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ECONOMIC FREEDOM AND PRIVATIZATION - FROM EGYPT AND MESOPOTAMIA TO EASTERN EUROPE

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"Fundamentally, there are only two ways of co-coordinating the economic activities of millions. One is central direction involving the use of coercion [and] . . . [t]he other is voluntary co-operation of individuals . . . ."[1]

INTRODUCTION

On the tenth anniversary of the sudden collapse of the Berlin Wall, the seemingly immovable symbol of the Cold War, a great debate exists among the people of Eastern Europe[2] about whether the end of communism was a mistake.[3] Disillusion surrounds the issue of what good is the freedom to travel when you cannot afford to travel, or what good is the freedom of speech if no one listens.[4] Capitalism has been the most common scapegoat for the countries making the bumpy transition from communism to a free market economy. But, is it really capitalism, or are there other reasons for this widespread dissatisfaction?[5] Although the global community generally advocates for privatization and a free market economy, the reality of the process of privatization

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1. MILTON FRIEDMAN, CAPITALISM AND FREEDOM 13 (1962) (Milton Friedman, a leading economist and free-market advocate, notes that totalitarian and free-market systems are the only two fundamental ways to run an economy).

2. *See* THE WORLD ALMANAC AND BOOK OF FACTS 2000 710 (1999) [hereinafter ALMANAC 2000]. The Eastern European countries include Albania, Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia and the former Soviet Republics of Belarus, Estonia, Latvia, Lithuania, Moldova, Russia and Ukraine. *See id.* The former Soviet Republics of Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan are now considered part of the continent of Asia. *See id.* at 516-17. The former Eastern European country of the German Democratic Republic ("East Germany"), as a result of the German reunification of 1990, is now the Federal Republic of Germany ("Germany") and is considered part of Western Europe. *See id.* at 800. The former Republics of Yugoslavia, which are considered Southeastern Europe, comprise Bosnia Herzegovina, Croatia, Macedonia, Slovenia and Yugoslavia. *See id.* at 876.

3. *See* Kevin Cullen, *Unity Eludes Germany 10 Years After Wall's Fall*, DENVER POST, Nov. 7, 1999, at A1.

4. *See id.*

5. *See id.* (discussing a general dissatisfaction with the new capitalism).

might not bring the economic prosperity initially expected.[6] Privatization, historically, has contributed to the socio-economic and political prosperity of a nation, although not without a few failures.[7] With a historical perspective in mind, this article will examine the problems with privatization, specifically in the Russian Federation and Czech Republic, where the privatization efforts have gone in opposite directions.

Part one provides historical background in the development of today's economies, the natural need for a free-market economy and the economic impact on society. Part two discusses the process of privatization in the Russian Federation and Czech Republic. Part three analyzes the three most common political, social, and economic problems of failed transitions to privatization. The article concludes with a general view of today's global economy.

I. BACKGROUND AND HISTORY

A. *Humans and Economics: Early Economic Development*

"Trade, in the simple form of barter, is as old as man."[8] Humans, historically, have never been satisfied with what they can produce for themselves, because they have always been driven by *want* rather than *need*.[9] Once humans possess what they need, they want to acquire what others possess, either by force or by exchange, and if they happen to possess what others might need, they trade.[10] Once local needs are satisfied, people frequently go beyond local markets and look for clients elsewhere.[11] Today, archaeologists have discovered ruins that provide evidence of ancient international exchange, proving the human nature of freely owning and trading, called the free-market.[12] Similar to today, these historical trade efforts did not occur entirely free of obstacles, such as excessive government control. Nevertheless, the commitment

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6. *See* Mark Baker, *Privatization in the Developing World: Panacea for the Economic Ills of the Third World or Prescription Overused?*, 18 N.Y.L. SCH. J. INT'L & COMP. L. 233, 237 (1999).

7. *See* Yuliya Mitrofanskaya, *Privatization as an International Phenomenon: Kazakhstan*, 14 AM. U. INT'L L. REV. 1399, 1400 (1999).

8. SIR LEONARD WOOLLEY, THE BEGINNINGS OF CIVILIZATION 321 (1965) [hereinafter CIVILIZATION] (discussing the rise of human civilizations all over the world).

9. *See id.*

10. *See id.*

11. *See id.*

12. *See id.* (noting that "in the Chalcolithic Age, we find in the house ruins of the early al'Ubaid period at Ur beads made of amazonite which must have been imported from the Nilghiri hills of southern India; presumably they had . . . passed from hand to hand").

to trade continued.[13]

With the introduction of metal and metallurgical science, trade became a greater necessity because only a few could manufacture the things that everyone needed.[14] The manufacturer, however, had to rely on raw materials, which often had to be imported, to keep up with the constant demand.[15] There was not one solution to this growing need for trade, therefore different civilizations approached it in different ways.[16] Unlike today, these differences were not due to ideologies, because the philosophical outlook was still lacking, instead these were a result of different "economic character[s] and resources" available in certain parts of the world.[17] For instance, the ancient civilizations of Egypt and Mesopotamia employed opposite methodologies toward their respective economic systems.[18] The Egyptian and Mesopotamian civilizations are two of the oldest civilizations known in the world,[19] and, therefore, the study of their economic systems reflects that the continuous tug-of-war between a state-controlled economy and a free-market system is nothing new. The study also helps prove an understanding of the failed state-controlled economies and, consequently, the trend toward the free-market system.[20]

