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John J.A. Burke

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I. INTRODUCTION

Legal reform in Eastern Europe and in the former states of the Soviet Union provides a rare opportunity to view the process of lawmaking on a wide scale. The collapse of the Soviet Union permitted select newly independent states (NIS) to dismantle their economic, political, and legal institutions that rested on planned economic principles. The NIS countries chose to establish

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* Associate Counsel, New Jersey Law Revision Commission; B.A., Columbia College; J.D., Seton Hall University School of Law; Ph.D., University of Fribourg, Switz. From June 1993 to December 1993, I served as legal specialist in Estonia for the Central and East European Law Initiative. From 1993 to 1994, I was also a lecturer-in-law at the University of Tartu where I taught securities law. From 1994 to 1995, I was employed as advisor to the Estonian Securities Board within the Ministry of Finance. Additionally, I reviewed and criticized draft laws prepared by the Ministry of Justice. My one and a half years stay in Estonia provided the opportunity to observe first hand the economic and legal developments in Estonia, and, to a lesser extent, in Latvia and Lithuania, as these countries underwent the transition from a planned economy to a market one.

1. For purposes of this Article, the term “NIS countries” refers to the following select countries: (1) former republics of the Soviet Union; (2) former members of the Soviet Union’s Council for Mutual Economic Assistance (COMECON); and (3) former countries of Yugoslavia. The use of the term does not cover every country affiliated with the former Soviet Union or Yugoslavia. Nor does the term imply a monolithic trend to adopt identical economic or legal policies. The term is a useful reference device, however,
political and economic systems based mainly on free market principles. The transition from a planned economy to a free market economy and from a single-party political system to democracy made obsolete large portions of the NIS countries' legal systems that reflected the design of a central economy and a dictatorship. Reform of the political and economic systems has required reform of the legal system. The NIS countries' experience shows how law is made and for what reasons, thereby permitting the construction of a legal theory based on empirical facts. The short time frame in which the NIS countries are implementing legal reform renders them a particularly valuable laboratory for observing change.

The NIS countries' legal experience reveals that law is used as an instrument to enforce legislatively established policies constrained by economic and historical circumstances. Therefore, legislatures are not free to shape policy in the same way an author is free to write a novel. Material economic relations shape the major portion of the legal system because considerations of restructuring the economy and raising living standards predominate. Most of the legal rules enacted in most NIS countries during the transition period pertain to economic issues, thus showing that an industrialized state uses law mainly to carry out its economic objectives.

because it is generally recognized that eastern Europe and the former republics of the Soviet Union are undergoing a transition in the general direction of free market economies and democracies. The former republics of the Soviet Union are: Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan. The former members of COMECON are: Bulgaria, Cuba, Czechoslovakia, German Democratic Republic, Hungary, Mongolia, Poland, Romania, and the U.S.S.R. The former Yugoslavia included Bosnia-Herzegovina, Croatia, Macedonia, and Slovenia. Yugoslavia currently is composed of Serbia and Montenegro.

2. Professor Sunstein frames the issue as follows:
   The new reform movements actually involve three distinct transitions. The first is a transition from a command economy to one based on markets. The second is a transition from a system of one-party domination to democracy. The third is a transition from a system in which government is unconstrained by laws laid down in advance to one of constitutionalism and the rule of law.

This Article advances the derivative theory of law. The starting point for this theory is an examination of the relationship between legal and economic developments in the NIS states. The data are drawn from the experience of NIS countries in general and the state of Estonia in particular. Then, the Article examines the relevance of this particular experience to legal systems generally and concludes that, by analogy, derivative theory applies to the legal systems of non-NIS states.

Part II of this Article introduces Estonia as a paradigm of the derivative theory. Part III provides an overview of the philosophical debate surrounding law and the legal system. Part IV presents an historical case study of Estonia to illustrate the dependence of the legal system on the economic one as evidenced by the pre-Soviet, Soviet, and independence (1991-1995) periods. Part V explains law as derivative of economic organization and gives a detailed historical and statistical analysis of the economic and legal reforms in Estonia since the independence period. Part VI examines the relevance of derivative theory for other NIS countries. Part VII considers the probable application of the derivative theory to non-NIS countries as it is not limited to the specific historical circumstances of the NIS countries. Part VIII concludes that the pattern of law's repeated dependence on economic structure demonstrates the derivative relationship.

II. ESTONIA AS A PARADIGM OF THE DERIVATIVE THEORY

Two propositions about the law-making process may be deduced from the NIS countries: (1) a legal system is mainly derivative of the economic system; and (2) the predominant purpose of a legal system is to implement a legislatively determined economic program. The first proposition validates the idea that the mode of production is the material structure on which the legal

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3. The use of the phrase "legislatively determined economic program" does not imply that legislatures have a unified coherent economic theory in mind when they enact laws. Rather, it refers to the set of loosely defined concepts that motivate legislatures to enact laws having economic effects. Economic and non-economic policy concerns motivate the reform policies of the NIS countries. Because economic needs (food, shelter, and clothing) are primary, NIS countries' legal reforms tend to involve questions of economic policy. See KARL MARX & FRIEDRICH ENGELS, THE GERMAN IDEOLOGY PART ONE 48 (C.J. Arthur ed., 1986) (explaining the primacy of economic need).
system rests. The legal system is neither a self-contained system of mathematically applied doctrines nor a delineation of abstract ideals such as liberalism, equality, or egalitarianism. Rather, it is a system of rules dependent on material factors deeper than itself. The second proposition involves an obvious but important theory. Modern states concern themselves primarily with one thing: economic growth. An economy based on free market or planned principles is designed to achieve this goal. Legal systems complement the goal of economic growth and help carry out the economic vision of modern states by setting rules of conduct for market actors. Facts drawn from the NIS countries' experiences prove this claim. Because the primary, although not exclusive, purpose of a legal system is to implement the legislative economic program of a given country, law is derivative of the economy. This theory is referred to as derivative theory.

To prove these propositions, a description of every economic and legal development in the NIS countries since their independence is not necessary. Because these countries comprise more than twenty countries of diverse historical, cultural, and linguistic backgrounds, a study of all economic and legal reforms taking

4. This means that the set of relations involved in the production and delivery of goods and services serves as the base for legal rules. A "corporation" is an example of these relations. A corporation is a network of relationships among people—shareholders, workers, executives, and customers. The legal rules governing corporations may be diverse to balance competing interests, but they must facilitate the purposes of corporate activity. In this sense, the nature of the corporation shapes legal rules. While legal rules also may shape these relationships, practical consequences of the law limit the influence of law.

5. For criticisms of the formalist view, see RONALD DWORKIN, LAW'S EMPIRE (1986); ROBERTO M. UNGER, CRITICAL LEGAL STUDIES (1976); RICHARD A. POSNER, THE PROBLEMS OF JURISPRUDENCE (1991).

6. The derivative theory is not new. Marx first presented it in the nineteenth century. Although the term "derivative" is not Marx's, it is a useful shorthand description. Succinctly put, the theory advances that law is determined mainly by the economic and productive forces of a community rather than by ideas such as justice or rational coherence. Acknowledging that economic relations shape legal rules, however, does not suggest that other portions of Marx's theory are correct. For example, his claims that he discovered the laws of history or that the "base" totally controls the "superstructure" are misguided. Nevertheless, the connection between type of economic system and type of legal rule is a claim subject to verifiable observation. For a good description of Marx's ideas about law, see KONSTANTIN STOYANOVITCH, MARXISME ET DROIT (1964).
place would require an extensive research project. Moreover, constructing general correlations about the effects of economic policy on law in the NIS countries does not require a detailed undertaking.

While local conditions, practices, and traditions differentiate the reform process, the NIS countries share certain common elements. Politically, NIS countries share the development of democratic rights and the establishment of legal rules. Economically, the transfer of state assets to private persons, the protection of private property rights, the liberalization of prices, and the establishment of commercial banks and financial service institutions represent common elements. These general political and economic reforms bear remarkable similarities that transcend individual country differences. It is, therefore, possible to resort to the simplifying assumption that the correlations between law and economic policy of one NIS country have applicability to other NIS countries, although with varying degrees of accuracy.

This Article takes data from the Republic of Estonia (Estonia) and, to a lesser extent, from other NIS countries to illustrate these two propositions. Since declaring autonomy from the Soviet Union in 1988, Estonia has quickly made deep structural changes in its political, economic, and legal systems. Estonia has implemented price and wage reforms, established a convertible currency, and privatized state industrial and residential property. Additionally, it has adopted a democratic constitution, revised its legal system, and reformed the court system. The political and business center of the country is located in Tallinn, the capital, while the oldest university and the National Court are located in Tartu, the second largest city.

7. The name Tallinn derives from the Estonian term taani linn or Danish castle. TOIVO U. RAUN, ESTONIA AND THE ESTONIANS 16 (2d ed. 1991). With a population of about 500,000 people, Tallinn is the largest city in Estonia and accounts for a third of the total population. Reflecting the Russification process, about 30% of its population is Russian. THE WORLD BANK, ESTONIA, THE TRANSITION TO A MARKET ECONOMY at xv (1993). Tallinn is an active port and harbor located on the Gulf of Finland. The central bank, the largest commercial banks, and private securities firms have their main offices in Tallinn. The legislative and executive branches of the government also are located in Tallinn. Although the physical center of the city is small, Tallinn is by far the most important city in Estonia.

8. In 1994, Tartu’s estimated population was 105,800. See Estonia, 1 THE EUROPA WORLD Y.B. 1995, at 1114 (Europa Publications Ltd.).
political, judicial, and private sector power, Estonia provides a paradigm for the study of the relationship between law and economic policy in the free market transition process of the NIS countries.

Examining Estonia's economic activity and legal acts since its formal independence in 1991 may best prove the two propositions. The economic activity shows that when the constraints of the Soviet Union were lifted, market actors began to form joint stock companies, joint ventures, banks, and securities firms outside the context of any free market regulation. The legal activity shows that Estonia broke completely with the Soviet legal system and practically rebuilt its legal system from scratch. Efforts to encourage the development of private property, such as the legalization of private property, the privatization of state-owned property, and the recognition of the right to engage in free market activity, dominated legal reform. Not only do laws containing a clear economic component constitute the majority of laws enacted since 1991, but they also constitute the most significant group of laws. Although Estonia re-examined its whole body of law and made changes in all departments, economic policies predominated. Conversely, planned economic policy justified the existence of the pre-independence legal system, but it was abandoned after having outlived its usefulness.

