Civil Economy in Russia*, 5 TRANSNAT'L L. & CONTEMP. PROBS. 65 (1995).

23. See Christopher Osakwe, *Anatomy of the 1994 Civil Codes of Russia and Kazakhstan: A Biopsy of the Economic Constitutions of Two Post-Soviet Republics*, 73 NOTRE DAME L. REV. 1413, 1427 (1998).

24. See *id.* at 1483.

25. See *id.* at 1486-87.

26. See *id.* at 1487-90.

27. See Kathryn Hendley, *Growing Pains: Balancing Justice & Efficiency in the Russian Economics Courts*, 12 TEMPLE INT'L & COMP. L.J. 301, 326-29 (1998) (discussing how the pre-1998 system handled non-payment cases).

28. RUSS. CONST. pt. 1, ch. 7, art. 126.

29. RUSS. CONST. pt. 1, ch. 7, art. 127.

30. RUSS. CONST. pt. 1, ch. 7, art. 125.

31. See Rubin, *supra* note 19, at 41 (noting that rather than enforcing arbitration agreements, Russian courts will hear disputes *de novo*).

32. See Jeffrey Sachs, *What is to be done?*, ECONOMIST, Jan. 13, 1990, at 21.

33. See Micheal Chossudovsky, *Russia: Go for an Alternative Economic Program*, INT'L HERALD TRIB., Apr. 1, 1993, Opinion sec. (criticizing shock therapy for causing the "dramatic impoverishment of the population").

the idea that a market system requires certain legal structures.<sup>34</sup> This contrasts sharply with shock therapy. The quick privatization ignited by shock therapy also gave myriad opportunities for corruption as businesses were sold off. Shock therapy further fueled corruption by throwing even more people below the poverty line. Professor Stephen Cohen, of New York University, puts the figure at eighty percent.<sup>35</sup> No matter what the real figure would be in Western terms, Russian economics is now neither Marxist nor capitalist but Malthusian. During the 1990s, median life expectancy for Russian males has declined from perhaps sixty-five to fifty-seven years.<sup>36</sup>

Western policy toward the nascent democracies of the newly independent states represented a massive failure of political will. Following World War II, the United States fashioned the Marshall Plan to allow a devastated Europe to get back on its feet.<sup>37</sup> The West should have financed Russia's transition to a free market economy. Yavlinsky called this the grand bargain, but aid was small compared with the Marshall Plan after World War II, which cost over thirteen billion dollars.<sup>38</sup> In today's dollars, that would be approximately eighty-two billion dollars. To have been successful, aid would have had to have been massive. Minimally, Yeltsin needed a safety net so that he could close inefficient businesses. Because he was afraid of layoffs and accompanying political unrest, he subsidized inefficient firms instead.<sup>39</sup>

In a recent speech, Joseph Stiglitz of the World Bank stated of Russia:

When most economists said the problem in the former Soviet Union was that they had central planning, no property rights and therefore inefficiencies, distorted prices. You were going to change all that and it was supposed to release a burst of energy of entrepreneurship and output was supposed to increase. Instead, output has fallen markedly and poverty has increased markedly and I think the lesson we've learned is that market economies are far more complicated than text book models often describe them. And that issues of governance, issues of legal infrastructures, issues of institutions are absolutely central.<sup>40</sup>

This lesson, plus the lack of political will in the West in the early nineties to do something like a Marshall Plan, may yet cost us dearly. If Russia crumbles and there is an intensification

34. See Clay Chandler, *Two Americans Given Nobel in Economics*; Fogel, *North Focused on Study of the Past*, WASH. POST, Oct. 13, 1993, at C1.

35. See Stephen F. Cohen, *Look at What's Happening to Russia Under Reforms*, INT'L HERALD TRIB., Aug. 21, 1998, at 8.

36. See *Russia's Death Rate Continues to Climb*, CURRENT DIG. OF THE POST-SOVIET PRESS, July 9, 1997, at 4 (reporting that in 1994, the average male life expectancy was 57.6 years compared with 64.9 years in 1987).

37. The Marshall Plan supplied such critical goods as food, livestock feed, fertilizer, cotton, coal, petroleum, and other critical commodities. It also supplied needed machinery and vehicles. Approximately \$545 million was capital aid for the European Payments Union. See generally JOHN KILLICK, *THE UNITED STATES & EUROPEAN RECOVERY 1945-1960* 80-104 (1997).

38. See HARRY BAYARD PRICE, *THE MARSHALL PLAN AND ITS MEANING* 87-88 (1955) (noting that the total funds made available by Congress during the four-year program from 1948 to 1952 came to about 13.15 billion dollars).

39. See Steven Erlanger, *Russia: Only Better, Not Yet Good; Inflation Slows, but Big Policy Decisions Remain*, INT'L HERALD TRIB., Apr. 23, 1994, Finance sec.

40. Robert Lyle, *The East: World Bank Asks If Economic Transition Has Failed Former USSR*, RFE/RL News-line (Apr. 27, 1999) <<http://www.rferl.org/nca/features/1999/04/F.RU.990427124556.html>>. See also Joseph E. Stiglitz, Keynote Address at the World Bank Annual Conference on Development Economics (Apr. 30, 1999) transcript available at the World Bank website (visited Dec. 17, 1999) <<http://www.worldbank.org/research/abcde/pdfs/stiglitz.pdf>>.

of military conflict, what will a desperate Russian people do? Already, we see violence in Dagestan and Chechnya,<sup>41</sup> strong resistance to NATO's campaign in Yugoslavia,<sup>42</sup> and a reapproachment between China and Russia.<sup>43</sup> Primarily for economic reasons of inability to support adequate conventional forces, Russia has changed policy to allow nuclear force to respond to a conventional attack and to allow first strikes with nuclear weapons.<sup>44</sup> Russia has also stopped destroying its nuclear arsenal.<sup>45</sup> A career KGB agent is now Acting President and terrorist explosions have rocked Russia, killing hundreds. Where can all of this lead?

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41. See Yemelyanenko, *supra* note 9.

42. See William Drozdiak, *Kosovo Mediation on Edge of Failure: NATO says Russia Ignores Key Terms*, WASH. POST, Apr. 25, 1999, at A1.

43. See *Russian Warships in China for Anniversary*, N.Y. TIMES, Oct. 4, 1999, at A12.

44. See *Russia's Nuclear Defense*, N.Y. TIMES, July 19, 1999, at A16.

45. See *id.*