

The Russian Dilemma: Achieving Stable Federalism and Preserving the Market Economy

“It is not by consolidation, or concentration of powers,
but by their distribution, that good government is effected.”¹

During the last century, the Russian Federation has experienced a dramatic change in its political structure and its economy. The era was bookmarked by revolutionary periods; the Russian Revolution in 1917, ending the rule under the Romanov czars, and the quiet revolution in the late 1980s and early 1990s, resulting in the dissolution of the Union of Soviet Socialist Republics (USSR) and the emergence of the Russian Federation. Following the dissolution, economic reform from the communism to capitalism was a central goal for Russian leaders to establish a presence in the global market. The leaders aimed “to protect national economic interests... [and] serve the cause of the overall development and modernization of the country.”² One step in development and modernization is to increase private domestic and foreign investment in existing and new industries. To attract investors, a stable, predictable and transparent business environment is essential. Sustainable federalism is critical for achieving this type of environment.

Since the election of Vladimir Putin in 2000, efforts to stabilize distribution of power between the central and regional powers have trended towards increased centralization of state power. This trend led Russian observers to lament that Russia is leaving the West.³ At the same

¹ JEFFREY KAHN, FEDERALISM, DEMOCRATIZATION, AND THE RULE OF LAW IN RUSSIA 238 (2002) at 18.

² FIONA HILL, THE FOREIGN POLICY CENTRE, ENERGY EMPIRE: OIL, GAS AND RUSSIA’S REVIVAL, THE FOREIGN POLICY CENTRE 20 (2004).

³ Garry Kasparov, *What’s Bad for Putin is Best for Russians*, THE NEW YORK TIMES, July 10, 2006 at A17; Peter Finn, *Russia’s Signal to Stations is Clear: Cut U.S. Radio*, THE WASHINGTON POST, July 7, 2006 at A01; Peter Baker, *U.S. Warns Russia to Act More Like a Democracy*, THE WASHINGTON POST, May 5, 2006 at A01; Peter Finn, *Putin Links Espionage to NGO Funding*, THE WASHINGTON POST, January 26, 2006 at A16; Michael McFaul, *Russia and the West: A Dangerous Drift*, CURRENT HISTORY 307 (October 2005).

time, the economy has enjoyed a period of dramatic economic growth, driven primarily by profits in the energy sector – the oil and natural gas industries – which currently comprises 25% of the state’s gross domestic product (GDP).⁴ This apparent success in economic reform⁵ has arguably solidified Putin’s control, but this centralization has undermined the predictability, stability, transparency and efficiency needed for greater market growth. Does the increased centralization evidence a failure of the federal system or an attempt to reach a point of equilibrium within the system? What role does the quality of the Russian federal system have in providing a healthy business environment for investment outside of the energy industry?

This paper examines the Russian federal system and its ability to provide a predictable, stable, transparent and efficient environment for economic growth and investment. The first part outlines the history of federalism in Russia, specifically federalism in the USSR to the present. The second part discusses Russia’s economic reforms and the status of the economy. The third part discusses the form and substance of federalism, and identifies features and concepts for assessing whether a federal system supports market reform. The fourth part analyzes the form and substance of Russia’s federal system to assess its ability to support sustained and diversified economic growth. While Russia’s system has the form of federalism, it lacks essential substantive concepts for ensuring predictability, stability, transparency and efficiency necessary for a market economy and foreign investment.

⁴ Clifford G. Gaddy and Barry W. Ickes, *Resource Rents and the Russian Economy*, 46 *Eurasian Geography and Economics* 559, 562 (2005).

⁵ Fiona Hill and other economists argue that the growth in the energy sector has distorted the quality of the economic growth, creating a situation which is heavily dependent on continued high oil and natural gas prices.

The Form and Substance of Federalism in the Russian Federation

Federalism in its basic form is the distribution of state power between levels of government. Historically, the Russian state has been autocratic, first under the Romanov czars, followed by the centralized regime of the Communists. Despite this strong centralization, Russian leaders – czars or Bolsheviks – turned to federalism to decrease ethnic tensions and to manage their sprawling empire effectively. Disbursing power to regional groups began under the czars, but was too late to remedy growing dissatisfaction. The Bolsheviks subsequently turned to a federal structure and this basic structure has carried through to present Russian federalism.

*Federalism in the U.S.S.R.*⁶

Ethnic nationalism contributed to the instability that preceded the Russian revolutions in 1917. After securing control of the state through the Civil War, Vladimir Lenin and Bolshevik leaders faced the challenge of containing that nationalism to retain and expand the territory of the USSR. During this time of political uncertainty, national groups – the Ukrainians, Georgians, Cossacks, Chechens and others – sought to establish autonomous regions from a federal government.⁷ In 1913, Lenin had written, “Marxists will never, under any circumstances, advocate either the federal principle or decentralization. The great centralized state is a tremendous historical step forward...and only *via* such a state...can there be any road to socialism.”⁸ The goal of Marxism was to establish a centralized state where citizens’ identity was defined by their class, rather than their ethnic or national proclivities. However, the ability for

⁶ The information in this section has been compiled from various sources. G. Alan Tarr, *Creating Federalism in Russia*, 40 S. TEX. L. REV. 689, 693-694 (1999); Irina Busygina-Traenert, *The Decay of the Pseudo-Federal Structures in the Former Soviet Union and the Formation of the Russian Federation*, 1995 ST. LOUIS-WARSAW TRANSATLANTIC L.J. 173, 174 (1995); Viktor Knapp, *Socialist Federation: A Legal Means to the Solution of the Nationality Problem: A Comparative Study*, 82 MICH. L. REV. 1213, 1218-1219 (1984); Vernon V. Aspaturian, *The Theory and Practice of Soviet Federalism*, 12 THE JOURNAL OF POLITICS 20, 34 (1950); Paul P. Gronski, *The Soviet System of Federalism*, 23 THE AMERICAN POLITICAL SCIENCE REVIEW 159, 160 (1929).

⁷ S.V. Tiutiukin, *Where Were the Socialists Leading Russia in the Early Twentieth Century*, 42 RUSSIAN STUDIES IN HISTORY 38, 41 (2004).

⁸ KAHN, *supra* note 1 at 70.

federalism to appear to give autonomy to concentrated minority groups caused the Bolshevik leaders to retreat from Marxist orthodoxy and embrace a federal form of governance.⁹ Their attitude evolved from “the denial of federation in principle (*in principle, but not absolutely*), to its acceptance as the most suitable form of organization for a multinational state” as a transitional step towards a centralized, socialist government.¹⁰ A federal system was viewed as “a necessary and effective means of reconstituting shattered state authority and cementing political loyalty in the ethnic borderlands and expecting it to be a temporary, transitional arrangement.”¹¹ Ultimately, the Bolsheviks believed that nationalism would give way to unity based on class, the ideal type of socialist system.

