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Foreign Investment in Eastern Europe- an Insider's View

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I. INTRODUCTION

The opening of new business opportunities in Eastern Europe has been documented by volumes of literature devoted to legal aspects of foreign investment in that region, most of which examines the Soviet Union and Hungary. This literature, composed of several books and many articles, has been followed by publications originating in Eastern Europe, the United States, Great Britain, and other countries containing translations of certain laws in Eastern Europe. These publications are devoted to providing up-to-date information to prospective investors or lawyers involved in preparatory work or negotiations.[1]

This has been followed by growing numbers of conferences and seminars devoted to investment in Eastern Europe. Several American law firms have opened offices in East European capitals, the majority of them in Moscow. Periodicals increasingly publish articles devoted to changes in this region and the experiences of existing investors.

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1. *See generally* PECHOTA, USSR & CENTRAL AND EAST EUROPEAN LEGAL MATERIALS (1990); OSAKWE, JOINT VENTURES WITH THE SOVIET UNION (Butterworths Legal Pub. 1990).

All of the information published for lawyers concentrates on statutes affecting joint ventures. These publications cover most of the rules relating to foreign investment in Eastern European countries. They also focus on the problems of emerging securities markets, corporation regulations, property law, currency transfer problems, and taxation. Some writers go deeper, trying to explore the entire set of legal rules important to prospective investments. Currently, American lawyers who want to acquaint themselves with the laws on foreign investment in Eastern Europe have no problem finding literature published in English representing high quality explanations of current law, future trends, and developments.

What may be missing is an understanding that Eastern Europe, particularly the Soviet Union, represents a very different legal, social, and economic environment. This is especially true in this period of vast transition. Many of the problems investors face in Eastern Europe come from underestimating the significance of that environment.[2] For that reason, focusing on broader significant problems for foreign investment, rather than on easily available technical rules relating to joint ventures, is advisable.

II. DEVELOPMENT OF FOREIGN INVESTMENT IN EASTERN EUROPE

A. *The Initial Steps*

First attempts to attract foreign investment to East European countries took place almost a quarter century ago. At that time, no one could have foreseen the changes which were to take place beginning in the late 1980s and continuing today. In 1967, Yugoslavia passed legislation permitting joint ventures. This first step was followed by Hungary and Romania in 1972, Poland in 1976, Bulgaria in 1980, Czechoslovakia in 1985, and the Soviet Union in 1987. However, since that time, the respective legislation has been either replaced by new laws, or at least substantially amended. It should be mentioned that in some countries western

2. *Soviet Ventures are Losing Appeal for U.S. Business*, N.Y. Times, Feb. 4, 1991, at A1, col. 3.

companies gained contractual rights earlier, with the consent and full support of communist governments. This resulted in the introduction of foreign philosophies into the communist economies.

Acceptance of foreign investment was a step out of the ideological foundations of the communist system. Governments which forbade or substantially restricted the possibility of economic activity by their own subjects permitted foreign entities to operate in their territory.[3] This was probably one of the reasons for putting several restrictions on foreign investors concerning the percentage of foreign shares in joint ventures and the nationality of the top executive officers. These restrictions could also have been an overestimation of western investors' interest in entering East European markets as well as xenophobic fears of foreigners coming from the West, who were treated with more than suspicion.[4]

However, the poor performance of communist economies and the lack of resources for the purchase of western technology compelled a search for some other mode of attracting hard currency and modern technology. The less than moderate interest of foreign investors caused the lifting of many restrictions, or foregoing the application of existing ones to bring in foreign capital. Still, the amount of foreign investment in East European economies was next to nothing. Of course, the situation varied among countries.

Hungary managed to secure the biggest portion of foreign investment. This was due to several factors, most significantly, the better condition of the Hungarian economy resulting from economic reforms enacted there. Poland attracted many petty investors, mostly of Polish origin. The Soviet Union made a few huge deals with big western companies. In some cases, obtaining the advantages of first presence in the Soviet market resulted in initial showings of modest profits.

