

# Opportunities In Soviet-Style Joint Ventures

BY ALEXANDER KEVCHETZ\*



*New legislation opens opportunities for joint ventures; problems and pitfalls are outlined.*

## HISTORY AND IDEOLOGICAL CONTEXT

If there has been any major new development that the entire world has been paying much attention to the last few years it is certainly the new Soviet course in the world community. The Soviet Union with its new leader, Mr. Gorbachev, has been heralded by the world media, sending major tributes throughout the world. Even with the second largest GNP and one of the best national resource endowments in the world, it still is considered a second-rate economic power. And in the political arena, the Soviets have accepted a position of suspicion and distrust for decades. However, the new Soviet leader is attempting to reverse the course of history with his new initiative of *glasnost* and *perestroika*.

While the main thrust of his initiative is domestic reforms, there is no question about the fact that the initiative has worldwide implications. Mr. Gorbachev is attempting to improve the Soviet Union's external political image so he can gain trust and support from the outside world for his domestic reforms. Such external attempts can be seen through the signing of the SALT Treaty with the U.S.A., the gradual withdrawal from Afghanistan, the new support for the increased role of the United Nations and International Court of Justice as a means of resolving international disputes, and also the Soviet desire to be integrated into the world economic order through GATT and IMF, etc.

It is obvious for the time being that, after a history of having ideol-

ogical leaders, the Soviet Union now has a pragmatic one who is not, unlike his predecessors, paranoid about the outside world, but is willing to face that world and all the challenges the external environment has in store for him. Mr. Gorbachev's pragmatic attitude is reflected in the fact that sweeping changes, foreign to the Soviet thinking, have been introduced into the Soviet economy. Nevertheless, the ideological justifications sometimes lags behind.

To spur the pace of the domestic economic reforms, Mr. Gorbachev loosened up the highly centralized control over the economy with its central five-year planning and introduced some concepts of a free enterprise market system. And after realizing that Western assistance is some times indispensable to Soviet economic modernization, the Soviet leadership invited Western capitalists here to do business in the Soviet Union in the form of joint enterprises ("JV") with Soviet companies. Not that the Soviets suddenly came to terms with the capitalist notion of profit-making or that the Soviet suspicion of the West completely evaporated. Rather, the Soviets see the potential benefits of socialist-capitalist cooperation outweighing the fears of the West.

It is not new to the Soviet economic system. Its roots in existence in the 1930s under Lenin's New Economic Program, but were abolished under Stalin's rule in the 1930s. On January 1, 1987, the permission to establish JVs with partners from socialist countries as Soviet territory, which had been in effect since 1963, was extended to partners from capitalist and developing countries.<sup>1</sup> Such authorization was enacted on January 13, 1987, by the Council of Ministers'

Decision in conjunction with the Edict of the President of the Supreme Soviet.<sup>2</sup> Both laws were retroactive in effect to January 1, 1987. Since then, various Ministries and other agencies promulgated a number of regulations with respect to JV.

## Why JV

The new Soviet leadership makes no secret of its desire for Western economic participation in reforming and modernizing the Soviet economy. Nonetheless, the Soviets want to make sure that the strong economic ties with the West won't be used as a political tool to exert pressure on the Soviet Union. The Soviets would like to see that Western companies are mutually involved in the reforms but also have a vested interest in the Soviet economy and its success. Thus, the argument goes, it will be more difficult for the Western governments to change gears quickly. Furthermore, the Russian with its acute lack of Western currency, are afraid of running too high a debt with the West when obtaining the much-needed financing for the reforms.

Consequently, the Soviets see the JV avenue, and not other forms of East-West cooperation, as a way to resolve a number of the above-mentioned and other problems. The 1980s saw, alongside rapid growth of Soviet foreign trade, large-scale development of such commercial

\* Former law student at Case Western Reserve University Law School, Cleveland, Ohio. Left CasWestern after one political refugee in 1981, was graduated from Babcock Political College, Cleveland, in 1986 with major in political science, business, and international relations.

operations-as purchases of licenses, complete sets of plans for industrial enterprises, and the construction of projects on a "turnkey" basis in Soviet territory. The Soviets acknowledge that such policy had its significant drawbacks.

They had to spend the much-needed hard currency for buying the technology and licenses. It took a long time to negotiate, purchase, and construct complete sets of plants, which in the meantime grew outdated due to advances in science and technology. Further, the Western partners supplying the plants, licenses, or technology had no interest in continued modernization and innovation. They had no interest in providing the latest innovations to a potential competitor. Moreover, having supplied the USSR with technology and processes, the foreign partner lost the Soviet market as a result.<sup>10</sup> Thus, the Soviets see JE as a way to resolve these problems, in addition to a possible Soviet belief that improved East-West economic relations will lead to improved political relations.

