

# *Fordham International Law Journal*

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*Volume 20, Issue 2*

1996

*Article 3*

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## Permitted Unless Prohibited: The Changed Soviet Mentality

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# Permitted Unless Prohibited: The Changed Soviet Mentality

Jenik Radon

## Abstract

Even more basic than the presence of an abundance of experts and specialists, however, is the need for an amorphous intangible, the will to achieve and succeed. The will of a nation, an admittedly nebulous and vague idea, ideally is discerned, expressed, and exercised by its leaders in the government and in the legislature. It is up to these leaders to want and then to initiate, adopt, and implement the rule of law, a term which itself embodies many concepts but contains no therapeutic formulas. In this regard, the darling of the International Monetary Fund (“IMF”), the small nation of Estonia, with a population comparable to that of the island of Manhattan, had the political and intellectual leadership with the will and the drive to create a market economy embedded in the rule of law. How such a will arises or is created is the subject for a separate sociological study and not a topic for this Essay. But the positive consequences of the leadership of Estonia in exercising and implementing this national will stands not so much as a challenge to other nations still struggling with the transformation process, such as many of the member countries of the Commonwealth of Independent States (“CIS”), but as an example and a confirmation that a successful transition from a centrally planned economy to a free market economy can be achieved quickly. To simply attribute and dismiss Estonia’s emergence as an anomaly due to the difference of its culture from that of the other peoples in the former Soviet Union, however, as is commonly done by many academicians, legislators, and other leaders in the nations of the CIS, is simply a self-fulfilling excuse for inaction, inevitable failure, and cultural arrogance, even if masked as a compliment. In fact, the prospective, still unheralded, success of the Republic of Georgia in its law reform efforts belies any such assertions. It is of note that the remarkable emergence of Estonia, and the expected achievements of Georgia, did not develop in a vacuum, but utilized the support of the international community to buttress national will.

# PERMITTED UNLESS PROHIBITED: THE CHANGED SOVIET MENTALITY

*Jenik Radon\**

## *INTRODUCTION: THE RULE OF LAW/ THE RECHTSSTAAT*

The concept of the rule of law and its European continental variation, *Rechtsstaat*, has received considerable popular play from politicians, businessmen, and reformers since the collapse of communism in the transforming countries of Eastern Europe,<sup>1</sup> specifically in 1989 in Poland and the other Central European nations and in 1991 in the then Soviet Union. The need for the rule of law, especially in the transforming economies of these nations of Eastern Europe, is regularly heralded by the press. Economists encumbered in their work by its absence particularly decry that omission. Professor Jeffrey Sachs, a past and present economics advisor to many of the governments of those transforming economies, including Poland and Russia, has underscored the importance of the rule of law on a number of occasions. He noted, in describing the situation in Eastern Europe, that the "vital role of the rule of law really strikes you when

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1. The term "Eastern Europe" is used to refer to the countries of Central Europe consisting of Albania, Bulgaria, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic, and the countries of the former Union of Soviet Socialist Republics ("USSR") consisting of the previously occupied Baltics States, or Republics of Estonia, Latvia, and Lithuania, and the member nations of the Commonwealth of Independent States of Armenia, Azerbaijan, Belarus, Georgia, Kazakstan, Kyrgyzstan, Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

you see a country that doesn't have it."<sup>2</sup> Talbot D'Alemberté, former President of the American Bar Association, in a message to the Association in 1992 on the challenge presented by the former Soviet Union, did not fail to notice Professor Sachs's esteem for the work of the legal profession: "Russia doesn't need economists. It needs lawyers."<sup>3</sup>

The mere presence of an army of lawyers representing different and normally opposing interests and clients could not have been what Professor Sachs contemplated, at least not for the initial period of transformation in Eastern Europe. Lawyers at their idealistic best, however, act as exacting public spirited legislative craftsmen, supporting their fellow lawyer legislators as well as the economists, poets, and writers and other newly, and mostly democratically, elected parliamentarians. In this role, they draft the statutes required by a market economy, which are what Russia and the other Eastern European nations need during the first stage of the revolutionary transformation process. It is an obvious yet frequently overlooked or forgotten fact that "a process characterized by a high degree of uncertain, statutory law - which has the specific quality of determining reasonable expectations in the short, medium and long term - can make a positive, and indeed indispensable, contribution to creating a framework for macroeconomic and macropolitical changes."<sup>4</sup> Moreover, lawyers, with the structured thinking, approach and methods that are assumed and expected qualities of a professional counselor in the West, were and are needed to lay the foundation and the direction of a *Rechtsstaat* by preparing both interim acts and permanent enactments.