A review of Estonian legal reform, however, does not show legislative economic policy decisions as the origin for all law found in the Estonian legal system. Reducing a complex institution, such as a legal system, to a single principle is impossible. Estonia has enacted laws that do not have obvious economic relevance. Estonia's non-economic law generally may be explained in terms of its ethical preferences. These preferences, which received international attention, emerged in its citizenship law.9 The

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9. "[N]on-Estonians, most of them ethnic Russians, make up about 37 percent of the population of 1.6 million." Steven Erlanger, Russians in Estonia Feel Lost in a Baltic Limbo, N.Y. TIMES, July 1, 1994, at A6. After independence, the Estonian government adopted a law granting citizenship to residents registered prior to 1940. People arriving in Estonia during the occupation period could obtain citizenship after a two-year waiting
admission that every rule in a legal system cannot be explained in terms of its economic function does not negate the validity of the two propositions this Article advances. Rather, it merely limits their explanatory power.

Subject to the qualifications already noted, derivative theory has probable application to legal systems in other NIS countries. These countries currently are reconstructing their legal systems to fit democratic institutions and a free market economy. The NIS countries have adopted constitutions laying the foundation for democratic government and the free market system. They also have enacted laws to protect private property, to allow the formation of proprietorships, partnerships, and joint stock companies, and to eliminate obsolete state companies by using bankruptcy codes. Some of the specific economic laws adopted in these countries are similar to those adopted in Estonia. This is certainly true for laws governing banks and the capital markets. Although the experiences in these countries require individual study, the differences between the commercial statutes adopted in Estonia and those adopted, for example, in Poland, Hungary, or the Czech Republic are not conceptual, but rather reflect differences in national culture or local circumstances. Similar overlap is found in constitutional law.

More fundamentally, derivative theory has relevance for mature and developed legal systems like those of the United States and Europe. These legal systems also serve their free market economies. In the United States and Western Europe, the major categories of law, such as property, contract, and commercial law, show that the legal system's main underpinnings are economic policies, particularly free market concerns. Contemporary attempts to reform the commercial code and financial service institution laws demonstrate the continuing strength of economic policy to drive

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period and passing an Estonian language test. Celestine Bohlen, Russia Cuts Gas Supply To Estonia in a Protest, N.Y. TIMES, June 26, 1993, at A4. See also Riigi Teataja Part 1 1993 [Law on Estonian Language Requirements for Applicants for Citizenship], No. 11, art. 171, translated in 7 LEGAL ACTS OF ESTONIA 163 (1993) (specifying language requirements). Those who are neither Estonian nor Russian citizens are considered stateless persons who must apply for a residence permit within two years. This designation generally applies to persons holding Soviet passports. Stateless persons do not necessarily have the right to re-enter Estonia without a visa.
legal change in the United States. The wealth of these countries permits the luxury of using law to incorporate non-economic social policies. A country like Estonia presently cannot afford that luxury because its economy has not yet generated sufficient wealth and its legal system is in the early stage of development. The wealth of the U.S. economy has produced law that obscures the legal system's basic economic foundation, and spawns a rich and complex, although mostly misguided, literature of legal theory.

A theory derived from the legal reform process in NIS countries may have far-reaching ramifications for general legal theory. Even a casual reading of newspapers or history books demonstrates that modern states are primarily concerned with the economy. The state's economic well-being is a major factor in determining its standard of living. Because law sets the framework for human actions, it logically should focus on economic ends. Derivative theory is purely descriptive; it makes no normative

10. Examples of the market determining legislation are too numerous to identify. The history of deposit insurance, securities regulation, and incorporation statutes provide some examples. Recent developments in the financial markets have generated a reexamination of banking, securities, and insurance regulation. See U.S. DEP'T OF TREASURY, MODERNIZING THE FINANCIAL SYSTEM: RECOMMENDATIONS FOR SAFER, MORE COMPETITIVE BANKS (1991). The economic considerations also influence areas not purely concerned with business activity. Environmental and family law are two examples of laws heavily influenced by the economic consequences of legal rules. See RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 146-48 & 375-82 (1992) (discussing the economic function of alimony and the economic effects of regulatory approaches to pollution control).

11. The U.S. obsession with the judge is a good illustration of this approach to legal theory. Dworkin's theory of law, which is called "integrity" in its latest version, focuses almost entirely on judicial decision-making. See DWORKIN, supra note 5, at 225. Even Posner, whose scope of analysis is wider than that of Dworkin's, focuses considerably on the analysis of legal reasoning judges and lawyers use to dispel the myth of formalism. See, e.g., POSNER, supra note 5, at 101-23 (concluding "legal reasoning is not special and that it often does not yield determinate outcomes"). See also RICHARD A. POSNER, OVERCOMING LAW 109-44, 171-214 (1995). While the judge is an important figure in U.S. jurisprudence, the twentieth century trend to codify law has altered the judge's role in a common law system. In cases where the law is codified, the judicial opinion serves as a delineation of the statute mainly on its margins, where cases arise that the legislature did not foresee. While the judge legislates interstitially in these cases, the language, legislative intent, and policies of the statute restrict the scope of his or her legislative activity. Although these restrictions do not yield one conclusion, they nevertheless serve to distinguish between the judge and the legislator.
claims of what a legal or economic system ought to be. Claims about the Estonian legal system are based on enacted laws, interpreted in the context of well-documented political and economic change. Derivative theory, thus, refocuses legal theory on a modern legal system’s most basic premise—the achievement of a legislative economic vision.

Western institutions’ attempts to shape the reform process have influenced legal reform in the NIS countries. “The potential prestige and long-term advantages of being directly involved in this process have proved irresistible to numerous Western law firms, government bodies, international agencies and academic institutions.”

The United States is heavily involved in Estonian legal reform through institutions such as the Central and East European Law Initiative and the U.S. Treasury Department program for technical assistance. Foreign advisors from the United States, Great Britain, France, and Germany are active in Estonia. Because the Estonian legal system has historical ties to the German system, German law serves as the basis for some major parts of Estonia’s new economic legislation. This is particularly evident in Estonia’s company law code. The wisdom and feasibility of transplanting Western legal norms to the NIS countries is a separate issue from the purpose of the reform.

III. THE PHILOSOPHICAL DEBATE

The question of what is law has spawned numerous and conflicting theories in the history of jurisprudential thought. Various philosophers from Plato to Hart have addressed the subject of law or justice. The level of disagreement among the theorists and the apparent lack of any standard or method to test the empirical validity of particular theory are the most striking features of this history of jurisprudential thought. Contemporary U.S. jurisprudence has taken place squarely within this standardless tradition of legal theorizing. For example, the dispute among Dworkin, Unger, and Posner shows the competing political

interests of liberals, radicals, and conservatives, respectively. Their individual vantage points make it difficult to assess the accuracy of their legal assertions. Recent developments in U.S. jurisprudential thought, such as feminism and critical race theory, continue this trend using legal theory to advance political or special-interest views.

This diversity of opinion does not befit a field of inquiry that claims to have, as its object of study, an identical set of legal rules. Diversity of this magnitude is not characteristic of science or economics. Theoretical differences in these areas tend to be more precisely defined, such as the debate over the extinction of the dinosaurs. Additionally, the differences of position may be useful depending on how the competing theories are applied.14 Even in the field of economics, certain correlations, such as supply and demand, constrain the number of theories that may explain economic events. Law is not a science because it does not concern itself solely with the search for truth; nevertheless, no reason exists as to why the existing legal theories cannot be measured against actual law-making processes to determine their relative explanatory power in light of the abundance of legal data. The NIS countries' experience in the twentieth century provides a discrete set of data for measuring the value of existing legal theories by introducing a "reality check" into debates about the question of law.

The NIS countries underwent two major changes in the twentieth century involving their legal systems. The first change took place when the Soviet Union annexed these states and

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13. Reducing the views of Dworkin, Unger, and Posner to convenient categories entails some risk of oversimplification; however, the academic community generally has treated them in this vein. See, e.g., A. ALTMAN, CRITICAL LEGAL STUDIES 7 (1990) (discussing the encounter between Dworkin and Unger). In Posner's recent writings, he maintains that he is a pragmatist, and, thus, evades easy qualification. Nevertheless, some of his long held views, if implemented, would support basic conservative principles. See, e.g., POSNER, supra note 11, at 102-108 (criticizing affirmative action in law school faculty hiring).

14. A simpler analogy makes the same point. For example, a road map and a topographical map both describe the same geographical space. The question is not which map correctly describes the physical space. Rather, the question is how accurate is the map given the purpose of its use, as the accuracy of one map does not preclude the correctness of the other.
imposed its political, economic, and legal systems. The second change occurred when the Soviet Union collapsed, and the NIS countries independently reformed their political, economic, and legal systems. The juxtaposition of these fundamental changes is a remarkable opportunity to study the role of law in society. This approach has the advantage of developing a legal theory based not on abstract principles contained in philosophy books but on the legal process operating in the real world. Thus, the historical data provide a useful measuring stick to evaluate the validity of legal theories.

Despite many existing legal theories, Karl Marx's theory posed in the nineteenth century best accounts for the NIS countries' and any industrial country's experience. Marx stated that law is derivative of economic organization. A particular form of economic organization yields a corresponding set of legal rules to serve the economy's productive forces. In his view, changes in legal rules stemmed from changes in the underlying relation of economic factors. Economic developments render existing legal rules obsolete and shape the development of alternative legal rules. The evidence for these postulates is overwhelming. The switch from capitalism to socialism and then back to capitalism attests to the fact that legal systems implement forms of economic organization. Therefore, internal logic does not autonomously drive a legal system, and any such formalist view of law conflicts with historical

15. Referring to property rights in the marketplace, Marx states, "[t]hus juridical relation, which thus expresses itself in a contract, whether such contract be part of a developed legal system or not, is a relation between wills, and is but the reflex of the real economic relation between the two. It is the economic relation that determines the subject-matter comprised in each juridical act." 1 KARL MARX, CAPITAL. A CRITIQUE OF POLITICAL ECONOMY 88 (1967) (footnote omitted). See also KARL MARX, EARLY WRITINGS 348-49 (1975). Professor Galbraith elegantly states the continuing vitality of Marx's thought:

In recent years, and in consequence, in no slight measure, of the collapse of communism just mentioned, the name of Karl Marx, which was once a symbol of fear, has now become an object of disdain. It would be unfortunate were this carried too far. In large part, we owe to Marx the concept of economic determinism, an understanding of the powerful even decisive role of economic force in the shaping of human history. That was true a century and a half ago when Marx's ideas and system were being formed; it is not less true today.