Josef Stalin formalized the federal structure in the 1936 Constitution of the USSR, creating a centralized state with a federal form.¹² The system was defined as “ethnofederalism,” because the primary means of distributing power and drawing boundaries was the ethnic minority that lived in the area. “To keep minorities content within the Soviet Union, Russia gave some areas...special designations and increased autonomy in the day-to-day operations of their ‘homeland.’”¹³ Areas drawn based on territorial considerations or administrative convenience typically had a smaller share of power and less autonomy.¹⁴ The resulting ethnic regions largely mirrored the boundaries drawn by the czars.¹⁵ “Two distinctive aspects of Soviet ‘federalism’ appeared early: fusion of party and state institutions and the manipulation of ethnic groups to

⁹ Tarr, *supra* note 6 at 693; Aspaturian, *supra* note 6 at 20.

¹⁰ Aspaturian, *supra* note 6 at 25; VIKTOR SHEVTSOV, THE STATE AND NATIONS IN THE USSR 36 (1982).

¹¹ Rogers Brubaker, *Nationhood and the National Question in the Soviet Union and Post-Soviet Eurasia: An Institutional Account*, 23 THEORY AND SOCIETY, 47, 53-54 (1994).

¹² Nikolai Petrov, *Federalism*, in BETWEEN DICTATORSHIP AND DEMOCRACY: RUSSIAN POST-COMMUNIST POLITICAL REFORM 214 (Michael McFaul, Nikolai Petrov and Andrei Ryabov, eds. 2004).

¹³ Todd Alan Frommeyer, *Power-Sharing Treaties in Russia’s Federal System*, 21 LOY. L.A. INT’L & COMP. L.J. 1, 5 (1999).

¹⁴ Petrov, *supra* note 12 at 214.

¹⁵ *Id.*

establish central control over distant regions.”¹⁶ It was through this fusion that state power – the substance of a federal system - remained centralized, while the form of a federal system created a façade of autonomy and distributed power.

Three types of sub-national units were created: republics, territorial units and administrative units.¹⁷ The units with the greatest autonomy from the center were republics. Republics reflected the significant ethnic or national groups that lived in the area; groups that often were not the majority of the population. There were two classes of republics: union republics and autonomous republics. Both units had separate constitutions, representative bodies and executive ministries, complementing the federal structures, however, union republics had greater degree of autonomy from the center.¹⁸ Union republics were guaranteed the rights of self-determination and secession in the Constitution and were administrators of autonomous republics or other units within their territory.¹⁹²⁰ Stalin outlined that status as a union republic would be granted based on three criteria: “(1) the nation had to constitute a majority on its own territory; (2) the national territory had to be located at the USSR’s border or at the open sea; and (3) the territory’s population had to be of a certain minimum size.”²¹ Union republics included present day Ukraine, Russia, the Baltic States, Georgia and Uzbekistan.

Autonomous republics enjoyed legislative autonomy, which allowed them to have representative bodies and constitutions, but they did not have the right to self-determination or secession, and thus were not independent members of the Soviet Union.²² Through these units,

¹⁶ KAHN, *supra* note 1 at 72.

¹⁷ Scholars have classified the regions in various ways. These are the basic categorizations.

¹⁸ Knapp, *supra* note 6 at 1219.

¹⁹ *Id.* at 1218; Frommeyer, *supra* note 13 at 8.

²⁰ Frommeyer, *supra* note 13 at 10.

²¹ Alex Deghan, *Federalism, Regionalism and Sovereignty in Russia* 5 SETON HALL CONSTITUTION L.J. 1, 14 (1994); Ian Bremmer, *Post-Soviet nationalities theory: past, present and future*, in NEW STATES, NEW POLITICS: BUILDING THE POST-SOVIET NATIONS 8 (Ian Bremmer & Ray Taras, eds., 1997).

²² Knapp, *supra* note 6 at 1219. Frommeyer, *supra* note 13 at 9-10.

the crafters of the federal system were able to provide territory to ethnic groups they deemed significant, while retaining control over their governance. A majority of the autonomous republics were located within the union republic that later became Russia, because it contained more ethnic minorities than the other Union republics.²³ Some republics would change names as national groups were displaced or relocated due to conflict, or became disfavored by the center. Examples of autonomous republics included present day Tatarstan and Chechnya.

Other federal units had no autonomy from the central government, but were created for greater administrative efficiency or to nominally recognize a national group. They were labeled krais, oblasts and okrugs, with krais having a defined territory. These federal units were located within republics and were accountable to both the republican and central governments.

The Dissolution of the USSR

The Bolsheviks intended the federal system of the USSR to appease nationalist tensions within this large, multi-ethnic state as it transitioned into a class-based system. However, the ethnofederal system reinforced nationalism and, when coupled with Mikhail Gorbachev's reforms, contributed to the dissolution of the system. "Gorbachev's reforms created contradictions for the old thinking on nationalities issues: modernization and equalization of living conditions required direction by the omniscient centre, while at the same time Gorbachev's economic program stirred increasingly raucous demands in the regions for more economic decentralization and less central control."²⁴ The union republics called for autonomous sovereignty from the USSR, led by Boris Yeltsin, President of what would become the Russian Federation.

²³ Tiutiukin, *supra* note 7 at 41; Dehgan, *supra* note 21 at 15.

²⁴ KAHN, *supra* note 1 at 85.

As the union republics gained independence from the USSR, the autonomous republics also sought recognition as sovereign states, causing the Parade of Sovereignties.²⁵ With most of the autonomous republics located within Russia, Yeltsin faced the challenge of maintaining control over these regions, while breaking from the USSR.²⁶ The dissolution of power in the USSR was mirrored in the Russian Federation through decentralization to strong regional leaders who can control over important resources.²⁷ Regions withheld access to or profit from resources - oil and gas, industries, and taxes – as leverage for gaining greater autonomy from the central government. Yeltsin benefited from this decentralization, because it undermined the power of the Communist Party, but he also struggled to keep it from breaking up the Russian Federation.²⁸

Federalism in the Russian Federation

The relationship between the central and the regional governments in the Russian Federation continued to deteriorate. Yeltsin used two mechanisms to reaffirm the form of the federal system passed down from the USSR, while reforming its substance through granting actual autonomy to the regions. One mechanism was the Russian Constitution of 1993. In this Constitution, the federal boundaries of the USSR were retained, but the demands of the regions for “sovereignty to replace subordination; supremacy of local laws over federal laws; autonomy to control economic decision-making and natural resources; respect for local languages and

²⁵ Organization for Economic Co-operation and Development (OECD), *The Regional Dimension: Investment Policies at Sub-Federal Level*, in ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, THE INVESTMENT ENVIRONMENT IN THE RUSSIAN FEDERATION 105 (2001).