1. Egypt

Egypt, under Pharaohs, had an economic system that in the modern world is called "nationalization," closely resembling the state-controlled communist-style economic system of today.[21] Under this system, Pharaohs controlled all commerce in Egypt, and the concept of free-trading merchants practically did not exist.[22] Merchants worked for the government and could not individually enjoy the wealth they helped create.[23] Despite the evidence of Egyptian commerce, there is no

13. WILLIAM L. LANGER, AN ENCYCLOPEDIA OF WORLD HISTORY 21-27 (1952) [hereinafter WORLD HISTORY] (noting that besides physical obstacles, such as lack of communications equipment and difficulty in traveling, the most common of all obstacles was the excessive power of governments, or gods in some cases. In Egypt, for instance, Pharaoh controlled everything, while on the other hand, Mesopotamia was the least controlled economy, nevertheless triad gods Enlil, Anu, and Ea were in charge of Sumer and Akkad, god Marduk controlled the Babylonians, and Ashurbanipal ruled Assyria).

14. *See* CIVILIZATION, *supra* note 8, at 321.

15. *See id.*

16. *See id.* at 321-22.

17. *Id.* at 322.

18. *See id.*

19. *See* WORLD HISTORY, *supra* note 13, at 23, 25.

20. *See* Mitrofanskaya, *supra* note 7, at 1401-2.

21. *See* CIVILIZATION, *supra* note 8, at 322.

22. *See id.*

23. *See id.*

mention of word "merchant" in Egyptian texts, nor is there any knowledge of laws regulating trade because Pharaoh's nationalization functioned as "a law unto himself."[24] Pharaohs became "deified in life and in death, and exercised despotic authority, ruling through an elaborate, carefully trained bureaucracy."[25] Pharaohs forced the architects to erect pyramids and palaces, sculptors to portray gods, intellectuals to promote literature, scientists to invent and discover, and traders to trade.[26] The system continued with "forced" success, but eventually collapsed.[27]

In theory, the entire country was Pharaoh's personal property.[28] The well-being of the country depended upon the goodwill of the gods, who essentially represented the government.[29] With the exception of petty trade in the villages, Pharaohs monopolized labor, natural resources, domestic and foreign trade.[30] Profits from all trades went straight to the Pharaohs, which led to the dissatisfaction of craftsmen, construction workers, and merchants.[31] Consequently, trade weakened and eventually no merchants remained to carry out Pharaohs' business.[32]

2. Mesopotamia

In Mesopotamia, individual merchants freely conducted business within the limitations of laws, and were subject to taxation; in a system that today, we call capitalism.[33] The Mesopotamians depended almost entirely on foreign trade.[34] Although rich in agricultural land, they produced no timber, stone, gold, copper or any of the other metals that became a necessity.[35] Hence, the Mesopotamians imported most of the raw materials they needed and traded heavily.[36] A merchant in Mesopotamia could even do business on credit. For example, he could sell his product in exchange for a tablet with value expressed in copper

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24. *Id.*
25. WORLD HISTORY, *supra* note 13, at 21.
26. *See id.*
27. *See* CIVILIZATION, *supra* note 8, at 322. The Egyptian system was similar to the systems in Joseph Stalin's Soviet Union and Mao Ze-Tung's China, where farmers, scientists, athletes were all forced to perform under the banner of patriotism, but without any financial incentive.
28. *See id.*
29. *See id.* at 324.
30. *See id.*
31. *See id* at 324-25.
32. *See id.* at 329.
33. *See id.* at 322.
34. *See id.* at 329.
35. *See id.*
36. *See id.*

or silver to be collected later; the system was called "letters of credit."[37] The Mesopotamian system of economics benefited everyone and became an example for others to follow.[38]

The free market system of Mesopotamia provided its traders, merchants, and craftsmen with ample opportunities to do business not only in Mesopotamia, but also beyond the local market.[39] For instance, buyers paid on demand of merchant's tablets, comparable to modern day paper currency.[40] The system provided opportunities, freedom, and prosperity to the entire civilization where creation of wealth was not monopolized by the government. Overall, commerce in Mesopotamia flourished, their influence in establishing commerce and banking systems was unmatched, they used standard weights and measures, they were the first to codify civil law and to write contracts, and maintained a military far superior to that of the Egyptians.[41]

B. *The Beginning of the Modern Economic Era*

The Egyptians and the Mesopotamians left their impression on the world, with newly growing societies left to follow their models. Consequently, a new medium of exchange and fresh economic theories inevitability increased commercial world trade.[42] Several different commodities functioned successfully as mediums of exchange; even cattle provided an instrument of trade.[43] Salt acted as an instrument of commerce in Abyssinia, shells in India, dried cod in Newfoundland, tobacco in Virginia, sugar in the West Indies, leather in some countries, and "nails instead of money" in Scotland.[44]