JOHN KENNETH GALBRAITH, A JOURNEY THROUGH ECONOMIC TIME 7-8 (1994).

16. This follows from Marx's materialism. See MARX & ENGELS, THE GERMAN IDEOLOGY, supra note 3, at 80-81 (providing a description of the relation between the development of law and the development of property, and thus of the economy).
If derivative theory is correct, it is possible to identify classes of competing legal theories that are inaccurate, without practical value, or limited in scope of application. An example of an inaccurate legal theory would be any theory ascribing primacy to the role of ideas in the development of law. Dworkin's theory of U.S. law is an example of an inaccurate description of the legal process. Dworkin maintains that law is an interpretation of the community's political morality. In this case, the equality ideal translated into a system of law. Nothing in the legislative or judicial process supports this theory, however, because legislators and judges do not have a single "political morality."17 Even if Dworkin's theory is limited to case law, judges are not philosophers and do not decide cases against a single norm. Additionally, Dworkin's theory has little, if any, relevance for foreign legal systems because it derives from U.S. constitutional jurisprudence. Therefore, ideas isolated from economic realities are not predominant causes of the content and shape of legal rules.

Normative theories that are without practical value, such as Roberto Unger's legal theory, represent the second category of fallacious theories.18 According to Unger, legal and other institutions can be remade like pieces of putty to try out novel forms of social organization. Although some degree of flexibility exists in the design of a legal system, no actual system of law comes close to approximating the endless potential for variation implied in Unger's legal theory of empowered democracy. Economic necessity limits the scope of legal experimentation. Contemporary states, such as Estonia, must have legal institutions that are compatible with their trading partners' legal systems and that warrant the confidence of investors and creditors.

Finally, while theories that explain law as wealth maximization...
are true in some cases, they are of limited application to legal systems generally. While wealth maximization may explain the logic of U.S. common law, it seems irrelevant to legal systems based on non-free market principles, such as the Soviet legal system. The Soviet legal system commanded market actors to carry out the decisions of a central economic planning committee. Implementing the central economic planning committee's decisions has contributed to economic decline and resulted in wasted resources. If the Soviet legal system focused on wealth maximization, it would have been to maximize the average worker's wealth. Therefore, the wealth maximization theory is limited to situations in which transactions of property in the marketplace result in that property's best use. If economic analysis is used simply as an explanatory tool, the derivative theory differs from economic analysis in that the former does not maintain that all law is the embodiment of economic thinking. Rather, the derivative theory contends that the bulk of law in a legal system responds to historical economic conditions and that those choices may not achieve economic efficiency.

The derivative theory is not exclusive of other legal theories; it merely explains the motivation behind a society's choice of law. For example, derivative theory is compatible with H.L.A. Hart's legal positivism. The derivative theory explains the content and purpose of the predominant number of rules present in a given legal system. Unlike Hart's theory, however, the derivative theory does not identify legal as opposed to other non-legal rules. Furthermore, the derivative theory is a general legal theory that does not foreclose the development of theories addressing specific subsections of the legal system, such as a theory of insurance law. A general legal theory that does not acknowledge the fundamental purpose of a legal system is to support the state's general economic

19. According to Posner, "wealth maximization" is defined as the "sum of all tangible and intangible goods and services, weighted by prices of two sorts: offer prices (what people are willing to pay for goods they do not already own); and asking prices (what people demand to sell what they own)." POSNER, supra note 5, at 356. Because wealth is maximized through free market transactions measured by prices of services and goods, the wealth maximization theory cannot apply to an economic system that regulates prices and prohibits exchanges of goods and services based on the decisions of market participants.

objectives, however, does not adequately explain historical legal developments as demonstrated in this Article. Although a legal system cannot be reduced to a single principle, it is useful to describe a legal system as a means to apply economic decisions. Such a description explains a wide range of legislation and case law. Likewise, because derivative theory accounts for most legal rules, other theories are relegated to minor relevancy. Derivative theory explains these non-economic rules as instruments of ethical policy.

The argument that the law's primary function is to impose public order does not diminish the force of the argument that law is basically a means to apply a legislature's economic policy decisions. The experience of Estonia and most NIS countries demonstrates that they are enacting laws concerning economic reform and free markets in the context of substantial public disorder and crime. Thus, one may infer that, at least in this historical circumstance, the success of the economic and legal reforms is the necessary precondition of public order. In any event, public order rules serve an important economic purpose by permitting the implementation of the legislature's economic policies.

Although derivative theory uses the transition process of NIS countries to support its claims, it is not limited to these transition process states. Science often uses the aberrant case to discover basic principles about the object of its study. For example, neurologists study people with memory loss to track the memory system of the brain. Such a method of study can be applied to law to determine the nature of legal systems. The transition to the market economy in the NIS countries is such an aberrant case for law. The aberration consists in the short time in which these countries must revise their laws, as countries normally develop their legal systems gradually over a long time span. The NIS countries' unusual level of legislative activity reveals the factors that shape the basic rules of the legal system and, thus, shows how and why law is made.
IV ESTONIA. A CASE STUDY

Estonia is a small European country that "lies on the eastern shore of the Baltic Sea and shares borders with Latvia to the south and Russia to the east." 21 Finland and Sweden lie across the Baltic Sea to the north. Roughly the size of Switzerland or Denmark, Estonia has a territory of 45,215 square kilometers. 22 It has a population of approximately 1.6 million people, of which only 900,000 are ethnic Estonians; the remainder are primarily Russian. 23 The official language is Estonian, a Finno-Ugric language, related to Finnish and Hungarian. The capital is Tallinn, a medieval city and important Baltic port. The terrain of Estonia is flat, consisting of farmland and of forests that support the wood and furniture industries. Estonia has rich deposits of oil shale, phosphate, and peat. 24 The work force is highly skilled and well-educated.

Although Estonians have lived in the Baltic region for thousands of years, the state of Estonia, except for a brief period in the thirteenth century, was not an independent state until 1920 when it received international recognition as a state. 25 During most of its history, Estonia was ruled by larger European countries attracted to its location on the Baltic Sea. Russia, Germany, Sweden, and Denmark primarily controlled Estonia. Because of foreign rule, the Estonians did not have an opportunity to establish a stable ruling class or develop a strong national identity. A national movement did not emerge until the nineteenth century. The fact that the Estonian national epic "Kalevipoeg," compiled from earlier mythology, was not written until 1870 illustrates the late development of Estonian national identity. 26

21. THE WORLD BANK, supra note 7, at xv.
22. Id.
23. Id.
24. Id.
26. RAUN, supra note 7, at 77.
A. Capitalism of the First Republic

The first Republic formulated distinct political, economic, and legal institutions based on German antecedents. The first Republic's political system was a parliamentary democracy. The constitution, approved in 1920, was modeled upon the Weimar, Swiss, French, and U.S. constitutions. The legal system, based on ownership of private property, allowed for private sector development in agriculture and industry. Like most free market models, the central premise of the first Republic's legal system was the existence of private property rights. Given the historical link with Germany, Estonians of the first Republic codified law mainly based on German codes. The codification process, however, was never completed due to World War II. Nevertheless, the first Republic's legal system contained laws consistent with free market practices. The draft civil code, which contained a comprehensive set of commercial rules, recognized private property rights consistent with the economic organization of the first Republic as a small private property owner state.

When the first Republic was formed, Estonia was predominately an agricultural country. While nearly two-thirds of the population worked on farms or in agriculture, most of these farms were private estates that the Baltic German nobility and the

27. Id. at 112.
28. For example, in 1991, the Estonian government considered using the Property Code, which was drafted but never enacted during the first Republic, as the model for the new property code.
29. Telephone Interview with Jenik Radon, Esq. of New York, former advisor on civil and commercial law reform to Minister of Justice of the Republic of Estonia (Feb. 25, 1996). Mr. Radon noted that, during the first Republic, Estonians worked for more than a decade to perfect the civil code which was based on German law; however, the outbreak of war prevented its enactment. In 1992, Mr. Radon submitted a position paper to the President, Parliament, and Justice Minister which detailed the legal reform needed to stimulate economic development. He urged that the new civil code follow the German model, and suggested that Estonia use the pre-1940 civil code as a starting point for the new draft. Minister of Justice Kaido Kama approved the project. Subsequently, Mr. Radon, who also had circulated his position paper to the German government, organized the technical assistance of the Germans in the legislative drafting process. The current civil code incorporates legal concepts based on modern methods of finance.
church owned. To change this situation, the republican government expropriated many large estates and transferred the land to small farmers. The land reform program increased the number of family farms and “achieved a strikingly high degree of equality in land distribution on a comparative world scale.”

The land reform program also laid the foundation for a free market economy. Estonia exported its agricultural products and raw materials, and imported finished products from its main trading partners, Germany and Great Britain. Estonia extended its trade relations to the Scandinavian countries, the Soviet Union, the United States, and Western Europe.

Estonia made similar advances in the industrial sector. The first Republic inherited an industrial sector damaged during World War I. World War I resulted in the physical destruction of plants, a flight of capital, and the elimination of Russian markets. In 1929, the top five branches of industry, according to value of share in output, were “textiles (24.1%), foodstuffs (18.2%), paper (13.4%), metallurgy (9.2%), and woodworking (8.1%).” Industrial development improved during the 1930s, as indicated by the growing number of employed industrial workers and the rising trend of industrial production of oil shale, pressed peat, phosphorite, and other products. In 1939, nearly 60,000 workers were employed in industry, compared with 31,000 in 1922. For the comparable period in 1938, average annual oil shale production rose from 359,000 tons to 1,473,000 tons. Strong economic growth marked the first Republic, although fractionalized politics marked its government.