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3. Osakwe, *The Death of Ideology in Soviet Foreign Investment Policy, A Clinical Examination of the Soviet Joint Venture Law of 1987*, 22 VAND. J. TRANSNAT'L L. 1 (1989).

4. Brady & Boyle, *Combustion Engineering's Dislocated Joint Venture*, BUS. WK., Oct. 22, 1990, at 49-50. These phobias are not uncommon even today. *See Kremlin Accuses Banks in West of a Plot*, N.Y. Times, Feb. 13, 1991, at A3, col. 4.

B. Governmental and Economic Reform

The end of the eighties brought revolutionary changes all over Eastern Europe. Free elections and a desire to transform command economies into market economies were the most visible features of that time. The scope of desired changes and the tempo of transformation were different throughout Eastern Europe. In Poland, Hungary, and Czechoslovakia, elections were won by opposition groups, leaving the former communist parties with only about ten percent of the votes. These three countries tended toward a complete rejection of their communist past and a transformation of their governmental and economic systems toward Western European patterns in the hope of joining the European Economic Community. Still, among this group, passage of reforms varied, particularly in the area of economics, where Poland moved ahead of Hungary and Czechoslovakia.[5]

Results of elections in the Soviet Union, Romania, and Bulgaria differed and left, at least initially, the power in the hands of former communists. The scope of planned and desired changes in these countries seems to be smaller, tending to transform the system by finding some point where features of both systems could meet. Nevertheless, changes which have taken place or are currently under way in these countries cannot be underestimated.

C. Impediments to Reform

Initially, plans for transformation were very optimistic. Then several contradictions were discovered, making the path of reform much slower and more difficult.

The first contradiction relates to political change. Introduction of a democratic system requires lifting political control over the activities of citizens and their organizations and transferring of power to elected bodies. But this loosening of restrictions is immediately followed by the emergence of centrifugal tendencies,

5. Harden & Battiata, *East Europeans Weigh Costs of Change; Move Away from Communism More Difficult than Many Expected*, Wash. Post, Dec. 24, 1990, § 1, at A1 (final ed.).

endangering, in the case of a multi-national state, the existence of that state. This is particularly visible in the Soviet Union, Yugoslavia, and Czechoslovakia. Even in unitary states, freshly freed local governments show a proclivity for striping the central government of as many powers as possible to gain as much local autonomy as they can. This is the typical reaction to the communist system and strong centralism, in which even minor decisions required the consent of central authorities. Many localities felt exploited by central government, which was frequently identified with bureaucracy and authorities located in the distant capital of the country. To keep the country together the central governments resorted to more autocratic methods, which ended the move toward democracy and the advantages of a democratic system. The tendency toward retrenchment of autocratic power and central government are clearly visible in the recent coup attempt in the Soviet Union and the civil confrontations in Yugoslavia. That is the first contradiction which may result, on the broader plane, in shifts from broad democracy to some form of autocratic government.

The second contradiction relates to the economy. A net of government-owned enterprises was built in the communist countries on the basis of a full monopoly over the enterprises in a market designed by central planners. Introduction of a market economy, however, assumes freedom of economic decision making by enterprises and abolishment of the central government's economic bureaucracy.

However, once existing enterprises feel free of central government control they tend to behave like monopolies elsewhere: they abuse their position, raise the prices, lower the quantity and quality of production or services, and try to impose harsh conditions on all of their customers. To counter that effect, it is either necessary for the central government bureaucracy to again assume control or to introduce competition by extensive importation of goods.

Additionally, there could be economic difficulty due to the lack of resources such that the only feasible option is for the central government to resume control. This tendency is clearly visible in the Soviet Union, as a reaction to a disorganized market, and also

explains the slow passage of reforms in other countries and the fears of governments to renounce control over prices.

A third contradiction is that between high expectations of the society and the necessity of sacrifice to make economic reform possible. Transition of power to opposition groups is followed by high expectations of the society. Simultaneously, reforms toward a market economy will result in lowering the standard of living of most working people, causing visible polarization of the society.