Eventually, metal became a medium of exchange, which resulted in modern era coins[45] when William the Conqueror introduced the custom of paying in money.[46] The early coins were valued according to their weight, but eventually these coins were assigned denominations.[47] Today, money has become the universal instrument of commerce, and has had a tremendous impact on the world as noted by Adam Smith.[48]

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37. *Id.* at 340.
38. *See id.*
39. *See id.* at 341.
40. *See id.*
41. *See* WORLD HISTORY, *supra* note 13, at 25.
42. ADAM SMITH, THE WEALTH OF NATIONS 20 (Alfred A. Knopf, Inc. 1991) (1776) [hereinafter WEALTH].
43. *See id.*
44. *Id.* at 20-21.
45. *See id.* at 21.
46. *See id.* at 23.
47. *See id.*
48. *See id.* at 24.

Adam Smith, the father of modern day economics, first described economics' influence on society.[49] Adam Smith's book, *The Wealth of Nations*, although written in 1776, contains economic theories still observed today.[50] Adam Smith described the three ways the "increase and riches of commercial and manufacturing towns contributed to the improvement and cultivation of the countries,"[51] and moreover, that a free-market represents a natural need and a system that countries ultimately want to have.

The three ways described by Smith are: first, a free-market economy gives constant encouragement to further cultivate and improve the country; second, the wealth acquired by the citizens is frequently used to buy and sell land, which would otherwise be left uncultivated; and, third, increasing trade and commerce introduces order, peace, and good government by having people focus on economic well-being rather than conflicts and wars.[52] Adam Smith's theory became the symbol of prosperity and well-being around the world, in the form of privatization and free-market economics. An increasing number of countries continued to adopt, theoretically, the Mesopotamian economic system rather than the Egyptian system. Today, despite the challenges in transition, some countries faired well, while others went astray.[53]

II. TODAY'S WORLD: AN UPDATE

A. *Privatization*

Privatization has become a global phenomenon, as more and more countries experiment with what is called a "free-market economy."[54] The term "privatization" differs in interpretation from scholar to scholar, and from country to country. For instance, some scholars describe privatization as an action designed to "broaden the scope of private sector activity."[55] In general, privatization is defined as "a

49. *See id.* at xiii.
50. *See id.* at xix.
51. *Id.* at 362.
52. *See id.* at 362-63.
53. *See* Rumu Sarkar, *The Legal Implications of Financial Sector Reform in Emerging Capital Markets,* 13 AM. U. INT'L L. REV. 705, 707-08 (1998). Many developing countries of Africa, Asia, and Latin America, such as Tanzania, India and Brazil are moving away from the protectionist economies of the past, and Eastern Europe is racing toward privatization as well. *See id.* Some countries such as Poland, Czech Republic, Hungary, Chile and South Africa have done well, while others, such as Russia, Ukraine and Tanzania are still struggling with their reforms. *See id.*
54. *See* Mitrofanskaya, *supra* note 7, 1401-02.
55. CHRISTOPHER ADAM ET AL., ADJUSTING PRIVATIZATION: CASE STUDIES FROM DEVELOPING COUNTRIES 6 (1992).

conversion of businesses from governmental ownership to private,"[56] and as an act of "transferring (by the means of buying and selling) the legal title of state property, which was in the possession of state enterprises for restricted purposes of producing certain goods under owner-state control, to individual or associated owners."[57] However, the most common definition is "the transfer from the public to the private sector of ownership and/or control of productive assets."[58]

Privatization not only promotes economic stability, but also democracy and social stability, by reducing the power of centralized government and granting it to the ordinary people.[59] As a result, it satisfies a fundamental demand of human nature, that is the owner of something is more likely to take good care of it.[60] Privatization also encourages competition, which results in better products and customer service, whereas state-run economies tend to be inefficient and bureaucratic.[61] Today, failed state-run economies, improved systems of communication, increasing tax burdens, and basic human nature to strive for success provide some reasons leading to the trend of de-centralizing world economies, such as those in Eastern Europe.[62]

B. *Eastern Europe*

The transition of the communist Eastern European countries from state-run economies to free-market economies have provided some of the biggest news stories in the recent history. Yet in essence, it is simply a struggle between the ancient Egyptian and Mesopotamian economic systems.[63] "The widespread nature of privatization efforts in Eastern Europe has become a common topic in legal literature, although critical analysis of the success or failure of their efforts remains woefully underdeveloped."[64] In a short time, the Communist

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56. Privatization, available in Microsoft Encarta Encyclopedia (1997).

57. Andrei A. Baev, *Civil Law and the Transformation of State Property in Post-Socialist Economies: Alternatives to Privatization,* 12 UCLA PAC. BASIN L.J. 131, 150 (1993) (commenting that privatization is a way of abolishing the socialist command system).

58. *See* Baker, *supra* note 6, at 238.

59. *See* Mitrofanskaya, *supra* note 7, 1400-02.

60. *See* David Gordon, *Privatization in Eastern Europe: The Polish Experience,* 25 LAW & POL'Y INT'L BUS. 517, 518 (1994) (explaining that competition runs a market economy by generating incentives for maximizing profits, consequently insuring lower prices and better products, calling it the efficient market theory).