30. RAUN, supra note 7, at 129. By 1940, there were approximately 142,000 small farms. Serge Schmemann, Independent, Yes, But Estonia Shivers, N.Y. TIMES, Jan. 24, 1992, at A10 (quoting Jaak Leimann, Estonian Minister of Economics).
31. RAUN, supra note 7, at 125-26.
32. Id. at 126.
33. Id.
34. Id.
35. The fractionalized politics of the first Republic followed from Estonia’s tradition of having numerous political parties like most European countries. It also stemmed from the fact that during the 1930s, Estonia had the difficult task of trying to maintain independence in light of German and Soviet plans for territorial expansion. See Steven Erlanger, Estonia Savors Economic Success, But the Reformers May Be in Trouble, N.Y. TIMES, June 13, 1994, at A8.
B. Soviet Socialism

World War II halted the political, economic, and legal development of the first Republic. In the fall of 1944, the Soviet Union annexed Estonia and formed the Estonian Soviet Socialist Republic (ESSR). The annexation effectively reversed the achievements of the land reform program and destabilized an economy based on private property principles. The Soviet government confiscated property, deported or executed members of the burgeoning ruling class, and began to integrate Estonia into the Soviet planned economy. Consistent with the main precepts of the Stalin model, the Estonian economy was subject to Moscow’s dictates. The Stalinist model authorized Moscow’s central government to make all decisions affecting the economic system and to prohibit the unplanned activity of market participants. Additionally, the Soviet government imposed its legal system, which was based on the planned economic model and socialist ideology, thereby supplanting the Estonian legal system based on free market concepts.

The post-annexation period “was characterized by rapid industrialization as a result of aggressive capital formation and forced labor movements—from agriculture to industry, and from other parts of the Soviet Union (notably Russia) into Estonia.” In the agricultural sector, central planning called for the forced collectivization of farms. In the industrial sector, individual

36. The Soviet Union was the first modern state to implement a central planned economic system. MARSHALL I. GOLDMAN, USSR IN CRISIS: THE FAILURE OF AN ECONOMIC SYSTEM 30 (1983). Stalin introduced this economic model in the late 1920s, and it survived until the collapse of the Soviet Union in 1991. The central planned economic system sought to achieve, and succeeded in obtaining, the industrialization of the Soviet Union and the collectivization of its farms. Id. at 19-21. The underlying idea was to create the material conditions necessary to realize Marx’s ideal of the communist state. Although the Stalinist model posted impressive economic gains, this version of a central planned economy failed to achieve its intended goal and to adapt to the global market. MARSHALL I. GOLDMAN, GORBACHEV’S CHALLENGE 14-15 (1987).

37. By establishing the link between economic policy and legal rules through law, the transformation of the private sector into a socialized economy in 1917 Russia was accomplished by means of law. W.E. BUTLER, SOVIET LAW 242 (2d ed. 1988).

38. THE WORLD BANK, supra note 7, at xv.
factories were grouped into large state enterprises focused on electric power generation and the chemical industry. Because Estonia had a highly skilled workforce and a comparatively well-developed infrastructure, the central planners established relatively sophisticated industries in Estonia. Central agencies in Moscow provided inputs for production while almost ninety percent of exports were delivered to the Soviet Union.

The centralized economy had profound effects because the individual was dependent on the state for satisfaction of his economic needs. First, the suppression of individual rights to land eliminated the family farm system. Second, the central economy abolished markets developed during the inter-war period for Estonia's industrial and agricultural assets. Third, Estonia was forced to sever its relations with its main trading partners, and re-orient its trade toward Russia and other republics of the Soviet Union. Because of the large Soviet market and the subsidized cost of raw materials, the Estonian enterprises focused on transportation and energy. Moreover, the manufacturing technology was outdated and the service industry was practically non-existent. Consequently, Estonia mainly produced low quality products.

The Soviet legal system reflected the Marxist-Leninist postulate of the primacy of economic relations in society. As the mode of production changed from the free market of the first Republic to the Soviet planned economy, the importation of the Soviet legal system changed the law. Because the Soviet system followed a planned economic model, the quantity of legislation regulating the national economy exceeded that of all other laws in the system. From the Western point of view, the socialist rights set forth in the Soviet constitution and other legal acts functioned more as duties than as claims of right against the state. Therefore, it is accurate to conclude that the main functions of the Soviet legal system in the ESSR were to maintain state authority and to carry out the objectives of the planned economic program.

The juxtaposition of the political and economic systems of the first Republic and the ESSR shows a correlation between the economic and legal systems. The development of a small private property state during the first Republic took place alongside the

39. See id. at 97.
emergence of a legal system based on private property and democratic rights. By contrast, a legal system used to execute decisions of economic administrators accompanied the central planned economy of the ESSR. For example, the Soviet legal rules established prices, rents, and quotas. While the Soviet legal system also contained a system of rights, these rights served as "a funnel through which official standards were infused into individual lives."  

This correlation between the economic and legal systems observed during the transition from the capitalism of the first Republic to the socialism of the ESSR is also present in Estonia’s return to capitalism. The legal rules of the Soviet system are no longer suited for a capitalistic society based on democratic principles and, more importantly, an open market. The fact that the legal and economic systems of Estonia have come packaged three times in this century is compelling evidence of the dependence of law on economics. Purged of Marx’s ideas about the dialectic development of history, this primacy of economic relations states no more than that the legal system primarily imposes rules to implement the design and operation of the economic system. According to Yevgeny B. Pashukanis, law in its traditional role facilitates market transactions and, if one understands all relationships as voluntary exchanges of benefits, law has a total economic basis.

40. For overviews of the Soviet legal system, see BUTLER, supra note 37. See also GEORGE C. GUINS, SOVIET LAW AND SOVIET SOCIETY (1954); OLYMPIAD S. IOFFE & PETER B. MAGGS, SOVIET LAW IN THEORY AND PRACTICE (1983). The Soviet Ministries responsible for carrying out the central economic plan issued regulations binding on the republics.


42. Yevgeny B. Pashukanis was the best known Soviet expert on legal and constitutional theory in the 1920s. LESZEK KOLAKOWSKI, MAIN CURRENTS OF MARXISM, ITS ORIGIN, GROWTH AND DISSOLUTION 50 (1978). Pashukanis set forth his view of law in his General Theory of Law and Marxism, in which he maintains that in a capitalist society law functions to regulate exchanges of value in the marketplace. YEVGENY B. PASHUKANIS, THE GENERAL THEORY OF LAW AND MARXISM IN PASHUKANIS: SELECTED WRITINGS ON MARXISM AND LAW (Piers Beirne et al., eds. & Peter B. Maggs trans., 1980). He notes, "[w]herever the first layer of the legal superstruc-
C. Back to Capitalism

Although "Estonia enjoyed the highest standard of living among the republics of the former Soviet Union, with a per capita income 40 percent above the Union average," by 1980, the limits of the planned economic system began to show. From 1981 to 1991, the real growth rates of the Estonian economy ranged from negative 11 percent to 4.9 percent. In 1988, the ESSR decided that it would be bound by decisions of the Russian Soviet only if the ESSR independently ratified them. Later, in 1989, the Soviet Union adopted the law on economic autonomy for its republics. These decisions set the ground for economic experi-
mentation in Estonia and the abolition of the Soviet legal system, which discouraged free market economic developments. Finally, Estonia's declaration of independence from the Soviet Union in 1991 enabled Estonia to rebuild its economy and to revise its legal system to fit new economic needs.47

Estonia opted to develop an economy based on the free market ideas of Western European industrialized democracies.48 Although the exact reasons behind this decision are not entirely clear, it was a practical and expedient response to the failure of the Soviet Union's planned economic system. Estonia needed to act quickly to fill the void resulting from the Soviet Union's collapse. Officials did not deliberate the costs and benefits of different economic models. Similarly, people did not wait for the state to make an official decision before they began to act like entrepreneurs. Estonia's decision to follow a western-style model has its historical justification in the fact that it is a European country and has expressed the intention to join the European Union (EU).49

The transition to democratic government and a free market economy produced upheavals in the economic base and the legal system. First, the Estonian legal system, which was based on the Soviet system, became irrelevant and, with the exception of some

47. See Carl Bildt, The Baltic Lutmus Test, 73 FOREIGN AFF. 72, 73 (1994).
48. Estonia has provided an example of radical economic reform. The reform program was carried out mainly under the government of Mart Laar, who became Prime Minister in October 1992. He chose this path on the assumption that economic reform precedes social reform. Erlanger, supra note 35. Although Mr. Laar resigned in 1994, and candidates favoring greater commitment to social protections were elected to Parliament in 1995, economic reform is still directed toward the free market. The current Prime Minister, Tiit Vahi, who is a moderate, has “vowed to continue the reforms Estonia has undertaken since its independence from the Soviet Union in 1991.” Moderate is Approved as Estonian Premier, N.Y. TIMES, Apr. 6, 1995, at A14. Therefore, the economic reform program that Mr. Laar started is unlikely to change substantially. In Mr. Laar's words, “[t]he train is going too fast now for anyone to stop it.” Erlanger, supra note 35.
49. MINISTRY OF ECONOMIC AFFAIRS OF THE REPUBLIC OF ESTONIA, ESTONIAN ECONOMIC SURVEY 7 (1994) [hereinafter MINISTRY OF ECONOMIC AFFAIRS]. Although Estonia's membership in the EU would somewhat diminish its sovereignty, membership in a larger political organization provides security against foreign aggression, supports economic need, and, thus, outweighs the benefits of total independence.
criminal law, was not enforced. The interim government drafted a new constitution, which was adopted in 1992, that required the formation of new political institutions such as the Office of Legal Chancellor and the National Court, and also embarked on a revision of the entire legal system.\textsuperscript{50} Second, the break from the Soviet Union had substantial macroeconomic effects as the economy experienced the restructuring process. The key macroeconomic effects were the contraction of the economy, the restructuring of the industrial and service industries, inflation, and trade realignment.

The economic and political disruptions of the early independence period left Estonia without a legal system. The "gap" between the collapse of the Soviet legal system and the formation of the new legal regime provides the opportunity to study the forces that shape and determine law. This study conclusively reveals in the Estonian case that the macroeconomic effects noted above are the determining forces. Consequently, a detailed exposition of these key macroeconomic forces is necessary.