Probably the only solution is for a new government to move forward with reforms at maximum speed to make use of the moment of euphoria. Later, society may not accept the necessity to sacrifice. This explains the slow path of reforms in Czechoslovakia and Hungary. Poland, on the other hand, used the moment of social euphoria to put its society through the most painful changes.

The last contradiction is the one between traces of communism, or utopian socialist ideology, in the minds of employees and the requirements of efficient management of modern business. This is particularly important from the prospective investors' point of view.

Employees of government enterprises frequently organized into powerful trade unions. These unions have a tendency to treat the enterprise as a kind of community property of all the employees. Unions also tend to provide substantial employee influence on personnel decisions concerning top executive positions within the enterprise. Polish law concerning government-owned enterprise gives employee representatives broad powers in matters relating to the appointment and removal of directors of the enterprise.[6] Soviet statutes provide for the election of foremen by brigades in enterprises.[7] As a result of such employee control, management's

6. Ustawa o przedsiebiorstwach panstwowych (Law on State's Enterprises) Dziennik Ustaw 1987 No. 35, § 201 (last amended in 1990). *See* Dziennik Ustaw 1990 No. 17, § 99 (The director (chief executive) of the state's enterprise is appointed by the so-called "employees council" (*rada pracownicza*)). *See* Ustawa o samorzadzie zalogi przedsiebiorstwa panstwowego (Law on Employees' Self Government of the State's Enterprises) Dziennik Ustaw 1981 No. 24, § 123 (as amended). Rules set up in these two statutes do not apply to nongovernment-owned enterprises in Poland.

7. Zakon SSSR o predpriatiakh v SSSR (Law on Enterprises in USSR) art. 20, § 2 (Ved. S'ezda Nar. Dep. SSSR [VSNDSSSR] 1990 No. 25, item. 460). *See Life in a Soviet Factory*, ECONOMIST, Dec. 22, 1990, at 21-24.

main concern is to please employees. Most of the enterprises suffer from over-employment, which hinders attempts to cure the enterprise's performance. Over-employment also hinders privatization attempts. Employees are afraid of reductions and lay-offs by new owners. Therefore, during appraisals of the enterprise's property, employees insist on the inclusion of all the pieces of property, including old machinery, which leads to a total valuation of assets far exceeding the expectations of prospective investors. Calculation of enterprise assets and pricing of shares causes intense emotional reactions. In Hungary, the price on the first state-owned companies to be sold through public offering was far too low and caused dismissal of the responsible minister, which substantially delayed the whole process of privatization.[8] This type of reaction by employees is also visible in calls to privatize government-owned enterprises by distributing shares among employees.

All of these contradictions can be overcome, and to some extent have been overcome, in some Eastern European countries. For example, it appears that at least Poland has overcome most of these obstacles. On the other hand, this has lead to popular dissatisfaction, as evidenced by the poor performance of the Prime Minister in presidential elections (third place with less than twenty percent of the votes), so the price for overcoming these obstacles seems to be high. These contradictions substantially delay and hinder the process of transformation in Eastern Europe toward democracy and a free market and are probably most visible in Soviet Union.

III. THE DRIVE TOWARD DEMOCRACY

Experience shows that a democratic society, by guaranteeing the rights of citizens and providing mechanisms to decide disputes with government by impartial tribunals, is a much better climate for economic investment than systems based on autocracy. In this respect, changes in Eastern Europe are of enormous importance.

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8. Greenhouse, *Paths to Capitalism: Remaking Eastern Europe-A Special Report; Year of Economic Tumult Looms for Eastern Europe*, N.Y. Times, Dec. 31, 1990, § 1, at 1, col. 4 (late ed.).