Even more basic than the presence of an abundance of experts and specialists, however, is the need for an amorphous intangible, the will to achieve and succeed. The will of a nation, an admittedly nebulous and vague idea, ideally is discerned, expressed, and exercised by its leaders in the government and in the legislature. It is up to these leaders to want and then to initiate, adopt, and implement the rule of law, a term which itself

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2. *The Russian Republic: Issues and Opportunities*, PRISM, Third Quarter 1992, at 25 (citing conversation with Jeffrey Sachs).

3. Talbot D'Alemberté, *Our Eastern European Challenge: Providing Technical Assistance to Struggling Democracies*, 78 ABA J. 8, 8 (1992).

4. ROLF KNIEPER & MARK BOGUSLAVSKIJ, CONCEPT FOR LEGAL COUNSELING IN TRANSFORMATION STATES 65 (1995).

embodies many concepts but contains no therapeutic formulas. In this regard, the darling of the International Monetary Fund ("IMF"), the small nation of Estonia, with a population comparable to that of the island of Manhattan, had the political and intellectual leadership with the will and the drive to create a market economy embedded in the rule of law. How such a will arises or is created is the subject for a separate sociological study and not a topic for this Essay. But the positive consequences of the leadership of Estonia in exercising and implementing this national will stands not so much as a challenge to other nations still struggling with the transformation process, such as many of the member countries of the Commonwealth of Independent States ("CIS"), but as an example and a confirmation that a successful transition from a centrally planned economy to a free market economy can be achieved quickly. To simply attribute and dismiss Estonia's emergence as an anomaly due to the difference of its culture from that of the other peoples in the former Soviet Union, however, as is commonly done by many academicians, legislators, and other leaders in the nations of the CIS, is simply a self-fulfilling excuse for inaction, inevitable failure, and cultural arrogance, even if masked as a compliment. In fact, the prospective, still unheralded, success of the Republic of Georgia in its law reform efforts belies any such assertions. It is of note that the remarkable emergence of Estonia, and the expected achievements of Georgia, did not develop in a vacuum, but utilized the support of the international community to buttress national will.

### I. *LEGAL REFORM AND WESTERN SUPPORT*

Legal reform in Eastern Europe, although a prerequisite for carrying out a successful economic reform effort and the key for a transparent and non-corrupt privatization of state owned economies, has regularly been left to the vagaries of the political process with its shifting foci, switching alliances, and hidden agendas, not to mention inexperienced parliamentarians and government officials. International institutions, such as the IMF and the World Bank, possess the stature and the necessary financial clout, especially in Eastern Europe, to impose financial and other conditions, often decried as draconian by their detractors, prior to extending needed standby and other credits to those

nations seeking to achieve economic price stability and restore their economic health. Still, while many of the institutions' funding conditions, often presented as recommendations, are well reasoned and commendable, they are not necessarily adequately prioritized. At times, they lack a realistic timetable and generally only touch on legal issues. In fact, it is quite surprising that despite their intense, active, and indispensable involvement in the economies of Eastern Europe, these institutions refrain from mandating specific commercial or corporate law reforms. The only exception is foreign investment legislation, where the principle of equal treatment for domestic and foreign investors, whether in the form of tax holidays or other privileges, has become dogmatic, operating truth. In addition, major national donors such as the United States and Germany, as well as the European Union, readily offer development and other assistance, but do not condition their aid on the adoption of a recognizable and comprehensible legal system. Otherwise, such a politically pivotal nation as Ukraine would probably not be identified as a land of contradictory and incomprehensible statutes, conflicting and indeterminate presidential decrees reminiscent of the Soviet style of rule making, and excessive and confusing bureaucratic regulations.

This understandable, Western reluctance stems from an almost universal hesitation to impose or dictate, or to appear to impose or dictate, one's own legal norms on another nation, even in the area of business law, with the possible threatening outcries of legal imperialism. Nevertheless, all of the nations of Eastern Europe have individually, and in an uncoordinated manner, ultimately relied on foreign experts and adopted foreign legal concepts, principles, and laws, especially in the revamping of their civil and commercial law systems. After the passage of varying periods of time and intermittent discussions and debates about the merits of relying on another nation's laws, as well as the concomitant interpretations of such laws, the nations of Eastern Europe have invariably come to accept that which the West assumes as a self-evident truth, that commercial law is not a province of national norms. In fact, "[o]nly during the relatively short era of European nationalism in the nineteenth and early twentieth centuries was there a general - albeit disputed - view that commercial law should be subject solely to national provi-

sions.”<sup>5</sup>

There has also been a lack of an international consensus among donors as to which, if any, legal pattern or system to recommend, let alone follow. In particular, the debate has been between Anglo-American law, with its common law and particularly strong reliance on judicial interpretation, if not law making, and the statutory approach, whether of the German based Civil Code type or the French Napoleonic Code version. The basic German approach has normally won out, as in the case of Poland and the other nations of Central Europe, Russia, Estonia, and Georgia, although specialized laws have often followed a U.S. model and stock exchange regulations are not infrequently patterned upon the French format.