61. *See id.* at 518.

62. *See* Mitrofanskaya, *supra* note 7, at 1402; Sarkar, *supra* note 53, at 706.

63. *See* Mitrofanskaya, *supra* note 7, at 1406 (noting that although calls for privatization began in the 1970s, most Communist countries did not begin to privatize State enterprises until the early 1990s).

64. J. Robert Brown, *Culture, Chaos and Capitalism: Privatization in Kazakhstan,* 19 U. PA. J. INT'L ECON. L. 909, 910 (1998). The Eastern European Communist Bloc

Bloc countries of Eastern Europe tried various ways, with "varying degrees of seriousness," to move away from the Soviet-style economic system and embrace a free-market system.[65]

The 180-degree switch, from one-party controlled assets to public ownership, created the toughest challenge that the Eastern European countries faced. This challenge was different from other countries striving for privatization.[66] Author Yulia Mitrosfanskaya notes the following three factors: "first, no other country needed to transfer thousands of enterprises to the private sector; second, privatization in almost all post-Soviet countries was completed within a short period of time - less than ten years; third, post-communist countries used more radical means for transferring state property to private owners."[67] Therefore, the Eastern European transition was a major event, where not only the economies were in transition, but also the minds of millions of people who had no concept of the "resourcefulness of private property."[68] After almost a decade, the struggle of economic transition and nation-building still continues with varying results. The Russian Federation and the Czech Republic, like ancient Egypt and Mesopotamia, exemplify two countries facing similar economic challenges but producing different results.[69]

1. The Russian Federation

The Russian Federation emerged from the ruins of the Soviet Union, which disbanded in December 1991, after seventy-four years of communist rule.[70] The Soviet Union, geographically the world's largest country, led as one of the world's two superpowers since World War II.[71] Yet in the 1980s, the Soviet Union's economy stood in ruins; and even as Mr. Mikhail Gorbachev's economic and political reforms made some

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countries included Albania, Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, Romania, the Soviet Union and Yugoslavia. *See* ALMANAC 2000, *supra* note 2, at 710. Albania was considered a Soviet ally from 1944 until 1960, when, in 1960, it adopted the Chinese-style communism. *See id.* at 769.

65. Brown, *supra* note 64, at 910.

66. *See* Mitrofanskaya, *supra* note 7, at 1407. Author Yuliya Mitrofanskaya presents an interesting distinction between privatization efforts in the Eastern European countries and developed countries. The focus of her writing, however, is the former Soviet Republic of Kazakhstan.

67. *Id.*

68. *Id.*

69. Kent F. Moors, *The Failure of Russian Privatization 1992-94: How the Industrial Nomenklatura Prevented Genuine Reform,* 3 J. INT'L LEGAL STUD. 1, 51 (1997) (concluding that privatization failed to break the traditional hold on industrial power, hence proving bureaucracy's influence on the Russian privatization process).

70. *See* THE UNIVERSAL ALMANAC 1994 496-98 (1993) [hereinafter ALMANAC 1994].

71. *See id.*

headway, not enough changes occurred to preserve the Union.[72] The Soviet leaders enjoyed very little public trust during the communist regime, and the trend continued in Russia after the fall of the Soviet Union.

Russia began a massive privatization project after the fall of the Soviet Union.[73] The government's role in setting price limits relaxed and private property rights initiated as new promises.[74] The Russian government started the privatization process with small enterprises, such as food, retail and wholesale companies.[75] Larger enterprises, such as mining and air transportation, remained outside the private industry.[76] Soon after, the International Monetary Fund (IMF) announced its support of the Russian economic reform plan, which meant that Russia could receive up to four billion U.S. dollars in IMF aid over a year's time.[77]

The Russian government introduced several programs in order to provide the citizens with opportunities to buy-out state properties and state enterprises.[78] The voucher system, a "mass privatization" program, offered one of the most prominent reform programs.[79] The purpose of the voucher system was to provide ordinary citizens with resources (in this case, 10,000 rubles) to purchase forty to fifty percent of state property, thereby creating millions of private owners.[80] The vouchers provided the means of payment to buy state property or investment funds, but the government also allowed open trading in the market.[81] Some citizens, due to their lack of trust in the government and low expectation of investment return, sold their vouchers for cash.[82] This led to the devaluation of vouchers, and provided opportunities to the few with multiple vouchers to buy a bigger share in the state enterprises. This created a concentrated class of state property

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72. *See id.* Mr. Mikhail Gorbachev was the last leader of the Soviet Union. Mr. Gorbachev tried political and economic reforms to preserve the Union, but the idea of providing freedom in pieces did not work and led to the collapse of the U.S.S.R. *See id.*

73. Anthony V. Raftopol, *Russian Roulette: A Theoretical Analysis of Voucher Privatization in Russia*, 11 B.U. INT'L L.J. 435, 451 (1993) (reviewing Russian economic plans since 1991, specifically the Russian voucher program, introduced in October 1992).

74. *See* Moors, *supra* note 69, at 6.