The Soviets base their new legislation concerning JE on other socialist countries' laws, most notably Poland, Hungary and China, with certain adjustments for their particular needs. Thus, a practitioner in JE in the Soviet Union should pay close attention to developments in the JE area in those countries, since the Soviets will either avoid the mistakes or adopt the new improvements of their socialist neighbors.<sup>11</sup>

#### Soviet Goals and Objectives Through JE

The Soviets recognize the traditional advantages of JE such as the access to new markets, to resolve scarcity and availability of resources, capital, raw materials, production potentials, technology or scientific.<sup>12</sup> However, they expanded their national objectives for JE to attract new technology with guaranteed modernization and innovation to produce goods domestically; to reduce unnecessary imports and thus save much needed hard currency; and to generate export-oriented products that in turn

generate currency.<sup>13</sup> It should be noted and kept in mind that profit-generating per se may not be a primary Soviet objective of JE, a fact relevant to decision making. It may well be that the Soviets could be satisfied in certain circumstances with JE breaking even but reducing their dependence on Western imports or bringing in state-of-the-art technology, know-how, or know-how.<sup>14</sup>

Further, it should be noted that the Soviets will strongly defend JE proposals that appear oriented toward what the Soviets would view as exploitation of labor. They don't want to see the USSR reduced "to the status of South Korea, Hong Kong, and other states where, owing to cheap manpower, the multinational corporations have an opportunity to derive superprofits."<sup>15</sup> There are also indications that the Soviets will not allow JE to be used as a vehicle for the foreign partner to dump its products on Soviet markets without the Soviets deriving any of the above-mentioned benefits. The recognized advantage of JE is to extract mutual benefits.<sup>16</sup>

#### Western Goals and Objectives Through JE

As is quite obvious, the overall objective of a Western partner in JE with a Soviet co-partner in most cases is to generate profits, preferably as quickly as possible. Further, in general terms the JE is usually seen as a limited operation that should supplement and in no way change the parent organization's existing business or planned development.<sup>17</sup> In the context of JE with Soviet companies there are reasons the Western enterprises should be interested in doing business in the USSR.

First and foremost, the USSR with its population of 260 million people provides a JE with a vast domestic market. This domestic market has very important features, such as intrinsic lack of quality consumer products and services, abundance of goods-saving consumers, consumers equipped with purchasing power,<sup>18</sup> and a virtual lack of competition. Such a market can potentially be a gold mine for

a foreign partner, subject only to currency and other problems discussed later.

Second, the vast Soviet market can provide a foreign firm with an important alternative to a world capitalist market saturated with the products of that firm and its competitors.

Third, setting up a JE on Soviet territory may provide a foreign firm with an incentive to penetrate the neighboring socialist countries' domestic market since these countries may be engaged in protecting their markets with tariffs and other trade barriers vis-à-vis Western imports.

Fourth, but not least, Soviet producers are under great pressure to modernize their facilities, which may prove difficult without Western assistance.

Thus, a foreign firm must find one or more reasons to enter the potentially lucrative market, otherwise unaccessible, via JE.

## II. ESTABLISHING JE

### *Soviet Foreign Trade Establishment and the Legal Environment*

The Soviet Foreign Trade establishment underwent a major overhaul in 1986 and 1989 as part of Gorbachev's effort to reform the duties and responsibilities of the Party and government institutions under perestroika. The changes included in creation of a new Soviet agency, the USSR State Foreign Economic Commission (SFFEC), dissolution of the Ministry of Foreign Trade<sup>19</sup> and of the State Committee for Foreign Economic Relations, both being replaced by the newly-created Ministry of Foreign Economic Relations. The SFFEC was delegated the responsibility of overseeing the activities of all departments participating in foreign economic operations.<sup>20</sup> The restructuring also resulted in the elimination of the need for Soviet enterprise managers and directors to go through the Foreign Trade Organizations as intermediaries when negotiating, trading, or otherwise dealing with foreign entities. Managers and directors may deal directly with foreign representatives.

There has been a report of the formation of a Council of Joint Ventures in early 1986 consisting of six instruments of the Soviet [E].<sup>11</sup> One of the reasons for the formation is the obstacle of entrenched bureaucracies frustrating the operation of [E]. The Council's purpose apparently is to help in dealing with these bureaucracies.