The lack of agreement has had the logical and obvious consequence of a half-hearted international commitment to law reform in Eastern Europe. In addition, the lack of consensus and coordination hides the subdued, but not necessarily subtle competition between the donor nations, sometimes behind the mask of the European Union, as they consciously and unconsciously promote the export of their legal concepts or systems and offer competing drafts of different legislation. Moreover, legal advisors, who are normally practitioners in either private practice or government service and who are regularly selected for short term assignments in a national or EU bidding competition with its characteristic inadequate level of project funding and economical level of advisor compensation, often only have a practical knowledge of their own laws, without an appreciation for the historical, political, or economic context behind such enactments. A lack of understanding of the political situation, administrative structures, and economic reality of the nations in which they are advising regularly compounds the problem. The result is that questions such as why a particular statute is needed or why at a specific time, are regularly left unasked and, therefore, unanswered.

## II. *THE MODERN GREAT GAME: INTERNATIONAL ADVISING*

Law reform, while recognized politically, intellectually, and even economically as an a urgent priority, ranking on par in im-

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5. *Id.* at 66-67.

portance with inflation, budget deficits, and other economic issues, has often become a stage for petty competition between different donor nations' expert advisory groups. The extremes with which some advisors have lobbied for their own drafts of statutes, including esoteric ones if not in fact their own legal system, perhaps out of a sense of pride of authorship and a future need to be able to cite specific accomplishment, has exasperated this competition. Professors Rolf Knieper of Germany and Mark Boguslavskij of Russia, both legal scholars and active law reformers, have politely decried personal lobbying, not least of all because it tarnishes the development of the still infant legal process in Eastern Europe. Professors Knieper and Boguslavskij wrote:

In the Russian Federation, for example, various laws which simply imitated American legislative acts were proposed and accepted. They had been 'imported' by American experts who knew little about the history of (civil) law in Russia and ignored the peculiarities of Russian legislation. An interesting example of this approach is provided by the preparation and enforcement of legislation on trusts. Under American law the owner can entrust the management of property to another person who then acts as owner vis-a-vis third parties. This legal concept is unknown in Russian law and indeed in continental Europe as a whole. The advisers nevertheless presented the American system to the Committee on the Management of Public Property, which passed on the draft to the Russian parliament. After parliament had rejected the draft on the express grounds that it was incompatible with Russia's system of civil law, the authors of the law and the committee opted to submit the law to the president of the Russian Federation, who for his part put a sizeable portion of the draft into effect in the form of decree.<sup>6</sup>

Moreover, law reform itself has also been relegated to competing for attention, "effort," and aid funding with other areas of concern. Therefore, Eastern European law reform, with the random and non-systematic attention paid to it by the international community, has been left to the vagaries of individual governments and legislatures to establish their own reform agenda and follow their own pace or schedule for implementing reform. This challenging task has proven beyond the enduring capability

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6. *Id.* at 32.



of many a parliament, except during the short-lived periods of freedom or independence inspired exuberance and euphoria in 1989, 1990, or 1992 in the nations of Central Europe and in 1991, 1992 or 1993 in the former Soviet Union. Thereafter, only the political acumen of a strong president, as in the case of Russia or Ukraine, who is personally subject to intense international pressures, if not dictates, could move a faction riddled or Soviet style parliament to pursue a course of law reform and, even then, with only sporadic success. It is a tell-tale sign of this weakness that most nations of Eastern Europe have felt compelled to establish a government with a strong presidency rather than create a traditional parliamentary system with a prime minister as head of government.

### III. *CENTRAL EUROPEAN LAW REFORM*

Poland, the Czech Republic, and Hungary had to free themselves from a licensing mentality and a Sovietized legal system and forsake a centralized government's urge to control. This contrasts with the nations of the former Soviet Union, which simply had to brush off the dust from their selectively used, but still extant, civil codes and wipe the cobwebs off their unused commercial codes. The essence of a capitalistic commercial legal system, even if not always recognizable, had never fully disappeared from the law, although it was obviously officially disdained and ignored. Still, Poland, the Czech Republic, and Hungary also found it necessary to call upon experts from Germany, Austria, and other nations to support their modernizing legal reform programs. Local expertise in new, or even in respect of unused provisions of the civil code or commercial code, was certainly not readily available. Moreover, the nations of Central Europe all expressed an early, if not immediate, interest in quickly becoming members of the European Union. This goal implicitly imposed a discipline on the law making process of nations seeking to join the European Union as they realized that their laws would be scrutinized and critiqued by Western experts to ensure their compatibility and harmonization with the laws of the Member States of the European Union. Thus, this foreign policy objective provided the necessary domestic discipline and expert foreign support for the rapid modernization of the legal system. The nations of the former Soviet Union did not have such luxury

and, except for the Baltic States, who also aspire to EU membership, did not and do not have such indirect external discipline imposed on their law making processes.