75. *See id.* at 8.

76. *See id.*

77. *See* ALMANAC 1994, *supra* note 70, at 498. The International Monetary Fund, IMF, "aims to promote international monetary cooperation and currency stabilization and expansion of international trade." *See* ALMANAC 2000, *supra* note 2, at 886.

78. *See* Mitrofanskaya, *supra* note 7, at 1414-16.

79. *See* Moors, *supra* note 69, at 17-31.

80. *See* Raftopol, *supra* note 73, at 452-55.

81. *See id.* at 455.

82. *See id.* at 456.

owners.[83] Nevertheless, the program was partially successful, resulting in 40 million new Russian shareholders, returning 94 million out of 150 million vouchers initially issued.[84] Overall, Russian privatization programs resulted in approximately "85,000 small enterprises and around 14,000 medium and large enterprises" being transferred to private owners.[85]

Investment opportunities also became available to foreigners.[86] Foreign investors could freely participate in the privatization of small-sized enterprises, and use the voucher system to participate in medium-sized enterprises.[87] However, the Russian government did not enthusiastically support foreigners obtaining a big amount of Russian enterprises.[88] Consequently, foreign investors played a very limited role in the privatization of large enterprises.[89]

The Russian reforms resulted in increasing private properties and economic prosperity, with limited individual freedom. Simultaneously, however, the transition created bureaucracy, powerful state-owned enterprises, lack of rule of law, and uncontrolled corruption. Today, Russians, specifically those at the bottom of the financial ladder, quickly blame capitalism for their problems, as their country continues to struggle with the economic transition.

2. Czech Republic

Czechoslovakia, in the early 1990s, also committed to reform itself in order to move away from the communist system of government, and free itself from Soviet domination and a state-controlled economy.[90] Czechs and Slovaks, the two major ethnicities in Czechoslovakia, agreed on a bloodless division of the country into two independent states, one of which became the Czech Republic.[91] The "Velvet

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83. *See id.*
84. *See* Mitrofanskaya, *supra* note 7, at 1415.
85. *Id.* at 1417.
86. *See id.* at 1416-17.
87. *See* Raftopol, *supra* note 73, at 462.
88. *See* Mitrofanskaya, *supra* note 7, at 1416-17.
89. *See id.* at 1417.
90. *See* Mitrofanskaya, *supra* note 7, at 1408.
91. *See History of the Czech People*, (visited Dec. 24, 1999) <http://www.lawfirmusa.com/ medschools/palacky/people.htm>. At the end of the First World War, Czechoslovakia came into existence, comprising two major ethnic groups: Czechs and Slovaks. *See id.* Czechoslovakia became a Soviet ally at the end of the Second World War, and remained an ally until the collapse of the "Soviet-supported regime" in November of 1989. *Id.* In January 1993, Czechoslovakia was replaced by two independent states, the Czech Republic and Slovakia. *See Czech History*, (visited Dec. 24, 1999) <http://195.113.114.5/udalosti/iscev98/history.htm>.

Revolution"[92] led the Czech Republic to experience one of the fastest conversions from a state-owned economy to privatization.[93] Today, the Czech Republic maintains one of the most stable economies in Eastern Europe.[94]

The reforms in the Czech Republic occurred in two phases.[95] The first phase commenced in 1990, in both the Czech Republic and Slovakia.[96] During the first phase, a total of 1492 State enterprises were privatized.[97] In the second phase, performed only in the Czech Republic, the government privatized a total of 846 state-owned companies.[98]

The Czech government conducted an auction, first offering state-owned properties to Czech citizens to purchase, and then to foreign nationals.[99] In addition, the Czech legislature offered large-scale state enterprises and investment coupons to promote further privatization.[100] The Czech economic reforms continued further in the areas of financial services, banking, and telecommunications.[101]

Commentators characterized the privatization process in the Czech Republic as fair, genuine, and democratic.[102] Czech laws imposed very few restrictions on investment activities, and did not offer any favors or special treatment to anyone.[103] Consequently, the Czech model of

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92. *See History of the Czech People*, *supra* note 91. Of all the Communist Bloc countries of the Eastern Europe, Czechoslovakia witnessed the most peaceful change, hence labeled "[t]he Velvet Revolution." *See id.* The Velvet Revolution steered the country in the direction of Western thought and economic prosperity. *See id.*

93. *See* Michele Balfour & Cameron Crise, *A Privatization Test: The Czech Republic, Slovakia and Poland,* 17 FORDHAM INT'L L.J. 84, 93 (1993).

94. George Bogdan, *The Economic and Political Logic of Mass Privatization in Czechoslovakia and Poland,* 4 CARDOZO J. INT'L COMP. L. 43, 45 (1996) (reviewing necessary skills and practices for market economies).

95. *See id.* at 50-51 (noting that the first phase involved Czech and Slovak companies).

96. *See* Mitrofanskaya, *supra* note 7, at 1408 (*citing* CZECHOSLOVAK LAW ON TRANSFERS OF SOME STATE-OWNED ASSETS TO OTHER LEGAL ENTITIES OR PERSONS, SEC. 3 (1990)).