²⁶ Frommeyer, *supra* note 13 at 12

²⁷ Deghan, *supra* note 21 at 21.

²⁸ *Id.* at 20, 22.

cultures” were added.²⁹ The Constitution was ratified via referendum in the regions and approved by all but two regions – Tatarstan and Chechnya.³⁰

To secure regional approval of the Constitution or acquiescence after its ratification, Yeltsin entered into bi-lateral treaties with individual regions, first with Tatarstan in 1994. The failure of the Constitution to establish clearly defined rights and responsibilities between the federation and the regions has resulted in constant bargaining and the conclusion of bilateral treaties between different regions and the center which has added to the disparity among regions to get the best concessions from the center.³¹

By 1998, 46 of the 89 regional entities had signed bi-lateral treaties.³² Regions that entered into treaties had strong economic interest and/or significant political interests. “Richer regions have on the whole received treaties earlier, and with greater privileges, than poorer regions... The treaty process favoured republics whose executives had visible control over their republics but who were also astute enough to articulate demands that left room for negotiation and compromise.”³³

The substance of the treaties was identical to a great extent, covering areas such as delimitation of powers to the regions, the supremacy of federal law over regional law, the ability of federal law to supersede the treaties, the region’s right to “international and foreign economic ties,” the region’s ability to counter a federal act they see is unconstitutional, dispute resolution, with some including provisions regarding regional property control or taxation.³⁴ Per these bilateral treaties and the Russian Constitution, areas of federal jurisdiction included formulating

²⁹ KAHN, *supra* note 1 at 119

³⁰ Frommeyer, *supra* note 13 at 11

³¹ Jeffrey D Sacks and Katharina Pistor, *Introduction* in *THE RULE OF LAW AND ECONOMIC REFORM IN RUSSIA* 7 (Jeffrey D Sacks and Katharina Pistor, eds. 1997); see also Frommeyer, *supra* note 13 at 16.

³² Frommeyer, *supra* note 13 at 14.

³³ KAHN, *supra* note 1 at 161.

³⁴ Frommeyer, *supra* note 13 at 22.

national economic and environmental policies, providing national defense system, “establishment of the framework for a single market,” trade relations, regulation of intellectual property and the federal judiciary.³⁵ Regional jurisdiction mirrored many of the federal responsibilities on a local scale, with some treaties including language awarding unallocated jurisdiction to the regions.³⁶ The parties supplemented this generic treaty form in light of unique circumstances between them through an additional agreement. These agreements typically covered four areas: “economy/finances of the subjects;” “the control, use and division of natural resources in the region between federal and regional governments;” “present and future environmental problems of the region;” and “the social welfare of the citizens/residents of the region.”³⁷ For example, the treaty with Tartarstan, which has significant oil reserves, outlined how oil revenues would be allocated in an additional agreement.

Federalism under Yeltsin saw a shift from the strong centralized system of the USSR to a greatly decentralized, asymmetric system embodied in the 1993 Constitution and the bi-lateral treaties. This was necessary in order for the central government to retain control over regions that had significant resources.³⁸ “[T]he trend in federalism is to accept asymmetry in the government structure in order to further the integration of regional units into the Federation.”³⁹ The decentralization was also evident in the composition of the Russian legislature, where the regions gained significant control over the federal legislative processes through the upper house, the Federation Council.

The relationship between the center and the regions was volatile and became more unstable following the financial crisis in 1998. The people turned to local and regional

³⁵ *Id.* at 24.

³⁶ *Id.* at 26.

³⁷ *Id.* at 29.

³⁸ Petrov, *supra* note 12 at 221.

³⁹ Frommeyer, *supra* note 13 at 41.

government leaders for necessities, because the central government was unable to provide subsidies or pay its employees. This growing dissatisfaction toward the center allowed the regions to gain even more autonomy.⁴⁰ One illustration of the growing separation between the regions and the central government is a comparison of regional and national laws in 1999. It showed that 25-35 percent of the republics' laws were in contradiction to federal laws.⁴¹

The election of Vladimir Putin in 2000 brought a new focus on strengthening state power under the central government to stabilize Russia and to regain its status as a world power.⁴² Putin sought to undermine the independence of the republican leaders. "Regional governors' abilities to lobby their interests in Moscow were ... reduced by the reform and essential emasculation of the upper house of the Russian parliament, their locus of power at the centre."⁴³ He intimidated regional governors through anti-corruption campaigns and he divided the regions into seven federal districts headed by appointed representatives to oversee the regional governments.⁴⁴ He declared regional laws that were in conflict with federal law to be invalid; the new tax code directed a greater percentage of tax revenue to the central government.⁴⁵ Unlike Yeltsin who had to seek the support of regional elites to secure election, Putin did not have to rely on regional support, enabling him to continue to limit regional power.⁴⁶ In 2002, thirty regions renounced their bi-lateral treaties "under strong pressure from federal authorities."⁴⁷ Most recently, Putin

⁴⁰ Petrov, *supra* note 12 at 228.

⁴¹ Jeremy Regal, *Russia in the WTO: How Russia's Institutional Idiosyncrasies May Impede Its Ability to Abide by the WTO's Governing Cornerstones*, 9 UCLA J. INT'L L. & FOREIGN AFF. 97, 123 (2004).

⁴² HILL, *supra* note 2 at 15.

⁴³ HILL, *supra* note 2 at 16.

⁴⁴ KAHN, *supra* note 1 at 239; Petrov, *supra* note 12 at 223 and 229; HILL, *supra* note 2 at 16; Robert Ortung, *Key Issues in the Evolution of the Federal Okrugs and Center-Region Relations under Putin* in THE DYNAMICS OF RUSSIAN POLITICS: PUTIN'S REFORM OF FEDERAL-REGIONAL RELATIONS 15 (Peter Reddaway and Robert W. Ortung, eds. 2004).

⁴⁵ Petrov, *supra* note 12 at 230.

⁴⁶ *Id.* at 217-218.