The nations of the former Soviet Union had a more daunting task as they had to philosophically and conceptually, if not structurally, reinvent the legal wheel, despite the traditions of an existing, albeit Soviet, civil code. Effectively, a new language, new concepts, and new principles had to be learned, understood, and ultimately mastered. Estonia and its sister Baltic states were no exception, despite their memory, admittedly distant, consequently vague, and at times inaccurate, of the things of the 1920s and 1930s.

#### IV. *THE WUNDERKIND OF THE EX-SOVIET UNION: ESTONIA*

Estonia declared, or reconfirmed as it had been recognized internationally as an independent nation occupied by the Soviet Union since 1940 and, therefore, *de jure* not part of the Soviet Union, its independence from the Soviet Union on August 20, 1991. With this act, Estonia inherited a moribund Sovietized industry, dependent on Russia for its lifeline supply of gas and oil, and a Soviet legal system. Still, just five short years later, Estonia has already achieved a Gross National Product ("GNP") per capita which compares favorably with that of Korea, one of the renowned Asian Tigers.<sup>7</sup>

##### A. *Economic Wunderkind*

Estonia's GNP per capita as of 1995 was US\$2290, thirty percent of Korea's per capita GNP.<sup>8</sup> Estonia's currency, the first national currency of any part of the former Soviet Union, has been the most stable of the ex-Soviet lands at eight kroons to the Deutsche mark since its adoption almost five years ago on June 20, 1992. Estonia's unemployment rate has not topped 2.7 percent,<sup>9</sup> and its total foreign investment ranks it third after the

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7. Data provided by the Embassy of the Republic of Estonia, Washington D.C. (unpublished, on file with the *Fordham International Law Journal*).

8. Unpublished data from the World Bank, International Economics Department.

9. This rate of unemployment was registered in April 1993 and the data was provided by the Bank of Estonia. Private studies, such as the EMOR study, have estimated the unemployment rate as high as 9.1%, which is still not unfavorable in comparison with the Member States of the European Union. *Eesti Pank Bulletin No. 1* 12 (1994).

Czech Republic and Hungary on a per-capita basis.<sup>10</sup> Moreover, in 1994, Estonia ranked first among the East European nations on a per capita basis in receiving foreign investment.<sup>11</sup> In fact, Estonia was considerably ahead of its two peers, Hungary and the Czech Republic, as Estonia's per capita direct foreign investment totaled US\$158, while Hungary registered US\$111 and the Czech Republic registered US\$83.<sup>12</sup>

Estonia's privatization program, modeled on the East German Treuhand system of international tenders with direct cash sales and guaranteed new investment, succeeded in not only injecting fresh foreign capital of over US\$200 million in direct sales revenue<sup>13</sup> into the Estonian economy, but also in building a local entrepreneurial business class at the same time. These statistics do not reveal the basis for the success of Estonia's leap-frog, Asian Tiger type, economic performance, namely effective legal reform.

### B. *The Legal Wunderkind*

The law reform effort of Estonia was self-initiated, consistently and progressively pursued, and progressed step-by-step. Especially during the initial stage of law reform, the Government systematically drafted and enacted statutes with the regular advice and support of foreign experts. The subsequent, or secondary, stage of reform, with its focus on professional institution building, namely daily legal interpretation by practicing attorneys, judicial review, and enforcement, does not permit haste, but only can come with education, training, experience, and time. This second stage also places a premium on a judiciary not only versed in the principles of the newly enacted laws, but also a judiciary prepared to assume its new responsibilities as independent and objective interpreters of statutes and arbiters of

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10. Data provided by the Embassy of the Republic of Estonia, Washington, D.C. (unpublished, on file with Embassy).

11. Data provided by the Embassy of the Republic of Estonia, Washington D.C. (unpublished, on file with Embassy).

12. Republic of Estonia, *Government Activity Plan for Joining the European Union* 30 (1996) (citing reports of European Bank for Reconstruction and Development) [hereinafter *Government Activity Plan*].

13. Data provided by the Embassy of the Republic of Estonia, Washington D.C. In addition, US\$150 million was committed for further capital investment.

legal principles which are not necessarily explicitly set forth in a statute's provisions.

### 1. The Beginning of Law Reform

Estonia, inspired by its past as a prosperous independent nation during the 1920s and 1930s and challenged by the present prosperity of its northern neighbor, did not hesitate in seeking to adapt and adopt the structures of its economically prosperous neighbors on the Baltic Sea. Inspiration, however, clearly a source of strength and conviction, may indicate a willingness and an openness but, in and of itself, does not translate into understanding, and certainly not capacity, let alone ability. The old ways, the Soviet ways, especially in thinking and intellectual expression, had become a self-perpetuating frozen mind-set and reflexive habit which could only be overcome with conscious striving. Inspiration, a dream if you will, does provide a direction and here, in the case of Estonia, even a model. The conceptual model was a market economy anchored in private property and motored by entrepreneurial activity.