A. *Expansion of Individual Rights*

Abolishment of the privileged position of the communist party, free elections, multi-party systems, and an independent judiciary are only some of the achievements of countries in Eastern Europe. Even in the Soviet Union, where the danger of disintegration is most apparent and democratic tradition is almost nonexistent, changes are enormous. Without delving too deeply into these changes, this article identifies constitutional changes guaranteeing citizens rights, introduction of the Committee of Constitutional Supervision, broadening of judicial control over the acts of public administration, and substantial changes in criminal procedure. It is also worthwhile to note several laws relating to economic issues, statutes relating to enterprises in the Soviet Union, property problems, joint stock societies, and limited responsibility societies. Some of these statutes have been translated into English and are readily available.[9]

Among the newly guaranteed rights in the Soviet Union is the protection of private property of individual citizens (called "personal property"). This guarantee includes the right to use personal property to carry on economic and other activities not forbidden by law and the right to inherit. Property of corporations (including that of joint stock companies) has been included into so-called "collective ownership," which is now also under the protection of law.

B. *Altering the Judicial System*

Several other new statutes introduced substantial changes in the system of administering justice. The most significant seems to be the changes in criminal procedure, providing the possibility of limited introduction of jury trial (to be introduced by republican legislation) and the introduction of the right to counsel during investigation. Counsel may be present during questioning of a

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9. *See generally* PECHOTA, *supra* note 1; Osakwe, *supra* note 1; BUTLER, COLLECTED LEGISLATION OF THE USSR AND CONSTITUENT UNION REPUBLICS (1988).

suspect and, after the close of the investigation, can examine the entire dossier of the case gathered by police or by the attorney's office.[10] New statutes guarantee independence of the judiciary and obedience to their decisions, penalizing any attempt to influence or disregard a court's decisions.[11] Soviet citizens were also given the right to strike,[12] and censorship of the mass media has been abolished.[13]

C. Evidence of the Contradictions

These changes indicate a strong concern for and respect of citizens' rights and liberties. On the other hand, one also finds statutes exhibiting a repressive character, for example, the statute on protection of the honor of the President of the Soviet Union,[14] legislation concerning the legal regime in extraordinary situations (marshal law),[15] and legislation on the powers of internal troops (which are subordinate to the Soviet Ministry of Interior) for the protection of social order.[16] Anyone one who has studied the Soviet Union for several years understands how fundamental these pieces of legislation are.

D. Movement in the Soviet Union

Changes in the Soviet Union during *perestroika* have been enormous. Their significance, both in the area of democratization

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10. Osnovy ugolovnogo sudoproizvodstva SSSR i Soiuznykh Respublik (Fundamental Principles of Criminal Procedure of the USSR and the Union Republics) §§ 9, 13, 22, 23, *amended by* VSNDSSSR 1990 No. 16, item 272.

11. Zakon ob otvetstvennosti za neuvazhjenie k sudu (Law on Liability for Disregard for Courts) Ved. Verkh. Sov. SSSR [VVSSSSR] 1989 No. 22, item 418. *See* VVSSSSR 1989 No. 9, item 223 (Laws relating to the organization of courts and position of judges).

12. Zakon o pariadke razreshenia kollektyvnyh trudovyh sporov (konfliktov) (Law on the Procedure for the Settlement of Collective Labor Disputes (Conflicts)) VVSSSSR 1989 No. 18, item 342.

13. Zakon o pechati i drugikh sredstvakh massovoy informactsi (Law on Press and Other Means of Mass Information) VSNDSSSR 1990 No. 26, item 492.

14. VSNDSSSR 1990 No. 22, item 391.

15. VSNDSSSR 1990 No. 15, item 250.

16. VSNDSSSR 1990 No. 14, item 233.

and in the observance of individual rights, cannot be exaggerated. This is true for several reasons.

1. Reliance on the Republics

First, the legislation as noted above in Part III.C. has been adopted by the Union. However, its implementation to a great extent depends on the authorities of the different republics. Taking into consideration the number of republics that are at odds with the Union, one should not expect them to implement federal legislation if they officially declare independence or broad autonomy with plans for independence in the future. In the case of criminal legislation, which is generally republican, its implementation requires introduction in the republican legislatures. On the other side of the coin, different republics have adopted many pieces of legislation during their own drive towards democracy and a free market, breaking away from a unified legal system. One can distinguish several competing legal systems and conclude that the law to be applied rests within the discretion of local authorities. With the future of the Union unclear, it is difficult to rely on existing legislation.