97. Bogdan, *supra* note 94, at 50-51.

98. *See id.*

99. Mitrofanskaya, *supra* note 7, at 1408-09.

100. *See id.* at 1409 (*citing* Czechoslovak Act of Feb. 26, 1991 in CONDITIONS OF TRANSFER OF STATE PROPERTY TO OTHER PERSONS (Large Privatization Law) arts. 22-26 (1991).

101. *See* Mitrofanskaya, *supra* note 7, at 1410 (*citing* Henry Gibbon, *Pressing Ahead with Structural Reforms (Privatization of Telecommunication Companies in Central and Eastern Europe),* PRIVATIZATION INT'L, June 1, 1998, at 16 (reviewing privatization in the telecommunications industry).

102. *See id.* at 1410-11.

103. *See* Mitrofanskaya, *supra* note 7, at 1411 (*citing* Mark Kreisel, *Czech Republic: Investment in Freedom and the Future,* INT'L DIMENSIONS, Fall 1997, at 6 (explaining that Czech and foreign nationals were similarly treated).

privatization successfully led to increased economic activities, individual freedom, and better relations with the west.[104] The Velvet Revolution and the Czech government's serious economic reforms renewed the Czech Republic's contact with "Western thought, technology, information, and economic health."[105] In 1995, the Czech Republic became a member of the Organisation for Economic Co-operation and Development (OECD), and currently seeks to become a member of the European Union (EU).[106] In 1998, the Czech Republic won the military trust of the West, with its induction into the North Atlantic Treaty Organization (NATO).[107]

III. ANALYSIS

Traditionally, beginning with ancient Egypt, states played an important role in formulating economic policies, and the public expected their governments to interfere and even control everyday economic occurrences.[108] However, state-centered laws and state-controlled

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104. *See History of the Czech People*, *supra* note 91.

105. *Id.*

106. *See id.* The OECD was established on September 30, 1961 "to promote the economic and social welfare of all its member countries and to stimulate efforts on behalf of developing nations." ALMANAC 2000, *supra* note 2, at 883. The following countries are OECD members: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, South Korea, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. *Id. See also Organisation for Economic Cooperation and Development*, (visited Dec. 24, 1999) <http://www.oecd.org>. The European Community (EC) was renamed in 1994, to European Union (EU). *See* ALMANAC 2000, *supra* note 2, at 882. The EU is the collective designation of three organizations with common membership: the European Economic Community (Common Market), the European Coal and Steel Community, and the European Atomic Energy Community (Euratom). *See id.* The EU membership includes: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom. *Id. See also European Union*, (visited Dec. 24, 1999) <http://europa.eu.int/index/htm>.

107. *See* ALMANAC 2000, *supra* note 2, at 883. The North Atlantic Treaty Organization (NATO) was created by a treaty, signed on April 4, 1949 and went into effect on August 24, 1949. *See id.* The NATO membership includes: Belgium, Canada, Czech Republic, Denmark, France, Germany, Greece, Hungary, Iceland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Turkey, the United Kingdom, and the United States. *Id. See The North Atlantic Treaty Organization*, (visited Dec. 24, 1999) <http://www.nato.int>. NATO countries have agreed to settle their disputes peacefully and to regard an attack on one as an attack on all, and will take necessary measures to retaliate. *See id.*

108. Alfred C. Aman, Jr., *The Globalizing State: A Future-Oriented Perspective on the Public/Private Distinction, Federalism, and Democracy*, 31 VAND. J. TRANSNAT'L L. 769, 770-74 (1998) (explaining that in the majority of the countries, states played an important role, however in the case of the Eastern European Communist Bloc, the states had total control over their national economies).

economies began to gradually reduce individual and economic freedom, resulting in frustration, chaos, and economic ruin.[109]

Today, the trend continues toward de-centralizing and privatizing what once belonged to the state.[110] Progress in rapid transportation, technology, and cultural awareness generated a global network between sovereign states and individuals, resulting in a more prosperous world.[111] A free-market system may be as old as the ancient civilization of Mesopotamia, nevertheless, it has revolutionized today's world. The need for economic freedom continues to cause the countries with years of centralized and controlled economies to rapidly adopt the free-market economic system.[112]

The privatization efforts in Eastern Europe produced varying results. Some countries experienced a successful transition, while the rest still struggle with adopting the new economic system.[113] For instance, the Czech Republic is working shoulder-to-shoulder with the West to improve its economy.[114] Conversely, Russia, in order to regain its super-power status, frequently misallocates resources, resulting in drained budgets.[115] In fact, given the immense problems with reform, the World Bank took control of assisting governments facing the economic challenges and achieving the reform goals.[116] This article discusses the three most common political, legal and economic problems that, if not addressed correctly and promptly, can severely hamper

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109. *See id.* (explaining that in recent history in Eastern Europe, the masses began to challenge the government's role in their lives and in the market. Consequently the state-owned economies collapsed, leaving a number of countries striving for individual, political, and economic freedom).

110. *Id.* at 772.