### 2. A Small But Significant Change in Thinking

In adopting the Law of the Republic of Estonia on Ownership in 1990, while Estonia was still a Soviet state, the statute's authors, composed mostly of reform-minded professors from Tartu University Law Faculty, succinctly set forth the forward-looking philosophy of this interim statute in the Law's preamble:

The transfer of the economy of the Estonian Republic to the principles of market economy presumes the legal regulation of new social relations. Until the adoption of the new Civil Code of the Estonian Republic the property relations shall be regulated by the present law . . . . The Property Law of the Estonian Republic is the legal basis for developing entrepreneurship, [and for] privatization of property . . . .<sup>14</sup>

This statute was revolutionary, for it restored the discredited concept of private property in a territory within the Soviet Union. Furthermore, it encouraged private initiative by declar-

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14. ESTONIA'S WAY TO MARKET ECONOMY: SELECTION OF LEGISLATION OF THE REPUBLIC OF ESTONIA ON BUSINESS ACTIVITIES 5 (Anu Avi, ed. & Tiiu Allik et al. trans., 1991) [hereinafter MARKET ECONOMY] (adopted by Supreme Council of Estonian Republic on June 13, 1990).

ing that the "private ownership right originates from the profit obtained from entrepreneurship . . . ." <sup>15</sup> Still, this empowering statute rested on its implementation in the Enterprise Law <sup>16</sup> adopted less than one year earlier, on November 23, 1989, which still adhered in many of its provisions to Soviet-type thinking. The drafters, consisting of the same group of reform-minded professors, were conscious and apologetic about their work, but in 1989 they did not have the theoretical or scholarly tools, not to mention political power, to pursue a different, or more Western, approach. They lamented, "there were serious difficulties in finding English-language equivalents to some legal terms . . . [and, therefore,] these terms are based on the Soviet legal system."<sup>17</sup> They noted ruefully, "this is not a justification."<sup>18</sup>

The Enterprise Law enshrined the right and power of a bureaucrat to deny any person a permit for founding an enterprise on vague, imprecise, and prospectively arbitrary standards, if "the enterprise [is] detrimental to the interests of the corresponding administrative area."<sup>19</sup> Fortunately, in practice, independent-spirited Estonian bureaucrats did not exercise this right regularly. Still, the underlying theory, although now slightly modified, was that a private endeavor was prohibited unless and until permitted. A license was still the order of the day.

### 3. The Break in Sovietized Thinking

The break with Soviet tradition and Soviet thinking occurred coincidentally with the restoration of Estonia's independence on August 21, 1991 and with its adoption of a permissive foreign investment law on September 11, 1991.<sup>20</sup> This law enabled a foreign investor to undertake an investment in any activity whatsoever unless an activity specifically required a license or was in fact prohibited. The traditional Soviet rule had been reversed as now everything was permitted unless prohibited. With this provision and the subsequent adoption of a short list of restricted investment areas, a foreign investor was at last free to

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15. Property Law, art. 16.1, *reprinted in* MARKET ECONOMY, *supra* note 14, at 13.

16. Enterprise Law, *reprinted in* MARKET ECONOMY, *supra* note 14 at 24.

17. MARKET ECONOMY, *supra* note 14, at 5.

18. *Id.*

19. Enterprise Law, art. 10.1, *reprinted in* MARKET ECONOMY, *supra* note 14, at 27.

20. Foreign Investments Act (unofficial translation provided by Embassy of Estonia in Washington, D.C.).

determine its field of investment activity, subject ironically to the conflicting provisions of the Enterprise Law, which was still in effect. At the legislative level at least, the vestiges of Soviet legal thinking were beginning to disappear, and an openness to outside foreign investors and foreign methods of doing things was demonstrated clearly and forcefully. In this manner, the Estonian foreign investment law followed the pattern being set by the more advanced reforms in Central Europe, for example, Poland, which was in the process of enacting a very permissive foreign investment law giving foreigners free investment reign.

#### 4. Adoption of a Scheduled Legal Reform Program

Estonia, in its rush to transform itself into a Scandinavian country, did not have any reluctance to adopt, and at times copy, the systems of the West. In October 1992, the Minister of Justice approved a policy paper entitled "Foundational Commercial Law Agenda for The Republic of Estonia."<sup>21</sup> The Minister introduced this paper after examination and adaptation of the European continental, specifically German, civil and commercial code system into Estonia in accordance with a schedule of legislative priorities. The policy paper both stressed the pre-Soviet legal traditions of Estonia and underscored its geographical, cultural, and economic proximity to Scandinavia and the continental nations of the European Union, both primary sources for expected foreign investment.