The [E] legislation does not limit the scope of [E] activities. The only condition is that the [E] will not violate Soviet law, that [E] is not excluded from any activity within the Soviet economy.<sup>12</sup>

#### Initial Contact

It is Mr. Shein's belief that the best approach to initiating [E] in the Soviet context is not to contact the prospective partner directly, but rather to target officials in the branch ministry that oversees the particular area of commerce, or even a ministry in another area with which the foreign firm may have an established relationship. Such personnel might be in a good position to identify the Soviet enterprise or put the best team on the Soviet side.<sup>13</sup> Furthermore, it is an important tactical advantage in getting the branch ministry committed to the project from the outset.<sup>14</sup> In addition, it may be advisable to be dealing with several ministries with overlapping jurisdiction over the prospective project, since if the project receives a cool reception with one ministry another might take a much more positive attitude.<sup>15</sup>

#### Letter of Intent and the Initial Negotiation

After locating or targeting an appropriate Soviet partner, the next step is to draft a letter of intent outlining the basic concept of the [E]. This document is by no means legally binding.

While the Soviet enterprise is legally permitted to conduct the negotiations on its own without the interference of outside agencies, from the Western partner's viewpoint such bilateral negotiations are not very practical.<sup>16</sup> The Western partner should insist on inviting other legally and practically relevant Soviet agencies to participate in discussions about the details of

the prospective project. These agencies may include ministries such as the Ministry of Finance or Ministry of Foreign Economic Relations, which are empowered to decide all the questions that may arise. Other agencies to be included in the multilateral negotiations may include the banks that are empowered to extend credit to [E], insurance companies, financing agencies, etc.

Further, the Western partners may want to begin discussions with their respective government authorities to insure that the Western participation in the [E] will not be constrained, e.g. by export control legislation.<sup>17</sup>

The parties to the negotiations may consider drafting protocols for the Letter of Intent as the negotiations progress to create a mutual and agreed record of what has transpired.<sup>18</sup>

#### Feasibility Study

After signing the Letter of Intent, the parties may proceed to prepare a feasibility study. Such study may involve market research, industrial-economic efficiency, exchange of business data, or understanding of basic accounting concepts that will be utilized by the [E]. Such feasibility studies may be also required by some Ministries as a precondition to approval of the [E] project.

The foreign partner may want to ensure that adequate procedures and agreements are in place to protect its property during negotiations and in the event that a [E] agreement is not reached.<sup>19</sup>

#### Development of [E] Constitutive Documents

Once the parties to [E] complete bilateral negotiations and reach an agreement on specific details, they may proceed to draft the Constitutive Documents ("CD") that will outline the specific structure of the proposed [E] with particular attention paid to details such as rights and responsibilities of the parties. The CD will be the new foundation of [E], legally binding on the parties once approved by the appropriate authorities. CD may include one or a series of agreements and documents incorporated to-

gether by reference. In addition to the required provisions specified in Article 9 of the Decree on [E], the CD may contain any other provisions agreed to by the parties and not contrary to existing Soviet legislation.<sup>20</sup> These provisions may include licenses or technical transfer agreements, [E] bylaws, opinions, addressing compliance with the host country's laws, operational contracts providing for energy, services, leasing, management, purchase of machinery, transfer of technology, size of output, etc.<sup>21</sup>

The CD are then submitted to the ministries and departments for approval.<sup>22</sup> While the approval of the USSR Council of Ministers was originally required, this procedure was changed to the effect that the [E] could be approved at the lower level of the USSR ministries, departments and the regional council of ministers in order to cut down on time and red tape of the Soviet bureaucracy.<sup>23</sup>

#### Final Creation of [E]

After all the appropriate CDs are drawn and forms filled-out, the last step is to have the proposed [E] registered at the Ministry of Finance and notice of the creation of [E] published in the press. Only then does [E] become a legal entity. It may then begin operations.<sup>24</sup>

#### Practical Considerations of [E]

From a Western viewpoint, it is obviously better for the organizations to fail than for the relationship to fail after the business is under way. Therefore, it is probable that the negotiations are carried out in a way that clarifies the nature of the commitments and confirms that the main participants are in fact working successfully together.<sup>25</sup>

A foreign partner may well keep in mind that, even when an appropriate ministry is involved in assisting to set up the proposed [E], it is the foreign partner's ultimate responsibility to ensure that all of its interests are well represented and appropriate guarantees have been written into the [E]-documents. A Western partner should not be surprised by the amount of red tape and obstacle it may encounter. The Soviet culture is different from

the Western culture and it operates in different dimensions. Time, so valuable in Western business dealings, means nothing in the Soviet context. Moreover, Soviet ministries and agencies are notoriously known for a lack of communication and cooperation. The left hand of the Soviet bureaucracy may not know what the right hand is doing. Consequently, it's the foreign firm's responsibility to ensure that both hands are moving in the right direction.