Leaving the Soviet economic zone caused a decline in Gross Domestic Product (GDP) and led to a contraction of the Estonian economy.\textsuperscript{51} According to best estimates, the size of the Estonian economy fell by eight percent in 1990, fourteen percent in 1991, and fifteen percent in 1992.\textsuperscript{52} Not until the third quarter of 1993 did the decline of the economy halt, showing a growth rate of five percent in comparison to the second quarter of 1993.\textsuperscript{53} Between 1989 and 1993, industrial output decreased by sixty percent.\textsuperscript{54} While some industrial sectors produced fewer goods, others discontinued the production of certain goods or shut down completely. During the first nine months of 1993, Estonia did not produce standard industrial base products, such as phosphate

\textsuperscript{50}. \textit{See generally Estonian Constitution} (1992).
\textsuperscript{51}. \textit{International Monetary Fund}, IMF Economic Reviews 1 (1994). The International Monetary Fund noted that "[i]n 1991-92, Estonia's economy suffered from serious economic shocks that were largely beyond the authorities control and caused a severe contraction in output and real incomes of the population. Macroeconomic imbalances were first aggravated by the breakdown of traditional trade and financial links within the former Soviet Union." \textit{Id.}
\textsuperscript{52}. \textit{Ministry of Economic Affairs}, supra note 49, at 12, 13.
\textsuperscript{53}. \textit{Id.} at 13. Note, however, that according to the International Monetary Fund, real output grew by six percent in the third quarter. \textit{See supra}, note 51, at 5.
\textsuperscript{54}. \textit{Ministry of Economic Affairs}, supra note 49, at 21.
fertilizers and steel cables. Furthermore, energy production prices fell by fifty percent in 1993 in comparison to 1992.\textsuperscript{55} The lack of demand, shortage of raw materials, and price liberalization attributed to the decline in industrial production.

The agricultural sector suffered a similar fate. The break-up of large collective farms and the re-emergence of small privately held farms interrupted agriculture. Agricultural production declined twenty percent in 1990, twenty-one percent in 1992, and seventeen percent in 1993.\textsuperscript{56} Estonian and international authorities attributed the decline to three factors, two involving the restructuring process.\textsuperscript{57} First, the collective farm system, which was designed to serve the needs of the Soviet Union, had to be redesigned to compete in the international markets. Second, agricultural workers lacked the expertise to run a farm in a free market system. Farmers were not accustomed to competition and producing high quality products. Third, farms did not have the capital necessary to upgrade machinery and facilities. Obsolete equipment reduced the production capacity of farms.

Notwithstanding these problems, in 1993, the agriculture and industrial sectors began to stabilize.\textsuperscript{58} Estonia had 6000 farming enterprises in 1993 compared to 300 collective farms in 1989.\textsuperscript{59} Although Estonia may be unable to sustain a network of small farms, the transition process has set the basis for creating agricultural entities that can satisfy domestic and foreign demand. In 1993, industrial output also began to rise. Out of the nearly 300 large enterprises, “[one] fifth succeeded in finding their place in the

\textsuperscript{55} Id.
\textsuperscript{56} Id. at 69.
\textsuperscript{57} INTERNATIONAL MONETARY FUND, supra note 51, at 5.
\textsuperscript{58} The International Monetary Fund reports that in 1993 “real output is estimated to have declined only 3.5 percent and during the year it began to recover, growing by 6 percent in the third quarter.” INTERNATIONAL MONETARY FUND, supra note 51, at 3. The 1993 recovery in industrial production was due in part to an increase in demand for production. Id. at 4. While the share of agriculture in total value continued to decline in 1993, output for some products increased and food exports to Russia became more profitable. Id. at 5, 6.
\textsuperscript{59} MINISTRY OF ECONOMIC AFFAIRS, supra note 49, at 71.
new economic climate." In the third quarter of 1994, industrial output grew by six percent. Western firms established new and labor intensive industries in Estonia because of cheap labor. While the restructuring process continues in industry and agriculture, these industries apparently have survived the bleakest period of the economic reform process.

Fortunately, not every industry suffered from the GDP decline. Between 1989 and 1994, the service industry's proportion of GDP grew. In 1991, the service industry accounted for thirty-four percent of GDP; by 1994, it accounted for almost fifty percent. The number of retail shops and the variety of manufactured goods increased. In 1989, Estonia had approximately 3800 state and cooperative owned retail enterprises and almost no privately owned shops. By contrast, in 1993, more than 3200 of the approximate 7200 retail enterprises were privately owned. These privately owned enterprises accounted for seventy percent of the retail trade. The supply of goods distributed through the retail and wholesale markets responded to price liberalization and trade, and helped to halt the decline of real wages.

Prices and wages underwent significant changes in the transition process. Estonia began the process of price liberalization in 1989. State enterprises initiated changes in prices subject to rules the government established. By 1992, Estonia permitted a full pass-through of cost, save for certain goods state enterprises

60. Id. at 21.
61. INTERNATIONAL MONETARY FUND, supra note 51, at 4.
63. "Since the currency reform, the Estonian service sector has expanded rapidly. In fact, several sub-sectors, such as trade, transport and communications, finance and real estate, recorded positive growth both in 1992 and 1993." INTERNATIONAL MONETARY FUND, supra note 51, at 6.
64. MINISTRY OF ECONOMIC AFFAIRS, supra note 49, at 38.
65. Id. at 42, fig. 4.
66. INTERNATIONAL MONETARY FUND, supra note 51, at 6. By offering better quality goods for sale, these retail shops proved that the transition was worth enduring, at least for those who had enough money to buy the new goods. Items such as Nike sneakers and Sony televisions were in plentiful supply in Estonia by 1994. Upgraded hotels, restaurants, and cafes showed substantial improvement in both the quality of service and in the provision of amenities.
67. Id. at 7.
produced and sold. These cost adjustments, expressed as inflation, reached 210% in 1991 and peaked at 1176% in 1992. The increase in the price of oil purchased from Russia mainly caused the 1992 hyperinflation. While prices were rising, wages were falling to nearly forty percent in 1992. The price-wage disparity lowered the average worker’s standard of living and created serious economic difficulties for people on pensions or fixed incomes. The inflation rate was brought somewhat under control by 1993, when it was reduced to 35.6%. The purchasing power decreased, however, given the lethargic rise of wages and the low interest rate on investment and savings.

Under Soviet rule, Estonian trade was limited to the republics of the Soviet Union. After Soviet rule, Estonia completely reformed the trade system to establish worldwide trade relations. "Trade liberalization began in 1991 when the very high Soviet tariffs were abolished." Consequently, "trade with the republics of the former Soviet Union fell from 95% in 1991 to 26-27% in 1993." Estonia pursued a very liberal trade regime, removing all import trade barriers to allow manufacturers to buy imported machinery and goods at world market prices, as well as removing all export barriers to encourage exports. Removing import barriers forced domestic business to compete with foreign business, thereby raising the quality of Estonian-made products and accelerating the adjustment of prices to world levels. In 1992, member countries of the European Free Trade Association (EFTA) accounted for thirty percent of Estonia's imports and exports. Additionally, in 1993, Estonia, along with Latvia and Lithuania, signed a Baltic free trade agreement modeled along the lines of EFTA. In 1994, Estonia

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68. Id. at 8.
69. 1 BANK OF ESTONIA, QUARTERLY REVIEW 7 (1993).
70. Although the International Monetary Fund notes that the average wage rose by six percent in 1993, this rise in income had little effect against the impact of rising prices.
71. BANK OF ESTONIA, BULLETIN No. 1, at 9 (1994).
72. INTERNATIONAL MONETARY FUND, supra note 51, at 32.
73. Id. at 44.
74. MINISTRY OF ECONOMIC AFFAIRS, supra note 49, at 45.
75. INTERNATIONAL MONETARY FUND, supra note 51, at 33.
began negotiations with the EU on a free trade agreement. To support its liberal trade policies, Estonia permitted decentralized payment agreements between commercial banks, and removed restrictions on capital account transactions due to the full convertibility of the kroon.

V LAW AS DERIVATIVE OF ECONOMIC ORGANIZATION

Estonia's legal system established during the transition period developed in reaction to economic conditions and the political reforms resulting from independence. The popular desire to have a free market economy, the preoccupation with increased wages, and improved living standards cemented focus on legislation with economic objectives. This detracted from other issues, such as human rights, that could have been the focus of legal regulation. An analysis of legislation enacted in the transition period demonstrates that the law's primary function is to implement an economic system.

Even before the adoption of the constitution and the implementation of explicit rules, the first major changes to take effect were the recognition of private property and the default rule that everything is allowed unless expressly prohibited. These changes reflected two economic realities: (1) individuals and firms do not wait for governments to develop formal legal rules before they begin to open businesses and make money; and (2) government's ability to control economic events in a free market system is limited. The outburst of entrepreneurial activity following the collapse of the Soviet Union is probably the best

76. Id. at 32-33. Foreign and international institutions played a significant role in the transition process. Estonia desperately needed to attract capital investment and to borrow money for development. The World Bank, the International Monetary Fund, and the European Bank for Reconstruction and Development provided technical assistance, programs, and loans to Estonia. Advisors from these institutions also participated in the establishment of the central bank, the Estonian Privatization Agency, and the health and educational industries. The governments of the United States, France, Great Britain, and Germany offered technical advisors to create a securities market, a clearance and settlement system, and a debt management system. Foreign governments established trade and diplomatic relations with Estonia to gain a new trade partner. Foreign businesses, particularly those based in Finland, Sweden, and Germany, entered the market and established an Estonian presence.

77. Id. at 33. For a discussion on the kroon and currency reform, see infra notes 87-88 and accompanying text.
evidence that economic reform precedes and shapes the formation of legal rules. The incorporation of 20,000 businesses in 1991 and the registration of 300 new companies per month in 1992 in Estonia indicate the level of private sector activity. As of November 1993, 41,820 enterprises had registered with the state. By contrast, in 1991, Estonia had 2234 state-owned enterprises, 421 enterprises under the control of local governments, and 1173 cooperative enterprises. Even allowing for the greater value and output of state enterprises, the behavior of firms and individuals in the market reflected the private sector's impact in reversing the negative macroeconomic consequences of the transition process.