⁴⁷ *Id.* at 222.

gained the authority to appoint and remove regional governors, and to dissolve regional parliaments.⁴⁸

Economic Reform in the Russian Federation

Simultaneous to Russia's political reforms, the country experienced dramatic economic reforms as it transitioned from state controlled system to a free market system. The economic reforms contributed significantly to changing of the federal relationship between the center and the regions. One Russian Minister stated, "We tie politics with economics."⁴⁹ The economic transition can be summarized in three trends. First, there was a rapid privatization of industries and decentralization of market controls from approximately 1991 through 1998. In 1991, Yeltsin sought economic autonomy from the USSR, as well as political autonomy due to growing dissatisfaction with the state-controlled economy.⁵⁰ He wanted to privatize state-owned industries, liberalize trade, and stabilize the financial system.⁵¹

These reforms contributed to the unstable and unbalanced political environment. The program of rapid privatization benefited members of the Communist Party elite, leaders of the secret police and those who had been "managing" the corporations for the state.⁵² Within the oil industry, control was gained by individuals who "had no prior experience in the Soviet oil industry, but instead had access to financial capital from private banks, which they owned and controlled, and close political connections to the Russian government."⁵³ The process of privatization "lacked even minimum standards of transparency and accountability" and control

⁴⁸ ANDERS ASLUND, CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE, POLICY BRIEF NO. 41: PUTIN'S DECLINE AND AMERICA'S RESPONSE 4 (August 2005).

⁴⁹ HILL, *supra* note 2 at 7.

⁵⁰ Sacks, *supra* note 31 at 7.

⁵¹ *Id.* at 8-10.

⁵² *Id.* at 10; Dmitri Trenin, *Reading Russia*, 42 CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE POLICY BRIEF 2 (October 2005).

⁵³ HILL, *supra* note 2 at 11

of the revenue-producing energy sector “was later returned largely to the center.”⁵⁴ Yeltsin pursued trade liberalization through eliminating quotas, except those in highly sensitive areas, such as oil and gas. “These quotas had the effect of reducing the internal price of oil on Russia’s markets relative to world prices....Multi-millionaires could be, and were, created overnight by the distribution of quota rights to favored individuals and enterprises.”⁵⁵ Corporate owners rarely reinvested profits into the oil and gas industry for infrastructure maintenance and development, but hoarded it in foreign banks, creating a class of oligarchs.

The second trend in Russia’s economic transition was the collapse of the financial system in 1998, which further weakened the center’s power in proportion to the regions, because it was unable to pay salaries and provide social services.⁵⁶ One reason for this drop in state resources was decline in demand for oil. “Demand for oil declined by more than 40 per cent between 1990-1995, owing to the contraction of energy-intensive manufacturing industry and the huge military-related Soviet-era oil outlays.”⁵⁷ The industry also suffered from poorly maintained pipelines and the lack of investment in drilling and researching new fields. To restore stability to the economy and the financial sector, the state underwent price adjustments and import substitution, and boosted domestic production.⁵⁸ The people turned to regional governors to remedy the crisis through emergency measures. “These were largely unconstitutional measures such as price controls and customs duties imposed at regional level as well as the withholding of taxes due to the federal centre.”⁵⁹ This was the apex of the republics’ autonomy from the central government.

⁵⁴ *Id.* at 10.

⁵⁵ Sacks, *supra* note 31 at 9.

⁵⁶ Petrov, *supra* note 12 at 228.

⁵⁷ HILL, *supra* note 2 at 11.

⁵⁸ *Id.* at 11-13.

⁵⁹ OECD, *supra* note 23 at 106.

The third and current phase in Russia's economic transition is the explosive growth of the economy, largely due to the increase in oil prices. The energy sector makes up 25 percent of the Russian gross domestic product due to the increase in oil and gas prices.⁶⁰ The phenomenal profit has provided the central government with funds to pay off international debts and to pay government employees; it has helped to stabilize the ruble; and the real incomes of the Russians have grown six percent and their wages 20 percent.⁶¹ This has led to a growth in consumerism in Russia. "Russia is now ranked as the number one developing market for international retailers after its consumer market grew by almost one third between 1999-2003 to \$280 billion."⁶² Fiona Hill relates that through growing consumerism, the *lingua franca* of the Russian language as the business language in the region, and growing cultural industries have "made Russia a more attractive state for regional populations than it was in the 1990s."⁶³

A third sign of the growing economy is an increase in domestic and foreign direct investment.⁶⁴ In December 2005, Putin lifted the restriction on foreign investment in Gazprom, the state-controlled gas company, abolishing the 20 percent cap, but keeping in place the requirement of 51 percent state ownership.⁶⁵ Along with access to these state owned industries, investors have also found attractive opportunities in the regions. In some regions, corporate owners have become political leaders.⁶⁶ However, such arrangements are not the rule. Owners prefer political neutrality in struggles between the regional governors and the federal government. The new owners of the factories no longer provide social services like day care and

⁶⁰ Gaddy, *supra* note 4 at 562.

⁶¹ HILL, *supra* note 2 at 15-16; ASLUND, *supra* note 48 at 5.

⁶² HILL, *supra* note 2 at 25.

⁶³ *Id.* at 3.

⁶⁴ *Id.* at 4.

⁶⁵ Holly Nielson, *Gazprom Opens for Foreign Investment*, 2 RUSSIA/EURASIA COMMITTEE NEWSLETTER 3 (March 2006).

⁶⁶ Orttung, *supra* note 44 at 40.

health care, causing the republic government to foot the bill.⁶⁷ One observer noted, “Russian economic expansion will continue, but it will be driven by companies (some of them government-owned) pursuing concrete interests and so will not be territorial.”⁶⁸

The Effect of the Economy on the Federal System

The economic growth has improved the predictability, stability, and transparency, as evidenced by growing foreign direct investment and in the accession of Russia into the World Trade Organization (WTO). Membership in this organization marks the establishment of a legitimate and transparent market economy and, while observers have argued over whether Russia has achieved this, its accession process continues to move forward.⁶⁹ With the profits from the oil and gas industry, the central government has been able to regain legitimacy and reassert control over the regions. This centralization has enabled the center to pass legislation creating a more uniform investment environment. “Putin’s autocratic ways, however bad for democracy, have nonetheless created an atmosphere of stability for investors, both domestic and foreign.”⁷⁰

Some observers argue that the center should continue its efforts to create a predictable business environment.⁷¹ Nikolai Petrov argued that a stronger central government would check growing regional government authority, allowing local governments to obtain a greater measure of authority. “[T]he preservation and development of a unified political space will facilitate the separation of economic activities from politics: the segregation of political and economic power

⁶⁷ *Id.* at 39.

⁶⁸ Trenin, *supra* note 52 at 6.