The Western firm may well consider contacting various organizations and agencies that facilitate East-West economic relations, including setting up an office in Moscow.<sup>12</sup>

The foreign firm should not be surprised by the initial lack of initiative on the part of a Soviet partner. The reasons are deeply rooted in the Soviet culture. The Soviet officials and managers in charge may not be willing to risk their own personal careers for the success of JE. Further, many bureaucrats are skeptical about the success of the ongoing perestroika, and in case of its failure the bureaucrats can be held accountable for their "un-Marxist" orientation.<sup>13</sup> Or, they may have been labeled as political or technical elements of the perestroika. It's a "Catch 22." Individual initiative is not deeply rooted in a socialist system.

## II. STRUCTURE OF JE

### Form of Business Enterprise

Article 6 of the Decree specifies that JE will take the form of juridical persons, in other words, a corporation, according to Soviet Law.<sup>14</sup> One or more Soviet or foreign enterprises, organizations, or other juridical persons may be a participant in a JE.<sup>15</sup> The newly created JE will operate under principles of full economic (self-accounting, self-financing, and self-reliance) from the State.<sup>16</sup> The JE will be liable for its obligations and the Soviet State and participants of JE will not be held liable for such obligations.<sup>17</sup> A JE will not be subject to Soviet economic planning and will work independently from the State. The market for the

JE's products will not be guaranteed by the State.<sup>18</sup> It appears that JE are effectively treated as "self-chose" entities.<sup>19</sup> However, it is hard to perceive a complete independence from the Soviet planned economy: whose supply and demand for (e.g., raw materials) is centrally and artificially controlled, lives it life. Gorbachev's perestroika accomplishes a degree of decentralization of economic decisions in the Soviet system, a great deal of inflexibility will remain within the decentralized but still planned economy. Thus, Soviet suppliers may still be locked in long-term contracts with other enterprises and, thus, be unable to quickly respond to market forces such as greater demand. So, the JE's performance may fluctuate and depend accordingly to Soviet five-year economic planning.

### Equity Participation

Article 5 of the Decree provides for Soviet enterprise contributing at least 51% of the initial capital into the charter fund of the JE.<sup>20</sup> The obvious reason is to give the Soviet partner effective control of the JE since that partner contributed a majority of the initial capital. However, there are indications that the Soviets are moving Article 5 to allow a foreign partner to contribute a majority of constitutive capital and thus have a controlling interest in the JE,<sup>21</sup> whereas the Soviets will be able to control certain aspects of the JE's operation through other means such as specifying the duties of the officers and the manner of voting by the board. It is an apparent move to rectify the discrepancy of foreign firms' participation in JE on the Soviet territory.

The equity interest of each participant is fully transferable to a third party, with the Soviet participants having a preferential right to acquisition of the interest of foreign participants.<sup>22</sup>

### Capitalization

Article 10 of the Decree mandates creation of the charter fund in which both parties shall contribute.<sup>23</sup> However, such contributions may be made in the form of cash or in the form of equipment,

materials, buildings, natural resources, property rights, inventions, know-how, etc. Such contributions will be valued in rubles with due account to world market prices, materials, property, and other equipment imported into the USSR as a contribution to the charter fund are exempted from customs duties.<sup>24</sup> Subsequent contributions will be treated in the same manner.<sup>25</sup>

However, there are some implicit problems of valuation and foreign exchange rate. From a Western partner's viewpoint, how does one value the Soviet contribution of fix-it-oriented buildings, land, water, know-how, etc., with due respect to world market prices? The matter is further complicated by the lack of precedent or comparable assets on the world market. While Soviet officials have issued broad regulations in order to facilitate the process of assigning fair market values to Soviet contributions, it is suggested that the burden be placed on the negotiators of the prospective parties to reach an agreement on such matters or to refer it to arbitration.<sup>26</sup>

Even if the fair value is placed on each participant's contribution, the next complicating factor is the exchange rate. The official exchange rate of rubles to Western currency does not reflect the real rate, and thus further distorts the value of contributions. The exchange rate difficulty is further discussed later in this paper.