The policy paper called for the draft Estonian Civil Code of 1940 to be modernized taking into account both current German legal norms and EU requirements. The Civil Code of 1940 was influenced heavily by traditional German legal thinking, but was never enacted because of the 1940 Soviet invasion. The policy paper assumed that membership in the European Union would inevitably become a primary foreign policy objective of Estonia. Harmonization of its laws with that of the European Union had, therefore, an importance all of its own. The Commercial Code and other business related laws were also to be drafted in accordance with such norms and requirements.

This decision of the Justice Ministry signaled for Estonia in 1992, just one year after the restoration of its independence and

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21. This plan was prepared by Jenik Radon and was subsequently put into the form of a work plan with the assistance of a team of German legal experts.

only a few months after the introduction by Estonia of the first post-Soviet currency, its prospective reintegration with the market economies of the West, in particular Western Europe. It meant that Estonia would have a set of laws which were recognizable, familiar, even if not in every detail, and useable by prospective economic partners. The language of business would at least be similar, even if not identical. Thus, although some scholars and politicians naturally questioned whether the legal system of Germany was the most appropriate, Estonia readily accepted the position that the legal system of a successful economy, and preferably a geographically proximate one, had to be followed in order to achieve steady and, hopefully, rapid economic transformation as well as economic integration with the West.

As a consequence of the adoption of the policy paper approved by the Minister of Justice, rapid progress was made in law reform. Estonia almost immediately began to draft and adopt, with the assistance of a team of German legal experts as well as this author, a new Civil Code, albeit in parts, as well as a new Commercial Code.<sup>22</sup> The first section of the civil code, enacted as a separate law, was the Property Law,<sup>23</sup> which quickly invigorated the financial sector because secured lending, the absence of which was seriously hindering economy development, was now at last possible. The progressive, step-by-step enactment of the different parts of the Civil Code and related laws were tied quite pragmatically to the need to energize the Estonian economy or, in the vernacular, "to get Estonia moving."

Estonia, nevertheless, also had to endure legal mishaps or

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22. The Civil Code consists of five parts: The Law on General Provisions became effective in 1994; the Property Law, a key piece of legislation necessary for the full operation of the banking sector, became effective in 1993; Family Law, which is not critical for the conduct of business related transactions, became effective in 1995; Inheritance Law, also not critical for the conduct of business related transactions, is presently in draft form and has not been adopted; and Law on Obligations, presently in draft form, has also not been adopted, but many of its principles are adequately contained in the contracts section of the Soviet civil law legislation, which still governs to the extent not modified by the Property Law, the Law on General Principles, and other laws, including the Law on Ownership which entered into force in 1991, all of which had the effect of significantly modifying that contracts section. The "piece meal" approach is complex to implement, but achievable as Estonia pursued a systematic plan for critical economic legislative enactments. Law on the General Principles of the Civil Code, Riigi Teataja Part I 1994, No. 53, art. 889, in *Legal Acts of Estonia No. 2* 35 (April 12, 1995) (unofficial translation provided by Embassy of Estonia in Washington, D.C.).

23. Property Law, reprinted in *MARKET ECONOMY*, *supra* note 14, at 8.

errors in legal reform, especially prior to the adoption of a legislative reform policy program. These occurred often, especially when the rationale for a statute, its intended purpose, and possible consequences under the local economic conditions had not been examined reflectively. The Bankruptcy Code,<sup>24</sup> drafted at the urgent behest of officials and legislators uncertain about what to do with all the financially-insolvent, state-owned enterprises, is a modern Western-style code, but a prime example of the adoption of a statute without consideration of its possible effects. The Bankruptcy Code applied to both private and state or government-owned entities, including those designated for privatization. In one case, the Estonian tax authorities initiated bankruptcy proceedings for unpaid taxes against a state-owned enterprise in the process of being privatized. This had the anomalous result that the enterprise was no longer subject to the authority of the Estonian Privatization Agency, but instead became subject to the jurisdiction of the city court administering the entity's bankruptcy proceedings. The enterprise ceased operations, its employees were dismissed, and the assets, consisting effectively of real estate, were sold at an auction to satisfy the claims of the entity's debtors. This had the absurd consequence that one government ministry was simply enriched at the expense of another as well as at the expense of the Government of Estonia. Only thereafter was an amendment adopted to lift the effectiveness of the Bankruptcy Code in respect to enterprises subject to privatization.

#### V. *GEORGIA: THE SURPRISE CIS REFORMER*

The Republic of Georgia, a nation without any direct traditional ties to Europe or to elsewhere in the West, other than its neighbor Turkey, has, despite several years of secessionist and civil wars, quietly and independently without any intellectual, legal links to Estonia, followed Estonia's pattern of statutory law-making. The Georgian motivation stemmed directly from economic motivation or, perhaps more appropriately, desperation, as there was "a growing awareness that radical reform of legal institutions and commercial law is essential to halt the decline in

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24. Law on Bankruptcy of the Republic of Estonia, Riigi Teataja 1992, No. 31, art. 403 (adopted June 10, 1992), in *Legal Acts of Estonia No. 4/5 83* (Oct. 7, 1993) (unofficial translation provided by Embassy of Estonia in Washington, D.C.).



production and the increase in illicit economic activity and to permit the politically desired transition to a social market economy."<sup>25</sup> Of its own accord, Georgia has proved itself as open-minded to readily adopting the legal norms of another nation such as Estonia. Georgia, however, has pursued a more comparative course.