⁶⁹ Regal, *supra* note 41 at 136.

⁷⁰ Michael McFaul, Nikolai Petrov and Andrei Ryabov, *Conclusion* to MICHAEL MCFAUL, NIKOLAI PETROV AND ANDREI RYABOV, BETWEEN DICTATORSHIP AND DEMOCRACY: RUSSIAN POST-COMMUNIST POLITICAL REFORM 309 (2004).

⁷¹ Petrov, *supra* note 12 at 233-234; see also Sacks, *supra* note 31.

will turn governors from feudal lords into top corporate managers.”⁷² Jeremy Regal argued that Russia still lacks the “unitary legal space” necessary for ensuring that the WTO protections are adhered to; the center has yet to take back the authority given to the regions to conduct international trade, regulate and set up protectionist trade barriers.⁷³ “The central government simply does not possess the capacity to ensure that regions abide by the creation of a unified economic space and sole sovereign on the international stage” and that the WTO should not be expected to, nor will it, serve to remedy this imbalance in the federal system.⁷⁴ Despite the improved investment environment, “arbitrary regulations, rampant corruption and legal irregularities raise concerns about the reliability of Russian markets... Squeezing out Western companies from choice Russian energy developments and other investments only exacerbates investors’ fears.”⁷⁵

Others argue that the growing centralization will thwart the transition to a free market economy resulting in less predictability, stability, and transparency, particularly in the energy sector.⁷⁶ They admit that “the state badly needs to become more cohesive and business urgently requires a level national playing field,” yet the intention appears to be to undermine political rivals rather than strengthening the economy.⁷⁷ “[I]t stands to reason that strengthened rule of law and greater accountability and transparency would foster increased investment and growth.”⁷⁸ For example, in 2002, the Organization for Economic Cooperation and Development

⁷² Petrov, *supra* note 7 at 235.

⁷³ Regal, *supra* note 31 at 122-125.

⁷⁴ *Id.* at 127-128.

⁷⁵ Ariel Cohen, The Heritage Foundation, *President Bush’s Agenda for the G-8 Meeting in St. Petersburg*, 1948 BACKGROUNDERS 1, 4 (June 2006).

⁷⁶ KAHN, *supra* note 1; HILL, *supra* note 2 at 49; See also Trenin, *supra* note 52.

⁷⁷ Orttung, *supra* note 44 at 16.

⁷⁸ McFaul, *supra* note 70 at 309.

(OECD) acknowledged that greater centralization of funds was needed; yet it voiced concerns that the regions were not allocated enough funds to cover their given responsibilities.⁷⁹

Structuring a Federal System that Preserves Market Reform

Assessing the quality of a federal system requires the scholar to identify essential characteristics of a federal system. The definition of “federalism” in Merriam-Webster’s Online Dictionary provides a very foundation; federalism is “the distribution of power in an organization (as a government) between a central authority and the constituent units.”⁸⁰ State builders offer three reasons for preferring a federal distribution of power: to prevent tyranny, to preserve diversity and to secure needed benefits at the lowest cost. Beyond the foundational requirement of divided power, the structure of a federal system is a product of the unique history and traditions of the state. However, scholars have identified characteristics common to stable and adaptable federalism. A stable federal system is necessary for a healthy market economy, because it provides predictability, legitimacy, transparency, fairness and efficiency. Thus, this section will begin by discussing the principles underlying a federal system. Next, common characteristics of a generic federal system will be identified. The section closes with a discussion of “market preserving federalism” and its relevant characteristics.

Why Do States Choose a Federal System?

The last half-century has witnessed an explosion of new states due to decolonization of former empires and the dissolution of the U.S.S.R. One of the first questions addressed, whether

⁷⁹ Orttung, *supra* note 44 at 31.

⁸⁰ “Federalism,” available at <http://www.webster.com/cgi-bin/dictionary?va=federalism>, accessed on July 30, 2006.

expressly or implicitly, was whether the state should be federal or unitary.⁸¹ The history of the state, particularly experience under colonization, uniquely influences the structure of the system, but the system also reflects a desire to prevent tyranny, to preserve diversity and to provide affordable national goods. These considerations also influence the distribution of power between the regions and the center, discussed below.

Scholars assert that federal systems restrain the central government from evolving into an autocracy or tyranny. By distributing government powers vertically between regions and the center and horizontally between the executive, legislative, and judicial branches, consolidation of power under the executive or the central government would be difficult. This principle of checks and balances is manifested in the United States Constitution and reflected the founders' distaste for the English monarchy from which they declared independence.⁸² Particularly in the context of preserving a market economy, scholars have noted:

[A] government strong enough to protect property rights is also strong enough to confiscate the wealth of its citizens. Thriving markets require not only the appropriate property rights system, an unfettered price mechanism, and a law of contracts, but a secure political foundation that limits the ability [of] the state to confiscate wealth by altering those rights and systems.⁸³

Thus, dividing power between central and regional government prevents the power from centralizing into the hands of one actor.

Following closely from this principle, a second reason for choosing a federal system is its ability to preserve the diversity between regions, particularly in large states that have significant geographical, territorial and cultural differences.⁸⁴ For example, in Russia the regions were given

⁸¹ For purpose of this paper, "federal" broadly includes confederated systems.

⁸² KAHN, *supra* note 1 at 18.

⁸³ Jonathan Rodden and Susan Rose-Ackerman, *Does Federalism Preserve Markets?*, 83 VA. L. REV. 1521, 1522 (1997) (citing Barry R. Weingast, *Constitutions as Governance Structures: The Political Foundations of Secure Markets*, 149 J. INSTITUTIONAL & THEORETICAL ECON. 286, 287 (1993)).

⁸⁴ Paul Chen, *Federalism and Rights: A Neglected Relationship*, 40 S. TEX. L. REV. 845, 852 (Summer 1999).

jurisdiction over education and language policies, allowing ethnic groups, which were sufficiently compact within a region, to teach their cultural histories and languages. When faced with common problems, decentralization allows regions to experiment with different policies to address those problems. A balanced federal system provides sufficient decentralization to preserve diversity, but also has a central government that can also protect individuals from discrimination by regional authorities.

Finally, a federal system may be preferred in light of economic considerations. Federalism allows regions to take advantage of economies of scale, spreading out the costs of expensive government functions such as maintaining a military, collecting taxes and providing a common market.⁸⁵ Riker described this cost/benefit analysis as two key circumstances: (1) a political leader's need to compromise in order to expand the territory (thus, access to resources) and (2) the presence of a severe external (typically military) threat that pushes a region or state to relinquish a degree of their independence.⁸⁶ The central government would also be in a better position to offset costs from behaviors that affect neighboring regions, such as pollution. "If the costs and benefits of an action, whether public or private, stray across jurisdictional lines, then the highest level of government that can fully internalize the costs and benefits of the action ought to take responsibility."⁸⁷ Thus, a cost/benefit analysis may lead regions to choose to a federal system or to opt out of one if they feel they can provide these services on their own.