### Right to Profit

The basic motivation for Western participation is one JE is the expectation of profits. Thus, the foreign partner desires that the right to share in the profits of JE is transferred into the structure of the JE. Soviets recognize this reality, though for decades the word "profit" was synonymous with evil and a sign of Western decadence. Thus, Article 13 guarantees the distribution of profits from a JE's activities to foreign participants in proportion to their investment in the charter fund — their equity.<sup>27</sup>

The question of repatriation of profits is a more difficult issue. Article 12 of the Decree guarantees the

foreign participants the transfer of these profits in foreign currency.<sup>27</sup> However, this provision is qualified by another that requires that "all currency expenditures of a [E], (including the payment of profit (tax payments added) and other amounts due to foreign participants and specified, must be received by the [E] on account of receipts from sales of its products on foreign market."<sup>28</sup> This means, in effect, that unless the [E] generates its own hard currency from sales abroad or otherwise, the foreign participant may not be able to repatriate profits in hard currency. Consequently, the [E] will have to place a heavy emphasis on export if the foreign participant expects repatriation of profits in hard currency. Such a rigid foreign exchange requirement is understandable in an economy where hard currency is scarce. By stating it explicitly, however, the Soviets may avoid disappointments such as those experienced by Chinese [E] partners who found it difficult to repatriate profits.<sup>29</sup>

The repatriation issue leads to another difficulty, particularly for the Soviets. Once profits are generated in hard currency and rubles from foreign and domestic sales respectively, it is quite conceivable that each partner will retain his share of profits in their respective currencies with due regard to the exchange rate. But which rate? If the official one, the Western partner incurs a substantial loss to the inflated value of the Soviet ruble.

A Western partner should also bear in mind that there might be attempts to keep profits within the USSR by manipulation of costs and prices. For instance, raw materials or other supplies sold to the [E] by the Soviet partner at inflated prices may keep [E]'s profits down, while the Soviet partner is still generating profit in his own way.<sup>30</sup> Thus, partners in a [E] must rely on the other's good faith with the knowledge that such manipulation will terminate the [E] operation.

Finally, it should be noted that all repatriated profits are being taxed at an additional rate of 20%.<sup>31</sup>

#### Control and Management

For foreign participants parting

their capital at risk in a foreign [E], control of the enterprise is their most basic concern. Some assurance of effective participation in management is a prerequisite to the commitment of substantial resources.<sup>32</sup>

Article 23 mandates creation of the board appointed by the partners but chaired by a Soviet citizen. Furthermore, the Director-General in charge of operational activities must be a Soviet citizen as well, and the procedure for adoption of decisions by the board shall be stipulated in CD.<sup>33</sup> There are no further comments on how the board or management shall be constituted or operated. That leaves considerable room for negotiation to set up details and specifics in partners' interests. Indeed, foreign firms engaged in [E] negotiations confirm the Soviets have interpreted the above-mentioned provisions liberally allowing the partners to establish their own extensive list of issues to be decided by consensus, including the most sensitive and important issues: assurance of quality control, how much output to export, and how the hiring and firing decisions will be made.<sup>34</sup> Another example of Western partner interest open to negotiation is a non-Soviet Deputy Director-General placed in charge of virtually all crucial day-to-day operations.<sup>35</sup> It should also be possible to negotiate equal representation on the board and a veto right on all board's decisions through consensus requirements.

However, the management's discretion is constrained by the Decree requiring certain matters to be governed by applicable Soviet Law, e.g. collective contracts with the trade union,<sup>36</sup> labor conditions, social and security insurance.<sup>37</sup>

Overall, a well-negotiated agreement relating to management and board of directors should give a Western investor a strong voice in the destiny of the [E] and its investment.

#### Labor and Wages

Article 47 of the Decree mandates that "the personnel of [E] shall be made up principally of Soviet citizens."<sup>38</sup> While this provision is

fairly broad, it has been reported that this injunction is being observed. The M East-West [E]s registered with the Finance Ministry as of April 1989 employed 10,000 Soviet workers and only 70 foreigners.<sup>39</sup> This fact is also understandable from an economic viewpoint, while it is more cost-effective to employ much cheaper Soviet labor.

As already reported, the [E] must conclude the collective contracts with the trade union created at the enterprise. The contents of these contracts are being governed by Soviet legislation and CD.<sup>40</sup> It is not all that clear how far the negotiated CD provisions can deviate from the existing Soviet labor law.