The first modification of the legal system embodied the heightened degree of economic freedom existing in the market during the early stages of the reform period.

Estonia had to eliminate state-owned enterprises, which were a hold-over from the Soviet system and an obstacle to a free market economy. Consequently, the interim government adopted a temporary bankruptcy decree to allow the reorganization or termination of non-productive state enterprises. This bankruptcy decree constituted one of the most important formal legal changes. Once Estonia became fully independent, parliament responded by enacting the 1992 Bankruptcy Code. More thorough than the earlier decree, the Bankruptcy Code allowed for the reorganization or dissolution of failing state enterprises, protected creditors' rights to recover assets from their debtors, and provided an encouraging environment for lending and investing. The priority of the creditor over the debtor rights was based on the economic need to establish a lending system to propel developments in the industrial,

78. MINISTRY OF ECONOMIC AFFAIRS, supra note 49, at 94.
79. Companies initially registered according to specifications of temporary decrees that did not impose substantial compliance burdens. For an English translation of this corporation statute, see PAUL VARUL & VESA A. LAPPALAINEN, VIRON KAUPALLISTA LAINSAADANTOA EEStI KAUBANDUSE SEADUSED: ESTONIAN LAW ON BUSINESS 238-44 (1992) (setting forth the Enterprise Act).
80. THE WORLD BANK, supra note 7, at 46.
agricultural, and service sectors.

Simultaneously, Estonia gradually developed legislation in the privatization and commercial law areas. These legal rules also were a response to market developments, not the other way around. For example, the law establishing the Estonian Privatization Agency (EPA) responded to concerns about the slow and disorganized pace of privatization, as well as claims of fraud concerning several early privatized companies. Subsequent legal acts, such as the 1993 Law on Privatization, the 1993 Law on the Privatization of Dwelling Rooms, and the 1994 Regulation on Issuing Privatization Vouchers, further refined the character of Estonia’s privatization process. Because the market system hinges on private property, these legal acts helped to establish a free market by providing a vehicle through which the state could transfer the ownership of its assets to private parties, and through which these parties then could transfer the ownership of their assets.

Developments in the commercial area further reflect the primacy of the economy to legal development. Initially, befitting the unsophisticated nature of the economy, Estonia adopted a very simple decree requiring the registration of juridical entities entitled to do business. While this decree applied to partnerships and joint stock companies, it provided only the most cursory provisions regarding formation, management, and termination. Subsequently, Parliament enacted the Commercial Code, reflecting the advances in market development and the necessity for laws commensurate with those of its trading partners. This code consists of 320 sections and addresses issues that privately held and publicly owned companies are likely to encounter in a free market.

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82. The EPA identified companies for sale, conducted international auctions, and organized sales of several companies as initial public offerings to augment the stock market.
The development of financial markets followed the same pattern. Capital markets first developed in response to early bank failures and strict lending practices. The securities market was necessary to finance: (1) emerging firms because banks were unable or unwilling to do so; and (2) banks that needed cash to meet newly established minimum capital requirements. Investment funds sprung into existence to compete with the banks for consumer accounts and provide alternative means of corporate financing. Firms raised cash through the capital markets to support expansion and improve plant and equipment.

In 1993, Parliament enacted the Securities Market Act, and in 1994 Parliament created the Securities Board to regulate public distributions of securities.85 In 1994, Parliament also enacted the Investment Funds Act to encourage the development of investment funds, establish financial adequacy requirements for these institutions, and protect consumers.86 In 1995, the stock market and central depository opened without any specific regulatory framework. The rise of economic institutions prior to any legal regulation designed to support and regulate them further demonstrates the correlation between economic development and legal rules.


86. Whether these regulations are necessary to achieve economic growth and honest business practices is debatable. If the market were unregulated, the competition of firms might produce adequate standards. In the early period of the transition process, this development took place and appeared to work well. It will never be known whether the unregulated market would have produced adequate business standards since Estonia decided to enact market regulations.
Currency and banking reforms provide additional support for the dominant position that economic policy shapes law. Estonia was the first former republic of the Soviet Union to abandon the ruble. Because the ruble was unstable, not fully convertible into hard currency, and untrustworthy as a medium of exchange, its use slowed the reform process. In 1992, Estonia introduced the “kroon” as its currency, pegged it to the German mark, and opted for a currency board arrangement to guarantee its value. Currency reform allowed businesses to conduct transactions in a stable currency. Additionally, ordinary individuals were able to measure the value of their work and compare foreign and domestic prices. The creation of the Central Bank in 1992 laid the foundation for the commercial banking system and supported further development of financial markets. As a practical matter, the enactment of appropriate legal acts accomplished the currency and banking reforms, and clearly constituted an instrument of economic policy.

Similarly, the legal rules covering price liberalization, trade, and tax collection derived from economic policy issues. To set demand and consumption of goods according to supply and demand, Parliament enacted a series of legal acts to remove state subsidies. These legal acts reflected the need to adjust prices of goods according to their actual cost. Estonia established a system of trade and customs regulations reflecting its policy of open markets. Additionally, Estonia constructed a favorable tax

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87. The idea of introducing its own currency dates back to 1987 when Estonia was under Soviet rule. See Slim Kallas, Significance of Monetary Reform in Estonia, 1 Estonian Kroon 4, 4-7 (June 1993) (explaining the origin of monetary reform in Estonia).

88. Under the Estonian arrangement, the Issue Department of the Central Bank operates the currency board. The currency board gives the kroon holders confidence in the currency by guaranteeing the exchange of bank notes and deposits in kroon placed with the bank. The guarantee is backed by foreign reserves comprised of gold reclaimed from foreign countries. The guarantee is based on pegging the kroon to the German mark at a rate of one German mark to eight kroons. “This [exchange rate] corresponded quite closely to [the] market rate of the rouble to the deutschmark at the time of monetary reform in Estonia.” Kallas, supra note 87, at 10. For a full explanation of the Estonian currency board arrangement, see Adam G.G. Bennett, The Operation of the Estonian Currency Board, in Paper on Policy Analysis and Assessment of the International Monetary Fund (1992).

89. Because Estonia is a small country, it must “rely on open international competition to establish a rational set of prices, ensure competitiveness in its markets, and provide for
environment for business to attract foreign investment and establish foreign enterprises. For example, the tax code provided a tax break to foreign firms willing to invest in Estonia, and set a flat tax of twenty-six percent, which is low in comparison to tax rates in other markets in the same region.\(^\text{90}\)

Economic policies also partially accounted for changes in criminal law. First, the market required amendment of the provisional criminal code. To make lawful the basic economic activity of a free market, crimes based on speculation—the sale and purchase of goods by private business—had to be deleted from the criminal code. Second, because the provisional criminal code conflicted with the new Constitution, Estonia ordered a complete revision of the criminal code. The revised criminal code, not yet adopted, recognizes the protection of property rights and the right to engage in market activity found in the Constitution. Moreover, laws criminalizing theft, damage, or destruction proved necessary to provide security for market place competitors whose lawfully acquired property needed protection.

Observation of other, less obvious commercial legislation also supports the conclusion that economic policy permeates the substance of Estonia's new legal system.\(^\text{91}\) The Estonian constitution sets the framework for a market economy by protecting the right to own and dispose of property, and to engage in commercial activity. Article 32 provides that "[t]he property rights of all persons shall be inviolable and shall enjoy equal protection" and that "[e]very person shall have the right to freely possess, use and control his or her property," subject to the usual restriction to

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91. This is not to suggest that only economic policy dominated public debate. Withdrawal of Russian soldiers, the law of citizenship, and the treatment of the Russian minority also produced fierce debates in the legislature. The international attention the latter issues received, however, provided a narrow view of the Estonian transition process.
protect the public interest. The Constitution extends property right protection with equal force to intellectual property. Additionally, Article 29 provides that "[e]very Estonian citizen shall have the right to freely choose his or her fields of activity, profession and place of work." Article 15 enforces these rights by guaranteeing that "[e]very person shall have the right to bring a case before the courts if his or her rights or liberties have been violated."

The addition of individual rights of privacy, speech, and religion to economic rights marks a clear division between civil and state society. The individual rights spelled out in the Constitution are the typical "negative" rights found in the U.S. Bill of Rights and other international documents. Contrary to the Constitution of the former Soviet Union, which spelled out citizens’ duties and the states’ goals, Estonian individual rights arm citizens with rights against the state. By conferring authority on physical and juridical persons, the Constitution diminishes the state’s authority and sets up the division between civil and political society present in most market economies. The independent judiciary and the legal chancellor play an important role in Estonia’s free market framework by ensuring that the legislature does not lessen the

92. ESTONIAN CONST. ch. II, art. 32. Additionally, it provides:
No property may be expropriated without the consent of the owner, except in cases of public interest, in accordance with procedures established by law, and in exchange for equitable and appropriate compensation. Any person whose property has been expropriated without his or her consent shall have the right to bring a case before the courts and to contest the expropriation, and the nature and amount of compensation.

Id.


94. ESTONIAN CONST. ch. II, art. 29. It also states that “[u]nless otherwise established by law, this right shall exist equally for Estonian citizens and citizens of foreign states and stateless persons who are sojourning in Estonia.” Id. The Constitution also gives workers the right to establish a union or association to protect their rights. Id.

95. Id. art. 15.
degree of economic protection the Constitution guarantees. Thus, the Estonian Constitution creates safeguards facilitating the transition to a free market economy. Protection of property rights, combined with an independent judiciary encourages international investment and spurs domestic investment and initiative. Persons who engage in economic activity in Estonia, therefore, are assured that the state may not take their property without due process or abrogate their contracts.