⁸⁵ Thomas S. Ulen, *Economic and Public-Choice Forces in Federalism*, 6 GEO. MASON L. REV. 921, 929 (Summer 1998).

⁸⁶ WILLIAM H. RIKER, *FEDERALISM: ORIGIN, OPERATION, SIGNIFICANCE* 12 (1964).

⁸⁷ Ulen, *supra* note 85 at 928.

How is Power Distributed in a Federal System?

The distribution of power between the regions and the center is influenced by the same considerations that drive the choice of a federal system. How it is distributed reflects the need to restrain central and regional governments, to preserve regional diversity, and to take advantage of economies of scale. Jeffery Kahn describes it as a distribution of sovereignty “within the state on several, inter-connected levels of governmental authority.”⁸⁸ Central or regional institutions are allotted control or sovereignty over an area of policy or a resource, often with overlapping or undefined areas of jurisdiction.⁸⁹ These areas of jurisdiction – education, health care, national defense, welfare – need to be sufficiently defined and structured to provide predictability and consistency, but they also need to have a degree of fluidity to adapt to changing circumstances. Regulation of labor in the United States is an example of this adaptability. In the early twentieth century, the regulation of labor practices, such as child labor or limiting working hours, was deemed to be within the purview of the states. However, as disfavor grew towards these practices, the authority to regulate shifted to Congress.

What are the Characteristics of a Federal System?

Federal systems share several common features, despite the different histories and traditions of the state, or how state power is distributed. These characteristics provide a good basis for assessing the sustainability of a federal system. The foundational scholar, William H. Riker, identified three characteristics:

A constitution is federal if (1) two levels of government rule the same land and people, (2) each level has at least one area of action in which it is autonomous, and (3) there is

⁸⁸ KAHN, *supra* note 1 at 27.

⁸⁹ Chen, *supra* note 84 at 851.

some guarantee (even though merely a statement in the constitution) of the autonomy of each government in its own sphere.⁹⁰

Jeffery Kahn compared Riker's definition of federalism to definitions by three other prominent political scientists and distilled these characteristics: "(1) divided government, (2) a written constitution, and (3) explicitly formulated exclusive and concurrent areas of jurisdiction."⁹¹

Underlying these features is a desire in the polity for a degree of unity, but also a degree of autonomy.⁹²

While the first and third characteristics have been adequately discussed above, the second requires a brief discussion. The requirement of a written constitution connotes the government's acquiescence to the rule of law, creating a "culture of legality."⁹³ This culture of legality provides legitimacy, predictability, stability, fairness and transparency in rules and regulations, qualities that are essential to preserve federalism and democracy. A federal system will not be sustainable if the center and the regions take unilateral actions that are outside their areas of jurisdiction. Such actions "must eventually give way, if the federation is to survive, to consensus over how best to establish jurisdiction over an issue, what level of government shall possess what jurisdictional authority and how best to handle the inevitable disputes that arise."⁹⁴

Kahn's model provides a good standard for assessing federalism; however, it has been criticized for utilizing a Western definition of federalism. William E. Butler argued that Kahn's use of the word "federal" does not take into consideration "the finer distinctions of the federative

⁹⁰ RIKER, *supra* note 86 at 11. In a later article, Barry Weingast defines Riker's system as having two characteristics: "(F1) a hierarchy of governments... each with a delineated scope of authority... and (F2) the autonomy of each government is institutionalized in a manner that makes federalism's restrictions self-enforcing." (Italics omitted) Barry R. Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 THE JOURNAL OF LAW, ECONOMICS & ORGANIZATION 1, 4 (1995). I have chosen to retain Riker's original division of three characteristics.

⁹¹ KAHN, *supra* note 1 at 21-22.

⁹² *Id.*

⁹³ *Id.* at 22 and 280.

⁹⁴ *Id.* at 280.

syndrome” – form versus substance - that is highlighted in the Russian language.⁹⁵ He offers a different spectrum than that and differentiates between a confederation, a federation (Russia), and a federal system (United States). The difference between his “federationism” and federalism is that the latter is “a more centralized scheme, legally, formally and actually than federationism, which is a looser relationship that invokes statehood and sovereignty to a greater degree than would be the case in a federal system.”⁹⁶ Butler’s concern about distinguishing between form and substance in defining federal systems is the central issue in the debate over whether non-democracies can have truly federal systems.

Can a Non-Democracy be a Federal System?

Riker answered this question with a resounding, “yes.” He argued the belief that federal systems should be tied to other substantive concepts of democratic governance is American myth:

This refusal [to recognize the USSR as a federal system] is, however, merely the expression of the American-Commonwealth mythology that federalism ought to prevent tyranny. Since the Soviet Union preserves all the features of federalism, the mere fact that a federalism fails to prevent tyranny should not lead to casting it of the class of federalisms. Rather it should lead to a re-evaluation of what federalism means and implies.⁹⁷

He focuses on federalism as a form of government; a state that has divided its power between different levels of government. This argument focuses on the cost/benefit analysis as a reason for creating a federal system.

⁹⁵ William E. Butler, *Federalism or Federationism* 100 MICH. L. REV. 1444, 1447 (May 2002).

⁹⁶ *Id.* at 1448 - 1449.

⁹⁷ RIKER, *supra* note 86 at 40.

Kahn disagrees with Riker's assertion that federalism can exist in an authoritarian state. He argues that the presence of a democratic government and components such as the rule of law are closely related to, but not necessary for federalism.

A non-democratic regime requires the active use of coercion well beyond Weberian requirements that establish a state...[and] rely on the ability to pre-empt or countermand choices or preferences made by citizens about their government. Such a regime is clearly incompatible with fundamental requirements of federalism... Wheare corroborates this view, noting that the presence of autocratic or dictatorial government, in general or regionally, "...seems certain, sooner or later, to destroy that equality of status and that independence which these governments must enjoy, each in its own sphere, if federal government is to exist at all."⁹⁸

In this context of examining the relationship between federalism and the market economy, substance is as important as form in evaluating a federal system. The system needs to provide predictability, consistency, transparency, stability and efficiency in the government in order to benefit economic transition to a market system. These describe the substance of the system, not merely the form. Thus, adherence to the rule of law should be included as an essential characteristic of a federal system in this assessment of the relationship between federalism and the market economy.