The wages of [E] Soviet personnel are also governed by Soviet law, but [E]'s Ministry employee wages are governed by individual contracts.<sup>41</sup> The management may set up incentives and bonus plans into their collective agreements with the unions, e.g. for high labor efficiency or enhanced quality, and fit such bonuses with due regard to the overall profitability of the [E]. However, Mr. Shere states two issues pertaining to the wage system whether such inducements to the Soviet employees will be allowed in hard currency and whether Soviet managers will be able to receive salaries higher than those of the involved Ministry heads.<sup>42</sup>

#### Production Concerns

**Supplies.** The problem of reduction of all supplies, raw materials, component equipment and utilities at contractually agreed prices with due regard to world-market prices has been already mentioned. However, the access to supplies is not guaranteed. Therefore, it might be practical to incorporate into the CD Ministerial guarantees of uninterrupted supplies.

**Planning.** While Article 23 of the Decree guarantees the [E]'s independence from Soviet five-year planning, [E]'s economic performance will be affected by Soviet planning. Soviet enterprises dealing with the [E] remain tied to the planning and predictably will have minimal flexibility adjusting to [E]'s changing demands.

**Quality Control.** While there is an assumption that the [E] will pro-

duce high-quality products, the main concern regarding quality stemmed lies with the incoming supply of Soviet inputs. This problem also plagues well-run Soviet enterprises. Under economic pressure, Soviet officials loomed the gap of "imperfections" (state acceptance) in order to avoid massive supply shortages, so the standard of quality control for Soviet products was lowered once again.<sup>15</sup>

### Technology

One of the major reasons for Soviet involvement with the West through JE is to have an access to new technology, know-how, and know-how, and the Soviets make no secrets about this. Article 17 of the Decree guarantees JE's rights to industrial property in accordance with Soviet law. However, nowhere in the Decree are the foreign partner's technological and intellectual rights protected. Consequently, in the absence of adequate Soviet legislation on protection of such rights, the foreign participant should negotiate the explicit terms of their rights in transferred technology, know-how, and know-how, and incorporate these terms into the CD. Moreover, such protection should be afforded even during the initial negotiations, when data and information is being exchanged in preparation for the creation of JE.

### Financial Considerations

**Bank Accounts and Credits.** A JE may obtain credits in hard currency at the Bank for Foreign Economic Activities ("BFEA") or at a foreign bank with BFEA's approval. Credits in rubles can be obtained from BFEA or the State Bank of USSR.<sup>16</sup> Both banks, however, retain the right to control the use and timely repayment of these credits.<sup>17</sup> Foreign partners may wish to negotiate guarantees into the CD that credits will be available without regard to determination of "necessity, the whatever purpose the management see fit, subject only to adequate security," thus ameliorating undue Soviet interference into JE's activities.

**Official Exchange Rate.** Many transactions of JE will necessitate a conversion of Soviet currency to

Western currency and vice versa. This is being done according to the official exchange rate of the USSR's State Bank<sup>18</sup> on the date of such transaction. Unfortunately, the value of the Soviet ruble is substantial inflated vis-à-vis Western currency, reflecting "a measure of social value."<sup>19</sup> Consequently, a foreign partner is significantly prejudiced when converting, e.g., its contribution to the general fund. However, the converse is true in that converting profits from rubles to Western currency. According to Soviet officials, the exchange rate is not negotiable.<sup>20</sup> However, it has been suggested that potential inequities could be avoided through "readjustment" of prices of non-currency contributions.<sup>21</sup> Also, to solve the long-standing problem of ruble exchange, there are strong indications that the Soviets will attempt to make their ruble fully convertible, thus readjusted to its real value. It will take some time, however, to accomplish this objective.

### Taxation

Article 36 of the Decree exempts JE from the payment of taxes on profit during the first two years of operations.<sup>22</sup> This provision is, however, modified by the 1987 Additional Measures Decree, which states that "it is possible to exempt JE from payment of profit tax during the first two years from the time that declared profits are made"<sup>23</sup> (emphasis added). It is presumed that this point of exemption will be applied at a matter of course with respect to all JE.<sup>24</sup> Furthermore, the Finance Ministry has the discretion to reduce or wholly exempt individual JE from the tax.<sup>25</sup> Experience suggests, however, that special tax breaks will not be dispensed routinely. As of mid-April of 1989, only 6 out of 32 registered JEs had been afforded tax privileges.<sup>26</sup> There are indications that general regulations on special tax benefits are being drafted.<sup>27</sup>