Georgia elected a reform-minded legislature in the fall of 1995. Today, this parliament is actively pursuing Georgia's "national will." It is expected that during the summer of 1997 parliamentary session, the Parliament will enact a civil code, based primarily on the German code, although the intellectual influence from the Dutch code and from other codes is also evident. In addition, U.S. legal concepts, for example, in the area of franchising, have also been introduced and integrated into the prospective Georgian Civil Code. A new foreign investment law is also being drafted which will at last dispense with the onerous licensing requirements for foreign investors, admittedly a recent throw back to frozen Soviet thinking. A foreign investor can presently be denied a license under vague, imprecise, and arbitrary standards. For example, if a proposed investment "runs counter to the demographic and social interests of the Republic of Georgia" the license can be refused.<sup>26</sup> The recently adopted Commercial Code, however, is a skeletal, but functional and comprehensible, version of the German code on which it is based. Other economic or commercially-focused laws, such as the Banking Code, adopted at the behest of the IMF, have U.S. origins and will have to be revised and conceptually integrated with Civil Code definitions and Commercial Code corporate structures. By June 1, 1997, Georgia will have a free market-oriented legal system which will be comprehensible, understandable, and familiar. It should be attractive to foreign investors, and it will no longer be an obstacle to economic progress, although improvements will still need to be enacted.

The basic advisory work, except with respect to the foreign investment law which admittedly was drafted with the assistance of other foreign advisors, has, surprisingly, been consistently co-

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25. KNEIPER & BOGUSLAVSKIJ, *supra* note 4, at 59.

26. Law of the Republic of Georgia on Foreign Investments, art. 17, adopted on June 30, 1995 (unofficial translation provided by Embassy of Georgia in Washington, D.C.).

ordinated for several years by the same group of German experts, assisted periodically by short term specialists. Since the Georgian parliamentary election in the fall of 1995, the law-making process has been quite disciplined without the motivation of the hope of EU accession. Presidential decrees vying for authority with parliamentary enactments are not the order of the day. Commercial legislation has been centered in one parliamentary committee as well as in the Ministry of Justice. Georgia had already experienced the depths of economic and civic chaos, and this disaster has become the impetus for change.

#### VI. *THE HARD YEARS AHEAD: THE NEED FOR INTERNATIONAL COMMITMENT*

Estonia and Georgia, each powered by a goal, whether it is the restoration of the past, EU membership, or an end to an economic depression, demonstrate that effective legal reform can result if given priority and appropriate attention. The nations of Central Europe, which had the easiest physical task of law production, also underscore the allure and power of a vision, namely membership in the European Union. These dreams can become reality through the discipline which emanates from pursuing concrete steps to achieve these goals.

Estonia's commitment to law reform has already propelled it into the arduous second stage of law reform, legal institution building. This stage, of course, clearly overlaps with the first, characterized by law-production, almost in an industrial sense, but receives more attention when the first stage decelerates. Estonia has recognized that the "ultimate enforcement of legislation is, of course, the judiciary."<sup>27</sup> As a natural consequence, but one which demands the dedication of scarce budget resources, Estonia intends to launch a training program of seminars for judges as well as lawyers in order to improve their qualifications to work with all of the new laws, most of which have been EU conformed.<sup>28</sup> This was a diplomatic way of stating the obvious. The judicial systems in the nations of Eastern Europe, and especially of the former Soviet Union, have to overcome a legacy of actual and perceived corruption and incompetence. Consequently, public acceptance of the judicial system, even a re-

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27. *Government Activity Plan*, *supra* note 12, at 44.

28. *Id.*

formed one, has to be earned. Only the former East Germany had the luxury of importing well-trained and impartial judges and, thereby, recreating its entire judiciary.

Georgia, still in the first stage of accelerated law-production, will reach the second stage as early as the beginning of 1997, although law production, notwithstanding the reams of laws being enacted, will still be a major priority. Moreover, it is not realistic for most, if not all, of the members of the CIS to contemplate EU membership or even associate status in the near future. But these nations do aspire to attract significant amounts of foreign investment and increase the volume of trade with the West. This will require that these nations offer a familiar, legal regime. To the extent that their legal systems are still incomprehensible to the ordinary foreign businessperson and his or her counsel, disciplined law-making and legal implementation need to be actively encouraged by the major international financial institutions and the major donor nations, as well as by the European Union. A firm commitment to law reform in the CIS nations by the international community could accelerate the process and assure success. This requires a recognition that law reform is as important as economic reform and deserves equal priority.