2. Unique Considerations in the Soviet System

It is quite important to realize that the role of the legal system in Soviet tradition is different than in western society. This is the legacy of the legal traditions of imperial Russia blended with Marxist legal positivism. Law is treated more as a tool of government than a set of superior rules equally binding people at the top of government and at the bottom of society. The Russian saying, "governing by means of the law," occupies the place reserved in other societies for the rule of law.

In addition, the government, as the ultimate owner of most of the property in the Soviet Union, has many ways of influencing the citizen's behavior without resort to legal means. This can be done through an adequate policy of appointments to different positions, through an allocation of subsidies, or through the allocation of

scarce materials or goods. Also, respect for orders coming from direct superior officers can be stronger than respect for rules of law which no one is going to enforce. Persons experienced in doing business in the Soviet Union would agree that a lot more can be achieved through personal connections and an ability to approach governmental officers than through legal means by resorting to the courts.

A deep understanding of the different legal environment in the Soviet Union can be crucial for any lawyer conducting business in the Soviet Union or advising a client on Soviet business.

The Soviet Union represents a distinct legal culture with roots in a civil law system. Because of the size of the Soviet Union, even in the case of partial disintegration, its distinctiveness will probably be maintained. It is a country which, at least now, seeks its own means of improvement, not a total rejection of the past. Actually, despite recent developments, this country, trapped by the contradictions mentioned above, has relatively little room to maneuver between concepts of western society and the traditional communist system.

E. Progress in Poland

On the other side of undertaken reforms, one may point to Poland, where features of economic and political crises were more visible than in any other East European country. Nevertheless, reforms in Poland went much further and faster than in other countries.

1. Preliminary Reform Under the Old Communist Regime

It must be mentioned that several reforms toward democratization and a free market economy in Poland had been undertaken during the last years of the old regime. This occurred before power was taken by anticommunist opposition. Poland

already had a Constitutional Tribunal[17] and the Supreme Administrative Court[18] adjudicating on the legality of administrative acts and ombudsmen. Poland also had freedom of economic activity with a developed private sector of the economy, particularly in agriculture. This looked like a good starting point for substantial reform. However, other factors like hyperinflation and huge foreign debt made the initial steps of the anticommunist opposition government more difficult. Nevertheless, a program of extensive reforms has been developed and its implementation has begun.

2. *Sweeping Governmental Changes in Poland*

In the movement toward democracy, a great deal of emphasis has been put on changes in institutions followed by a change of the communist-dominated staff members. Huge reforms in local government have taken place, followed by local elections. Political police have been disbanded, and new laws on the power of the police have been introduced.[19] Criminal codes have been substantially amended. *Procuratura*, an institution imported from the Soviet Union, has been made subordinate to the Ministry of Justice. Its powers have been restricted by the virtual elimination of its authority to oversee obedience to the law in the entire country (the equivalent of Soviet *Procurators*' supervision).[20] The system of courts has been changed to provide full independence of the judiciary.[21] The scope of judicial review has been enlarged leaving no so-called "government administrative acts" outside the administrative court's scrutiny. Exceptions to this expansion of

17. *See* Garlicki, *Constitutional Developments in Poland*, 32 ST. LOUIS U.L.J. 713, 717 (1988).

18. *See generally* Wierzbowski & McCaffrey, *Judicial Control of Administrative Authorities: A New Development in Eastern Europe*, 18 INT'L LAW. 645 (1984), *reprinted in* 8 MODERN LEGAL SYSTEMS CYCLOPEDIA pt. I, ch. 6, § 2, at 8.110.5 (K. Redden rev. ed. 1991).

19. Dziennik Ustaw 1990 No. 30, § 179.

20. Ustawa o Prokuraturze RP (Law on Procuratura of Polish Republic) Dziennik Ustaw 1985 No. 31, § 138 (last amended in 1990).