The JE's actual tax on profits is 30% calculated after all deductions have been made for transfers to reserve funds and other JE's funds for research and developments. In addition, a 20% tax is levied on the foreign partner's share of profit be-

ing repatriated abroad.<sup>28</sup> However, there are some indications that this tax could be substantially reduced as a part of comprehensive inter-governmental trade agreements.<sup>29</sup>

### Dispute Resolution

Article 38 of the Decree and Article 5 of the JEI stipulates that all disputes regarding JE be decided in Soviet courts under Soviet law, or by arrangement of the parties in an arbitration tribunal.<sup>30</sup> However, these articles are silent whether the arbitration tribunals must be Soviet or in Soviet territory or governed by Soviet law, except for instances provided by USSR legislation where State Arbitrals agencies must be used.

A Western partner may consider negotiating a provision into the CD providing for an option to go to an ad hoc or institutional arbitration outside of the USSR, which is not governed by Soviet substantive law or procedural law. It may be advantageous to have a mechanism set up in CDB by which disputes or any foreseen situations can be resolved before the parties will resort to resolution in arbitration or courts.

### Termination

Article 51 of the Decree provides for the termination of the JE. This can be done in two ways: if by unilateral decision of the USSR Council of Ministers where it finds the JE's activities are not corresponding to the purpose and tasks set forth in the CD, or by procedures provided for in the CD.<sup>31</sup> These provisions may include an automatic expiration after a certain date if specified pursuant to Article 8.

Mr. Short suggests that "foreign partners can justifiably argue that the substantial uncertainties inherent in the enterprise — the weak legal framework for conducting business activities, the lack of precedent in joint ventures with capitalist firms, the rapidly changing economic environment under perestroika . . . entitle it to special considerations with respect to the grounds for and terms of termination."<sup>32</sup> Such grounds may include the inability to realize profits in hard currency, failure of Soviet agencies to supply promised credits, supplies or in-

variance, or similar interference by state agencies into JE activities. Such guarantees should also include a "home manager" clause.<sup>17</sup>

There is an interpretative problem with Article 53 as to the extent of the scope of the purposes and tasks clauses in CD.<sup>18</sup> Consequently, there is no guarantee that the Council of Ministers could not terminate the JE for political reasons using Article 53.

Finally, the Western partner should protect the terms of initial investments, assets, and other property upon liquidation by inserting appropriate clauses into CD. Such clauses should include an agreement on post-liquidation use of intellectual property by the Soviet partner.

## CONCLUSION

The new Soviet legislation on JE provides Western companies with unprecedented business opportunities. It is a very exciting time period not only for the Western investor but for a Soviet entrepreneur as well. But like anything new, the new Soviet initiative poses foreseeable and unforeseeable problems and challenges.

**Problems and Challenges.** A number of them have already been identified and addressed throughout the previous analysis. Furthermore, it is beyond the scope of this analysis to identify all of them. However, here are a few:

— The newly created JE are likely to attract the best Soviet engineers and managers due to the better financial packages JE are able to offer. Such financial differentiation may, not surprisingly, generate resentment and jealousy among the general population. Furthermore, some more conservative elements of the Party and government may not be perfectly happy with JE and the implicit implications of Western values. These elements may pose practical problems to successful operations of JE. Examples are red tape, bureaucratic delays, or non-cooperation.

— The Soviet institutional system is structured for its inefficiency. Thus, a Western manager should be prepared to deal with it with per-

sonal persistence and creativity.

— One can not completely discount the state of world affairs. It would be very unfortunate, but not completely unpredictable, if JE's Western partners are caught in the middle of a charged political climate in the East-West relations.

— One should also keep in mind that even export restrictions may be imposed upon the Soviet Union in the name of Western national security. A hi-tech company engaged in JE on Soviet territory may pay a high price.

— A similar argument can be made regarding future or existing industrial legislation.

— The repatriation of profits from the Soviet Union is not completely settled. It appears though, that the Soviets will come out with a more favorable way for Western participants to repatriate the profits.

— It is also widely expected that the Soviets will lift the lid on the 49% equity restriction applied to Western participants.

— The economic legal and economic system is still underway in the USSR poses a great degree of uncertainty and difficulty to all participants in JE, Western or Soviet. However, the lack of firm legal structures leave a lot of room for negotiations.

— Before the 1987 Additional Moscow Decree was issued, all JE had to be approved by the USSR's Council of Ministers. Such approval if not in perfect harmony with the existing Soviet law, gave the CD in effect the status of national law and of precedent. Now, after lower levels of authority may approve the CEs, the Western partner must make sure that all the guarantees, papers, waivers, and the like have the full legal effect intended.

