WESTERN DIRECT INVESTMENTS IN EUROPEAN CMEA COUNTRIES IN THE 1970s AND 1980s

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List of abbreviations

ATS	=	Australian Schilling
BCP	=	Bulgarian Communist Party
BNB	=	Bulgarian National Bank
CBC	=	Cooperative Central Bank/Austria
CC	=	Convertible Currency
CHF	=	Swiss Franc
CIB	=	Central European International Bank
CMEA	=	Council of Mutual Economic Assistance
COCOM	=	Coordinating Committee for Multilateral Export Controls
CPE	=	Centrally Planned Economy
CPSU	=	The Communist Party of the Soviet Union
DEM/DM	=	Deutsche Mark
EC	=	European Communities
ECE	=	Economic Commission for Europe
EE	=	Eastern Europe
EEC	=	European Economic Community
EES	=	European Economic Space
EFTA	=	European Free Trade Area
EG	=	Ekonomicheskaya Gazeta
EPT	=	Entrepreneur's Profit Tax
FDI	=	Foreign Direct Investment
FEZ	=	Free Economic Zone
FF	=	French Franc
FIM	=	Finnish Mark
FRG	=	Federal Republic of Germany
FTO	=	Foreign Trade Organization
GATT	=	General Agreement on Tariffs and Trade
GDR	=	German Democratic Republic
GNP	=	Gross National Product
GVK	=	The State Committee for Foreign Economic Relations
HSWP	=	The Communist Party of Hungary
HUF/Ft	=	Hungarian Forint
IBEC/MBES	=	The International Bank of Economic Cooperation
IBRD	=	International Bank of Reconstruction and Development

IEO	=	International Economic Organization
IFC	=	International Finance Corporation
IIB	=	The International Investment Bank
IMF	=	International Monetary Fund
IPS	=	International Processing System
JV	=	Joint Venture
JVC	=	Joint Venture Club (in Hungary)
LDC	=	Less Developed Country
MFN	=	Most Favoured Nation
MNC	=	Multinational Corporation
MTI	=	Hungarian News Agency
NATO	=	North Atlantic Treaty Organization
NEM	=	New Economic Mechanism
NEP	=	New Economic Policy
NIC	=	Newly Industrialized Country
OECD	=	Organization of Economic Co-operation and Development
OPEC	=	Organisation of Petroleum Producing Countries
PUWP	=	The Communist Party of Poland
RBL	=	Soviet Rouble
RFE/RL	=	Radio Free Europe/Radio Liberty
SAG	=	Sowjetisch Aktiengesellschaft
SCCF	=	Standing Commission for Currency and Finance (of the CMEA)
SDAG	=	Sowjetisch-Deutsche Aktiengesellschaft
SEK	=	Swedish Crown
SEO	=	Self-managing Economic Organization
TR	=	Transferable Rouble
UN	=	United Nations
UNCTAD	=	United Nations Council for Trade and Development
USD/US$	=	US Dollar
UWH	=	Ungarische Wirtschaftshefte
VEB	=	Vneshekonombank = The Bank for Foreign Economic Relations of the USSR
WIIW	=	Vienna Institute for Comparative Economic Studies

A note on sources used

In the East plenty of material on "socialist international division of labour" is available. This material, which underlines the "anti-imperialistic" stance of the CMEA-cooperation, contains very little economic analyses. Therefore, these writings have been virtually omitted.

However, Hungary has a long tradition in critical and realistic writing on intra-CMEA affairs. By reading Hungarian economists on international economics one can win an insight on how foreign trade and other international deals are managed in the East. These Hungarian writings, which are easily available in the English and German languages, also provide a good picture on the CMEA international monetary system based on transferable rouble.

Thus, extensive use of Hungarian sources has been made. Especially two outstanding Hungarian scholars, S. Ausch and L. Csaba, have strongly influenced the present study, when the international economic framework of the CMEA region has been described.

Undoubtedly, Hungarian writers have also had clear impact on Western thinking on intra-CMEA affairs. Among Western scholars three specialists, M. Kaser, J. van Brabant and A. Smith, can be singled out as writers, who have most valuably contributed to the understanding of the topic of socialist international economic affairs..

Literature on FDIs across ideological borders is not easily available. Most books which cover this topic cover the legislation of JVs in the East. In this sphere the writer has relied mainly on his own analysis drawn from the legislative texts of Eastern Europe governing FDI-rules.

Case studies and details on JVs operating in the CMEA-area have been taken from various articles in newspapers and magazines in the turn of the decade 1980-90. Writings on this topic have increased considerably. It has been impossible to analyse all of that material.

The consulting firm "Business International" has intensively watched and analysed the technology exchange between East and West for a long time having a close link to those Western companies which are instrumental for this sphere. The writer of the present study has previously been deputy director of the Vienna office of Business International. Information compiled by Business International form the core of JV case studies represented here.

The German language business letter "Ostwirtschaftsreport" is published by Handelsblatt in Düsseldorf in cooperation with Business International. Also this publication has been an invaluable source of information.

Covering economic reforms in every single CMEA country under review (Romania, Hungary, Poland, Bulgaria, the CSSR and the USSR) has been extremely problematic for two reasons. Firstly, rapid changes took place in political and in socio-economic spheres of these countries during the writing of this study. Thus, continuous up-dating became necessary. Secondly, the writer is not able to read all of the East-European languages.

Thus, the present analysis relies heavily on papers published by The Vienna Institute of Comparative Economic Studies (WIIW) which has the highest possible international reputation in covering CMEA economic reforms in a brief, up-to-date and qualitatively excellent manner. Without WIIW-papers finalising this study in two years would hardly have been possible.

Basic data on FDIs in Hungary and in the Soviet Union has been easily available. This data has been collected during the first half of 1989, and analysed during the second half of the same year. The author is well aware that new JV units were established all the time during the period of this analysis. It was, however, impossible to consider the new establishments all the time. Data concerning FDIs in the other countries under review did not allow an overall analysis of the situation in the manner done in the Hungarian and Soviet cases.

These two countries under special consideration, Hungary and the Soviet Union differ from each other in many important respects. It is easy to conclude that Hungary is going through an important transformation period from a CPE toward a mixed economy. The same clear judgement cannot be made in the case of the USSR where different perestroika models have been presented. Opinions by some outstanding Soviet scholars, like A. Aganbegyan, T. Zaslavskaya and N. Shmelyov have been taken into consideration as representatives of radical economic reform. More cautions opinions from N. Ryzhkov and I. Ivanov who represent the Soviet executive have also been brought up because they are decisive for the immediate future of Soviet perestroika.

In order to characterise the variety of Soviet opinions, it can be mentioned that in a meeting for some Finnish businessmen in Moscow, February 11-13, 1990, A. Aganbegyan was in favour of the Soviet membership in the IMF, while I. Ivanov expressed the opinion that no hasty decision in this matter should be made.

No intensive research has been done on Eastern FDIs in the West. On this topic only some most important points compiled from information easily available have been mentioned in order to complement the picture of internationally mobile capital across ideological borders. Carefully collected and extensively described material of socialist FDIs in the global economy would have endlessly complicated the study.

The author has been actively involved in East–West economic cooperation since he left Glasgow University in 1974 as a business consultant first in Vienna and then in Helsinki. This first–hand experience on the micro–economic level has certainly influenced the writing of this study. However, emphasis has been put on macro–economic aspects of Western FDIs in the East underlining especially some features of the political economy connected with the topic.

The author is well aware that the present theme contains a possibility to cover a magnitude of micro–economic aspects including JV book–keeping, management problems, marketing strategies, etc. These topics which are not covered here provide exciting opportunities for further research also in the academic sphere.

A note on terminology used is necessary here. "Foreign direct investments" (FDIs) is used throughout the study in order to describe the activity in which risk capital from one country is directly invested in another. FDIs can take various forms; a foreign investor sets up a new wholly–owned company in the host country; a foreign investor can set up a joint venture with a local partner; a foreign investor can enact an acquisition of a company existing abroad, whereby the take–over can be total or partial; a foreign investor enacts a portfolio–investment acquiring a stake of a foreign company without the aim of getting actively involved in the management of that economic unit. In this study Western participation in Eastern JVs is understood as a FDI. A couple of years ago all Western FDIs in the CMEA countries were part ownerships in JVs (with the exception of "Polonia"–firms in Poland). Now other forms of FDIs except JV–partnerships are also possible, with country differences. Especially important in the framework of this study is the distinction between FDIs (including investments in the JVs) and financial credits granted by Western banks to CPEs. In sum: all Western contributions in JVs in the East are classified as FDIs, but not all Western FDIs in the CMEA countries are any more necessarily stakes in JVs.

Two appendices have been included. The first one describes the main feature of decision making in foreign trade when state monopoly in this sphere is applied using the model applied in the Soviet Union in the pre–perestroika period. The inclusion of this text which is compiled by the author for business guide–book purposes, is justified because it illustrates in short form the main features of the vertical–administrative system in

CPEs. It is clear that no spontaneous internationalisation of an enterprise can take place under circumstances of the state monopoly of external economic relations.

The second appendix is taken from Sandor Ausch's widely recognized CMEA–book. It is entirely impossible to find better evidence on the unsuitability of the CMEA currency system for advancing FDIs among CPEs than Ausch's text on the Polish–Hungarian joint–stock company "Haldex". This text underlines one of the most important points of the study: reasonable monetary and currency environment is required in order to advance economically reasonable international operations, FDIs included.

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Summary

The purpose of this study is to investigate how Western enterprises can participate in the development of centrally planned economies (CPEs) of Eastern Europe by making foreign direct investments (FDI). Only those East European countries which are members of the Council of Mutual Economic Assistance (CMEA) are included in this study, although other socialist countries, like Yugoslavia and China, also allow FDIs on their territories. Cuba, which is a full, non European member of the CMEA, and has joint venture rules, is excluded. The disregarding of these three countries mentioned is justified, because their inclusion would complicate the study unnecessarily.

By the late 1980s all European members of the CMEA, except the GDR, had created regulations for FDIs. Therefore, this study covers the Soviet Union,Romania, Hungary, Poland, Bulgaria and Czechoslovakia as recipients of Western FDIs.

This study comprises four major chapters. The first deals with international economics under socialism as well as foreign trade practices within the socialist system. In this context an attempt is made to show that Western FDI is something which is fundamentally alien to Marxism–Leninism. Furthermore, this first chapter tries to point out that modern internationalisation of CPEs is extremely difficult to achieve under the conditions of the socialist international economic system. As modern internationalisation of CPEs within the CMEA cannot be reached, Western FDIs have been invited to develop CPEs, even if socialist ideology is hostile towards international capital.

The second main chapter concentrates on problems of East–West trade and cooperation. This trade experienced a strong boom in the late 1960s and early 1970s. Also various forms of cooperation developed in an exciting way.

However, this development did not integrate the CMEA–countries into the world economy as strong competitive members of the global scene. The export structure of

CPEs in Western trade has remained rather primitive and credit financing of trade deficits has grown more difficult.

Thus, the need in the CPEs to accept the rules of the international economic game has increased continuously. They have accepted the Paris convention concerning industrial property rights, although this convention is based on capitalist principles. Some of the CMEA–members have joined the IMF and World Bank, even if these organizations are regarded as imperialistic in traditional socialist thinking. The CMEA and EEC signed a political declaration in 1988 ending the long–lasting dispute over whether EEC exists at all in the eyes of the socialist countries.

These are all important background factors for the functioning of FDIs in the CMEA–area. If the CPEs prove able to make their monetary units convertible with the help of an IMF–link, Western FDI activity in the East is likely to experience a considerable boom. If the CPEs can lower the impact of Western protectionism, this too will be good for FDIs flowing into the CMEA–countries.

The third chapter deals with the FDIs between East and West. This is, in fact a two–way road. There are some Eastern investments in the Western industrialised countries and in the less developed countries (LDCs). However, the main emphasis is on Western FDIs in the six European CMEA–countries mentioned above.

Firstly, this third chapter describes the motives which the Western companies have when they make their FDIs in general and why they invest in CPEs.The main actors in this scene on the Western side are the multinational corporations (MNC).

The first sub–section of chapter three goes back to the 1920s when the Soviet Union pursued the so called "concession" policy, giving business permits to foreign companies. Foreign involvement in Soviet development remained rather thin and of short duration in the early years of Soviet power.

Thereafter, Western FDIs in various CMEA–countries are described. Rules regulating FDIs are commented and details on functioning joint ventures provided.

The material connected to the themes of chapter three is extremely extensive. Therefore, some limitations are appropriate. The two countries most successful in attracting FDIs, the Soviet Union and Hungary, have been handled in more detail than the CSSR, Romania, Bulgaria and Poland.

FDIs have certain economic and ideological consequences. They are economically needed by CPEs, but at the same time, Western FDIs are difficult to reconcile with the socialist, anti–imperialist tradition. However, it has become more and more clear, that in the 1980s economic need has become more important than ideological purity. These topics will be dealt with more comprehensively in chapter four.

During the last months of the 1980s serious changes took place in the political and socio–economic spheres of CPEs. It can be assumed that these changes will have a basically positive inpact on Western FDIs in the East.

In conclusion the following scenarios are mentioned: If Western FDIs in the CMEA region grow rapidly, the result will be neo–colonialisation of socialist countries via direct influence of MNCs. This process may lead to neo–stalinistic tendencies in CMEA countries with a revival of anti–imperialist feelings. If Western FDIs remain thin, there is a danger that the reform process in the CMEA countries will lack economic dynamism. In this case it is likely that mass movement of labour from the East to West will take place. In the ideal case Western FDIs will be important but not dominant in the CMEA countries' national economies exercising indirect influence by forcing the local economic units to become fully competitive. Only the last scenario will guarantee harmonious transformation of CPEs toward mixed economies.

1. Socialism and international economics

1.1. Missing theory of international trade

Karl Marx himself never produced a systematic examination of the operation of the international economy of his time, since he died before starting the fourth volume of "Capital", which was to take up the problem. 1) Fundamental for Marxism–Leninism in international economic thinking has been the theory of imperialism by Lenin. The essential points of imperialism theory are as follows:

- The concentration of production and capital has developed to such a high stage that it creates monopolies, which play a decisive role in economic life of capitalism

- The merging of bank capital with industrial capital and the creation, on the basis of this "finance capital" of a financial oligarchy

- The export of capital, as distinguished from the export of commodities, has become extremely important

- The formation of international capitalist monopolies aiming at sharing the world among themselves

- The territorial division of the whole world among the greatest capitalist powers is completed.

On the basis of imperialism theory Lenin concludes that:

- The world is divided into two camps: the camp of a handful of civilized nations, which possess finance capital and exploit the vast majority of the population on the global scale and the camp of the oppressed and exploited peoples in the colonies and dependent countries, which constitute that majority
- The colonies and the dependent countries, oppressed and exploited by finance capital, constitute a vast reserve and very important source of strength for imperialism
- The revolutionary struggle of the oppressed peoples in the dependent and colonial countries against imperialism is the only road that leads to their emancipation from oppression and exploitation
- The most important colonial and dependent countries have already taken the path of the national liberation movement, which cannot but lead to the crisis of world capitalism

- The interests of the proletarian movement in the developed countries and those of the national liberation movement in the colonies call for the union of these two forms of revolutionary movements into a common front against the common enemy, imperialism
- The victory of the working class in the developed countries and the liberation of the oppressed peoples from the yoke of imperialism are impossible without the formation and consolidation of a common revolutionary front
- The formation of a common revolutionary front is impossible unless the proletariat of the oppressor nations renders direct and determined support to the liberation movement of the oppressed peoples against the imperialism of its "own country"
- This support implies the upholding, defence and implementation of the slogan of the fight of nations to independent existence as states
- Unless this slogan is implemented, the union and collaboration of nations within a single world economic system, which is the material basis for the victory of world socialism, cannot be brought about
- This union can only be voluntary, arising on the basis of mutual confidence and fraternal relations among peoples.2)

Obviously, the theory of imperialism contains very little theoretical help on how socialist states should conduct their foreign trade.

A socialist theory of international economics could hardly develop in Stalin's era in the USSR, as Stalin himself proclaimed the doctrine of "socialism in one country", formulated towards the end of 1924 against Trotsky and his idea of "permanent revolution". The idea of "permanent revolution", formulated by Trotsky before 1917, presupposed that the Russian revolution would pass directly into the socialist phase, but that its fate would depend on the inevitable world revolution. As the question of the "transformation of the bourgeois revolution into a socialist one" had meanwhile lost its application, Stalin presented Trotskyism as signifying that socialism could definitely not be built in one country – thus suggesting to his readers that Trotsky's real desire was to restore capitalism in Russia. In proclaiming that the Russian revolution was self-sufficient Stalin was less concerned with theory than with countering the demoralization produced by the failure of world communism. He wished to assure party members that they need not to be troubled as regards the uncertain support of the "world proletariat", since their own success did not depend on it; he wanted, in short, to create an atmosphere of optimism, without, of course, abandoning the consecrated principle that the Russian revolution was the prelude to a world-wide one.3)

However, even before the Stalin era there were some proposals as to how the economic relations between socialist countries should look. N. Bukharin and E. Preobrazhensky proposed in their book "ABC of Communism", which was first published in 1921 that integration among countries in which the proletariat gains the upper hand should be extended beyond pure trade relations into factor integration under the direction of a common economic plan:

> "We must aim not merely at economic exchange with such countries, but if possible must collaborate with them in accordance with a common economic plan. Should the proletariat prove victorious in Germany we should establish a joint organ which would direct the common economic policy of the two Soviet republics. It would decide what quantity of products the German proletariat industry should send to Soviet Russia – how many skilled workers should migrate from Germany (to the Russian locomotive factories for instance) and what quantity of raw materials should be sent from Russia to Germany".4)

The Party Programme of the CPSU adopted at the VIII Party Congress (March 1919) called for a single unified plan to co-ordinate activities with other socialist countries, stating:

> "We must promote a close economic collaboration and a political alliance with other peoples, simultaneously striving to establish a unified economic plan in conjunction with those among them that have already established a Soviet system".5)

The institutions created in the USSR after the October revolution in 1917 aimed at breaking with the "exploiting" nations, as the official argument of the period ran. The target was to build an independent and efficient economy, self contained and self-reviving. One of the most significant commitments to economic isolationism came in April 1918 with the establishment of a state monopoly of foreign trade. It was a sort of barrier through which the government could make, as a matter of exception, the necessary provisions required for a controlled exchange of goods with the outside world in accordance with the interest of the Soviet State. 6)

The controlled and also limited exchange of goods with other states was underlined when revolutions elsewhere failed and "socialism in one country" became official dogma in the USSR. The only function of foreign trade was to widen bottlenecks in case of shortages in home supply. Export had the main task of helping to finance necessary imports. This autarky concept seemed reasonable taking into consideration that the

USSR with its huge natural resources had a high autarky endowment and had the feeling of encirclement of hostile Western powers, which tended towards fundamental crises in their social systems. In 1939 the foreign trade of the USSR had declined to a mere 12 % of its volume in pre–revolution time (1913).7)

The circumstances of creating a new, socialist theory of foreign trade were, as we have seen, not favourable in the pre–war Soviet Union. In addition to that, it is questionable, whether a new, unconventional trade theory can be created at all, or whether the classical theory based on comparative cost advantages is the only right applicable one. This theory, which has been modified, and improved since Ricardo, is now commonly called the Hecksell–Ohlin or the Hecksell–Ohlin–Samuelson model. The classical theory of international trade was accepted also in the USSR in the 1960's.