21. Prawo o ustroju sadow powszechnych, Dziennik Ustaw 1985 No. 31, § 138; Ustawa o Sadzie Najwyzszym (Law on Supreme Court) Dziennik Ustaw 1990 No. 26, § 153.

judicial scrutiny include visas, asylum, expulsion of aliens, and patents.[22]

3. The Role of Lech Walesa

All these changes do not substantially restructure the central government as it was shaped at the moment of the transition of power from the Communists to the Solidarity opposition. A new structure of government should be adopted with the introduction of a new constitution for Poland. This constitution should be drafted and adopted after parliamentary elections in early fall. The election of Walesa as President of Poland resulted in an attempt to introduce a system of government based on a strong presidency, following either the French or American model. A strong presidential system may give the Polish President the power to legislate by way of presidential decrees, as in France. Currently, the President of Poland has no such power. Several times before the elections, Walesa claimed the necessity for presidential legislative power to accelerate reforms, which moved ahead too slowly, because of the inefficiency of Parliament to quickly adopt new laws.

The election of Walesa to the presidency will result in the implementation of the new approach to the structure of central government. For that reason, it seems that drafts of the Constitution prepared by the existing Parliament can be treated simply as interesting historical documents. Even without special prerogatives, Walesa's role in the government has increased. This is due to his very active role with respect to all the problems faced by the government of Poland. Several drafts of new legislation have been submitted reprimanding Parliament and developing, within the structure of presidential office, a structure parallel to the existing government. The development of hand-picked advisory bodies has also aided in increasing President Walesa's power.

22. Ustawa o zmianie ustawy k.p.a. (Law on Amendment of the Law, Code of Administrative Procedure) Dziennik Ustaw 1990 No. 34, § 201.

All of these developments indicate the tendency of the Polish President, still a national hero, to introduce a new system of government in which the key role is played by the President. These ambitions cause different reactions, from deep appreciation, to assertions that such a President will play the same role as that assumed by the First Secretary of the Party under communist rule. But broad open discussion about the shape of the future government indicates how far Poland has moved from the regime it was a couple years ago.

IV. THE TRANSFORMATION TO A MARKET ECONOMY

A. Difficulties in Transformation

The experts and politicians have apparently underestimated the difficulty of transforming a command economy into a market economy. Initial plans, like the Shatline Plan, were too optimistic. The case of East Germany, where the possibility of huge amounts of capital influx were far greater than in any other Communist state, indicate the degree of difficulty. The painful example of a thirty percent decrease in the standard of living in Poland during the first few months of reform is clear confirmation of the hardships. On the other hand, the thirty percent decrease could be misleading because it does not take into consideration the flourishing and vast bazaars not covered by government statistics.[23]

It must also be clearly stated that the difficulties of transformation do not stem solely from the difficulty of replacing central planning with market mechanisms. It seems that the greater obstacles are the technological backwardness of Eastern European economies and the lack of economic skills in the managerial groups.

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23. *Reform in Eastern Europe: Poland; Look on the Bright Side*, ECONOMIST, Jan. 26, 1991, at 43, 44.

B. Requirements for Achieving Transformation

Achieving transformation to a market economy in Eastern European states requires the following steps:

1. **Introduce freedom of economic activity**

   This has been introduced all over Eastern Europe except in the Soviet Union where some restrictions still apply.

2. **Abolish central planning**

   This has taken place in some countries. The task is not as simple as it appears because, with the abolishment of central planning, market mechanisms must take over and provide operation of the economy. This requires abolition of government regulation of prices and assumes free decisions of economic subjects concerning the prices they charge for their products or services.

   Free pricing requires the existence of a competitive market. In communist economies, prices were set by the government, sometimes remaining at an artificially low level with some strong government subsidies to cover the difference between price and costs of operations. Some governments now prefer smaller, more restricted reforms, such as raising prices to match real costs while still maintaining government control of prices.

   Freeing prices inevitably results in their substantial rise, which results in popular discontent. Abolishment of central planning should be coupled with unrestricted ability to convert local currency. With the exception of Poland, having so-called internal convertability, unrestricted convertible has not yet been fully achieved.