**Realizations of the New Soviet Initiative.** It appears that Soviet cooperation with the West will dramatically increase. Anticipating that the political and economic climate will not change for the worse as perceived by the West, it will not take long for Western enterprises to realize the tremendous potential the Soviet economic environment has to offer. The effect is to be, as seen by some Western politicians and theorists, a better

political climate in the world resulting from the web of inter-related East-West economies. But conservatively others argue that in the long run, assisting the Soviets to rebuild their economic infrastructure may lead to a new round of arms race. It is not so far-fetched to argue that the new Soviet course is a direct result of the Soviet economic inability to match the U.S. "Star Wars" program. The Soviets have a history of being unpredictable consequently, where is the guarantee that they will not act unpredictably. This inevitable cooperation compromises the U.S. and its allies' national security. Let's hope that the benefits of the new cooperation outweigh potential risks.

**Notes on JE.** Undoubtedly, a successful future depends upon the degree of success of Mr. Gorbachev's policies. While the success of JE may greatly contribute to the success of Mr. Gorbachev's initiative, it would be naive to assume that JE are high on his priority list. The new Soviet leader faces far more pressing domestic and foreign problems — Afghanistan, arms control and reduction, America and Azerbaijan, Latvia, human rights — to name a few. While economic restructuring is the central theme of perestroika, it won't be terribly surprising to see Mr. Gorbachev's attention gradually shifting to the inevitably increasing political and institutional challenges whether he likes it or not. The pace of economic changes may slow down somewhat. Mr. Gorbachev has "let a dog sit on the chair," and that dog is "going wild." At stake is not just Soviet economic revitalization, of which JE are a part, but survival of the Soviet Union per se. The USSR is a pressure cooker waiting to blow up. The real question remains: What are Mr. Gorbachev's true intentions?

## NOTES

1. E. Baklanov, *Foreign Trade with the USSR: A Manager's Guide to Soviet Commerce* (1987).

2. USSR's Council of Ministers, Decree, No. 13, 1987 on Joint Enterprises with Foreign and Domestic Companies, 26, 11, 82, 1st 1987, translated by State, 11-82.

3. *Id.* at 76.

4. *Id.*, *supra* note 3, at 70-71.

5. *Personal interview with Dr. Murray J. Kravitz, Senior Research Fellow, 1994-1995 Lincoln Institute of the U.S.S.R. Academy of Science, Nov. 28, 1995.*

6. *Id.*, *supra* note 3, at 67.

7. *Id.* at 67-67.

8. *Id.*, *supra* note 3, *supra* note 3, at 66-67.

9. *Id.*, *supra* note 3, at 67.

10. *John Pridemore, "Rationality of International Joint Ventures in 1990's,"*

11. *Accounting Times Magazine, "As Soviet population had dropped to 20% of what it had in 1916, it should have 20% per capita. Companies showed profits equal to the 1990s by about \$10 billion per year according to a PricewaterhouseCoopers report issued in October 1995. *Accounting Times Magazine - "Capitalism Lost: Payments to the U.S.S.R.,"* *Legal and Practical Monthly Paper 20*, at 1 (1995).*

12. *Id.* An uncorroborated account of the "quest" why such important military and financial assets of disorganized and the industry was returned with foreigners who brought jobs, money, and infrastructure jobs to the military that in many cases at night converted to service partly and State officials rather than due to their psychological repression and complicity in the field. It was not the case in the 1990s, it's certainly not in 1995-1996.

13. *Foreign Economic Relations of the USSR, 1970 and 1971-1972* (1974).

14. *Id.*, *supra* note 11, at 67-71.

15. *Id.*, *supra* note 3.

16. *Id.*, *supra* note 11, at 70.

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.*

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.*

54. *Id.*

55. *Id.*

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.*

64. *Id.*

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.*

79. *Id.*

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

132. *Id.*

133. *Id.*

134. *Id.*

135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.*

152. *Id.*

153. *Id.*

154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.*

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.*

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. *Id.*

173. *Id.*

174. *Id.*

175. *Id.*

176. *Id.*

177. *Id.*

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.*

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.*

193. *Id.*

194. *Id.*

195. *Id.*

196. *Id.*

197. *Id.*

198. *Id.*

199. *Id.*

200. *Id.*

170. *Michelin, "The Soviet Union: Open for Business?"* *Harv. Bus. Rev.* 44 (1996).