Obviously, it was the well–known Soviet economist O. Bogomolov, who invented the old theory of comparative cost advantages as a guideline for socialist economic integration. 8)

Marx's theory of value has been of little use in international economics, because of the enormously complicated set–up of prices on the world market. For example, G. Haberler states, that

> "in the international sphere the labour theory of value could not be applied, this explains why the theory of comparative costs has stood up much better than other parts of the old classical theory". 9)

Also professor A. Nove makes the point that Marx died before writing his piece on international economics. Therefore, one must imagine what the communist society would look like on the international level:

> "presumably there would be some kind of world socialist commonwealth, in which all would draw freely from the common pool of abundantly available products, though one can read into Marx the possibility that he envisaged separate socialist communities interrelating in some undefined comradely way. It is difficult enough to envisage a medium–sized country being planned as one gigantic cooperative workshop. The world is bigger yet! It is possible, therefore, that the separate but allied socialist commonwealth of the imagination might enter into some sort of exchange."10)

1.2. CMEA and the international division of labour

From the point of view of Western FDIs in the CMEA–region it is essential to know the basic features of the Eastern economic bloc. It is a well established fact that one of the main motives of MNCs in making FDIs is to avoid trade barriers. For example, many exporters have found it profitable to establish production facilities within a tariff wall which is hampering their direct export.

There is empirical evidence that MNCs based outside of the EEC have increased their FDIs within the Community in order to produce inside the trade barriers. This motive has been investigated, for example, among US and Swedish MNCs. 11)

The CMEA is neither a customs union like the EEC, nor a free trade area, like EFTA. In the former case member countries abolish trade barriers among themselves and agree on unified tariffs and unified trade policy towards the rest of the world. In the latter case too, tariffs are dismantled among the members, but every member of EFTA is still responsible for its own trade policy and protective measures vis–à–vis the outside world.

It is extremely difficult to define the nature of the CMEA with traditional means. It cannot be a customs union, like the EEC, nor a free trade association, like EFTA, because the members do not use tariffs as the main means of protection. One cannot speak about "a common market" of CPEs, because the members are non–market economies.

The Swedish economist G. Adler–Karlsson states that the CMEA was originally devised as a new form of economic cooperation between the socialist states, a form which was to do away with all the injustice of the Western imperialist system and with the exploitation of the huge Western monopolies. This was the message spread during the first decade of the CMEA. 12) This statement, however, tells us very little of the actual economic nature and functioning of the CMEA.

According to the Hungarian F. Kozma economic cooperation among socialist countries can be described as "the community of interests in industrialization".13) His compatriot, B. Csikos–Nagy, who has served in Hungarian economic administration, for a long time points out that CMEA–countries relied on two main principles of state planning and regulation of the economy: the first one was self–reliance, accepting the fact that East–West trade would be marginal; the second was the preference given to planning in natural units in the expectation that transition from socialism to communism would follow soon abolishing commodity production and monetary economy.14)

At the beginning of the 1960s supranational planning for the CMEA–area was proposed by the Soviet Union. According to W. Seifert, who has been involved in CMEA affairs when living in the GDR, this proposal of N. Khrushchev caused heated controversy and eventually that proposal was rejected. 15) However, a document called the "Basic Principles of the International Division of Labour" was signed by the member countries (June 7, 1962). This document concludes with the statement that the main integrating force should be the co–ordination of economic plans without overlooking the legitimate interests of the participating countries. At its end this document states that the strengthening of mutual economic ties will promote the realization of an objective tendency which was outlined by Lenin: the creation in the future of a world communist economy directed by the victorious masses of the proletariat according to one plan.

These "Basic Principles" have obviously been interpreted differently in various countries. The USSR thought that the one plan strategy was meant to be applicable more or less immediately, whereas some other members of the CMEA – especially the Romanians thought that it was to be carried out sometime in the future. In 1963 the Soviet leaders quietly agreed to shelve the one plan integration scheme. 16)

These citations show how difficult it is to define the CMEA in economic terms. It is clear that the socialist economic group is neither a free trade area, nor a customs union, nor an internationally planned economic unit. "Anti–imperialist community" which aims at communism or "interest community for industrialization" are terms which are of very little help when a Western economic unit plans to make FDIs inside that economic bloc.

It is of utmost importance that Western enterprises are unable to penetrate the entire CMEA–market from the one country where the FDI is made in the same manner as they are made for example, in the EEC. The difficulties of selling on the other CMEA–country markets stem from the inconvertibility of the currencies and shortcomings of CMEA trade mechanism. 17)

Thus, these two aspects, the inconvertibility of CMEA currencies, as well as the nature of the transferable rouble, the international CMEA–money, and the socialist trading system must be investigated. Both of these have a decisive impact on Western FDIs in CMEA–countries.

1.3. State monopoly of foreign trade and bilateralism

In this section the main features of the socialist trading system will be discussed in the form they emerge in the traditional CPE–model. The target is to clarify how the socialist system functions on the international level.

During the last two decades the foreign trade system has been modified, and thus differences between individual CMEA–countries can now be observed.These differences will be dealt with in chapter three, when the business environment of joint ventures in various CMEA–countries is dealt with.

The Soviet system of foreign trade administration was originally developed to cope with the organization of trade between a socialist economy and capitalist economies, rather than between CPEs themselves. The principal feature of Soviet administration is that the state (through the aegis of the Ministry of Foreign Trade) has the exclusive right to conduct foreign trade transactions. Individuals and enterprises are therefore prevented from directly purchasing or selling commodities in foreign markets.18)

The East European countries also adopted a state monopoly of foreign trade very closely modelled on that of the Soviet Union. Domestic enterprises are permitted to deal with foreign customers and suppliers only through special foreign trade enterprises. When a domestic enterprise produces goods as part of an export plan, the goods are sold to the foreign trade enterprise at the prevailing domestic wholesale price. The foreign trade enterprise sells the goods to the foreign purchaser and receives payment in foreign exchange. This exchange is promptly surrendered to the state bank in return for the domestic currency equivalent at the official exchange rate. The loss or gain of the foreign trade enterprise on the deal is routinely covered by a payment from or to a Price Equalization Fund.19)

This traditional planned system of foreign trade carried out by the state monopoly is known for its high inefficiency, because it includes an inability to adapt exports to world market conditions and involves difficulties discovering the correct trade specialization for the national economy. The separation of producer from seller in the monopoly system alienates the export producer from the world market as far as price, quality, after sales service, etc. are concerned.

In addition to the problem of adaptation to world market conditions, there is the problem of determining the most efficient structure of production and foreign trade. In the traditional centrally planned economy, the decision to export is determined centrally on the basis of the availability of goods for export. The arbitrary nature of the domestic price system, with its lack of relation to the structure of world market prices, and the absence of an economically founded exchange rate make comparisons between domestic and foreign costs difficult, if not impossible. Only in the late 1950s were the first attempts made to establish criteria for the profitability of exports. Since then a multitude of indices of foreign currency return per unit of domestic expenditure have been calculated.20)

In the traditional system of planned economy there are two levels of economic administration. At the top, the planners determine priorities and issue instructions, which are executed by the lower level of managers. The task of preparing detailed plans has two main parts. First the planners must elaborate a co-ordinated series of balances of sources and uses of products. This is functionally equivalent to constructing an *ex ante* input-output model for the entire economy. 21) This plan must be translated into compulsory tasks for the branch ministries and the individual managers. From the planner's perspective, foreign trade provides a means by which to obtain input into to the production process and goods for final consumption. In the main, exports have no utility for the planners other than to create the ability to import. This is in contrast to the situation in a market economy, where exports are part of aggregate demand and an important element affecting the level of economic activity.22)

Obviously, supply and demand in the external world are beyond the planners' control, and therefore, there is a degree of uncertainty in planning for the external sector. Unexpected developments in the rest of the world may disrupt the planned balances. In order to minimize uncertainty, the planners may conclude long-term and binding agreements with foreign partners. The bilateral way of trading thus seems suitable for CPEs.

However, bilateralism is not a discovery of socialist economies. It did not originate from the Marxist theory of unequivalent exchange nor from imperialism theory. Bilateralism has emerged several times and in various forms in the Western world.

According to the Hungarian economist Sandor Ausch, there have been three kinds of bilateralism:

1) The clearing agreements and quota systems which came into being in the wake of the 1929–33 world depression had the common characteristic that the only limits set in advance were on the value of exports and imports by commodity groups. An equilibrium balance was ensured by a system of export and import licences, by the application of ever changing restrictions in one area or another, and by the related measures of foreign exchange policy. The buyer and seller had thus, as far as the individual deal was concerned, a more or less free choice as regards the market of purchase or sale, and complete freedom in the question of price. Converted at some rate of exchange, the price obtained abroad represented the returns of the seller and the outlays of the buyer. The deal could be concluded only if the price that could be obtained abroad still left some profit margin for the seller over and above the domestic cost, and, in the case of the buyer, if the purchasing price paid abroad still enabled the realization of some profit in the domestic selling price (taking into account the system of subsidies and import levies, which became common at the time). Were the exporter unable to sell his product in the other country at an adequate profit, he still had the choice of looking for a more profitable outlet in a third or fourth country. In this manner, the domestic currency and the clearing currency served also – if only a limited and imperfect way – as a measure of the international value of domestic goods. The credit balances arising were adjusted, though in a limited manner, by means of "balance compensation" and with the necessary discounts to fulfil the function of an international means of payment and purchase.

2) Another type of bilateral clearing emerged from the war economy primarily between Germany and its trading partners, but also between other countries. In the case of Germany these clearing agreements were characterized by the fact that they constituted a suitable way of exploitation of the satellite countries. Their form and pattern was determined by the rules of the war economy (fixed domestic prices, the control and allocation of materials, fixed wages, etc.). The quotas not only fixed the upper limits of exports and imports, but also represented guaranteed deliveries by commodity groups on their inter–state level. The compulsory quotas also contained inter–state price agreements fixed in some form. Tying clauses were increasingly introduced in respect of both the type and quantity of goods to be delivered, and their prices. This clearing system thus represented a further qualitative restriction of the functions of the clearing currency as against the earlier type of clearing. In this system, the principles of the national and international comparability of values and

profit maximization on the basis of comparative advantages were replaced by government instructions in respect of a considerable part of trade. In the market thus distorted, the clearing currency became more or less an accounting unit for barter trade, with the existing function of money appearing only in the domains where the government did not or could not intervene.

3) Bilateral relations of CPEs were based on direct plan instructions. The limitations of money functions which occurred in the bilateral clearings of capitalist countries were fully asserted also in the particular type of bilateral clearing that emerged between the CPEs operating under direct plan instructions. This follows from the fact that in CPEs the economic mechanism involves a complete centralization of the government decisions regarding the factors of production. In the CPEs the domestic prices are institutionally and completely isolated from external prices. The production units are paid for their exported goods at fixed domestic prices and similarly, they must pay the fixed domestic price for imported goods. Thus, the system cannot pennit the existence of such foreign exchange rates in foreign trade, as realistically confronting domestic and foreign prices from the point of view of comparative advantages. Consequently, in the mutual trade of two or more CPEs, no objective value limits exist (neither from above nor from below) for the prices of individual goods entering foreign trade.23)

The sacrifices of efficiency and technological standards, which are unavoidable concomitants of the policy of economic development and cooperation aimed at regional import substitution and regional autarky, were understood relatively early by some economists of the CMEA-countries. However, it was rather commonly thought that the negative effects would be offset by the safe and stable framework given by the CMEA cooperation to fast economic development, as against the insecurity and incalculable nature of relations with the world economy, because of politics and the cyclical nature of the capitalist economy. 24)

From the point of view of the smaller CMEA countries this stability basically meant two things: firstly that they could safely build their long-range plans on the knowledge that they would be able to satisfy the major part of their needs for raw materials from sources within the CMEA and, do this on advantageous conditions known well in advance. B. Csikos-Nagy even points out that the question of relative scarcity of raw materials was not considered before the 1960s. 25)

Secondly, the CMEA countries had the advantage that products intended for export by their quickly developing manufacturing industries could be disposed safely and in large volume on the CMEA market. 26)

Kozma points out that the socialist trading system brought about a peculiar system of economic protection which is unique in world history. There was strong protection for the maintenance and development of the emerging new industries. This holds true not only for the international markets of the participating countries, but on the market of the whole community as well. Sufficient protection for "infant industries" could certainly not have been provided for through any kind of traditional instruments – customs duties, subsidies etc. – not through the quota system known in the capitalist world. Much more drastic measures were needed: the undertaking of mutual selling and purchasing obligations. 27) Especially the last point, purchasing obligations, represent a unique feature of the CMEA infant industry protection system.

The more the less developed countries wanted to export machinery and equipment to the more developed ones, the sharper became the problems deriving from the poor technological base, the substandard quality of the product and neglected after–sales services. As formulated in classical terms, the products of the new industries in the less developed countries were not competitive on the markets of the more advanced countries and their use did not sufficiently raise efficiency in the latter countries on either national or enterprise level. It seemed to be worth while to produce the products, originally "assigned" to the less developed countries parallelly, because domestic small scale production – uneconomical as such – was still more favourable than the purchase of poor–quality products released by the young, inexperienced industries. At the same time, the needs of the nearby industrialized countries to export their manufactured products became so pressing that they began to render their raw material and food supply commitments increasingly dependent on each other. The phenomenon of "linking" matched with unwanted exports began to emerge on a massive scale, a sure sign that the harmony of mutual interests was upset. The collision of interest was well advanced already in the mid–1960s. 28)

According to Kozma, initial socialist cooperation, with rapid overall industrial growth was based mainly on the advantages of adoption: the newly developed industries copied the technological level – and partly also the production pattern – of the industries of the earlier developed countries, they multiplied them in CMEA dimensions. This development made its way into the export structures, particularly in the 1960s. At the same time with the overall attraction for industrialization, the demand for imports of raw and basic materials increased. 29)

The result of early socialist industrialization and international economic cooperation, which are very well presented by Kozma, can hardly be surprising. As all of the participating countries followed the same pattern of economic growth with high investment shares and a favouring of heavy industry over light industry, and managed foreign trade according to the "single-core" model (trading bilaterally mainly with the Soviet Union), the emerging of parallel economic structures is not an accident. Neither is it surprising that the overall industrialization includes relative scarcity of raw materials in the economic region. If, furthermore, all of the participating nations apply mainly quantitative aims of the activities of the economy (neglecting quality aspects), and at the same time apply strong protective measures in order to send off outside competition, it is self-evident that quality problems arise.

Sandor Ausch points out that most of the raw materials needed for the rapidly growing industries could be purchased in the framework of guaranteed supplies. All this contributed to reducing the balance of payments deficit, most characteristically associated with economic growth in this development stage, thus enabling socialist countries to avoid many of the well-known economic and political consequences of such deficits. In addition, when deficits happened to occur in the bilateral trade between any pair of socialist countries, the Soviet Union frequently helped to balance them, under conditions that were, as a rule, very favourable to the interested countries.30)

Thus, the centralized control and guidance of the economy were introduced to support the strategy for fast growth in key sectors all over the region. If percentage growth is the objective, value indicators are certainly not very important in guiding decision-making when the policy makers have already opted for heavy industry as the core of long term economic expansion, and when the huge natural resources of the USSR were conveniently available for this growth.