3. **Introduce institutions which are necessary for the existence of modern free market society, like a modern banking system, securities market, stock and commodities exchange, and a modern tax system**

   This requires not only much new legislation, but also many institutional changes which cannot be achieved without support from the outside. Introduction of new laws

relating to banking, securities, and corporations has occurred or is currently under way all over Eastern Europe.

Unfortunately, this is not yet immediately followed by the development of such institutions. Lack of necessary capital and experience substantially hinders the entire process. The greatest difficulty is introducing a modern, stable, tax system based on western experience.

4. Privatize the majority of government-owned enterprises

This stage is still in its beginnings in Eastern Europe, with Poland, Hungary, and Czechoslovakia having some introductory stages behind them. In spite of a lack of special incentives to privatization in the Soviet Union, some enterprises were purchased by foreign investors which, of course, also results in their privatization.

Privatization is achieved in two parallel ways. The first is by returning confiscated property to expropriated owners. Special legislation has been passed in this respect in Czechoslovakia and Bulgaria. There are attempts to introduce similar legislation in Poland. Only in this way will some pieces of property be returned to former owners or their heirs. Huge enterprises are kept outside of reprivatization in this manner. For other pieces of government property, other means of privatization are prescribed. Secondly, in Poland, Czechoslovakia, and Hungary privatization is mainly accomplished through transformation of the existing enterprises into companies solely owned by the government and a subsequent sale of shares to either domestic or foreign investors.[24] The lack of necessary capital by domestic investors to purchase shares must be overcome by the distribution of special vouchers among the entire population, as in Poland and

24. *See* Law XIII of 1989 on the Transformation of Business Organizations and Companies (available in English at Hungarian Chamber of Commerce); Law VII of 1990, Foundation of State Property Agency with the Purpose of Management and Utilization of Property (publication in Hungarian Rules of Law in Force, May 5, 1990); Ustawa o przywatyzacji przedsiebiorstw panstwowych (Law on Privatization of State-owned Enterprises) Dziennik Ustaw 1990 No. 51, § 298.

Czechoslovakia, or low interest loans as in Hungary. That mode of privatization still creates disputes and respective governments move slowly with transformation of other enterprises.

C. *Claims of the Opponents of Privatization*

It is asserted that the idea of privatization does not lead to any advantages for a national economy. It is claimed that the sale price is usually far below the actual value of the privatized property. Opponents also urge that having a vast army of petty shareholders, each owning a few shares, leads to a new edition of utopian socialism and not an economy of contemporary western-style companies. These fears lead to a search for some alternative plans, like the transformation of shares into several mutual funds, which would play the role of holding companies and run the economy during the transitory period. Individual investors should be the shareholders of these funds.[25]

The process of privatization also seems to be hindered by organized employees of government-owned enterprises. These organizations fear that privatization will result in layoffs and will end employee control over management of enterprises. All over Eastern Europe, employees gained broad powers concerning management of state owned enterprises. These powers would, of course, come to an end with privatization of these enterprises.

All of these problems delay fast, full scale, privatization. As a result, East European economies are still dominated by state owned, inefficiently managed, state enterprises. In spite of all that has been said about privatization, the role of privatized enterprises in East European economies is still slight.

25. *Poland, Pioneer of Capitalism*, N.Y. Times, Jan. 30, 1991, at A22, col. 1.

V. The Role of Foreigners

A. A Continuation of Old Programs

To some extent, opening foreign investment by current East European governments can be seen as a continuation from the first openings to foreign capital made by communist governments in the 1970s. This phenomenon is quite easy to explain. East European countries passed through a period of fast political and democratic change, but their economies did not and could not undergo any such revolutionary change. Changes in economies are always much slower, particularly when bureaucratic orders have to be replaced by naturally-grown market mechanisms.

Of course, the role envisioned for private investment by communist governments is very different from the role assumed by postcommunist authorities. Communist governments saw foreign investment as a convenient way of achieving some goals within the existing economy, goals they were not able to achieve by themselves.