Some may argue that the theory of economic factors shaping legal rules proves only that a small portion of a legal system derives from economic order. Such an argument, however, misses the crucial point that the preponderance of legal rules deriving from economic need overwhelms the legal rules based on non-economic considerations such that the legal system fairly can be explained as an instrument of economic policy. Legal rules based on non-economic concerns are subordinate to legal rules implementing economic policy. Individuals and firms seek wealth. In Estonia, this is exemplified by the virtual domination of the political process by economic issues. Theoretically, Estonia could have focused on the development of human rights. It did not do so, however, because of the importance of economic welfare. To argue that a legal system's main function is not the expression of

96. "The courts shall be independent in their work and shall administer justice in accordance with the Constitution and law." Id. ch. XIII, art. 146. Article 147 of the constitution provides that "[j]udges shall be appointed for life," and "[g]uarantees for the independence of judges and the legal status of judges shall be established by law." Id. ch. XIII, art. 147. Chapter XII establishes the office of the legal chancellor, whose role is to monitor the constitutional validity of law made by the Riigikogu or the government. Id. ch. XII. Article 142 of chapter XII states that, if the legal chancellor deems a law to be unconstitutional, "he or she shall propose to the body which has adopted that act that it bring the act into accordance with the Constitution or the law within twenty days." Id. In the event the Riigikogu or government fails to act, the legal chancellor is empowered to ask the National Court to declare the law invalid. Id.

97. See generally Sunstein, supra note 2 (demonstrating the relationship between constitutionalism on one hand, and economic development and democratic self-government for eastern European countries on the other hand).

98. Id. at 907-08.

99. The protection of property against takings without due process and the protection of contractual relations against government interference are two main components of the rule of law. Id. at 923-24.
economic need just because advanced legal systems have numerous non-economic rules, is like arguing that because people use contraceptives the theory of natural selection is wrong. Sophisticated legal systems are feather-bedded away from their essential roots in economic necessity.

While the above discussion focused on select examples of some of the most important changes in Estonian law, an analysis of all the Estonian statutes enacted from 1991 through 1995 provides compelling support for the hypothesis that a legal system consists primarily of legal rules regulating economic issues and, consequently, a legal system's main purpose is to implement underlying economic policy. Because Estonia has a civil law system in which judicial authority to make law is limited, these statutes comprise the essential laws of the legal system.

Additionally, although the government has the authority to issue decrees, it must do so within the confines of the relevant statutes.

For purposes of this Article, the legal acts are divided into four categories: (1) economic; (2) non-economic; (3) hybrid; and (4) governmental structure and procedure. The economic acts refer to laws with a purely commercial purpose, such as the law of business entities and the Sales Code. The non-economic acts refer to laws unrelated to economic relationships, such as the law on cultural self-government for minorities. The hybrid acts refer to laws having combined economic and non-economic purposes, such as environmental laws. Finally, the governmental structure and procedure acts refer to laws that are procedural rather than substantive or that bear on the creation or management of public institutions. Other statutes, which were difficult to classify, were categorized into the non-economic acts so as not to skew the results in favor of the hypothesis.

100. For example, lower and intermediate courts do not have any law-making authority whatsoever and their decisions are not published. The National Court reviews acts of the legislature on constitutional grounds. While the National Court publishes its decisions and considers its decisions to have precedential value, its law-making role is significantly less than the broad powers of the U.S. courts. Telephone Interview with Juri E. Taalman, ABA Legal Specialist at the National Court of the Republic of Estonia (Oct. 27, 1995). Mr. Taalman explained that the National Court has interpreted the Constitution as a source of authority to issue binding decisions having the authority of law. The Riigikogu has not opposed the court's interpretation of its own power. Several of the court's opinions have been translated and published in the English language. Mr. Taalman has translated approximately twelve of them.
The data consist of 353 statutes enacted by the Estonian Parliament between January 16, 1991, and May 3, 1995, and contained in the List of Current Acts found in the National Computer Center of Estonia.\textsuperscript{101} The statutes include domestic legislation, and international conventions and treaties. International conventions and treaties (treaties) are included because they have the force of law.\textsuperscript{102} For purposes of analysis, the statutes are classified and graphed as follows, with the actual number of statutes in a classification appearing within the brackets:

(1) economic domestic statutes [109];
(2) non-economic domestic statutes [43];
(3) hybrid domestic statutes [32];
(4) government structure and domestic procedure [42];
(5) economic treaties and their ratification [54];
(6) non-economic treaties and their ratification [22];
(7) treaties related solely to formal inter-country political issues [18];
(8) hybrid treaties [14];
(9) loan agreements and their ratification [12]; and
(10) budget laws [7].
The ten categories were reduced to four by combining domestic statutes and treaties into the appropriate classification, and removing the statutes related to loan agreements and budgets as irrelevant. This leaves the four categories of economic, non-economic, hybrid, and governmental structure and procedure, and reduces the total number of statutes in the sample from 353 to 334. Each category, expressed as a percentage of the 334 statutes enacted in the 1991 to 1995 period, represents the following percentage of the whole: (1) economic (48%); (2) non-economic (19%); (3) hybrid (14%); and (4) governmental structure and procedure (17%).103

103. The percentages are computed as follows: economic domestic (109) plus economic international (54) totals 163; non-economic domestic (43) plus non-economic international (22) totals 65; hybrid domestic (32) plus hybrid international (18) totals 50; and government structure domestic (42) plus government structure international (18) totals 60. These totals are then taken as an approximate percentage of the 334 statutes in the reduced sample.
If the statutes related to government structure are removed in order to identify the substantive law of Estonia, and if the hybrid and economic categories are combined, then the legal acts implementing economic policy account for sixty-six percent of Estonia's substantive legislation.
This Article does not attempt to explain rights unrelated to economic policies in economic terms. Rather, it explicitly acknowledges the limit of derivative theory. Legal rules, such as Estonia's citizenship law, are better explained as difficult ethical decisions solving complex political and emotional problems. Estonia based its determination of the Russian minority's status on "principles accepted by the Council of Europe and the CSCE." Applying an economic analysis to the citizenship issue would not reflect an accurate reading of history. Acknowledging the limit of derivative theory, however, does not diminish its effective use as a descriptive device.

VI. APPLICATION OF THE DERIVATIVE THEORY TO NIS COUNTRIES

The derivative theory applies to legal systems regardless of the ideological bent or the particular character of the underlying economy. The derivative theory is relevant to each NIS country undergoing the transition from a planned to a free market economy and from a single party system to a democracy. The NIS countries differ in the degree to which they adhere to pure free market principles and in the practical application of their economic policies. The constitutional law of the NIS countries, for example, predictably contains substantial social welfare provisions requiring the state to intervene to provide jobs, education, and health care. By contrast, Estonia has embraced a different form of capitalism, preferring to limit the state's role and relying on market forces. Despite these differences of economic form, however, the premise of derivative theory holds true: Economic policy concerns drive the legal changes in the NIS countries.

For simplicity's sake, this Part focuses on economic and legal developments in the NIS countries that are similar to the economic and legal developments taking place in Estonia. For example, parallel developments are evident in these five areas: (1) constitutional law; (2) privatization programs; (3) recognition of property rights; (4) the banking system and capital markets; and (5) the restructuring of the legal system. Because an individual

104. Bildt, supra note 47, at 80.
study of every NIS country is beyond the scope of this Article, the secondary source literature explains many of the legal, political, and economic developments in the NIS countries. While the secondary literature tends to focus on the Czech Republic, Hungary, Poland, Romania, and Russia because these countries present substantial economic opportunities for western firms, it nevertheless is a rich source of data for developments in the NIS countries.

A review of the Constitutions of the Russian Federation, Republic of Romania, Czech Republic, Republic of Lithuania, Republic of Slovenia, and Republic of Bulgaria demonstrates that each embodies a set of economic policy decisions. These Constitutions protect private property rights, and the right to engage in private sector economic activity, and provide for enforcement of these rights by an independent judiciary. Some Constitutions contain welfare protections that deviate from the pure free market model but are typical of European traditions. In any event, the constitutions establish the fundamental legal framework for market activity. Although the economic component comprises a small part of the constitutions, the fact that they embody an explicit set of economic policy decisions supports the derivative theory's claim that law is a vehicle for the economic ordering of states.

The Russian Federation Constitution provides the best paradigm because of its clear statement of economic objectives. The Constitution expressly guarantees "the integrity of economic space, a free flow of goods, services and financial resources, development of the legal framework for economic activity and providing proof for the claim that the legal system implements economic policy)."

support of competition, and the freedom of economic activity."\textsuperscript{107} Additionally, it provides, "[e]veryone has the right for a free use of his abilities and property for entrepreneurial and other activities not prohibited by law."\textsuperscript{108} Further, the Constitution allows "citizens and their associations" to own land, and it legitimizes the existence of private property by allowing individuals to possess, use, and alienate property without state approval.\textsuperscript{109} Additionally, "the right of inheritance is guaranteed."\textsuperscript{110} To complement this system of private property rights, the Constitution clarifies that individuals may freely select their professions and type of work.\textsuperscript{111} To give substance to these abstract rights, the Constitution states, "[e]veryone shall be guaranteed protection of his or her rights and liberties in a court of law."\textsuperscript{112} Taken together, these articles of the Russian Federation Constitution promote economic development along free market lines and thereby implement economic policy.\textsuperscript{113}

Developments in the NIS countries in privatization, banking, and financial markets parallel those in Estonia. Moreover, the derivative theory explains these developments. Initially, as in Estonia, "the greatest importance was attached to reforms involving stabilization and liberalization of prices, lowering of trade barriers, fiscal restraint, and currency convertibility."\textsuperscript{114} Thereafter, as in Estonia, most NIS countries began a program to privatize state-owned enterprises in an effort to transfer state assets

\textsuperscript{107} RUSSIAN FEDERATION CONST. ch. 1, art. 8(1).
\textsuperscript{108} Id. ch. 2, art. 34(1).
\textsuperscript{109} Id. arts. 35, 36.
\textsuperscript{110} Id. art. 35.
\textsuperscript{111} RUSSIAN FEDERATION CONST. ch. 2, art. 3.
\textsuperscript{112} See id. art. 46.
\textsuperscript{113} For constitutional provisions dealing with protection of the right of private property, see SLOVENIA CONST. art. 33; LITHUANIA CONST. ch. 2, art. 23; ROMANIA CONST. tit. II, ch. 2, art. 41; id. tit. IV, art. 135; CZECH CONST. Charter of Fundamental Freedoms ch. 2, art. 11. Constitutional provisions dealing with free market activity are found in SLOVENIA CONST. art. 74; LITHUANIA CONST. ch. 4, art. 46; ROMANIA CONST. tit. IV, art. 134; CZECH CONST. ch. 4, art. 26. Examples of welfare provisions are found in SLOVENIA CONST. art. 66 (state job creation); id. art. 78 (subsidized housing); and id. art. 50 (state health and social security benefits).
to private individuals. This policy was aimed at reducing the government’s role in the economy and increasing the role of the private sector in the ownership of productive assets. Most countries established state agencies to supervise the valuation and sale of state property. For example, in 1990, Hungary set up the State Property Agency to examine “the valuation and selling of state-owned property” and to report to the Parliament.  