As investments were scattered over a large number of industries, and since in particular the exploitation of new sources of raw materials involved and required alarmingly increasing capital outlays, bottle-necks began to appear more and more frequently, especially in the smaller countries, leading to widespread disruptions. By the late 1950s it became perfectly clear that continued autarky policies were applying brakes to further economic development in the socialist world. It was the Polish economist M. Kalecki who first came to the conclusion that failure to expand foreign trade presents a barrier to economic growth just as critical as shortage of capital or labour – and thus rediscovered a well–established doctrine of Western economics. In his opinion the continued high rate of growth creates increasing pressure on the balance of payments, and the import–replacement investment is usually less profitable than investment outlays for expanding exports.31)

The negative consequences of the trade and growth policies for the more advanced socialist partners started become obvious in the early 1960s. The Czechoslovak economist Ota Sik states:

> "Trends in structure of goods produced and exported did not correspond sufficiently to the development of goods demanded on the world market. In particular, the structure of our production was not fully directed toward the most effective exploitation of home raw materials and toward the importation of raw materials that could advantageously be processed. Instead raw materials that could be least efficiently used were imported and processed. Therefore, the share of labour added to the value of imported raw materials (processed and re–exported) was small and even began to show a relative decline. To surmount the problems of foreign trade, it is essential to change the structure of the national economy and make its development more flexible, especially to change the proportion between the share of domestic and imported input in the value of exports and to increase the effectiveness of foreign trade. Of course, this requires a better relationship between domestic production costs and prices on world markets. And this, in turn, requires that gains or losses from a specific development of foreign trade have direct effect on the income both of the production enterprises and the foreign trade enterprises – instead of going directly to the state budget".32)

Beside alienating the Eastern European economies from the world market through the structural changes caused by CMEA needs, there was another harmful aspect in bilateral trade worth mentioning here. The efforts to balance the yearly trade and the concomitant exaggeration of the importance of the year–end trade position manifested themselves in the disproportionate volume of deliveries in the last quarter, and even in the last few weeks of the year. This strange seasonal character of trade is quite independent of the seasonal fluctuations in production or consumption. It is due exclusively to the techniques of planning and accounting and is entirely unjustified from an economic point of view. Its harmful effect cannot be questioned, since the sudden increase in shipping towards the end of the year unavoidably led to an undesirable accumulation of stocks and to warehousing shortages, and the stocks thus accumulated were absorbed only in later periods of the following year. In the opinion of many CMEA economists, notably expressed by the Hungarian, Vajda, these automatic results of efforts at obtaining equilibrium could not be eliminated without a fundamental change in the system.33)

The administrative system of the state's monopoly of foreign trade, in which the producer is separated from the export market and in which the end–user of the import items is separated from the buying organization, has certain implications in the business culture developing in the countries where this system is applied. Also the bilateral trading system within the CMEA influences business behaviour in CPEs. This behaviour, in which secured markets are often taken for granted by managers must be known by Western MNCs intending to make FDIs in CPEs.

The Hungarian economist Laszlo Csaba points out very well how CMEA inter–relations influence the whole business behaviour in CPEs:

> "The regional economic integration of the East European planned economies, the Council for Mutual Economic Assistance, is a major international organization, exerting determinant influence on the development of individual member states. Moreover, this statement holds not only in relation to the individual member states and their community, but also in the relation of both these entities to the international economic system. The impacts of external disturbances on the CMEA in the last decade made it clear that irrespective of their deliberations, the individual CPEs as well as their regional grouping are integral parts of the world economy, and the CMEA does not constitute in any way a separate economic "world socialist system" functioning according to its inherent rules and regulations (as it used to be customarily maintained). However, the structural interdependences, the common system of regulating intra–regional trade, and the nature and forms of regional division of labour has evolved in the last three and a half decades, and add up to what in any theory can be called integration. This highly specific integration of planned economies is on the one hand the extrapolation of domestic, national systems of (mostly directed) planning, and on the other hand is itself a factor cementing the former. This means among others that the behavioural norms and success indicators of enterprises formed

under domestic conditions are more or less valid in a substantial part of foreign economic activity too. In other words, these conditions of macro–economic and business activity are determinant, also when CMEA countries enter into economic intercourse with other parts of the world. In this sense it can be formulated that : while from the real economic point of view the CMEA is a function of the world economy, from the systemic point of view it is the other way around, i.e. it is the institutional structural and behavioural characteristics of intra–CMEA relations that determine to a considerable extent the ways and means of the individual member states joining world economic interaction". 34)

1.4. The international monetary system of CMEA

Communist society will know nothing of money. Every worker will produce goods for the general welfare. He will receive no money and he will pay no money to society when he receives whatever he requires from the common store. 35) This is what the Marxist utopia says about the future society.

No wonder that in socialist societies no serious attention has been paid to monetary matters. However, money has always existed in all CPEs in the national economy, and there is also international money in the CMEA. From the point of view of Western FDIs in CPEs it is essential to know that all those monetary units are inconvertible. As there is a general requirement for all JVs operating in the CMEA–area to be self–sufficient in convertible currency matters, it is essential to know the monetary environment in which they are operating.

Normally money has three functions: the unit of account, the medium of exchange, and the store of value.

The introduction of a unit of account in which to express and compare the values of different goods and services was as important for economic life as the invention of the wheel was for technology. A common unit of account is the sine qua non of the emergence of prices.

Prices are essential both for rational economic calculation and choice by the individual and for transmitting economic information between individuals. A common unit of account, and prices expressed in such a unit, render comparable goods and services not otherwise comparable; and such comparability is evidently necessary if the individuals choice is to be rational, in the sense of implying transitive ordering of preferences.

The advantage of having a medium of exchange is that with it barter can be avoided, in addition to the clumsiness, inconvenience, and inefficiency it entails. Therefore to appreciate the advantages of money as medium of exchange, one must first become aware of the disadvantages of barter. First, barter is a much more complicated transactions than either buying or selling for money. Second, the use of money reduces the number of transaction needed to achieve a given degree of specialization. Trading partners who would be satisfied with a single barter can seldom be found, because only in the rarest cases would the goods and services one person has to offer match exactly the particular goods and services another person wants to obtain. The use of money saves time and effort by enabling people to sell to one person and buy from another, or to sell in one place and buy in another; and the wider the acceptability of money as a means of payment, the greater the saving. In short, *money makes multilateral trade possible.* Third, the use of money as a medium of exchange increases the number of similar transactions and so enhances competition and the similarity of terms of contract.

While money as a medium of exchange enables a person to buy elsewhere than where he sells, or from someone else than to whom he sells, its store–of–value function enables him to buy later than he sells. Most people want to delay consuming at least part of their earnings; and once consumption is postponed, there are many reasons for also postponing the buying of the goods to be consumed. The greater cost and inconvenience of storing goods instead of money, the deterioration and obsolescence of goods stored, the advantage in an uncertain world of storing general purchasing power instead of specific commodities, and the desire to wait and be prepared for later opportunities of making a good buy, are some reasons. Money, however, is not the only store of value; most financial assets and some real assets as well serve the same function.36)

In spite of the obvious advantages of money in economy, there has been utopian thinking in socialism about the abolishment of money. During the so called "War communism" when inflation was shaking confidence in money, some theorists thought this wass a sign of the withering away of money.37) However, money has normally always existed under socialist circumstances.

The Central planning of a socialist economy is traditionally done in physical rather than in value terms. Tasks are assigned to managers in physical terms. In practice, however, it has been found convenient to use money for various purposes in CPEs. First, direct distribution of consumer goods from producers to individuals is an inefficient means of satisfying consumer demand. Thus, money is traditionally issued in the form of wages, pensions, etc., and is used by the recipients to purchase consumer goods and services. The volume of goods and services made available, however, is not determined by the level of effective demand but by an exogenous decision of planners.

Quite distinct from this wage–consumer goods sphere of monetary circulation is the use of money by the productive sector. In this sector, money serves as a means of keeping accounts, the need for which stems from the lack of detailed information available to the planners and their inability to process information coming from the production units in the necessary detail. If the manager keeps monetary accounts of his enterprise's activities, the planners can perform simple control on the internal functioning of the enterprise.38)

All foreign exchange is held by the planners who use it to purchase necessary imports, which are then allocated domestically either to the production sector or to consumption. The consumer who holds money may convert this money into those commodities released by planners, but not into foreign exchange or into goods that are allocated only to the production sector. An enterprise manager holds accounting money in the name of his enterprise. However, since all goods in the production sector have already been allocated by the plan, he has no freedom to spend this money. This money simply moves from one account to another in response to the planned movement of goods within the production sphere.39)

The different form of ownership of means of production and the controlled foreign trade system alone cannot explain the different measures of values in various social systems. The difference is mainly due to the isolation of the monetary system of the CMEA–countries from the rest of the world.

Also in the market economies there are certain price biases caused by subsidies or other factors. However, there is always a tendency to evening out country–differences, and the flexible exchange rate rule eliminates inflation rate discrepancies in the medium term.

The monetary limits of CPEs normally have systemic features which isolate them from the currency development of the outside world. Internal prices often have considerable subsidies or surcharges. Input products are priced relatively low, whereas consumer goods are priced relatively high. The rather inflexible exchange rate policy emphasizes the isolation of the internal price level from that of the world market. However, the economic reforms have at least had a tendency to decrease the level of price differences. 40) In spite of that, all socialist national monetary units are still inconvertible.

A major distinction between the functioning of money in a CPE and its function in a market economy is that, in the former, money is frequently described as being "passive". In this sense the possession of money alone does not enable the owner to acquire resources or goods and services which are allocated by plan instructions. Money is thus only a unit of account since predetermined resource flows are followed by money flows. If money in that sense is passive, one can say that money is inconvertible even in the internal economy. 41)

In socialist international economies the role of money has been discussed for a long time. The history of socialist international money is highly interesting.

The settling of accounts in the bilateral clearing manner was globally relatively usual in the 1940s and 1950s, but gradually this system was abolished more and more especially among market economies. Also among the CPEs already by the mid 1950s views were expressed that bilateral balancing unnecessarily restricted trade and economic cooperation. These views were based on the fact that the process of negotiating compensatory agreements was awkward, time consuming and complicated.

Therefore, it is only natural that in the CMEA region calls for a more rational multilateral settlements system appeared. This topic was on the agenda on the 7th CMEA session in Berlin, May 1956. One year after that, during the 8th session in Warsaw, June 1957, a preliminary recommendation for an agreement was adopted and signed by all eight members of the CMEA.42)

According to this document, bilateral balancing was to remain the basic clearing principle in regional trade, but multilateral clearing was permitted marginally. Each central bank of the CMEA–countries opened special, interest–free rouble–accounts with the newly created clearing house, which was a special department of the Soviet state bank (Gosbank), and since 1961 the Foreign Trade Bank (Vneshtorgbank). Actual multilateral settlements had in principal to be balanced within a year, and the clearing house prevented any partner from accumulating debts. Actual trade transactions were to be agreed ex ante.43)

This new multilateral arrangement was only meant for trade peaks, and it was stipulated that any member could, on balance owe to the clearing house 3 per cent of the planned value of its regional exports. Interest was to be charged if credits exceeded the stipulated ceiling. 44)

Obviously the multilateral trade possibility was little used and mainly for selling the "softest" commodities - unsaleable at the world price in normal bilateral trade. The 1957 agreement stipulated that the final balances were to be settled in "hard goods", gold, or convertible currency. Actually, gold or convertible currency has never been used for this purpose.45)

The idea of improving the international currency system remained alive in the early 1960s. The reshaping of the 1957 agreement was on the agenda of the 17th CMEA council session in 1962, during which the Standing Commission for Currency and Finance (SCCF) was set up with the task of elaborating details for a new multilateral clearing system and establishment of a new clearing centre. This standing commission was instrumental in the development following. Proposals of the SCCF were examined during the 18th Council session in 1963 and a final agreement was signed after the 9th executive committee meeting in October 1963 by all CMEA–members.46)

According to the 1963 agreement a new bank – The International Bank of Economic Cooperation (IBEC, or in its Russian initials, MBES) was established and started operations in January 1964. At the same time, a new monetary unit, the transferable rouble (TR) was created.

The TR is not an actual currency, but merely a collective accounting unit used in intra–CMEA foreign trade books. Bilateral trade agreements are denominated in TR, and surpluses or deficits, also expressed in TR, between the banks of the CMEA countries are settled through IBEC.

The idea of the TR was to allow a country with a positive balance in bilateral trade at the en of the year to use its surplus to buy goods outside the bilateral agreement, either from the deficit partner or from other CMEA member countries. Therefore, the accounting unit is called "transferable" to replace bilateral balancing as the surplus country can transfer this claim from one member country to another.

A gold parity of 0.987412 grams of pure gold was nominated for the TR. This gold parity is the same as for the Soviet rouble. However, no gold backing has been created for the TR, and therefore gold parity is purely nominal: a claim shaped in TR is thus actually inconvertible in gold.

IBEC's capital was set at 300 million TR to be paid up; according to quotas in TR, in convertible currencies or gold. Each member country's share in the statutory capital was determined according to its participation in intra-CMEA trade in 1958-62. 47)

To provide medium and long-term financing for investments of common interest, the International Investment Bank (IIB) was established in 1971 with headquarters in Moscow. The present membership includes all the CMEA-countries (including Vietnam). The basic capital of TR 1 billion was allocated according to each country's export volume in mutual trade turnover, with 70 % to be contributed in transferable roubles and 30 % in gold and convertible currencies. If more convertible currencies are needed for approved credits, the IIB has authority to float bonds in the international capital markets.

The IIB's purpose is to promote economic cooperation among CMEA-countries. Crucial in the financing of a project is the mutual interest of all members in the project. IIB board approvals must have a 75 % majority, and each member country has a vote regardless of its contribution quota. 48)

Interest charges on TR loans were originally from 4-6 % p.a. and since 1974 3-5 %. Interest rates on credits in convertible currencies fluctuate according to the international money markets.

IIB's credits are intended for intensifying specialization and cooperation within the bloc, with the ultimate goal of achieving top quality products that will be competitive in world markets. This is clear from the criteria by which applications for IIB credit are to be measured: the technological level of the project; indications that it will reach optimum production and be amortized within the optimum period; the output must match world standards and be produced profitably at levels corresponding with world prices.

In January 1974, the IIB established a TR 1 billion fund (of which TR 100 million was initially paid in) to finance projects in developing countries. Loans from this fund are to be mainly in transferable roubles, with up to 5 % in convertible currencies if the CMEA-countries are unable to supply all deliveries. 49) However, it does not seem likely that developing countries will make significant use of the IIB special fund. The fact that the transferable rouble cannot in practice be used anywhere outside the bloc, narrowly limits the usefulness of the fund, because the members do not offer goods of high standard for this currency. The individual CMEA countries will therefore continue to seek bilateral accords with developing countries to cover their own need for primary products, and in this they will continue to compete with one another in prices and payment terms.

In April 1974, Yugoslavia signed an agreement with the IIB under which it can share in the financing of CMEA-projects in which it is interested; it is also eligible to receive credits from the IIB for CMEA-approved projects within Yugoslavia. 50)

The creation of the TR and IBEC was in technical terms significant, because it finished the period of bilateral settlements and transferred all transactions between any two CMEA-countries to IBEC, where each member country has one account. This bank, as an intermediary, will effect the multilateral clearing automatically for all regional payments. Any net claim in any bilateral relation is, in principle, "transferable" for purchases from a third country within the region. 51)

The monetary system based on the TR was linked with hopes for a considerable increase in the multilateralization of trade in the CMEA-area. However, very soon it became obvious that the technical improvements included in the 1963 agreement could not bring about considerable changes in trade and payments, unless other aspects concerning international economy were reorganized.

It is no accident that the Hungarians have become the most outstanding critical observers of the TR system. Their economy has the lowest endowment permitting autarky in the whole region, and not surprisingly, their economy has felt the limits of "extensive" growth early on. Therefore, an important precondition for continued growth in Hungary is to make the best possible use of the available resources and become competitive in foreign trade.

Ausch wrote in the early 1970s his highly critical comments on the TR system. In his view the introduction of the transferable rouble has not changed the bilateral character of intra-CMEA trade, and the member countries continue to strive at strictly balanced bilateral trade with each of their partners and for every calender year. The TR cannot be converted into any currency outside the CMEA clearing system. In other words, the foreign trade aspect of the situation is that if a net creditor CMEA country wants to use its balance outside the CMEA - because the goods available in the countries of the region fail to meet the requirements of the creditors in respect of quantity, product range, quality, price, etc. – it has no possibility to do so. Thus, the TR, as a financial institution taken in itself, has not in the least modified the existing degree of regional autarky and protectionism. Should any non–CMEA country have gold or dollars for its claims expressed in TR, and if the central banks of the CMEA countries could ask for a similar settlement of their positive balances arising within the CMEA clearing system, the TR would become suitable for two–way operation within and outside the CMEA, and this could put an end to the endeavours at balancing out every country's annual trade with each of the others. Should we try to establish links in this way, argues Ausch, this would require a continuous feeding of large amounts of gold or convertible currency into the CMEA's multilateral system. 52)

As far as the monetary role of the TR as a measure of value is concerned, Ausch is also highly critical. In the socialist planned economies operating under direct plan instructions, the domestic prices are institutionally and completely isolated from external prices. The producing units are paid for their exported goods at fixed domestic prices and similarly, they must pay the fixed domestic price for imported goods. Therefore, the price situation does not, and cannot, permit the existence of such foreign exchange rates as could act selectively on foreign trade, by realistically confronting domestic and foreign prices from the point of view of comparative advantage. In the mutual trade of two or more countries with the same, planned economic mechanism, no objective value limits exist for the prices of individual goods entering foreign trade. These prices become independent of both the international value relations and the proportions of supply and demand; what is more, their individual deviation from international value, though being necessary, is distributed at random. Thus, differences as regards the price a country obtains for an identical product on its various clearing markets have never anywhere been, as wide as in the mutual trade between CMEA–countries. Furthermore, the prices of raw materials and agricultural products are not as far above their capitalist world market prices as those of either machinery or of other finished goods, despite the fact that the former are in short supply at the agreed price in the CMEA–market, and there is a surplus of the latter. Price ratios within the main commodity groups are not in harmony with supply–demand relations. Because price distortions prevail, multilateral trade and convertible currency cannot be introduced. 53)

According to Ausch, an accounting unit like the TR, which is thus unable to fulfil the function of universal equivalent must, obviously, also be unsuited to serve as a general means of international purchase, payment, credit or hoarding. This is why an economic mechanism based on direct plan instructions must replace genuine foreign trade transactions with obligatory quotas instructing each enterprise as to what, where and when they have to sell or buy abroad, in other words, by an administrative management of trade. In these transactions money can thus fulfil its function only in a formal sense. Therefore, as long as no qualitative changes come about in the basic conditions of its functioning, this money cannot be made either transferable or convertible. Practice proves every day, that the TR does not constitute a general equivalent, nor a vehicle of credit. It is nothing except a measure of a mass of use values of a definite pattern. It is definitely not a means of hoarding or accumulating wealth (the IBEC could not purchase anything for all its "capital"). And when money is not money and wealth is not wealth, also the rate of interest is only a formality, unable to fulfil its proper function. 54)