These goals were, or still are, expressed in laws relating to foreign investments. A good example of that approach is the Polish Foreign Investment Law, adopted in 1988 by the last Polish communist-dominated Parliament. This has been replaced by a new law without restrictions. The 1988 law required permits for foreign investments and indicated that the permit should be issued only when the business activity ensured (1) the introduction of modern technologies and management methods into the national economy, (2) a supply of goods and services for export, (3) the improvement in the supply of modern and high quality products and services for domestic market, and (4) the protection of the environment.[26]

The preamble to the decree of the President of the Soviet Union on foreign investment in the USSR provides:

> In order to activate the participation of the USSR in world economic relations and thereby to achieve a more complete satisfaction of the country's needs in production and

26. Dziennik Ustaw 1990 No. 41, § 325.

> services . . . [it is necessary to attract] additional material and financial resources, [and] advanced foreign technology and management experience in the form of foreign investment.[27]

Both current Soviet and old Polish laws indicate that drafters intended to achieve some goals with the assistance of foreign investors, but did not intend to wholly open the market to foreign investment. Additionally, the requirement of special permits indicated the active role of government bureaucracy in the evaluation and admission of prospective investors. Similar (but more general and vague) solutions can be found in the Czechoslovakian law of 1990.[28]

B. Breaking Away from Old Regulations

Current Hungarian regulation[29] and the new Polish regulation both reject the idea of the necessity of obtaining any special permit for foreign investment, except in the case of a few narrowly constructed activities. This is an expression of the willingness to open their domestic markets to foreign investment and to restrict the role of government bureaucracy in the economy.

1. The Effect of Competition

One can observe the competition between Hungary and Poland in the area of attracting foreign business. This competition results not only in the lifting of restrictions on foreign investment, but also in the introduction of incentives to attract foreign investors. To this point, Hungary seems to be the most successful among East European countries in attracting investors from abroad. Poland was very successful in attracting mostly small investment, each

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27. Decree of the President of the USSR on Foreign Investment, *translated in* PECHOTA, *supra* note 1.

28. The Enterprise with Foreign Property Participation Act (as amended 1990), *translated in* PECHOTA, *supra* note 1.

29. Act XXIV of 1988 on Foreign Investment in Hungary, *translated in* PECHOTA, *supra* note 1.

frequently less than U.S. $100,000, and several big western corporations are currently moving in. Small investors frequently exploited the over-valuation of hard currencies in the Polish market. This made investment possible with an unbelievably small amount of capital.

2. *The New Polish Law*

Newly-drafted Polish laws eliminate restrictions typical of Law on Economic Activity with the Participation of Foreign Parties (Foreign Investment Law of 1988), indicated above in Part V.A. Foreign investment does not require any special permit with the exception of some restricted areas,[30] unless such a permit is not required for Polish subjects, as in cases of insurance or banking businesses. There is no upper or lower limit on foreign investment, nor is there a limit on repatriation of profits abroad. These laws have been clearly designed with Hungarian regulation on foreign investment in mind. The change in law also reflects the Polish assumption that the restructure of the Polish economy requires foreign investment of at least U.S. $10 billion. It also displays the assumption that a free market should have a minimum amount of restrictions both for domestic and foreign investors. For Eastern Europe, it is a new approach, a consequence of the attempt to totally overhaul their economy and to seek membership in the European Community.

Questions emerge as to whether Polish society shares that approach to foreign investment. Certainly it does not. Some fear that the extensive sale of government property to foreign investors may lead to a modern type of colonization. Employees frequently fear for their job security. Communist education in mistrust of foreigners and to private economic activity is visible, particularly among older generations or people expressing postcommunist, utopian socialist ideologies.

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30. Restricted areas include harbors, real estate, trade, and the defense industry.

VI. CONCLUSION

With some generalization, the attitude towards foreign investment is sometimes based on fear. Some fear that foreign investment will come in and take over the entire economy; some fear that foreign investment will not come, leaving Eastern Europe as a kind of economic cancer. Fortunately for Eastern Europe, xenophobic fears are diminishing, and with foreign investment slowly moving in, fears about economic failure seem to be unjustified. Progress in negotiations on treaties relating to association with the European Community is also an optimistic sign, potentially giving easy access to the single largest market emerging in the world today.