What is a Market-Preserving Federalism?

Market-preserving federalism (MPF) was proposed by Barry R. Weingast and Yingyi Qian as a model federal system for states seeking growth in a market economy. The model builds upon Riker's characteristics based on observations of China's transition to a market economy. Weingast proposes three additional characteristics essential to have a federalism that encourages and maintains a market economy.⁹⁹ First, "subnational governments have primary regulatory responsibility over the economy." Second, "a common market is ensured, preventing the lower

⁹⁸ KAHN, *supra* note 1 at 49 and 50 (quoting K.C. WHEARE, FEDERAL GOVERNMENT 4TH ED. 46 (1963)).

⁹⁹ Weingast, *supra* note 91 at 4-5 (Numbering excluded).

governments from using their regulatory authority to erect trade barriers against the goods and services from other political units.” Thirdly, “the lower governments face a hard budget constraint, that is, they have neither the ability to print money nor access to unlimited credit.” These criteria contribute to the analysis of federalism by providing greater specificity concerning how economic power should be distributed.

MPF highlights two ways in which a market economy can provide checks in a federal system. First, MPF provides a disincentive for regions to over-regulate, instead, competition among the regions would encourage them to offer the greatest benefits in order to secure investment. “Jurisdictions must compete for capital, labor and economic activity by offering menus of public policies...competition implies that only those restrictions that citizens are willing to pay for will survive.”¹⁰⁰¹⁰¹ Foreign investors “shop around” for these benefits to secure the lowest cost for the investment with the lowest amount of risk. Thus, competition acts as another limit on over-regulation by regional government. Second, a market economy provides a disincentive for regional governments to subsidize failing industries, and encourages a balanced, transparent regulatory system.¹⁰² Again, competition among the regions for investment would entice regions from funneling money to failing industries and instead offer greater incentives to long-term investors in order to offset the cost of the investment.

Oliver Blanchard and Andrei Shleifer comment on Weingast’s assertion that a market economy needs decentralization. “We believe that the experience in Russia indicates that another ingredient is crucial, namely political centralization. In doing so, we echo a theme first developed by Riker (1964): for federalism to function and to endure, it must come with political

¹⁰⁰ Yingyi Qian and Barry R. Weingast, *Federalism as a Commitment to Preserving Market Incentives*, 11 JOURNAL OF ECONOMIC PERSPECTIVES 83, 88 (Fall 1997).

¹⁰¹ *Id.*; See also Weingast, *supra* note 91.

¹⁰² Qian, *supra* note 100 at 88

centralization.”¹⁰³ Blanchard and Shleifer also used the transition to the market economy in China to support their conclusion. They argue that the central Chinese government retained significant authority over the economic decisions made by local governments due to their ability to appoint governors, which they use to “support the governors whose regions have performed well economically and to discipline governors who have followed anti-growth policies.”¹⁰⁴ Thus, China is not a model of a decentralized federal system necessary for preserving a market economy.

In summary, a federal system aims to prevent an autocratic government, preserve regional diversity and secure lower costs for services, like the military. Federalism has four features: a divided government, a written constitution, exclusive and concurrent areas of jurisdiction, and a polity that desires unity, but also autonomy. A federal system provides predictability, transparency, stability, and efficiency, which are essential for a market economy. In order to provide this economic environment, the form and the structure of the federal system needs to be evaluated. One key substantial concept is the rule of law, which ensures that the central and regional governments will adhere to their delegated areas of jurisdiction. A second concept is the degree of decentralization of economic authority. Based on the MPF model, greater decentralization would limit interference by the regional governments in the market in order to attract foreign investors.

Evaluating Russia’s Federal System and Its Impact on the Market Economy

¹⁰³ Oliver Blanchard and Andrei Sheifer, *Federalism With and Without Political Centralization, China versus Russia*, in ANDREI SHEIFER, *A NORMAL COUNTRY: RUSSIA AFTER COMMUNISM* 148 (Harvard University Press, eds. 2005).

¹⁰⁴ *Id.* at 152.

“Russia’s problem is one of insufficiently strong checks and balances, which could have stopped Putin from harming himself.”¹⁰⁵

A stable and sustainable federal system requires the presence of formal elements – a divided government, written constitution, and areas of exclusive and concurrent jurisdiction. The substance of the system should also manifest characteristics in keeping with the principles of federalism – respect for the rule of law, a polity that desires unity and autonomy, an absence of coercion in maintaining the federation. Federalism in Russia should pursue these characteristics in order to provide predictability, stability, transparency and efficiency for continued economic growth and democratization. “The deployment of lesser criteria as analytically circumspect and politically self-defeating for those in Russia and the West seriously committed to further democratization in Russia.”¹⁰⁶

The federal structure Russian Federation retained the form of the ethnofederal system under the USSR. The form exhibits the features of a federal system. The structure has two levels of government that rule the same territory and people, the central government located in Moscow and regional governments operated out of their respective capitals. Each has its own executive, legislative and judicial branches of government. Second, the structure is codified in a written constitution, the Russian Constitution of 1993. Thirdly, this Constitution and subsequent treaties identify areas of exclusive and concurrent jurisdiction for the central and the regional governments.

Substantively, the Russian federal system has moved from the strong centralization under the USSR, to significant decentralization during the Yeltsin presidency, and now is swinging back towards increased centralization under Putin. During these periods, the economy has

¹⁰⁵ ASLUND, *supra* note 48 at 6.

¹⁰⁶ Michael McFaul, Nikolai Petrov and Andrei Ryabov, *Introduction* to MICHAEL McFAUL, NIKOLAI PETROV AND ANDREI RYABOV, *BETWEEN DICTATORSHIP AND DEMOCRACY: RUSSIAN POST-COMMUNIST POLITICAL REFORM 5* (2004).

transitioned from complete state-control to what one observer has described as “a free wheeling rather than a free market economy, but it is definitely capitalist.”¹⁰⁷ For continued progress towards a true free market system and increased foreign direct investment, the federal system needs to provide predictability, stability, transparency and efficiency through ensuring respect for the rule of law, flexibility in the distribution of power between the center and the regions to accommodate economic changes, and decentralization of economic regulatory authority.

One significant challenge for economic reform in Russia is the unilateral centralization of power under Putin. He continues to act in a manner that disregards the sanctity of the constitution and properly enacted statutes, conflicting with the rule of law.