According to Ausch, it is evident that "money", which cannot be termed real money, cannot be lent out either; more exactly, it cannot be lent out as real money, i.e. something that is a commodity in itself, without being expressed in terms of use-value. The accounting and credit system now enforced between the CMEA-countries is built on the assumption that their mutual money and credit transactions develop automatically in accordance with, or rather, as a consequence of the fulfilment of their mutual foreign trade plans. Short and medium-term credits are not "granted" by the credit countries; they come about almost automatically as a result of the position of the bilateral trade balances, i.e., of the fact that the debtors are not able to pay. No country is interested in accumulating claims against its clearing partner. 55)

As there is no international money capable of fulfilling money functions, the rate of interest, the "price" of borrowing capital, can play only a subordinate, inactive role. Interest to be paid to foreign countries is the concern of the central authority in charge of foreign exchange control only. The "interest" mutually paid by CMEA countries on "credits" for imbalances of bilateral trade are isolated from the profits of economic units as foreign market prices are indifferent to them. Interest is the concern of the central bodies only: interest is only an extra income or liability for the Ministry of Finance, and is paid to or received from each partner country in the form of commodity deliveries of a definite pattern. Within these deliveries, the share of various "hard" and "soft" commodities is a result of mutual bargaining. It follows that the rate of interest in itself cannot have sufficiently stimulating effects, even if it were substantially raised. 56)

Ausch comes to the conclusion that the "multilateral" clearing system of TR has only formally satisfied the requirements of multilateralism. So called multilateral negotiations have still been taking place comprising not even 1 % of total trade, concerning the "softest" goods. At the same time, even greater bureaucratic difficulties than before have emerged. 57)

Ausch thereafter stipulates the preconditions which are necessary for truly effective multilateralism. Firstly, the rate of exchange must establish an unequivocal correlation between internal and external prices, in the sense that external prices shall directly influence the earnings of enterprises producing for export or using imported goods. All the market conditions must be regarded, and thus differences between "hard" and "soft" goods must disappear. Secondly, within the limits of government regulations, the economic units shall have free choice in respect of a sufficiently wide range of commodities to effect their sales and purchases, according to the given market situation either at home or in any CMEA country, and be given reasonable freedom in choosing the point of time for the transaction as well as in negotiating its terms. The trade quota system must be gradually liberalized, and market–oriented prices introduced. After that the IBEC crediting activity should be extended and realistic interest rates established. 58)

Ausch is well aware that his proposal of qualitative transformation, with the abolition of the system of direct instructions, must lead to severe structural tensions involving social problems (e.g. periodic unemployment). However, he maintains that the strategy described by him is a sine qua non condition of multilateralism and convertibility. He speaks about a system of "planned and regulated market economy" which is not the same as departing from socialist principles in the society.

Kalman Pecsi, another outstanding Hungarian specialist in CMEA–currency matters, writes about ten years after Ausch very much in the same manner. Although some changes in IBEC policy have taken place in the 1970s, e.g. the interest rates have been slightly increased and the IIB has provided long–term credits for some big integration projects, the basic set–up of the TR system has remained unchanged. 59)

According to Pecsi, the national economies engaged in CMEA economic cooperation are usually characterized by central planning, administrative directives, and control and finance of production of the extensive development of the economies. Trade's stagnant growth rates in real terms, its lag behind the growth of production, its relatively unchanged pattern, will be reflected in difficulties of transition to intensive development of the economies and of international specialization. There will also be continuing shortages of modern, quality products and a surplus of obsolete, low–quality products on the socialist market for machinery. The prevailing international economic model does not require the co-ordination of investment plans, and thus, international specialization lags behind the development of planning in the national economies. This strategy continues to be embodied in the excessively detailed stipulations of deliveries by a centrally determined quota system that in some cases disregards quality requirements. 60)

There seems to emerge something near to a consensus that multilateralism in planning, in trade – and consequently in accounting – is mostly formal; in practice, bilateralism prevails, and has even been strengthened by the existence of a general shortage of "hard goods", and of a parallel over-supply of "soft goods". All this implies a growing "naturalization" i.e. "demonetarization" of trade with increasing specification in physical forms, bilateral dealing and tying together the trade of specific products. 61)

This also means that – since the TR reflects trade flows predetermined up to 90% in physical units – the common currency strictly follows the movement of commodities, which precludes it from being a separate, anonymous presentation of value. This is called the lack of money function for the TR. When Csaba represents this remarkable criticism of the TR, he quotes two Czechoslovak economists Ondracek and Chvojka. 62)

During the co-ordination of plans there is bargaining among national monopolies. Consequently they are indifferent to individual costs and benefits and are sensitive only to aggregate cost and benefits. From this it inevitably follows that individual processes cannot influence production structures. So prices become merely an accounting device and play no part in automatic microeconomic adjustment. The spontaneity of the market is replaced by miscalculation in planning. 63)

Although there is bargaining among national monopolies, the basis for price-setting in intra CMEA trade has always been "borrowed" from the world market. Before the first oil crisis CMEA-prices were fixed for the entire 5-year planning period whereby the basis was taken from the world market average for the previous 5 years. The new method of sliding prices means a yearly revision of values.

According to Csaba, the new pricing system was expected to create an incentive to flexibility and to transmit the requirements of the world market by decreasing the differences between intra- and extra-CMEA prices. These expectations, however, have not been realised. For several reasons the new pricing formula, in fact, had no effect on enterprise activity. The main reason is that each CMEA country had to use budgetary and other measures to offset the impact on enterprise costs and prices of the changes in CMEA contract prices; thus the new formula has led only to a redistribution of national incomes through changes in terms of trade. 64)

The annual pricing procedure has in fact introduced an alien body into the whole system of economic cooperation within the CMEA, as it comes into conflict with the kind of planning practised in member-states – which requires stability in general and stability of prices in particular. Current national economic planning procedures do require stability of prices for the period set by the planning horizon. Annually changing prices make it practically impossible to evaluate the effect of national participation in a long term special purpose program or in a joint investment. Annual pricing also involves an enormous extra burden for the financial and foreign trade apparatus without being offset by any direct and positive microeconomic advantage. 65)

At the same time, there is one more serious problem in applying international prices in the CMEA: as they are external for the region, they don't reflect scarcities in the internal market. Considerable differences in cost structure make the "borrowing" of a price model highly irrational. 66)

There has always been a remarkable inflexibility in exchange rates in the CMEA. Obviously, the consistency of planning requires stability of currency exchange rates. However, the lack of flexibility of exchange rates has created a situation, in which the exchange rates deviate so strongly from economic realities that official exchange rates as such can hardly be applied any more for practically any purposes. Therefore, a whole series of coefficients are used for various purpose leading to a complicated and in many senses irrational practice.

Under present circumstances it seems to be absolutely necessary to take some kind of guidance from world market values, although it is said to be suboptimal (Csikos-Nagy). Otherwise, there would be no economic objectivity at all in intra-CMEA valuations.

When the monetary system of the Transferable Rouble was created, there was a clear intention to get non-members of the CMEA involved in the system. This intention is mentioned in the introductory paragraph of IBEC statues and in III/10 of the same paper. 67)

This intention was clarified in the Comprehensive Program of Economic Integration signed by the CMEA–members in the Council meeting of July, 1971. Point 7/5 of the Complex Program stipulates:

> "The collective currency (TR) can in the long run according to its strengthened role in payment transactions be used with third countries (non–members), whereby it can occupy among other international means of payment a position, which corresponds to the role and importance of CMEA–member countries in the world economy".

This general statement is supplemented with point 7/12:

> "The expansion of the application area of the collective currency (TR) with non–members of CMEA must be carried out, not only by the measures defined in this Complex Program but also through active measures by foreign trade and banking organizations aiming at involvement of third countries, first of all socialist and developing countries, in order to get them participating in payments effected in the collective currency (TR)".

The 43rd IBEC council session held in October 1976 offered non–members the option of employing its unit of account, the TR, in settlements with members. This was stated in a document entitled "Procedures for Undertaking Settlements in TR between member countries and non–member countries of IBEC". At the same time, outside depositors of TR were offered interest rates slightly over the level offered for Bank members. 68)

Obviously, no non–IBEC member has ever joined the TR payment system in any form. According to Csaba

> "under present regulation not only does an outside holder of TR assets face the same problems as an intra–CMEA holder but he would even be disadvantaged by joining the multilateral payment system. A non–member of IBEC is indeed in a better position from the point of view of the liquidity of his assets if there is a bilateral clearing agreement than if he joins the multilateral clearing system where no one can be made directly responsible for the liquidation of claims or assets". 69)

The TR monetary system with all its shortcomings has certain implications for Western FDIs in the CMEA–area. Firstly, it is clear, that the local partners of a JV and economic policy makers of the host country are unwilling to promote JV product exports to the TR area, if payment is to be made in this monetary unit. Secondly, input items which are available in, e.g. Bulgaria, and could be used in a JV, e.g. in Hungary, are not self-evidently available on intra-CMEA terms, because the Bulgarians probably have no incentive to deliver against TR payment. Thirdly, the TR-system, which has been established for old-fashioned commodity flows defined in physical units, is hampering factor mobility within the CMEA.

The last point is favourable for Western FDIs in the CMEA-region in so far, as intra-CMEA JVs are extremely difficult to establish and run under the monetary circumstances governed by the TR system. Competing ventures which involve two or more socialist countries are highly unlikely to emerge in any large scale. The CMEA financial system is an obvious obstacle for intra-CMEA FDIs.

1.5. Technology exchange and International investments in the intra CMEA-sphere

The integration process of European CPEs has been a complex one. Various organizations have been set up, specialization programmes stipulated and joint investments carried out. JVs in which CMEA-partners share the equity ownership, are extremely rare.

The transition period of Eastern Europe after World War Two has normally been described by Western observers as an era of Soviet domination based on coercion and exploitation. Soviet domination of the new communist states meant a political-economic system modelled almost exactly on its own. Soviet policy, which strived to gain a complete control over Eastern Europe, completely ignored the historical and cultural disparities that divided the countries of the region. In the area of economics the communist regimes introduced programmes focussing on high investment and the development of heavy industry at the expense of the other sectors of the economy. Foreign trade was reoriented towards the USSR on terms generally very unfavourable to the East European countries. 70)

Because of the small size of East European countries, except that of the USSR, foreign trade is very important to these countries. Despite their considerable participation in foreign trade in the pre-war period, the development strategy adopted by these countries in the 1940s and early 1950s was essentially autarkic.

Autarky is, however, not necessarily synonymous with complete severance of all foreign contacts, although at one time a narrowly defined economic self-sufficiency was certainly the prime concern in the socialist concept of best allocation of resources. This economic concept means, in fact, that the crucial task of economic policy is the creation of a well balanced, diversified industrial economy, which is relatively independent of fluctuations abroad. The strategy adopted by the Soviet policy makers in the 1930s has for a long time been the accepted example of how to achieve that goal. It was transplanted into Eastern Europe because it suited immediate Soviet interests and also because the chief mentor of economic policy in post-war Eastern Europe could not quickly adapt its own experiences and interests to conditions that differ substantially from those in the USSR. 71)

The original purpose of the CMEA, as spelled out in the communique of its founding conference in 1949, was to facilitate the mutual exchange of economic experience, technical assistance, and material aid in the form of raw materials, machinery and equipment. 72) Given the prevailing cold-war climate, the primary goal in the CMEA's early years was to maximize the economic autarky of the bloc through the development of indigenous natural resources and the rapid building of industrial capacity, particularly in heavy industries.

While intra-bloc trade developed rapidly in the post-war period, this primarily bilateral trade between each East European country and the USSR, essentially involved Soviet deliveries of raw materials and fuels in exchange for machinery and other manufactured goods. This "radial" pattern of integration, centred on Moscow, created an economic dependence on the USSR, supplementing the political ties between Communist parties and the military alliance embodied in 1955 in the Warsaw Pact.

The CMEA as such played little part in the post-war growth of bilateral trade between its member countries. The organization was virtually dormant until the latter 1950s, when the creation of the EEC sparked a fresh look at integration possibilities within the CMEA. Thus the first 12 Permanent Commissions were created in 1956 and a Charter was finally drawn up in 1959 (ratified in 1960) proclaiming the member countries determination to work towards an "international socialist division of labour".

The Eastern literature emphasized the new character of the international economic links between the socialist countries, free of exploitation, oppression and national antagonisms. 73)

It is not surprising that rules in intra–socialist technology transfer were proposed just after the creation of CMEA. The first rules were prepared at the II CMEA Council meeting in Sofia, August 1949.

The main points of the "Sofia agreement" of 1949 are:

- Exchange and delivery of technical documents
- Exchange of information and licences
- Mutual exchange of specialists, scientists and skilled workers in the sphere of transfer of know–how, training in production and technical assistance
- Exchange of scientific personnel in the sphere of certain technical problems as well as in cases of tests and experiments
- Education of technical and scientific personnel in universities
- Organization of scientific–technical conferences for member–countries. 74)

This "Sofia agreement" has been seen as a direct opposite of the "capitalist" Paris convention. According to the spirit of the Sofia Treaty, immaterial values are the common property of the signatories, and can and should be transferred without payment from one country to another.

There is clear evidence that at the beginning of CMEA–activity technical documents, results of scientific work and know–how actually were transferred gratis from one member country to another. Only the translation costs were to be covered by the receiving country. 75)

Pure grants of licences were, however, limited to such results of intellectual work, which were already available. In case of new developments the full value of documents was charged. 76) However, the spirit of Sofia was obviously functioning in the 1950s helping the development of less advanced CMEA–countries. It has been estimated that Soviet aid alone given in this form to CMEA–members was some 9–10 billion roubles up to 1960. 77)

The period after the signing of the Sofia agreement with free supply of invention is in many senses extremely interesting and obviously unique in its economic consequences. The handing out of technical documents without payment was namely important contribution to formation of parallel economic structure in the CMEA region. It was agreed that the receiving country of licences had to limit the sales of licensed products to its home market. 78) This clause contributed to the emergence of inefficient small–scale production in the documents receiving countries. 79)

In the light of experience changes to rules were made in the 62nd meeting of the executive committee of the CMEA. In the amendment it was stipulated that if the documents were received without payment, licensed products could only be used in the home market, but export was not prohibited if it was agreed upon by a supplementary protocol signed by partners. 80) The Complex Program of the CMEA (1971) stipulates that the exchange of scientific–technical documents takes place by agreement between the parties interested. Thereby the results of scientific–technical research can be exchanged, depending on their level and value, either with or without payment, depending on the achieved result in negotiations, whereby the national interests of every country involved, as well as the common interests of all member countries must be taken into consideration. 81)

Alongside with exchange of intangible assets joint investment projects have been carried out in the CMEA region. Csaba speaks of two separate "investment waves".

According to Csaba 82), the first wave of joint investments took place in the late 1950s and early 1960s when a great number of investment credit agreements were signed. The CSSR, and to a smaller extent, the GDR, were particularly active in this field: beside the Soviet Union they granted investment contributions to Poland and Bulgaria, in exchange for a long–term stable supply of various kinds of raw materials. Joint effort created such exemplary projects as the "Druzhba" pipeline and "Mir" electric grid. In the absence of convertible currency it was impossible to calculate the efficiency of joint investments in a reliable manner. In 1963 a methodology was introduced which prescribed a way in which inconvertible national currencies could be reduced to a common denominator. This could only be done in a most complicated manner, through a plethora of calculations, since each cost item had to be separately calculated. At this stage it became evident that this form of cooperation was in fact a substitute for the market clearing function of the price mechanism, and that the final distribution of gains in a given deal was much more a function of random factors than in the case of a market bargain. 83)

From 1975 huge multilaterally co–ordinated joint projects enjoying political priority were undertaken in the framework of the so called Concerted Plan, which received preferential treatment in national planning too. During this "second wave" of joint investments two approaches came together. On the one hand, the discrepancy between nominal CMEA and Western market prices for raw materials and especially fuels reached unprecedented magnitudes, which led a number of economists and decision makers to the somewhat perfunctory and hasty conclusions that exporters of the above commodities incurred significant losses and/or opportunity costs. On the other hand, the impact of the oil shock brought supply security considerations to the fore in the East European countries, who favoured long-term agreements as a guarantee of a planned way of meeting these strategic needs. This overlap of interests produced the Concerted Plan, which differed from standard CMEA practice since a final state-level compulsory obligation was undertaken in a multilateral form, and furthermore a finalised agreement was signed prior to clarifying technical and financial issues in detail. 84)

According to Csaba there was a temporary spread of approaches advocating in principle a massive international flow of capital among CMEA countries. This boiled down in fact to an apology for a very specific form of capital flow under physical planning, namely investment contribution. In this context there was nothing wrong if, in an area with such high political priority as securing energy and raw material supplies penny-wise calculations played a tertiary role. The aim of securing supply and maintaining dynamism of growth took precedence over adjustment to the world economy. 85)

In the opinion of Csaba the investment contribution in fact constitutes an additional price rise for the fuels and raw materials. It can be substantiated by practical evidence that investment contributions "are not a theoretically new integration form, a socialist version of capital exports, but exclusively a substitute for a sharp rise in prices, under the present conditions of the CMEA non-monetary relations". In other words they have nothing to do with the peculiarities of the raw materials and energy sector, as they spring from the underdevelopment of the regional monetary system. Investment credits are granted in the fuel sector because the shortage in this commodity group is most keenly felt by the system of physical balances, playing a central role in macro-economic planning. Other shortages, for instance in agriculture and foodstuffs, can be equally acute, without evoking any reaction by planners. This is partly due to industrialization priorities, and partly to the different nature of the two fields from point of view of "Planability". Production of basic items can in theory be co-ordinated by a system of physical balances, but this is a far cry from balancing supply and demand on the consumer market. In the meantime this equilibrium can be achieved in the less assortment-sensitive raw material and intermediate product sector. 86) In the context of joint CMEA-investments it is important to notice that in both investment waves the natural riches and production and transport facilities (pipelines) remained in host country ownership. None of these huge projects, to which Csaba is referring, is a jointly owned venture by several CMEA members.