111. *Id.*

112. *See id.*

113. *See Privatization and Enterprise Reform* (visited Dec. 31, 1999) <http://www.worldbank. org/html/fpd/privatesector/priv-ent.htm>. The Czech Republic, Hungary and Poland are considered efficient and fast transitions, while the former Soviet Republics, with the exception of the Republic of Kazakhstan, have been very slow and have failed in many attempts to obtain needed improvements. *See* Mitrofanskaya, *supra* note 7, at 1418-22; Brown, *supra* note 64, at 911-12.

114. *See History of the Czech People*, *supra* note 91.

115. *See Yeltsin Signs Russian 2000 Budget, Kremlin Says*, RUSSIA TODAY (Dec. 31, 1999) <http://www.russiatoday/investorinsight/business> (reporting that the last budget signed by President Boris Yeltsin, before resigning, has unrealistic targets).

116. *See Privatization and Enterprise Reform*, *supra* note 113. The International Bank for Reconstruction and Development (IBRD) (commonly known as the World Bank) "provides loans and technical assistance for projects in developing member countries: encourages cofinancing for projects from other public and private sources." ALMANAC 2000, *supra* note 2, at 885. The World Bank has four affiliates: 1) The International Development Association (IDA); 2) The International Finance Corporation (IFC); 3) The Multilateral Investment Guarantee Agency (MIGA); and 4) The International Center for Settlement of Investment Disputes (ICSID). *See id.*

privatization efforts.

A. *The Political Problem*

An expected result of privatization is "reduced government role." The reduced role, however, does not necessarily mean a smaller role, but rather a different role.[117] Privatization is a political process, and therefore without an appropriate government role, a country may face anarchy or total chaos.[118] While a successful transition depends on the essential role of government, the system must not tolerate corruption, lawlessness, and violation of individual rights.[119] However, a state can play an important role during the transition period by overseeing a fair and balanced reform.[120]

According to the World Bank, a government's role is critical in the privatization process.[121] For instance, a government can do the following: introduce and maintain competition; regulate monopolies; ensure investors that their investments are safe; help negotiate and monitor contracts; use resources productively; and manage the inevitable political and social tensions, especially foreign ownerships and labor layoffs, during the enterprise reform.[122] Therefore, states can play the role of (economic) observers and (crises) managers, while staying away from directorial and ownership roles.[123]

The two prominent examples of "redefined" governments are the Czech Republic, in Eastern Europe, and Kazakhstan, a former Soviet Republic in Central Asia.[124] Specifically, the Czech Republic commenced its privatization process by enacting new laws in October of 1991. These laws provided protection and fair opportunities to the ordinary citizens and foreign investors interested in purchasing state-held enterprises.[125] Similarly, the Kazakhstan government enacted new laws and created a "State Committee on Privatization" (*Gos Kom*

117. *See* Sarkar, *supra* note 53, at 720-21 (noting that the state's role must be redefined, because notwithstanding good intentions, state intervention in the private sector produces uneven and disastrous results).

118. *See Privatization and Enterprise Reform*, *supra* note 113.

119. *See* Sarkar, *supra* note 53, at 720-21.

120. *See id.* For instance, the governments of the Czech Republic, Poland and Kazakhstan effectively enacted pro-privatization laws, lifted price controls and terminated government subsidies to businesses to ensure balanced reform and fair supervision. *See* Mitrofanskaya, *supra* note 7.

121. *See Privatization and Enterprise Reform*, *supra* note 113.

122. *See id.*

123. *See id.*

124. *See* Mitrofanskaya, *supra* note 7, at 1408-38.

125. *See id.* at 1408-11 (noting that the Czech laws provided equal opportunity to purchase state-held properties to all citizens and to the foreign investors. Additionally, the laws protected private property rights of the citizens).

Imevshestva or GKI) to oversee the disposing of state-owned enterprises.[126] By way of contrast, the Russian government's lack of success in redefining its role has brought the nation to the brink of economic chaos.[127] For instance, Russian President Boris Yeltsin's resignation, on December 31, 1999, represented a sign of anticipated stability.[128] The Russian government's possible role in laundering foreign aid, President Yeltsin's firing of his prime-ministers, and the continuing war in the southern province of Chechnya have severely hurt Russian efforts toward economic reform.[129] Hence, a stable government with an appropriate role is not only needed to supervise the reforms, but also to enact and enforce the rule of law, which is equally essential for a successful transition.[130]

B. *The Legal Problem*

An "individual's right to own property," provides the foundation to privatization, and thus, most transitional countries must develop and ensure such rights with a new set of laws, despite their existing laws.[131] Most developing countries in Africa, Asia, and Latin America, with some essence of private ownership, simply had to change their existing regulations and judicial systems.[132] However, absent the concept of private ownership, the Eastern European countries and the former Soviet Republics faced the need for a complete overhaul of their commercial laws.[133]

Enacting new commercial laws is not to be confused with adopting Western social values.[134] Although, some countries, mostly European, have adopted a Western way of life, others, mainly Asian and Latin American countries, are not willing to lose their customs, practices, and culture.[135] Nonetheless, despite their resistance, the Asian and Latin

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126. *See* Brown, *supra* note 64, at 940.