The ideal would be the creation of a legal institution with the stature and financial strength of an IMF, but this is obviously politically unrealistic and in actuality impractical. Still, the creation of an independent, international legal board with supervisory and management responsibility for creating, coordinating, monitoring, and implementing all public legal assistance programs would serve to prevent needless competition and duplicative counseling work, as well as ensure systematic law reform implementation, and control a wide range of programs, whether direct, bilateral, or multilateral, in the transformation nations, other than those nations subject to the rigorous EU law harmonization regime. With a now almost-universal acceptance among donors of the European continental civil law approach to Eastern European law making, narrow "nationalistic" competition should at least be less pronounced, even if not coordinated or systematic.

It may well be a dream, or certainly an ambitious goal, that the legal reform effort follow a coherent and unified approach, but it is one that nevertheless needs to be pursued, especially as "a certain transitional period has [now] elapsed and there are

unmistakable signs of disappointment at meager results, at the consequences of nationalistic segregation and indeed at the [legal] counseling work itself."<sup>29</sup>

These meager results are underscored by a rating issued by the European Bank for Reconstruction and Development,<sup>30</sup> which has a mandate to focus on the law reform efforts in Eastern Europe, concerning the extensiveness and the effectiveness of their rules on investment. Only three nations, namely the Czech Republic, Hungary, and Poland received a rating which compares not too unfavorably with ratings the most advanced industrial nations would receive.<sup>31</sup> Estonia alone of the former Soviet Republics received a satisfactory rating, just behind the

29. KNEIPER & BOGUSLAVIJ, *supra* note 4, at 69.

30. *Government Activity Plan*, *supra* note 12, at Annex 1.1.

31. *Id.* The ratings and their descriptions are elucidative of the extensive legal reform work which still needs to be accomplished in Eastern Europe and evaluate the extensiveness and effectiveness of legal rules on investment:

4\* (most advanced industrial economies)

Legal rules closely approximate generally accepted standards internationally and are readily ascertainable through sophisticated legal advice; investment laws are well administered and supported judicially, particularly regarding functioning of courts and land and the orderly and timely registration of proprietary or security interests.

4 (Czech Republic, Hungary and Poland)

Legal rules are clear, generally do not discriminate between foreign and domestic investors and impose few constraints; specialised legal advice readily available; investment laws reasonably well administered and supported judicially, although the support is sometimes patchy.

3 (Estonia and a number of Central European nations)

Legal rules do not impose major obstacles to the creation of investment vehicles, the taking of security or the export of profits; legal rules are reasonably clear and specialized legal advice is available; judicial and administrative support of the law is often inadequate; where such support is adequate, legal rules often impose significant constraints.

2 (Russian Federation, Georgia, Latvia, Lithuania and most of the member nations of the CIS)

Legal rules often unclear; legal advice often difficult to obtain; legal rules impose constraint to creating investment vehicles, the taking of security or the export of profits; judicial and administrative support of the law is rudimentary; where adequate legal rules or legal advice exist, administration of the law is deficient.

1 (Azerbaijan, Tajikistan and Turkmenistan)

Legal rules often very unclear and impose significant constraints to creating investment vehicles, security interests or repatriation of profits; availability of legal advice is limited; judicial and administrative of the law is substantially deficient.

rating given to the Czech Republic, Hungary, and Poland.<sup>32</sup> Russia, Ukraine, and several other ex-Soviet nations languish with very unsatisfactory ratings as well as civil war torn Tajikistan which received totally unsatisfactory ratings.<sup>33</sup> The only exceptions are oil-rich Azerbaijan and Turkmenistan.

To give such a board the clout of a legal IMF, so that its positions are considered seriously by various governments and parliaments, all foreign assistance grants and loans, other than humanitarian or other critical or specialized aid, should be subject to the satisfaction of stringent legal reform terms and conditions established by such a board. These conditions should be comparably as demanding, if not as stringent, as those imposed by the IMF and the World Bank in respect to the economic area. This board should consist of a limited number of lawyers and professors from the major donor nations, especially the United States and Germany, as well as representatives from the leading international financial institutions and agencies, which are lenders or investors in Eastern Europe, including the IMF, the World Bank, and the International Bank for Reconstruction and Development.

The law reform or legal transformation process in Eastern Europe, particularly in the CIS and even in the Baltic States of Latvia and Lithuania, not to mention some Central European nations, such as Romania, has progressed sporadically and too slowly. Consequently, the integration of most of these nations into generally accepted Western ways of conducting business will not become a reality, certainly not in the near future, without consistent and concerted Western support. But that support itself needs such an independent international legal board or other meaningful back-up, called clout, in order to affect concrete results. The challenge of urgent law reform in Eastern Europe is still with us.

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32. *Id.*

33. *Id.*