Socialist experiments with JVs and direct capital investments in the CMEA–region are rare, but the few cases available are highly interesting. These ventures can be classified in two groups, those which were established shortly after World War II, and those of later origin.

Those which were established by the Soviet Union in territories of other CMEA-countries belong to the first group. The confiscation of previous German property formed the basis of these ventures, which became operative in Romania, Bulgaria, Hungary and the GDR. The host countries contributed real estate, machinery and financial means according to the need to operate these enterprises. It is said that the capital shares in these ventures, which were run by Soviet officials, were unevenly valued, so that the Soviet share was recorded over its real value. 87)

These economic units had de facto extra–territorial rights in their operations enjoying freedom of foreign trade rights (also to the Western markets) and could operate outside the national economic plans. In addition, the ventures had priority to obtain imports from the Soviet Union and had profit guarantees agreed upon with local authorities. The production targets of the ventures oriented strongly towards Soviet import needs. The most important among them was obviously Sovrom–Petrol, active in the field of oil extraction and refining in Romania. 88)

These ventures were dismantled in the mid 1950s, whereby the host countries were obliged to buy the Soviet share. The fully Soviet owned company in the GDR, SAG (sowjetische Aktiengesellschaft) Wismut was changed to a JV between East Germany and the USSR, and renamed SDAG Wismut (Sowjetisch–deutsche Aktiengesellschaft). 89)

The Soviet owned, or partly Soviet owned ventures are not often mentioned in the Eastern literature. However. Pecsi mentions them in a rather positive way, but states at the end:

> "The joint enterprises operated in the form of joint stock companies. All the usual problems of such ventures occurred, that is, transfer of dividends, taxation, and so on. Their dissolution came about as a result of political, rather than economic, factors. This is why the planning and legal, financial, and related problems of operating these enterprises under socialist conditions have not been developed theoretically". 90)

The second group of socialist JVs is extremely thin. The first one engaged in production is the Polish–Hungarian enterprise "Haldex" founded for exploiting the relatively rich coal content of some old Polish pit–heaps, with a process invented in Hungary. Early in 1959, the joint stock company was founded with equal participation. Although the products, coal and its by–products, are homogeneous and easily priced, a mutual settling of investments, current costs and profits is extremely complicated. Books are kept in the form of two parallel sets of accounts, the first in zloty (Polish monetary unit) the other in a fictitious unit of accountancy specially constructed for the purpose, since the costs could not be converted either at the non–commercial zloty/rouble rate or at the exchange rate between the zloty and the TR applied in the Polish–Soviet trade. The investment and current costs are being converted from zloty to the TR with the aid of about sixty different "coefficients" (including one serving only for converting telephone costs). 91)

However, "Haldex" has survived and has operated over a quarter of a century. In the course of the 25 years of operations this limited liability company, which was formed under the provisions of the Polish civil law of 1934, has recovered 7.3 million tons of coal from the heaps, and in addition large amounts of materials for the ceramic and construction industries. The joint enterprise now operates six coal producing and one light–concrete ingredient plant and employs a work force of more than 1,200. 92)

The cotton spinning plant in Zawiercе, near Katowice, in Poland, which is owned by Poland and the GDR, is considered the first joint manufacturing venture between CMEA–countries. Haldex and this textile factory were the only producing JVs in the CMEA–region with socialist partners sharing the capital before the 1980s.

Rather than build smaller spinning mills in each country the two partners chose to set up a common venture because of the clear advantages of economies of scale with two adjacent consuming markets. Constructing and equipping the mill went smoothly; it was the planning of operations that brought about the serious disagreements.

Reportedly, fixing the relative value of the GDR–mark and zloty posed the most difficult task, since both countries have artificial exchange rates. When it came to deciding how each should be valued against the other for procurement, sales, and other purposes, national pride came to the fore, with each party feeling that "our money is worth more". In addition, months of negotiating and arguing about the proper accounting system to be used caused considerable delay in getting the project launched.

These and other problems were eventually ironed out, and production started in the fall of 1974. An annual output of 12,500 tons of cotton and synthetic thread is anticipated. Equipment for the new plant has been procured almost entirely in Poland, the GDR and Czechoslovakia. The cotton will come from the USSR and synthetic materials from the GDR. All construction and operating costs as well as profits and products are to be divided 50–50 between Poland and the GDR.

In earlier plans, there was to be factory management board with equal representation of Polish and GDR industry experts. In view of the novel situation of joint-state ownership, it was decided to have a board of directors with eight members – four from each side – including vice ministers of light industry as well as representatives of the foreign trade and finance ministries of both countries. Central government representatives on the board of directors make it possible for the development of this unusual organization to be kept under close watch at the highest governmental level in both countries. 93)

Alongside with the official CMEA organization, which comprises so called "permanent commissions" for various industrial branches, various functional organizations have been set up, especially in the 1960s and 1970s. These are the various types of international economic organizations (IEO), interstate commissions for the implementation of specific tasks, R & D co-ordination, international laboratories and scientific research centres. Legally the functional organizations are not part of the CMEA structure proper but occupy rather ambiguous ground between the official CMEA structure and the individual national structures. 94)

IEOs and the other functional organizations should not be regarded as East European multinational companies because they do not operate in a market environment and with market categories. However, when the function the IEOs perform within the CMEA paradigm is compared with the function of the multinationals in their respective environment, then certain important similarities emerge; while the general tasks of integration are set by CMEA institutions proper these tasks could not be implemented without the microcosm of the functional organizations active at the middle and microeconomic levels. The same may be said of the capitalist MNCs. The condition of the markets may be harmonised by inter state agreements, but the actual cooperation and specialization is undertaken by the companies. 95)

V. Sobell, who has made an intensive study on the functioning of IEOs, concludes that their role consists largely of alleviating the consequences of the errors of industrial parallelism committed in the early years of the CMEA, in other words, their role consists mainly of alleviating the disadvantages of belonging to the CMEA. 96)

The sub-optimality of CMEA integration methods has been discussed widely among the member countries in the 1980s. Speaking about the programme of CMEA cooperation at the 26th Congress of the CPSU in February 1981, Leonid Brezhnev suggested that the unfolding of direct ties between ministries, associations and the formation of joint enterprises were the means of integration he would prefer. 97) This idea was accepted in the extraordinary CMEA summit meeting on party leader level in 1984. In the following year the "Comprehensive programme for scientific and technological progress in the CMEA countries until the year 2000" was accepted naming the expansion of direct inter-firm relations as the major way of its implementation. 98)

In the second half of the 1980s it has become fashionable to direct criticism to the insufficient speed of signing inter-firm contracts across national borders. In business practice problems involved in this sphere of activity often prove to be insurmountable. In most cases the co-ordinary "head organizations" (golovnaya organizatsiya) could not even produce an acceptable technical and economic feasibility study for the cooperation project. When neither cost nor benefits can be properly calculated, their distribution among partners can hardly be quantified. As a result, neither commissioning, nor executing parties can be identified, since the determination of actual solvent demand is far too uncertain. 99)

The currency system is, in fact, the most important conceptual issue in the discussion of the CMEA-countries' internationalization process. In October 1987, the CMEA Council Session accepted that national currencies may in fact be used in direct inter-firm relations for accounting. This is of very limited scope, since the major element of the Hungarian proposal, the obligation to settle the year-end account at least in part (25 %) in convertible currency has not been supported by most countries. 100)

Attempts to renew the CMEA financial system and the character of integration, are as intentions extremely important. However, the implementation of both decisions is very difficult. An important aspect of this difficulty is that economic reforms are at different stages in various CPEs. 101)

It is, however, understandable that the CMEA-countries have been looking for new methods of economic intercourse in the late 1980s because there are severe constraints in the traditional way of trading within the CMEA. This is described by A. Köves in very straightforward terms:

> "In the past decade and a half Hungary's relations with the CMEA were marked by the narrowing of the purchase opportunities, by faltering of the earlier stability of purchase and sale, by a considerable deterioration of the terms of trade and of non-price conditions of trade. The difficulties can be attributed to a large extent to unfavourable developments in the Soviet economy.
>
> The slowdown of growth (in fact, stagnation, in numerous areas, regression) which did not spare the traditional heavy industry and raw material extraction, sectors, which play a decisive role in exports, the structural rigidity of the economy, the increasing technology gap, the deteriorating efficiency, including the rapidly diminishing specific energy- and material intensity, the worsening agricultural situation in spite of the gigantic investments etc. All this – aggravated by the compelling need of increasing, or at least maintaining, convertible currency receipts – increasingly hindered the Soviet Union's exports to Hungary and TR accounted exports in general, both in the traditional structure and in any other commodity pattern satisfying the requirements of the partner. Thus trade with the Soviet Union ceased to play the role of dynamizing economic growth in Hungary. All this has affected not only Hungary but all CMEA partners of the Soviet Union". 102)

Critical remarks concerning CMEA cooperation have not remained the monopoly of Hungarian observers.

The Czechoslovak economist L. Rusmich states that countries or groups of countries with a market of their own, cannot pursue a pricing policy for their own products independent of prices valid on foreign markets, if they do not want to fall out of step with world labour productivity. If a commodity is, in relation to all other commodities on the given market, more expensive than on other markets of the world, and can be sold here in spite of the fact that it cannot be exported profitably, it is obviously produced at an inadmissibly low level of productivity. The continuation of the production of such labour-intensive and low-quality commodities reduces, in the last resort, the productivity of social labour of all parties in the given market. As a consequence, the standards of living of the direct producers of such commodities will decline. 103)

However, Rusmich is right when he attacks the old socialist school of thinking, which sees commodity–money relations and planning as conflicting categories and writes that they (the old school representatives) deprive economic practice of the possibility of objective, consistently improving criteria of economic efficiency and incentives for further progress. In addition, they serve as a justification for autarky and for poor productivity of social labour as compared to world standards. Only a consistent understanding of socialist production as commodity production for the market and of the link between domestic and international prices can serve as a reliable scientific basis for the establishment of an open socialist economy and for the restructuring of the present, rather unsatisfactory mechanism of cooperation of the CMEA member countries leading to a mechanism of socialist economic integration for which truly efficient value categories are needed for fulfilling their functions. 104)

1.6. Summary and conclusions of Chapter One

The first chapter can be summed up by the following points:

- The theory of imperialism is a very essential point in the basic ideology of Marxism–Leninism. According to this theory, there is a competition between economic systems, which will at the end be won by socialism. The main economic agents of imperialist powers are the MNCs, in which industrial and financial capital have merged.

- The socialist world system in the framework of the CMEA has been unable to create institutions to carry out intensive economic growth via internationalization of socialist economies.

- Administrative methods of economic management on the international level have shown considerable difficulties, because the national interest of CMEA members disallow direct supranational planning.

- "Monetarization" of the economy has been the declared aim of economic reform in certain socialist countries. "Monetarization" of international economies in the socialist world is extremely difficult to achieve, because the bilateral trade system, accounted in the TR unit, has created and maintained uncompetitive industries. A sudden change in trade and financial systems would create structural changes that could be devastating.

- Multinational companies, which are the most dynamic part of capitalism, have hardly emerged in intra–CMEA activity. The IEOs cannot be described as an equivalent of Western MNCs. Therefore, the technology gap between East and West cannot be closed.

- Foreign trade in volume terms cannot be increased in intra–CMEA activity any more. Constraints are so severe that there is no going back to the early years of CMEA–cooperation.

- Summing these points up, there is a clear need to seek cooperation with Western countries, including joint investments with Western MNCs. This means alliance with the ideological enemy.

- From the point of view of FDIs of Western MNCs, the CMEA economic region is a very special one. The special nature of CMEA integration framework gives a clear disincentive to invest inside the region.

- Economic reforms in various CMEA–countries alleviate the disincentives of Western FDIs. "Monetarization" of the economy in CMEA scale is, however, difficult, because economic reforms are not advancing in all CMEA countries in a similar manner.

Some features of East–West trade during the last some twenty years speak for the necessity of looking for new methods of cooperation, including JVs. This necessity also gives the incentive for CMEA countries to approach Western international organizations which previously have been damned as imperialistic. These matters will be discussed in the next chapter.

Chapter 1

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2. East–West trade and co–operation

The history of East–West trade after World War II is complex. It could be investigated from the political angle covering trade policy and embargo matters. That history also naturally has economic dimension. In the context of this study, only some major features of East–West trade, which are of importance from the point of view of Western FDIs in CPEs, will be covered.

In chapter one it was shown that in intra–CMEA trade there are serious constraints in respect of increasing mutual deliveries and that qualitative improvements in mutual links are difficult to achieve in the international, out–dated monetary environment.

The first part of this chapter deals with constraints in East–West trade. It can be assumed that one of the main reasons for CPEs pursuing FDI–policy with the West is the lacking dynamism in technology exchange using conventional trade methods, with credit financing.

2.1. Main features of East–West trade

East–West economic relations have been inextricably linked with the ideological and political controversy between socialism and capitalism. It is this controversy that has made the East–West dichotomy a major division in world relations. In the late 1940s the USA steered Western policy towards economic containment of the Soviet Union. A common approach to East–West trade was facilitated more by US economic and political dominance than by a genuine consensus with the Europeans. As the US linked the provision of economic and military aid to the support for its policy of economic containment, the West Europeans were obliged to follow the US lead. There was however, widespread support among Western allies for the use of COCOM as a means of denying the Soviet Union goods and technologies which contributed directly to its military effort. 1)

Throughout the 1960s a modus vivendi developed in East–West trade relations as controls were liberalized on the Western side and the deeply defensive policy of CPEs was giving ground to the policy of a controlled opening. This was characteristic of the 1960s and the 1970s. 2)

In the 1960s and especially during the first half of the 1970s there was a considerable boom in East–West trade under the umbrella of detente policy. Economic euphoria replaced political tension in East–West relations. 3)

The external environment for the CPEs was exceptionally favourable during the 1970s. The CMEA countries had access to relatively cheap credits available on Western financial markets. The Soviet Union had huge windfall profits as a result of the first oil crisis. The impact of energy crises was lessened to the small CMEA–countries by CMEA–price–setting procedures. In addition, a relatively decent economic growth in the non–socialist world contributed to the growth in demand for CMEA–products, although their share in the world convertible currency trade declined between 1970 and 1980. 4)

However, in the turn of the decade from the 1970s to the 1980s some unfavourable external factors affected the CMEA countries' integration into global economy. Interest rates as well as oil prices increased rapidly and Soviet invasion of Afghanistan caused trade policy measures against socialist states. Polish crises in the social and financial sphere curtailed CMEA countries access to Western financial markets. High real interest rates boosted the cost of servicing the convertible currency (CC) debt that had accumulated as a consequence of "import led growth" strategy pursued by those countries in the 1970s. 5) The Soviet Union was thus so far an exception in that it profited from the second oil crisis and was thus able to keep its Western debt relatively well in check.

Towards the mid 1980s the small CMEA countries managed to consolidate their debt position relatively well with the exception of Poland which remained continuously credit unworthy. This stabilization of external accounts was, however, achieved mainly by cutting down Western imports, rather than by increased competitiveness of small CMEA countries' processed goods. 6)

P. Marer concludes in his study on Hungary in the 1970s that this period was the decade of illusions. This remark can be applied to other small CMEA countries as well. There is strong evidence that economic policies pursued in Eastern Europe rested on the illusive conviction regarding the possibility of insulating an economy from the effect of shocks in the world economy, of reorienting trade and investment toward the CMEA partners, and the belief that their economies may generate CC earnings to service international debt without economic reforms. 7)

Often CMEA countries blame the Western countries of having discriminatory trade policy towards Eastern Europe hinting at embargo measures. Csikos-Nagy, however, maintains that there has also been "self-discrimination" among CMEA countries. He makes the point that CMEA countries have stubbornly kept quantitative growth as the main aim of economic policy neglecting quality. Furthermore, the CMEA countries have been slow to learn international marketing and to change their economic institutions and infrastructure towards the needs of the internationalization of the economy. 8)

It is worthwhile recognising that the "illusion of the 1970s" (the import-led growth and debt financing), which was very much present in the CMEA countries in that decade, also contained the hope of achieving international convertibility of money, especially in Hungary. If that illusion had materialized, there would have been an essentially better basis for Hungary (and other CMEA countries) to enter the global economy as a "normal" partner offering opportunities for Western FDIs. However, in the 1980s this important precondition for flexible JV operations – the free exchangeability of local money – was absent in Hungary, as well as in other CMEA countries. This is due to the fact that in the 1970s and 1980s the CMEA countries were unable to integrate themselves into the global economy by essentially improving their competitiveness via East-West trade flows.

2.2. CMEA countries and international economic organizations

2.2.1. CMEA countries, technology exchange and industrial property rights

It can be taken for granted that the opening up of CMEA countries since the 1960s has brought about certain economic advantages, even if Western imports have had more of an import substituting than export drive effect. This positive effect could have been greater, had the adaptation capability of CMEA countries been better.

The organizational separation of buying agents (FTOs) from the end-users (production enterprises) has certainly caused large-scale waste. According to an interview with Professor W. Wallace of Glasgow in the Soviet magazine "Novoye Vremya" the stock of unused imported equipment in the Soviet Union is estimated at almost 5 bn roubles in 1986. 9) Similar waste affects have certainly been present also in other CMEA countries.

East–West economic ties since the 1960s have not only contained the sales and purchase of goods, but also various forms of other business deals. There are more than a thousand agreements between East and West which can be classified as technology exchange deals. Approximately 5 % of East–West trade flows is conducted on the basis of these agreements. 10)

It is not possible to cover all the details of these highly interesting business deals here. For the purpose of the present study only some general features of these agreements are of interest.