127. *See* David Lazarus, *Russia Pummels Stocks Again,* (Aug. 27, 1998) <http://www.wired.com/news/news/business/story/14702.html>; David Lazarus, *Russian Roulette Rattles Market,* (Aug. 24, 1998) <http://www.wired.com/news/news/business/story/14610.html>; Mitrofanskaya, *supra* note 7, at 1417-18 (pointing out that the Russian government's failure to assert its role as a fair supervisor led to the crash of Russian economy during the summer of 1998).

128. *See Russian Shares Surge 10.54 Percent As Yeltsin Resigns*, RUSSIA TODAY (Dec. 31, 1999) <http://www.russiatoday/investorinsight/markets> (reporting that the Russian Trading System was higher, because Yeltsin's resignation reduced uncertainty).

129. *See* ALMANAC 2000, *supra* note 2, at 853.

130. *See* Sarkar, *supra* note 53, at 721-24.

131. *Id.* at 721.

132. *See id.* at 722.

133. *See id.*

134. *See id.* at 722-23.

135. *See generally* Sarkar, *supra* note 53.

American countries have failed in completely preventing the influence of the Western culture.[136]

Once again, the Czech Republic finds itself on the proper side of the problem due to the government's willingness to reform critical areas of banking, energy, and financial services with fairness.[137] However, Russia finds itself influenced by a *nomenclatura* of organized crime figures and factory managers.[138] Additionally, oil, gas, energy and many such industries are still under the Russian government's control,[139] and the economy is severely infected by increasing corruption.[140] Having a rule of law encourages investment, particularly foreign investment, which is essential to avoid the increasing problem of lack of capital investment.[141]

C. The Economic Problem

The lack of capital investment represents one of the biggest challenges that countries face when making a transition to privatization.[142] Capital investment is essential because restructuring an economy requires the "building of modern roads, airports, and seaports; setting up telecommunications networks" and help supporting "industrial and consumer needs."[143] Most transitioning countries, particularly the Eastern European countries, lack a wealthy domestic private sector to invest in their own economies due to their previously state-run economies. Consequently, virtually all of the initial investment comes from foreign sources.[144]

An appropriate government role and the rule of law, as discussed above, are two essential factors needed to attract foreign investment by satisfying investors' expectations.[145] The expectations, however, are fairly predictable, as most investors seek the following: stable economy without political disturbances; freely convertible currency; the possibility of profits; and rule of law that provides adequate redress in

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136. *See id.*

137. *See* Mitrofanskaya, *supra* note 7, at 1410-11.

138. *See id.* at 1417-18.

139. *See* Moors, *supra* note 69, at 46.

140. *See* Daniel McGrory, *Civilizing the Russian Underground Economy: Requirements and Prospects for Establishing a Civil Economy in Russia*, 5 TRANSNAT'L L. & CONTEMP. PROBS. 65 (1995) (discussing the old Soviet underground economy and corruption in Russia's privatization efforts).

141. *See* Sarkar, *supra* note 53, at 721-22.

142. *See id.* at 709.

143. *Id.*

144. *See* Sarkar, *supra* note 53, at 709-719.

145. *See id.* at 720-21.

case of conflicts or disputes.[146]

Some governments have been a little slow in providing the favorable climate needed to attract foreign investments, while others have provided numerous incentives.[147] For instance, the Czech Republic placed only reasonable restrictions on foreign investments, and entered into treaties with several countries to provide protection against such risks as expropriation, and repatriation of earnings.[148] Russia initially attracted almost every foreign company and investor, but the Russian political instability, the free-falling stock market, and the de-valuation of the Ruble in the last few years have deterred many from investing in Russia.[149]

IV. CONCLUSION

The debate over whether a state-run economy or a free market system is superior, is as old as humans. Historical evidence speaks clearly that today's struggle, between the state-controlled economic systems of Eastern Europe and the free-market system of the West, is nothing more than history repeating itself. Moreover, from Egypt to Eastern Europe and from Mesopotamia to the United States, the evidence is convincingly in favor of free-market capitalism winning this war. Perhaps the human nature of freedom and ownership causes privatization to be the natural choice after every other option is exhausted.

Privatization is a complex process and it requires more than just the buying and selling of public property. It demands various levels of sacrifice from everyone, because it not only promotes economic freedom, but also individual freedom. A successful privatization effort in Eastern Europe demands from the governments and people, a total commitment and patience. The glimmering of change that is already apparent is hopeful augury, despite some failures.

146. *See id.* at 721.

147. Cheryl W. Gray & William W. Jarosz, *Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe*, 33 COLUM. J. TRANSNAT'L L. 1, 10-14 (1995) (outlining various incentives for foreign investors).

148. *See* Mitrofanskaya, *supra* note 7, at 1411..

149. TIME ALMANAC 1999 288 (1998) (noting that President Boris Yeltsin's young cabinet, the "young reformers," proposed several economic plans including overhauling taxation, welfare, housing, curbing monopolies, but all of these reforms went awry, and the firings of Prime Ministers Viktor Chernomyrdin, Yevgeny Primakov, Sergei Kiriyenko and Sergei Stepashin contributed to the political instability).