At its core, Putin’s strategy for strengthening the state has focused primarily on eliminating checks and balances on presidential power... Putin has effectively seized control of all national television networks, emasculated the power of the Federation Council (Russia’s upper parliamentary house), and tamed regional barons who once served as a potent balance to Yeltsin’s presidential rule.”¹⁰⁸

While one may argue that some of these actions did not violate the letter of the law, it is clear that they come in direct conflict with the democratic spirit of law. With the State Duma functioning essentially as a rubber stamp for Putin’s policies and the Federation Council now comprised of individuals that he appoints, one commentator has asserted, “the regional leaders represent the last bastion of democracy.”¹⁰⁹ In addition, “the manner in which the state seized the assets of oil magnate Michail Khodorkovsky... undermined any presumption of secure property rights in Putin’s Russia.”¹¹⁰ The experience under the USSR is a clear example of the futility of a federal system that does not embody the rule of law – the divided government, the written

¹⁰⁷ Trenin, *supra* note 52 at 4.

¹⁰⁸ McFaul, *supra* note 70 at 308; ASLUND, *supra* note 48 at 4.

¹⁰⁹ Petrov, *supra* note 12 at 237.

¹¹⁰ McFaul, *supra* note 70 at 308.

constitution and the distribution of power are merely facades of an authoritarian regime. Under the rule of law, the state does not only make law, but is also accountable to it.¹¹¹

With the rule of law as the foundation, a federal system needs to have a flexible distribution of powers between the center and the regions to accommodate changes in the economic system. Areas of jurisdiction should not be rigidly assigned, but fluid to take advantage of situations where local control may be more efficient than control from the center, and situations where central control is needed to thwart protectionist actions of the regions. The centralizing trend in Russia has been beneficial to economic reforms in several ways. It has protected the market from “encroachments on markets for private gain.”¹¹² One observer commented, “These reforms appear to have been good for the federal government, in that they hampered the ambitious attitudes of the governors and brought some stability to the nation.”¹¹³ By reducing the influence of the regional leaders in the Federation Council, Putin has passed tax and land codes that provided consistency and predictability. Weingast recognized that the central government needed to maintain “credible limits on state discretion provide the political foundation for secure property rights and a healthy market economy. Limits on potential exactions promote economic growth.”¹¹⁴ Action by the central government was needed due to the weak development of other institutions to check the regional governments, such as an effective civil society, relatively strong local governments, and a business class that operates independently from political leaders.¹¹⁵

However, as noted above, continued centralization may undermine the progress made.

¹¹¹ KAHN *supra* note 1 at 53-54.

¹¹² Weingast, *supra* note 91 at 24.

¹¹³ Orttung, *supra* note 44 at 15-16.

¹¹⁴ KENNETH A. SCHULTZ AND BARRY R. WEINGAST, *THE DEMOCRATIC ADVANTAGE; THE INSTITUTIONAL SOURCES OF STATE POWER IN INTERNATIONAL COMPETITION* 3 (1996).

¹¹⁵ Petrov, *supra* note 12 at 233-235.

[A] government strong enough to protect property rights is also strong enough to confiscate the wealth of its citizens. Thriving markets require not only the appropriate property rights system, an unfettered price mechanism, and a law of contracts, but a secure political foundation that limits the ability [of] the state to confiscate wealth by altering those rights and systems.¹¹⁶

Thus, flexibility is needed and decisions concerning the appropriate distribution of authority should be left in the hands of the judicial branch. One example of such flexibility in the distribution of jurisdiction over economic issues is the shift in the United States during the early twentieth century concerning economic regulations. The Progressive Movement argued for child labor laws, safe working conditions and forty-hour workweeks. The reticence of states to impose such regulations was not resolved by unilateral action by the federal executive or legislature. Initially, the Supreme Court deemed that laws passed by Congress attempting such regulation were unconstitutional. However, as the market evolved and commerce became more independent, courts gave the federal government greater discretion in economic regulations.

Thirdly, Weingast's theory of MPF suggests that a federal system should decentralize economic regulations to the greatest extent possible. Competition for foreign investment is a strong disincentive for regions from enacting protectionist policies. Market competition also discourages regional governments from subsidizing failing industries when there are other, profitable options. However, as noted by Blanchard and Scheifer and built upon the prior two concepts of the rule of law and flexibility in allocations of state power, economic regulation in the regions should be tempered by a strong central government. "[I]f the central government devolves so much power to the regions and municipalities, localism will grip the country and it will be almost impossible to implement any political or economic policies at any level higher than that of the town or city."¹¹⁷ Particularly until other institutions can be established to provide

¹¹⁶ Rodden, *supra* note 83 at 1522.

¹¹⁷ Frommeyer, *supra* note 13 at 50-51 (Italics added).

a check against the regional leaders, such as a civil society and greater consumer influence, which may be available in the near future with the growing middle, consumer class.

One final comment needs to be made regarding the three substantive concepts outlined in this paper to recognize that these concepts are substantially Western in their orientation. As the United States President George W. Bush has aptly cautioned, one should not “expect Russia to look like the United States.”¹¹⁸ Butler highlighted the need to define the substance of the Russian federal structure in light of its unique cultural traits, and not to require states to meet an Americanized standard.¹¹⁹ The features and concepts useful for analyzing a federal system and its impact on a market economy proposed in this paper are intended to provide a starting point for further discussion of the appropriate nature of federalism in the Russian Federation. The federal system has not stabilized or reached a point of equilibrium; it instead is still in the midst of dramatic fluctuations in the relations between the regions and the center. This paper offers some principles for guiding future Russian leaders in arriving at a more stable federalism within their historical experience, which will further efforts to provide a predictable, stable, transparent and efficient market system.

Conclusion

Federalism, in both form and substance, is a significant influence in transitioning to and preserving a market economy. A stable federal system provides predictability, stability, transparency and efficiency, which encourages growth in a free market economy. The form of a federal system requires a divided government, a written constitution and distributions of state power into areas of exclusive and concurrent jurisdiction. A federal system that seeks to

¹¹⁸ ‘*Democracy, Russian-Style*,’ THE WASHINGTON POST, July 18, 2006, at A18.

¹¹⁹ Butler, *supra* note 95.

encourage and preserve a market economy also manifests certain substantive concepts, such as respect for the rule of law, flexibility in the distribution of economic regulatory power and decentralization of economic regulatory power. The significant shifts from centralization under the USSR, decentralization under Yeltsin and the increase of centralized state power under Putin indicate that the Russian federal system is not stable. While the economy has grown, largely from the increased demand for and price of oil and natural gas, a sustainable, diversified economic system will not grow without the predictability, stability, transparency and efficiency provided by a stable federal system.