In the purest form of an technology exchange, or co–operation agreement between East and West, the Western MNC delivers machinery and equipment, licences, documentation, and so on, on credit and receives in exchange products from the plant, specified in annual quotas, whereby the East European country retains full ownership of the plant and is responsible for the planning of input (including labour) and receives a share of the production. These relatively widely used deals are called "buy back" arrangements. More diluted forms include subcontracting production, mainly of components, from the MNC to the CMEA country on the basis of direct instructions and documentation, without direct participation by the MNC in the construction of the plant. The East European country is effectively involved in selling domestic value–added to the Western MNC but receives only a limited amount of technology.Another form of cooperation includes various types of co–production agreements whereby the MNC and the CMEA country specialise in the production of specific components which are subsequently exchanged and the finished products are assembled in both countries and are marketed jointly in third countries and/or separately in predesignated areas. 11)

The cooperation type of trading which spread rapidly in the 1970s has in the 1980s slowed down. Due to slow rates of growth and problems of unemployment, Western enterprises have not been interested in delivering technology to CMEA countries. There have also been some changes in the political background of inter–firm relations. The technology exchange development in the 1970s required each participant in inter–firm cooperation to keep up with the technological level of the partner. This explains why the cooperation is often restricted to second–rate technologies rather than first rate products or processes. The majority of cooperation contracts are buy back licence contracts and machinery deliveries, which block the CMEA partner on the level of the introduced technology. 12)

There have been certain differences between small CMEA countries and the Soviet Union in the frequency, volume and structure of cooperation agreements which were concluded by trade intensive smaller countries such as Poland, Romania and Hungary. Agreements concluded by the USSR though less frequent, as a rule refer to a much larger basic transaction as well as to a much greater continued bilateral or multilateral flow of goods. The latter agreements have involved investment programmes in some key sectors of economy, for example, the chemical industry, and usually involved the latest achievements of technology. 13)

The growing interest in technology transfer by CMEA countries since the1960s has also made them change their policy towards Western conventions regulating Industrial Property Rights. As mentioned above, the socialist countries signed their own convention on technology exchange in the late 1940s in Sofia, stipulating that innovations can be transferred freely (without charge) from one fraternal country to the others. However, in time all European CMEA countries became a party in Western "Paris Convention" regulating Industrial Property Rights based on patent protection. Also the Western convention concerning Trademarks has been signed by European CPEs. 14)

This fact creates an extremely odd situation in East West technology transfer. In the East two international conventions, which in their spirit are diagonally opposite, are valid at the same time. The traditional business attitude that the person or institution, who made an invention, is supposed to have the sole economic advantages out of it, is formulated in the Paris convention, as amended in Stockholm 1967. The Sofia agreement stipulates that intangible assets are in fact common property of mankind.

There are certain Western firms that are unwilling to sell any licences to CMEA area as long as the Sofia agreement remains in force. Their argument is that selling a licence, say, to Bulgaria, means that the documents covering the licensed production,could be automatically transferred to, say, Hungary, on the basis of the Sofia agreement – free of charge and free of royalties for the Western partner.

Obviously, the Sofia agreement in this context has become an embarrassment for CMEA countries' trade officials. They explain that the Sofia agreement has no validity in practical terms anyhow. Licences are bought from the West with the motive of increasing competitiveness in intra-CMEA trade. Therefore, the articles of the Sofia agreement are not applied.

Trade officials in CMEA countries licensing trade outlets advise Western technology sellers to include a clause in every licensing deal stipulating that sub-licensing – paid or unpaid – is strictly prohibited under all circumstances. In this way the Sofia agreement is avoided. 15)

Trademarks are regarded in socialist thinking as a trick of certain capitalists to cheat their clients. That intangible asset enables the bearer of a trademark to charge the client more than the actual labour- and use-value which that special item presupposes. Therefore, a trademark is seen as a part of immoral business activity.

However, Trademarks, as well as Industrial Property Rights have been accepted by CMEA countries, because it has been recognised that ignoring Trademarks would hamper technology transfer. Certain franchising deals have been concluded between East and West. Hotels with international labels have been set up in CMEA capitals, even if they are not all JVs. Well-known soft drinks can be obtained in CPEs, made locally but bearing a Western Trademark, etc.

Summing up the first sections of chapter 2, one can say, that there has been wide-reaching illusion in the CMEA area in the 1970s that credit financing in East-West trade combined with technology transfer can be used as a substitute for economic reforms. There has also been the illusion that FDIs can be imitated by establishing cooperation deals on territories of CPEs involving foreign technology, but excluding Western equity participation. The disillusionment in these points is one of the main motives, why CMEA countries have started pursuing JVs in the 1980s much more vigorously than previously.

2.2.2. CMEA countries and the multilateral monetary system (IMF and World Bank)

It has been shown above that the CMEA countries have their own international monetary system based on TR, which is extremely unsuitable for international business operations. Evidence has also been cited to show that the CMEA countries have had an interest in the international division of labour and the international division of technology with the rest of the world. At the same time, the CMEA countries have been increasingly willing to accept the rules of the technology game, even if some ideological obstacles are still present.

When FDIs are put into operation there are certain factors which motivate the MNCs. Rich, local markets, educated labour force and sophisticated infrastructure are normally mentioned as preconditions for getting FDIs. Convertible currency in the host country of a FDI is an extremely important precondition, which is often not mentioned in this context.

From the point of view of classical economics it is surprising that the lion's share of global FDIs is made among industrialized countries, inside the OECD area. Only about one fourth of global FDIs goes to LDCs. 16)

International flows of capital have been a central concern of international economics, and economists working in this field have long tended to explain the MNCs as simply an arbitrator of capital between countries where its marginal productivity is low and those where it is high. The MNC's profit thus results from arbitrage activity. 17)

Without going into detail on the inconsistency between economic theory and actual FDIs, the assumption can be made here, that relative stability of the monetary economy (the predictability of inflation, exchange rate oscillations etc.) and convertibility in the host country are important elements when FDI–decisions are made in MNCd. Therefore, from the point of view of JVs between East and West it is of utmost importance how the CMEA countries manage their monetary policy and what their links to the IMF are. The relative scarcity of capital, as pointed out above, is necessarily not a sufficient precondition for receiving direct investments from more affluent countries.

Since the end of World War II, the dominant international monetary system, constructed at Bretton Woods in 1944, has centred on the International Monetary Fund. This system weakened substantially in the early 1970s. In the Bretton Woods system, the rules guiding the relations among states were intended to prevent the repetition of the international economic conflict of the 1930s, ie competitive devaluation, discrimination in foreign exchange dealings and tariffs, lack of convertibility, disorderly flows of capital. For unique historical reasons the United States and the United Kingdom had an unusually large influence in establishing the system and subsequently controlling it. Europe was in ruins; Germany, Italy and Japan were ex–enemy countries. Most developing countries were still colonies; only India, Egypt, Ethiopia and Liberia and the independent countries of Latin America attended the Bretton Woods conference. The Soviet Union and other East European countries participated in Bretton Woods, but the Soviet Union eventually chose not to join. Poland resigned its membership in 1950 and Czechoslovakia was required to withdraw from the IMF in 1954. After the revolution of

1949 the China that then retained membership did not represent the mainland.East European countries gave their main reasons for not adhering to the Bretton Woods system as (a) the procedure adopted for allocating votes (b) the requirement to report their national gold and foreign exchange holdings and transfer part of them to the US where the IMF and the World Bank (IBRD) have their headquarters: (c) the terms on which members were allowed credits to correct their balance of payments. An unstated reason was the deterioration of international political relations. 18)

The Bretton Woods system was originally intended to include an International Trade Organization which was negotiated and adopted in Havana in 1948; but the Havana Charter was never ratified by the US Congress. Some of its commercial processions were incorporated in the less ambitious General Agreement of Tariffs and Trade (GATT) of 1948, which was intended as an interim arrangement, but became a mechanism which has served as the principal forum for multinational trade negotiations. The wider aims, including steps towards organizing commodity markets, were never implemented. 19)

The system of international economic cooperation thus established by the industrially developed capitalist countries after World War II was based on the following principles:

- Every country is interested in the general development of productive forces. Due to the international division of labour, economic stagnation in any of the countries has an adverse effect on the economy of the other countries.
- Every country is interested in the convertibility of national currencies. If the currencies of all countries are convertible, this promotes multilateral economic relations.
- Every country is interested in equilibrium of the international balance of payments. If any one country becomes insolvent and intends to introduce foreign exchange and trade restrictions, this diminishes the trade possibilities of the other countries.
- Every country is interested in currency cooperation to ensure equilibrium in the balance of payments by an internationally harmonized foreign exchange policy, interest rate policy, gold and credit policy. The equilibrium of the international capitalist monetary system would became less secure if these questions were considered only as business of national economic policies. 20)

The last point, ie the right of the IMF to make recommendations on economic policy of the member countries, has been traditionally regarded by the socialist countries as unacceptable interference into the internal affairs of sovereign nations. Therefore, the

IMF is said to have an "imperialist" nature. The Soviet Union has usually complained about the considerable influence of the USA in the IMF which is based on its quota. The obligations to release information on the balance of payments and foreign exchange as well as gold reserves to the Fund is also unacceptable to the USSR. Furthermore, the USSR dislikes the IMF method of using certain Western currencies as an official reserve currency. The Soviet Union has thus appealed for the re–establishment of the gold standard in international monetary relations. At the IV UNCTAD conference in Nairobi 1976 the CMEA countries signed a petition proposing the re–establishment of the gold standard and the abolition of the monopoly position of one or several national currencies in the international monetary system. This declaration was not signed by Romania, which became an IMF member in 1974. 21)

In spite of the ideological controversy on IMF matters there seems to be a tendency toward a more realistic approach to international monetary matters among the CMEA countries. Hungary joined the IMF and the World Bank in 1982, and Poland handed in her membership application in 1981. 22) Poland became a member of both organizations in 1986.

Obviously, the Soviet attitude towards the IMF has not changed in principle. The IMF and the World Bank are described as institutions, which create a favourable framework for the "expansion of capital" favouring the imperialistic dominance of economy on a world scale. Normally this criticism is concentrated on US direct investments abroad. 23)

Joining the IMF does not mean that the monetary unit of the new member country automatically becomes convertible. The rules of IMF only stipulate that the member ought to aim to convertibility of their currencies.

Romania, which joined the IMF in 1974 is extremely far away from the convertibility of the lei. Nobody believes that Poland will be able to reach zloty convertibility in near future after joining the IMF.

Occasionally, the possibility of making the Hungarian forint convertible in the near future has been brought up. First Vice President of the Hungarian National Bank, Janos Fekete promised during his visit to West Germany in 1985, that the forint would be ready for external convertibility during the second half of the 1980s. 24)

The preconditions for currency convertibility are clear: the exchange rate must be on a realistic level, so that the currency will be accepted by outside persons or organizations without being afraid of suffering sudden losses due to huge devaluation; there must be sufficient currency reserve to guarantee the exchangeability of the currency; the currency must be freely usable for purchases of local goods and services, in other words, there should be as few limitations as possible in foreign trade administration; the exportable goods and services should be attractive for outside buyers as far as price and quality are concerned; there must be financial incentive for the outside unit to accept the currency, e.g. if somebody has a claim in that money, he expects competitive interest on this claim.

The Hungarians often mention the fact that in October 1981 a unified standard exchange rate was established for the forint. Since 1st January, 1985 a daily rate quotation has been established. As the economic reform has advanced, the state monopoly of foreign trade has been modified and many production units have been given foreign trade rights. The home market price level has been moving in a market clearing direction.

In spite of all these developments certain direct allotments of goods prevail, and in foreign trade transactions are still controlled by central bodies through the permit system. Competitivness is certainly not guaranteed in all branches of the economy, and subsidies seem to die hard.

A complete assessment of all preconditions of the forint convertibility is not possible here. It is sufficient from the angle of this study to point out certain details, which seem to be important when the possibility of Hungarian forint convertibility is evaluated.

Some 50 % of Hungarian foreign trade is with the CMEA area. This trade is still mainly conducted in the traditional manner, e.g. on the basis of 5-year agreements and yearly protocols with compulsory delivery quotas, also containing some "soft" goods, and payments effected in TR The maintaining of this system calls for state regulations, in order to fulfil the obligations laid down in protocols.

If now on a certain date Hungary declares its forint convertible

- even "partially", or financially creating a special monetary unit – this will mean the likelihood, that her CMEA partners will start asking for payment in that monetary unit for their exports; if that monetary unit accepted by the Western partners as a convertible means of payment. West partners must then be able to rely on sufficient currency reserves in Hungary

- the CMEA partner of Hungary after having earned convertible forints by exporting to Hungary, can use that money for purchases from the West. This can easily cause serious balancing problems in Hungary's CMEA trade: "soft" commodities are no longer accepted, because the CMEA partner can now divert the forints to purchases on the world market. At the same time, Western exporters to Hungary who accept payment in convertible forints, can divert that money to purchases from other CMEA countries. These can either accept it or not. If the CMEA partners do not rely on the lasting convertibility of the forint, they naturally can refuse to accept it as an alternative for dollars or other Western currencies. In that case an over-supply of convertible forint builds up causing a presumably rapid depreciation of the forint value.

The whole idea is economically viable only in the case that "soft" goods can be eliminated at the same time in all subsections of Hungarian foreign trade. How far this structural change is going to affect Hungary's commitments in CMEA cooperation is not clear. Such changes have a political aspect as the coherence of CMEA cooperation is put at stake, and the rigid mechanism of the "socialist division of labour" is endangered. This political side, however, is becoming less and less important.

The main question, however, is a psychological one: is it possible at the beginning that after declaring the forint (partially) convertible to find Western companies who accept their payments in that monetary unit. Very clear evidence of abundant currency reserves is required. If conversion to Hungarian goods is unsatisfactory, then financial conversion must be guaranteed. Obviously, extra incentive can be given at the beginning by providing high interest rates for forint claims. That, however, makes the whole business expensive for Hungary.

The exchange rate policy of Hungary has had some highly interesting features. According to two Hungarian economists, Katalin Botos and Werner Riecke, the exchange rate must simultaneously satisfy three-fold needs:
- it should reflect the purchasing power parity of forints vis-a-vis the convertible currencies
- it should hinder the imported inflation, and thus, be a means of price stability in the home market
- it should contribute to the equilibrium of the balance of payments. 25)

The second point seems to have been in the focus of economic policy considerations in the 1970s, when the forint was virtually continuously revalued vis-a-vis the dollar, in order to beat worldwide inflation. The opponents of devaluation argue, that because of the import structure and the low cost-sensibility of Hungarian enterprises, the price elasticity of imports is virtually zero. On the other hand the volume of exports is not dependent on the export price level calculated in forints, because high capacity utilisation exists in the enterprise sector. This view emphasizes that under these conditions devaluation of the forint has no significant influence on the balance of payments, but has an inflationary effect on domestic price formations. 26)

Obviously, this rather unorthodox view was predominant in the first half of the 1970s. However, it was soon realized (1976), that the deterioration om the terms of trade cannot be neutralized by exchange rate policy (by revaluing the forint), and by increased state subsidies. In 1979–80, a price reform was carried out (increased raw material and energy prices), thus allowing price hikes for manufactured goods. As at the same time the prices for export goods to CC area started to decrease, devaluation became unavoidable. Currency reserves declined rapidly, and it seemed that the third point in the Botos–Riecke classification (the balance of payments consideration) replaced the second one (the blocking of imported inflation) in exchange rate policy. 27)

Botos and Riecke also point out that the "Exchange Rate Deviation Index" in Hungary is extremely high by international comparison – over 290 per cent. The exchange rate deviates greatly from the purchasing power parity. The high figure of the ERDI–index obviously has historical a background: the long period of Hungarian economic isolation from the pressures of the world market has essentially contributed to the economic and price structure. 28)

Botos and Riecke argue that the exchange rate policy cannot alone create fundamental change. This had to be followed by other means of economic policy, ie by austerity measures. Austerity may lead to long–term stagnation, unless no favourable means are created for increased factor mobility in the social, political and legal sphere. 29)

In the concluding remarks Botos and Riecke make three points:

- institutional improvements (e.g. capital market) must be carried out. In order to change over from present devaluation policies to "hard currency" practice (including possible revaluations) is needed to counter inflationary tendencies
- if the rigidities of the present economic mechanism cannot be overcome, but the macroeconomic budget and monetary management is maintained, then the continuation of devaluation is unavoidable

- in the worst case scenario the present reshaping of the economy through market signals will be halted and replaced by politically founded regulations supporting the big enterprises (heavy industry). This scenario would also include the revaluation of the forint, not however, because the market situation justifies it, but because the exchange rate would be robbed of its role as a macroeconomic orientation figure. 30)

The two Hungarian experts plead strongly in favour of the first scenario, also using the argument that the membership of Hungary in international organizations (IMF, GATT) presupposes balance of payments readjustments with the help of orthodox exchange rate policy, and not with unorthodox methods involving budgetary export subsidies. It is self-evident, that only the successful application of the first scenario can create the economic preconditions for the external convertibility of the forint.

The assumption can be made that IMF economic policy recommendations have influenced Hungarian external economics in the 1980s. Severe mistakes, like revaluations in entirely wrong situations, the consequence of which has been continuous waste of energy and raw materials via price biases, have no more occurred.

The Hungarian case also shows how difficult it is to find the "right" or economically justified exchange rate (with the correct purchasing power parity) when historical price biases exist in the economy. The point has also been made, that individual country actions towards convertibility in the CMEA-area are not so simple, because they could undermine the whole TR and bilateral trading system in the bloc.

In the summer of 1987, the Central Committee meeting of the CPSU decided that the Soviet rouble should be made convertible, at first in CMEA-countries. 31) It is extremely unclear how this aim can be accomplished.

The Soviet Union has shown interest in becoming a member of GATT. However, the Soviet official attitude towards IMF is still virtually unchanged. The multilateral monetary system is still US-dominated and based practically on the dollar. In the IMF the US-dominance prevails making the Soviet membership still impossible. 32)

Altogether, in the late 1980s, there has been a strong feeling among CMEA-countries that international currency problems must be discussed, and in the long run, also solved by creating convertible means of payments. How this proclaimed aim can be reached is momentarily not in sight.