Poland established the office of Minister of Ownership Transformation in 1990, and the Russian Federation established the State Committee for the Management of State Property. While the details of the privatization programs differed from country to country, all the countries shared the objectives of wealth maximization, decentralization of state power, and empowerment of the private sector by providing financial resources and incentives to challenge state action.

In conjunction with privatization, several NIS countries established commercial banking systems and securities markets. The enabling legislation of these institutions demonstrates their free market character. The Constitutions of most NIS countries provide for the establishment of a central bank to control monetary policy. For example, the Russian Federation Constitution states, “the monetary emission [of the ruble] shall be the exclusive responsibility of the Central Bank of the Russian Federation.”  

Article 98 of the Constitution of the Czech Republic, in creating a central bank, states, “its main objective is the care for the stability of the currency.” The National Bank of Poland “regulates the circulation of currency, fixes foreign exchange rates and supervises

118. RUSSIAN CONST. ch. 3, art. 75.
119. CZECH CONST. ch. 6, art 98.
the foreign currency transactions of banking institutions."\textsuperscript{120}

Commercial banks in the NIS countries no longer perform the role they did under the central planned economic system. Rather, they perform functions typically associated with standard commercial banks. In part, the enactment of banking legislation approximating Western European credit institution law demonstrates this role.

Legal developments in the capital markets follow the pattern in the Estonian market. Many "[E]ast European nations, and a number of former republics of the Soviet Union, have established or are establishing their own stock markets to attract foreign and domestic investment capital."\textsuperscript{121} Consistent with their pre-communist tradition of free markets, Hungary, Poland, and the Czech Republic were the first countries to open stock markets after the Soviet Union's collapse.\textsuperscript{122} The legislation in this area incorporates widely recognized principles drawn from European and U.S. legal systems. Coinciding with the development of the markets is the growth of financial intermediaries that offer privatized business sources of capital and business expertise.\textsuperscript{123} Additionally, NIS countries have developed, or are in the process of developing, debt management programs to finance their budgets based on western economic and legal concepts. Moreover, most NIS countries have restructured their tax systems in response to the privatization process and other market developments.

The development of similar legislation in the NIS countries is compelling. Because the NIS countries generally have chosen to develop their economies along free market lines, their legal systems tend to contain western-style laws based on European, Scandinavian, and common law models. The similarity in legal rules demonstrates the economic system's authority to shape legal rules and override differences of culture, language, and location. For

\textsuperscript{122} The Budapest Stock Exchange was established on June 19, 1990. This interest in the development of securities markets is widespread. Latvia, Lithuania, Slovenia and Bulgaria have stock markets, and the Central Asian republics, such as Kazakhstan and Kyrgyzstan, have investment banks.
\textsuperscript{123} Yolanda K. Kodrzycki & Eric M. Zolt, Tax Issues Arising from Privatization in the Formerly Socialist Countries, 25 Law & Pol'y Int'l Bus. 609, 624 (1994).
example, from a technical point of view, there was no reason why Estonia could not have imported Poland's securities laws. Although Estonia enacted an individualized securities statute, the overlap between the Polish and Estonian laws shows that economic organization drives the construction of legal systems. The ideology of the free market, however, does not determine law. Had these NIS states chosen to follow another type of economic system, for instance an Asian one, the legal system would reflect the underlying business relationships of that system.

VII. PROBABLE APPLICATION OF THE DERIVATIVE THEORY TO NON-NIS COUNTRIES

The question arises whether the legal reform experience of Estonia and other NIS countries has any relevance to foreign legal systems such as that in the United States. The relevance, if any, is not obvious because countries like Estonia and the United States are the products of different histories, culture, and language. On this ground, some may argue that their respective legal systems are entirely different and, therefore, a theory explaining the Estonian legal system has no relevance for the U.S. legal system. The relevancy arises, however, based on the fact that countries like Estonia and the United States have similar economic systems and, broadly speaking, similar economic objectives. Thus, although other Western countries may not be undergoing a transition similar to that in Estonia, correlations made between law and economic organization in Estonia have relevance to those other legal systems.

Modern industrial societies share similar general objectives, namely economic prosperity and public order. Because the free market economies of the United States and western Europe are variations of Adam Smith's model, as modified by John

124. See ADAM SMITH, AN INQUIRY INTO THE NATURAL CAUSES OF THE WEALTH OF NATIONS (1776) (articulating the market run economic system and asserting that the market is self-regulating); see also JOHN KENNETH GALBRAITH, ECONOMICS IN PERSPECTIVE 57-72 (1987).
Keynes, a preponderance of contemporary law represents each government's attempt to intervene in the workings of the market. Although this explanation does not account for all legal rules found in these legal systems, it does explain debates about how to use law to achieve desired economic effects and provides a more satisfying answer than any competing legal theory. For example, it better explains law than Oliver W. Holmes' statement that law is a prediction of what judges will do. First, Holmes' statement is not a legal theory. Second, it does not apply to a non-common law system where judges do what legislatures instruct them to do. Finally, even in a semi-common law system such as the United States, it does not explain legislative law-making and underestimates the importance of statutory law.

The fact that law derives from developments in the marketplace is obvious. Recent changes in the U.S. Uniform Commercial Code illustrate this point. When leases, for tax and other finance reasons, began to overtake sales in terms of their popularity, the drafters of the Code wrote a new Article 2A to deal with the novel aspects of the lease transaction. Additionally, when people began to make payments by a series of electronic transfers, the drafters of the Code promulgated Article 4A to cover this new payment device. Furthermore, Congress is reconsider-

125. See John Maynard Keynes, The General Theory of Employment, Interest and Money (1936) (analyzing the "underemployment equilibrium" as setting the theoretical basis of government intervention in the marketplace); see also Robert Lekachman, The Age of Keynes (1966).

126. A vital link exists between free market economic policies and democratic rights. See Robert L. Heilbroner & James K. Galbraith, The Economic Problem 24 (9th ed. 1991). An example of a society having a planned economy along with the political freedoms of liberalism does not exist. Id. According to Marx and Engels, after the proletarian revolution and the destruction of the bourgeoisie, a period of transition to a communist regime would follow. Communism was to inaugurate a new era that would enable the freedom and equality of the individual to be fully realized. Such was the promise of the October Revolution and those that followed in China, Cuba, and Nicaragua. These revolutions, however, did not result in a society in which the individual could flourish, particularly in the arts, letters, and sciences. The question remains whether a society with a planned economy, which implies extensive regulation of society, is theoretically and practically incompatible with liberal political liberties.


129. Id. sec. 4A-101 et seq.
ing the Glass-Steagall Act,\textsuperscript{130} which separates commercial from investment banking, because of the view that U.S. institutions may be more competitive if allowed to combine banking and securities businesses. Additionally, areas of law such as antitrust, property, contracts, and torts have a firm basis in economics. Potential economic effects also shape other areas of the law that do not deal directly with economic objectives, such as environmental law and family law. Environmental laws reflect a balance between costs and benefits; family law sets rules for property division and payment allocation.

In the international area, particularly in the domain of statutory law, the market shapes a substantial number of legal rules. The EU directives setting uniform standards for business exemplify this relationship between law and economics. The fact that the EU's political unity developed from an earlier economic association is some evidence of economic relationships shaping non-economic legal rules. Another example is the level of similarities in business laws of most countries. Securities laws cover similar subject matter and address similar market place problems. They generally regulate public sales of securities, take a laissez-faire approach to the private market in securities, define and punish fraud, and establish special regulatory schemes for investment funds. Despite technical differences among the securities statutes based on local conditions of different countries, the strong degree of similarity demonstrates that the workings of the capital markets generally determine the form of the legal rule.

Finally, derivative theory fits with the historical variation that has marked the development of legal systems. Law does not have any object that is properly its own; it is defined by reference to social behavior, political procedures, and economic transactions. The derivative theory asserts that most law derives from the set of concrete relations pertaining to the way human beings satisfy their economic needs. If this is not so, then law must derive from

something that is abstract, like a notion of justice, or a non-economic set of concrete relations. If law derives from a non-economic set of relations, what are they? The argument that the majority of law in an industrialized country represents pure political choices is implausible, because these choices are partially the product of specific historical circumstances involving economic development and the pursuit of wealth. If law derives from justice, then legal theory is reduced to metaphysics, a field of inquiry that is not subject to testing, and, thus, falls outside the range of rational thought based on empirical proof. Under the metaphysical view, differences of opinion turn on preference rather than knowledge. While psychological and political reasons for turning to metaphysics may exist, attempting to introduce a "reality check" into the field of legal theory is intellectually more satisfying.

For Estonia, the overriding economic concern was to create a free market economy which required a total upheaval of the pre-existing system. Consequently, the dependent relationship between law and economic policy is fairly clear. This, in no way, however, diminishes the relevance of the derivative theory for legal systems generally. It only means that, in societies where a free market or command economy already exists, the precise economic goals are more difficult to ascertain because they represent complex judgement and trade-offs among various factors.

VIII. CONCLUSION

The idea that law derives from economic relationships is an old one that people have tended to avoid because it is too simplistic. Looking at law in this way, instead of resorting to philosophical texts, provides a method of understanding the origins and direction of a country's legal system. The legal system's derivative nature explains the evolution of legal rules in different societies at different periods of development, whereas, other theories that focus on legal rules outside economic structure miss the forest for the trees. Because any theory is only as good as its power to explain something, until someone comes up with a better explanation of legal rules in a modern society, derivative theory should be recognized for what it is—a conditionally true theory of law. The legal developments that occurred in the Soviet Union and later in the independent states provide compelling empirical evidence in support of derivative theory. The pattern of law's
repeated dependence on economic structure demonstrates the derivative relationship. This Article makes an empirical contribution in support of law as economic policy. Just as Richard Dawkins must continue to argue Darwin's theory of natural selection against false alternative models, derivative theorists apparently must continue to advance the argument of law as economic policy with equal urgency because a large number of legal theories do not start from this premise.