2.2.3. The trade policy of CMEA–countries towards the rest of the world

The willingness of CMEA–countries to accept Western FDIs in their respective territories is a sign of opening up towards the rest of the world. At the same time, however, the CMEA–countries have been unable to create convertible money. Thus, the enterprises doing business inside the CMEA–area with foreign participation are obliged to be "self–sufficient in CC terms".

On the basis of this constellation, it is of vital interest for the foreign firms investing directly in CPEs, how the products manufactured in the East can be exported to the rest of the world, and what kind of protectionism these exports will face.

There are, however, some possibilities to earn CC inside the CMEA–bloc. These opportunities can be seen in JV activity.

In all the European CMEA countries there exists a chain of "hard" currency, or so called "valuta" shops, which are originally meant to serve Western visitors only, with mainly Western high quality consumer goods. However, this special retail network has been largely expanded over the time, and rules entering them have been relaxed. For the local population it has become easier to have access to these shopping outlets. Only the Soviet Union and Romania apply relatively strict rules on rights to enter "valuta"–shops.

It is understandable that the economic mechanism behind this convertible currency retail selling are not widely discussed in the Eastern literature. The whole area is extremely sensitive from the viewpoint of political economy when capitalist means of payment are involved in a socialist planned economy.

One of the most striking facts in this context is, that the socialist countries have started to issue money, or quasi–money, which is accepted by local "hard" currency shops, as means of payment alongside with all convertible currencies. One of the currency coupons, the Polish PKO–cheque or "Pewex"–coupon even carries the US–dollar sign ($) on it.

In the framework of this "hard" currency business in the CMEA countries a new term of international socialist economies has emerged: it is called "internal export". 33) This means in actual fact that certain home–made products are sold to the local citizens for foreign (convertible) currency, or equivalent means of payment, that is, coupons which can be used for shopping in "hard" currency shop. Items in the "internal export" category are extremely difficult or even impossible to acquire with local, "normal" money. Internal export items are often produced with Western technology.

In intra-CMEA trade a part of the business is settled in CC. This trade in which the seller is normally interested in realising competitive, or "hard" items, is conducted outside the bilateral protocol. The question is how the seller's interest can be reconciled with that of the buyer. In principle the matter is simple: if the latter needs a certain quantity of a commodity and cannot buy it for TR, he will buy it anywhere for CC at the current world market price. In fact, even with quite identical trading conditions he might, for reasons of safety, political, or trade policy reasons prefer purchasing from a CMEA partner. The rigidity of trade settled in TR is in itself a satisfactory justification for the trade settlement in CC in intra-CMEA framework. 34)

CC deals are obviously becoming increasingly important in intra-CMEA activity. According to K. Botos, at the beginning of the 1970s, settlements in convertible currency in intra-CMEA trade were approximately 1-1.5 per cent of the mutual trade, while at the beginning of the 1980s the corresponding figure had grown to some 10-12 %. She points out that the erosion of the TR system can only be stopped by reforming it. 35)

Obviously, the "internal export" market and the intra-CMEA trade settled in CC can offer some healthy business ideas for JVs situated in CPEs. A jointly built and run hotel and/or restaurant can charge the clients in CC, a jointly manufactured TV-set or car can be sold in a CC-shop etc. Some products with Western design and technology can be sold from one CMEA-country to another for CC.

However, if a large-scale FDI is enacted in the CMEA-area, it is highly probable that outside export markets must be found, in order to earn CC. Therefore, the trade policy standing of CMEA countries must be investigated. Of special importance in this context are the relations of CPEs towards Western Europe, their most important export market.

Initially, after the signing of the EEC founding document in Rome, the Soviet Union ideologically condemned the European Community as providing the economic basis for NATO policy. In 1957, after the signing of Treaties of Rome the ideological periodical "Kommunist" condemned the EEC with marxist-leninist jargon based on 17 points. In this context it is defined within the viewpoint of the economic framework of imperialism; thus a United States of Europe is seen as either impossible or reactionary under capitalistic circumstances. The new community is a treaty of monopolies fighting for markets, sources of raw materials and spheres of investments without considering the interests of working masses. However, it is predicted, that tensions and contradictions between the member states of the EEC are only going to speed up the process of capitalistic self-destruction. 36)

In 1962 (August 26th) Pravda published theses called "imperialist integration in Western Europe", thus creating an official terminology for all socialist countries, when they wrote about the EEC. 37) However, at the same time the EEC is defined to be a strong and long lasting organization, and therefore, co-operation between two European economic groups (EEC and CMEA) cannot be excluded. Peaceful economic competition is not only declared between states applying different economic systems, but also between economic groupings (EEC and CMEA). 38)

However, Western Europe's union was not considered to be a de facto "integration" and was thus denied recognition in terms of international law. While, originally, this recognition issue was the dominant problem, this was replaced in the course of the years by a more pragmatic stance. Brezhnev's speech in March 1972 was seen as the turning point. He said:

> "The Soviet Union by no means ignores the situation that has in fact evolved in Western Europe nor does it ignore the existence of an economic grouping of capitalist nations such as the Common Market. We are keeping careful watch on the activities of the Common Market and its evolution." 39)

In Eastern Europe there was good reason to watch the development of EEC carefully in the early 1970s. In March 1971 the EEC Council of Ministers agreed on the aim of establishing common provisions for trade with state-controlled economies. The end of 1974 saw the expiry of the bilateral trade agreements between the member nations of the EEC and those of the CMEA. 40)

It is thus no accident that the first, unofficial meetings between the CMEA and the EEC took place in that period. However, no agreement could be reached between the two groupings in the 1970s. 41)

At the end of 1974 the EEC sent all CMEA-states a blueprint for trade agreements between the Community and individual countries with state-controlled economies.

CMEA responded in 1976 by presenting a draft framework treaty. However, the asymmetry in the scope of authority in the two organizations proved to be a fundamental problem from the very beginning.Since, in the EEC view, the CMEA lacked a basis in law that would enable it to commit the individual member states in the legally binding manner. Thus the EEC was not prepared to enter into a trade agreement with the CMEA but only with its individual member nations. In respect of the CMEA, the EEC was only prepared to talk about specific sectors such as transport issues, standards and environment problems. The detailed CMEA draft treaty of 1976 ran counter to this intention; this agreement lays down the official relations between the CMEA and the EEC. In addition, the draft treaty contained such provisions as the granting of MFN–status, removal of trade restrictions, credits on favourable terms and the development of trade in agricultural products. In its reply of November 1976, the EEC was consistent and refused to start negotiations on the basis of the CMEA draft. Even so, specialised talks continued. Eventually, these contacts lapsed – not least due to the general hardening of East–West conflict. 42)

It was not until June 1988 that the CMEA and the EEC signed a political declaration which meant the official recognition of the EEC by Eastern Europe. After that, the CMEA countries started having diplomatic relations with the EEC and start trade negotiations with Brussels. These negotiations can only be of bilateral nature, every single CMEA country on one side and the EEC on the other. In these negotiations the Western side has pointed out that mutuality in abolishing trade barriers is extremely difficult to reach because of the difference in protective methods. 43)

From the point of view of FDIs in the CMEA–area it is extremely important to realize that no all–European free trade zone is created on the basis of the CMEA–EEC agreement of 1988. If direct investments are made in the East, the Western protectionism concerning goods manufactured in the CMEA–area must be taken into consideration.

Chapter 2

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3. Foreign Direct Investment (FDI) between East and West

3.1. General aspects of Western FDIs in CMEA countries

It is easy to agree with P. Marer, when he states that

> "comparative economies should go beyond the simplistic classification of countries as capitalist vs. socialist, or as market economies vs centrally planned economies (CPEs), because those terms veil important similarities between countries belonging to different groups as well as significant differences within them." 1)

It is certainly true, that there are similarities, for example, between the CMEA–countries and Newly Industrialized Countries (NIC) in their respective industrialization drives and protection of infant industries. At the same time, it is impossible to regard the CMEA–area as a monolithic economic bloc in the 1980s, where all national economies would be supply–oriented and managed by directive planning.

Therefore, it is appropriate to analyse the CMEA–area country by country, in order to see what kind of "investment climate" and what kind of specific rules can be found for FDIs in each country. Advancing economic reforms, which differ from country to country, pose a serious problem for this analysis, because no ultimate reform goal can be seen.

In this context it is also appropriate to repeat an earlier quotation by L. Csaba, who stated that

> "... the structural interdependence, the common system of regulating intra–regional (CMEA) trade as well as the nature and forms as evolved in the last three and a half decades add up to what in any theory can be called integration. This highly specific integration of CPEs is on the one hand the extrapolation of the domestic, national system of (mostly directive) planning, on the other hand it is itself a factor cementing the former. This means among other things the behavioural norms and success indicators of enterprises formed under domestic conditions are more or less valid in a substantial part of foreign economic activity too. In other words, these conditions of macroeconomic and business activity are determinant also when CMEA countries enter into economic intercourse with other parts of the world". 2)

Bearing this in mind, one can say that the "business cultures" in all CPEs under review in this study have a similar history. However, the present period is characterised by multifarious economic reforms which affect the internal as well as external economic behaviour of CMEA-countries.

Therefore, it is justified to maintain, that JVs with equity sharing between East and West must try to amalgamate two different business cultures together, the Eastern supply-oriented and the Western demand-led.

It is somewhat paradoxical that in the supply-oriented economies of Eastern Europe the supply shortages become chronic in the mature phase of planning development. This phenomenon of vertically organized administrative economy is analysed thoroughly by the Hungarian economist J. Kornai.

According to him there are machines at a standstill, frozen stocks of goods and idle workers waiting for work, material or machines. What is called labour shortage arises when the firm would be willing to offer jobs for more people than are willing to accept them. "Unemployment on the job", or an unfavourable labour/output ratio within the firm are not only compatible with labour shortage but mutually reinforce each other. Disorganization resulting from shortage undermines the discipline and morale of labour. Chronic labour shortage has a similar effect, making it more difficult for managers to take effective actions against workers who violate factory discipline. Shortage phenomena affecting household supplies can weaken the population's enthusiasm for work. 3)

Difficulties with adequate supplies are often mentioned as the most serious problem facing enterprise managers in the CPEs. This problem is one of the most important factors behind the decentralization drive of CPEs in their economic reforms. 4)

Closely linked with the supply problem is the fact that the financial system is based on "passive money", where monetary flow follows rather than determines the movement of resources. The financial sphere of the economy is designed to service uncompetitive economies in which money is not channelled to the economically most viable projects but is used to subsidize weak enterprises. In such a system neither the unprofitable enterprises nor the banks can ever go bankrupt.

Successful economic reform must thus contain not only increased consideration for supply and demand on commodity market, but also on the financial market. The rigid and wasteful mechanism of "passive money" must be replaced by "monetarization" of the economy. Instead of being told from which state bank branch it must take out credit, enterprise management should be able to choose an alternative bank independent of the central instructions; at the same time, the banks should be free to choose their clients rather than being told which enterprises to finance. This would require banks to offer competitive interest rates and enterprise management that seeks out the best credits offered. The banks must, naturally, obtain reliable evaluation of enterprises' viability. Enterprises must be given the opportunity to raise funds not only from banks but also from elsewhere, by issuing bonds and shares.

Economic reforms in Hungary were running clearly in this direction in the late 1980s. Certain elements of initiating Hungarian reform can be observed in other CMEA countries.

From the point of view of economic reform Hungary is the most interesting country among European CPEs as an object of Western FDIs, because the "business culture" gap is becoming narrower between Hungary and Western market economies. In the Soviet Union economic reform or "perestroika" was still in a difficult, half way stage in the late 1980s. In spite of that, in the country–chapters special attention will be paid to the Soviet Union (alongside with Hungary), because of her large market and considerable natural resources, which make that country especially attractive for foreign investors.

3.2. Motives of enacting FDIs across ideological borders

In the European CPEs that allow Western FDIs, the only possible form allowed is normally a JV, in which the local economy is represented by one or several economic units. To this main rule certain exceptions exist: in Poland small scale, so called "Polonia"–firms, which are wholly foreign owned, exist; in Hungary, according to the new law that came into force at the beginning of 1989, wholly foreign owned limited liability companies are allowed. Bulgaria and Poland are following Hungary at the end of the 1980s.

Certain MNCs strictly refuse to enter into JVs. For example, IBM has constantly demanded and secured a 100% ownership in its overseas subsidiaries, even if it has led to problems in certain countries. 5) Allowing JVs, but not wholly owned subsidiaries thus limits the chances of CPEs receiving FDIs.

Studies in international JVs point out national differences in attitudes towards partly-owned subsidiaries. Swedish, British, U.S., Dutch and Swiss MNCs prefer sole ownership or a dominant capital share, while the Japanese, French, Italian and German firms opt for minority participation in JVs. 6)

JVs are formed above all to acquire skills and know-how not otherwise attainable or attainable only at a very high price. 7) Companies enter into JVs for a variety of reasons. The following list of aims (or potential advantages) provides an explanation of the enterprise decision to participate in a JV:

1. To reduce the capital cost (and risk) of setting up new capacity.
2. To penetrate a specific geographic market.
3. To acquire managerial know-how about operating in local market conditions.
4. To enter a new field of business.
5. To achieve vertical integration of existing products.
6. To acquire a manufacturing base or raw material sources.
7. To expand existing product lines.
8. To learn newly developing market needs.
9. To acquire a means of distribution.
10. To improve the effectiveness of existing marketing.
11. To avoid cyclical or seasonal instability.
12. To take advantage of lower input costs. 8)

A study made by ECE on East-West JVs contains a list of objectives the host country authorities have when approving FDIs:

1. To obtain new technology and/or technical know-how.
2. To expand the export sector and thus increase foreign currency savings.
3. To substitute imports and thus obtain foreign currency savings.
4. To obtain foreign capital.
5. To obtain enterprise management know-how.
6. To modernize host country industry.
7. To introduce new goods on host country market.
8. To create new jobs, raise labour productivity, train host country employees.
9. To economise manpower, material, energy, financial and other resources, increase profitability. 9)

The ECE study also provides a list of objectives explicitly stated by CPEs in their JV laws, which East–West JVs should pursue:

1. One aim of joint ventures in all CMEA countries studied is to obtain new technology and/or technical know–how; the acquisition of management know–how is an objective in Romania, Hungary, Bulgaria, Poland and the Soviet Union.
2. Improving supplies of modern goods and of high quality services is an objective in Poland. In the Soviet Union, JVs are expected to satisfy more fully the country's requirements in manufactured products, raw materials and foodstuffs. Similar objectives are also stated in the laws of other CMEA countries.
3. Expanding the export sector is an objective in most countries for increasing foreign exchange earnings or savings.
4. In Romania, raising labour productivity is an objective. Bulgarian law mentions economising manpower, material, energy, financial and other resources and increasing profitability, as JV aims.
5. Import substitution is specifically mentioned as an objective in both Romania and the Soviet Union. 10)

Expanding exports are of top priority to Western enterprises. They aim to facilitate and promote exports to the Eastern country in question, as well as to the whole CMEA–area. However, the hopes that the product of the JV will be sold in other CMEA countries against CC do not always materialize. 11)

East–West JVs usually create a competitive edge in information gathering. The post–sales service is also important. The public relations effect of JVs cannot be ignored either. The exploitation of labour cost advantages – in general an important motive for MNCs in their FDIs also plays a role – though secondary in importance – in JVs with the East. 12)

One of the advantages of a JV over a simple placing of orders is that it allows the firm to influence the management of the production firms, and thus, the quality, design and other characteristics of the product. In some cases, JVs are also a means of lengthening the life cycle of a product. In the background of all these deliberations on the part of the Western partner is the profit motive. As a rule, however, economic gains are not seen only in relation to the funds invested, but in the wider context of economic ties with CPEs. 13)

J. Stankovsky points out that the motives of the participating Eastern firms are less clear-cut. In the traditional CPE, firms display attitudes ranging from caution to aversion towards cooperation with the West, because this co-operation involves greater difficulties and risks than sales in the domestic or other CMEA-markets. In his opinion, however, economic reforms are likely to bring about improvement by giving incentives to firms. 14)

When a multiplicity of participants' interests are involved, contradictions cannot always be excluded. Perhaps the most serious problem stems from the conflicting objectives that may arise between the two parties, with the Eastern partners, on the one hand, seeking to meet planned production targets or gain access to Western markets, and the Western partners, on the other hand, interested in maximizing the rate of return on their investments and gaining access to Eastern markets. The degree to which the operations of the JV must match the requirements of the national economic plans may also be a source of difficulty. Questions concerning management control, decision making, marketing and cost and price determination may pose potential problems. Non-convertibility of Eastern currencies also acts to limit the attractiveness of earning profits in the local currencies. 15)

In addition to these points, J. Stankovsky points out that in some cases that have failed, on the Eastern side the authorities rather than the firms concerned were committed to the undertaking. 16)

The ECE study mentioned earlier, also deals with survival rates of JVs in the global economy by referring to several empirical studies made on the topic. On the basis of information available, the ECE study concludes that there exists a number of countervailing factors which either discourage enterprises from forming JVs in the first place or lead them to terminate the arrangement prematurely either by liquidation or by the assumption of complete ownership and control by one of the venture partners. 17)

Large multinational enterprises, in particular, are liable to perceive conflict between the advantages and disadvantages of the JV form for the attainment of their corporate aims. The fact that they have become multinational corporations in the first place means that they have preferred complete control of foreign subsidiaries. The reasons for this preference usually stems from reluctance to share control of intangible assets (chiefly technology and Research and Development) together with insistence on complete conformity of product quality and presentation. When, however, the legislation of the host country seeks to assure national control, there is no alternative for the foreign investor but to accept joint venture. The survival of the JV, particularly if one of the partners is a high-technology multilateral enterprise, will depend on constant monitoring of the perceived advantages listed earlier (above all, market access and local marketing know-how) with the disadvantages of sharing knowledge and control. This is also true of JVs formed within the same market economy or group of economies and may therefore account for the widely held view that JVs are often a transitional form of business association.

Some of the above considerations are illustrated by the findings of empirical studies. For instance, in a survey of 38 companies which had formed collaborating ventures, 23 of them (or 61 per cent of the total) were found to have fallen short of the partners' expectations, and were prematurely disbanded or were bought out by one of the partners. Only 12 of these JVs (32 per cent) met or exceeded the expectation of the partners. The main reasons cited for the failed ventures include misreading of the marketplace; cost overruns; unforeseen changes in the economy; and governmental actions.18)

However, not all surveys of JV survival reveal a large percentage of failures or disappointing results which led to either liquidation, take-over by one partner, or control passing from one partner to the other. A study of 52 joint ventures formed by American and Indian firms was carried out from 1966 to 1970 and followed up by monitoring published data until 1982. 19) This study found that the majority were still in operation in 1980; that eight of the joint companies were no longer joint in 1980, with ownership of five having passed to the Indian partner (while three had failed for a variety of reasons and were dissolved); and that "in many other instances the share of ownership by the American partner had been reduced substantially by 1980". The study's major conclusion was that over three quarters of the total number of JVs survived profitably for a decade or more.

An earlier study of joint venture survival, carried out nearly 20 years ago, was based on a sample of 1,100 manufacturing joint ventures entered into by United States multinational corporations and their subsidiaries. 20) Of these 1,100 joint ventures, 182 subsequently became wholly-owned subsidiaries of the parent firms domiciled in the United States. Another 84 joint ventures came to an end, either because the American partner sold its equity stake to the foreign partner or because the jointly-owned company was liquidated by mutual consent. In 46 cases joint ownership continued, but control passed from the foreign partner from a 50-50 basis over to the multinational firm domiciled in the United States. There were two cases of ownership shift from the United States to foreign hands.

In short, 30 per cent of the sample of 1,100 joint ventures formed before 1967 between American companies and foreign partners proved unstable because of changes in corporate strategy or organization by one partner, or control passed from one partner to the other. 21)

An interesting study on joint ventures has been compiled by P. Killing, who classifies joint ventures into three categories; shared management, dominant management by one partner and independent management of either partner. The author found out that independent management out-performs the others and shared management had the poorest performance. This suggests a positive relationship in a joint venture framework between performance and independence from parent companies. It also demonstrates the adverse effect on performance resulting from management conflict inherent in different organizational and cultural attitudes in a joint venture. Joint ventures with the poorest performance record and highest instability are those in which ownership and control are shared equally between the partners. These ventures may operate successfully when conditions are good, but may split apart along ownership lines when problems arise. 22)

Summing up it can be said that the CPEs of the CMEA cannot receive the most advanced Western technologies by using the method of joint ventures. Not only politically based restrictions co-ordinated by COCOM hamper the technology transfer, but also the economic considerations by some MNCs, can result in refusal to enter into joint ownership deals. Only the approval of fully-owned subsidiaries by Western companies can cause a change in this respect.

Joint enterprises have had certain difficulties in the global economic scene. Empirical studies point out that joint ownership is a rather unstable form of operation. However, this form of business operation has not always proven to be unsuccessful.

Allowing fully Western owned enterprises in socialist societies is not only an economic but also a political question. If the tradition of Marxism-Leninism has been attacking the influence of international capital for decades, it is not a simple task to invite this same capital to participate in and also to influence the socialist development without local participation.

As this is done, a severe contradiction in ideology obviously emerges. How is it possible to explain in ideological terms, that foreign (Western) capital has received the liberty to establish enterprises in a socialist economy, if at the same time it is impossible for the local population to set up economic units? Liberalization of the internal economy must thus advance hand in hand with the liberalization of rules concerning FDIs.

Conflicting interests between partners in East–West joint ventures are obvious. The most obvious ones are the differing motives in marketing; the Western partner wants to conquer the local market, while the Eastern partner is interested in CC earnings. The out-of-date monetary economy in CPEs on the national, as well as international level (transferable rouble) is the main reason for this conflicting situation. In this context it is necessary to emphasize the fact, that a FDI in one of the CPEs cannot easily be used as a bridge head to other CMEA countries, because of the transferable rouble payment system. Receiving CC payment for selling joint venture products from one CPE to another is not self-evident.

The point made by P. Killing, that joint ventures in which ownership and control are shared equally between partners have the poorest performance and highest instability, is of special importance. In East–West joint ventures there has been a tendency to balance the interests of the parties. In global comparison, this formula is not a key to business success.

In spite of the relative isolation of CPEs from the global economy, the CMEA–countries have enacted some FDIs outside their own economic area. In the mid–1980s CMEA–countries' JVs existed in 23 capitalist countries. Such JVs with Western firms are usually involved in trade: of 409 JVs studied in the mid 1980s, about 70% were active in trade. Transport accounts for 11% and banking for 6%. So far industry accounts for some 5% of the overall number of JVs. The overall capital investment of CMEA countries in the JVs in the West is not significant. 23)

The motives of CMEA–countries to establish JVs in the West are as follows:

- to boost their exports to the OECD area
- to improve the structure of imports from those countries
- to provide for the necessary conditions in transport and banking
- to reduce trading expenses

- to improve the quality of after-sales service
- to gather experience in labour management and marketing
- to implement new activities in practice. 24)

With all the conflicting objectives and potential difficulties in setting up joint ventures between two different business cultures, there were already many interesting cases at the end of the 1980s. The CPEs show clear differences in their ability to attract Western FDIs.

3.3. Soviet concession policies during NEP-period

The first example of East-West capital investments were the "concessions" of the Soviet Union in the twenties, which arose at the time of the "New Economic Policy". The concession was an agreement between the Soviet state and a foreign enterprise by which the state leased land or industrial industrial buildings to the enterprise, shared in the profits, and determined its business relations with enterprises in other sectors. The enterprise was run by the concessionaire. Mixed companies - another form of cooperation with foreign capitalists - were created by the issue of shares; the Soviet state held at least 50 per cent of the shares, collected dividends, and directly participated in running the company. The Soviet chairmen of the board of directors had the right to decide in case of disputes. 25)

In the early 1920s Lenin was prepared to go to almost any length to restore the economy. He was convinced that this was essential for survival. He fought hard to convince doubting comrades that foreign concessions were an entirely proper way out of the problem of reconstruction, and his works and speeches at this time abound in references to this subject. Some said: "We chased out our own capitalists, and now we call in foreign capitalists". Lenin insisted that, by letting foreign capitalists operate oil fields, exploit timber resources and so on, the Soviet state would obtain materials of which it stood in desperate need, and some modern equipment would be provided by the concessionaires. 26)

The significance of the concessions in the promotion of economic development was limited. The number of functioning concessions reached its peak in 1928 when 110 concession enterprises existed. In 1927-28 the stock of concession capital amounted to only 45 million roubles, while the Soviet national economic assets totalled 4,5 billion roubles. In October 1928 the concession enterprises employed 20,000 people – of whom 10 per cent were foreigners – and contributed 0.6 per cent of the total industrial output in that year. Concession policy did not come up to expectations. 27)

The profitability of concession enterprises was low. In agriculture German enterprises all made losses. In addition, there were conflicts between the parties. The Soviet arbitration court ruled the English Lena–Goldfields concessionaire to pay a penalty of 13 million pounds for violating the contract. Some concessionaires in the Donez–area were accused of being involved in espionage and sabotage. 28)

In the early years of Soviet rule some Soviet economic units were set up abroad. The main reason for that was that the Soviet state had no normal diplomatic and commercial relations with her trading partners. In 1920 "Arcos" (All Russian Cooperative Soc.) was established in Great Britain, and in 1924 "Amtorg" in the USA. In 1923 "Russwood" (Russian Wood Agency), which is still in operation, was set up in London with an English partner. 29) Moscow Narodny Bank, which is a wholly Soviet–owned bank in London, with branches in Beirut and Singapore, was established as early as 1919. 30)

The XVI Party Congress (1930) ordered that joint stock companies (and thus also mixed companies) were to be liquidated. It was the time of Stalin's rule. The Party Congress treated joint stock companies as an example of the forms of administration uncritically taken over from capitalism. The Party resolution went on to state that although joint stock companies were significant in the first years of Soviet power, they had lost their significance since the socialist elements of the economy of this country now predominated. 31)

The "concession period" was thus relatively short and economically unimportant. A long period of relative isolation of the Soviet economy from the Western markets followed. Only some marketing units in Soviet ownership have been established in the West since World War II. Contemporary FDIs in the Soviet territory were allowed first in 1987.

It is highly interesting that one Soviet analysis of the concession period mentions that there were hopes to create planned competition between the state–capitalistic and Soviet enterprises in order to improve the quality of the products of the state industries and reduce costs. 32) This idea has been revitalized in modern times, when socialists states have started accepting FDIs from the West.

3.4. FDIs in CMEA-countries in modern times

3.4.1. Romania

Romania has already for a long time been regarded as a sort of a maverick member of the CMEA. It is not possible to cover all the details of Romania's special position inside the CMEA here. From the point of view of this study it is sufficient to mention that as early as in the 1960s Romania managed to stake out an impressively autonomous position. Thus, in the course of the 1960s the Romanian leadership insisted that Romania be included among the less developed countries at the first session of the UN conference on Trade and Development, and increased Romania's activity in the UN. Bucharest skilfully diversified its trading patterns, thus reducing its dependence on intra-CMEA trade or on the Soviet Union specifically. 33)

A. Smith argues that Romania has placed great emphasis on the desire to preserve the power of domestic central-planning authorities, while simultaneously rejecting attempts to introduce any form of supranational authority and integration through market levers. As a result, Romania has effectively been forced to seek greater trade links with the West. 34)

Romania joined the IMF at the end of 1972. This move was seen as a means of emphasizing Romania's independent position from the Soviet Union, as Romania's balance of payments did not show any fundamental disequilibrium in the early 1970s. Thus, the IMF-membership of Romania had more political than economic reasons. 35)

Since the 1960s, there have been contradictory elements in Romania's economic development. In external economic policy matters Romania has shown independence, while in the internal economy the strictly centralized system has prevailed in the 1970s and 1980s. 36)

3.4.1.1. Romanian FDI Regulations

Considering Romania's pursuance of an independent external economic policy since the 1960s, it is no wonder that this country was the first one among CMEA-members to allow joint ventures. Law No 1 of 1971 on Foreign Trade authorized the formation of joint ventures by Romanian enterprises with foreign firms.

Recognizing that the 1971 legislation was only a legal skeleton for the development of joint ventures, the Romanian authorities published two more decrees in 1972: Decree No 424 on the constitution, organization and operation of joint companies; and Decree No 425 regarding tax on profits of joint companies. Decree No 395 of 1976 refers, among other things, to duty-free imports of goods for use by joint ventures. 37)

The Romanian joint venture decree 38) does not explicitly exclude any economic activity from the sphere of companies with foreign participation. Production and service units are thus allowed (art.1). However, the same decree stipulates that JVs ought to promote exports. Therefore, one can gain the impression that JVs in tourism, for example, are not especially welcome. The introduction of modern technologies is clearly emphasized (art. 2).

The Romanian decree does not allow foreign majority share of the JV equity (art. 4). No change has been made since on this crucial point. The foreign partner can be juridical, as well as a natural person (art. 5). The transfer of the foreign partner's profit share abroad is guaranteed after payment of taxes and other contributions under the law and the contract (art.7).

Joint companies have to be constituted as joint stock companies or limited liability companies (art.9). Apportation of all values, tangible and intangible as well as money is allowed (art.14). The value of the goods contributed by each party must be established in currency and the foreign trade price agreed upon (art.15). The expenses of JVs are made in the currency agreed upon (art.21). Supplies and raw materials can be purchased domestically also in the currency agreed upon, or can be imported duty free (art. 22). Only petty expenses and supplies payment have to be carried out from the account in lei (Romanian currency) (art.21).

In practice fact this means that JV partners must choose a Western currency to run the joint company in Romania. Internal and external deals are thus paid for in CC. Even wage and salary payments made by a JV must actually be enacted in CC. Article 29 stipulates that a JV must transfer an equivalent amount in foreign currency to its bank in order to obtain lei funds for covering labour costs.

Within the framework of the joint company, the foreign personnel may be employed in managing positions (art.33). The partners may agree, by the statutes of the company, to take decisions with the unanimity of votes of the members present at the legally constituted general meeting of the partners in matters concerning the programme of activity, the approval of the balance sheet and of the profit and loss account, the distribution of profits, the appointment of the executive bodies of the company and establishment of their competence. The proportion in which the parties are to be represented in the management bodies, and the appointment, remuneration and dismissal of the executive bodies as well as any other matters, are expressly stated in the Statutes (art. 11).

These points contain some liberal elements. It is not stipulated in the decree that management must be manner occupied by local citizens in certain. The majority share of the host country partner is not necessarily reflected in decision-making. The foreign partner can protect his interest by defining matters in which unanimity is required in the general meeting of the shareholders. However, the decree on JVs states that the general meeting of the working people must appoint their representatives to the board of directors (art.34).

The most surprising point of the Romanian JV decree is mentioned in art.8: Joint companies must work out annual and five-year programmes of economic and financial activity which are to have the approval of and stipulated in the Company's Statutes.

This point clearly aims at integrating all the JVs into the planning rhythm of the Romanian planned national economy. No spontaneous economic activity is allowed by JVs alongside the mainstream of planned economy.

Taxation of JVs has been kept stable since the beginning of JV-activity. Decree No 425 of 1972 regarding tax on profits of joint companies in Romania can be summarized as follows. 39): Profits shall be taxed at a rate of 30% before distribution to partners (art.1). Profits transferred abroad will be subject to an additional 10% tax (art. 13). 5% of the pretax profits shall be assigned to a tax-free reserve fund until the fund reaches 25% of the invested capital (art.2). Exemption from the basic profits tax can be granted by the Council of Ministers for the first year in which taxable profits begin to be made, with a 50% reduction for the following two years (art.3). The tax on that part of the profits that is re-invested for at least five years in the same JV or other JVs with Romanian enterprises is reduced by 20% (art.4). A registration fee of lei 5,000 in the CC specified in the company's contract, must be paid by the JV to the Ministry of Trade (art.14).

Altogether, the Romanian legislation concerning JVs is not prohibitive, but it contains certain points which act as a disincentive for foreign investors. The 49% clause for foreign maximum share is certainly a stumbling block for many a potential Western investor. Otherwise, the regulations are fairly liberally formulated leaving much leeway for partners to agree upon.

There is one important contradiction in the Romanian JV–decree. On the one hand, JVs are singled out of the internal national economy by forcing them to work on the basis of a foreign monetary unit, and on the other hand, the JVs are required to integrate themselves into the national planning system by providing yearly and five–year plans.

3.4.1.2 Experience of FDIs in Romania

After the launching of JV–regulations in Romania, there was some interest among Western companies to invest in that CMEA–country. The maverick position of Romania in the Soviet bloc was appreciated by the Western politicians and also by Western press, which made Romania a sort of "second Yugoslavia" with independent foreign policy. Allowing FDIs was regarded as a sign of that.

Also certain economic factors in the early 1970s helped to make Romania look attractive for Western investors. The balance of payments was at that time rather well balanced and no debt problem was in sight. Romania has for a long time been an oil producing country, and thus, the first oil crisis created the impression that Romania's relative wealth is rapidly increasing. Romania applied and got developing country status in Brussels from the EEC. It was also thought that Romania had good relations to many LDCs, and that Romania could thus provide a convenient bridgehead to those markets for Western products via JVs.

Therefore, it is not surprising that the first two joint ventures (Romcontrol Data and Resita Renk) were set up as early as 1973. 40) These two pioneering enterprises were still in operation in the late 1980s.

Control Data is the only US firm to have entered into a joint venture with Romania. Recognizing the difficulty of attracting Western personnel to Romania, the firm worked out certain benefits in the agreement with its Romanian partner. Western employees are allowed duty–free import of cars, furniture, refrigerators and similar items for personal use. The social security deductions made from their salaries – paid monthly in US–dollars – are deposited in a special bank account and allocated to the retirement or benefit system chosen by the US company.

To handle personnel matters not specifically covered in the agreement, a Managing Committee with representatives of the two principals was established. It determines for instance, how much of a foreign employee's salary may be transferred abroad in freely convertible currency. The committee also establishes the vacation policy for foreign employees.

The hiring and paying of local personnel also presented some problems. Some of the Romanians received training in the US, but the supply of a sufficient number of qualified local staff, the responsibility of the Romanian partner, was more difficult than anticipated: labour contracts in Romania are concluded for five years, and dismissals before the contract's expiration are extremely complicated. Extended discussions over pay, fixed by law in dollars, finally produced a reasonable level, but since then new exchange rates for the non-commercial lei have substantially increased expenditure.

Under the terms of the agreement, there is no hindrance to the sale of the joint venture's products (peripheral equipment for computers) in the other CMEA countries. In a modification of earlier estimates, approximately 55% of production is now stated for sale in Romania. Control Data will market the 45% balance elsewhere, mostly in Western Europe initially but later also in other East European countries, where the sales will be in dollars only. The products will be interfaced with Felix, a Romanian-designed computer currently being produced under French licence.

One of the areas requiring the most preparation was accounting. The Romanian joint ventures law does not prescribe any particular accounting method, so a 38-page appendix to establish accounting practices was worked out between Control data and the Romanians. The principal area of difficulty concerned depreciation. Romanian law requires that 5% of profits must be accumulated each year until the depreciation reserve amounts to 25% of the total equity. Since this is a legal requirement applying to all Romanian enterprises, Control Data was obliged to accept it. However, the agreement's accounting provisions as a whole follow US practice. Under the agreement, there is no limit on the amount of profits Control Data may transfer abroad. Nor is there any stipulation that Control Data must reinvest a percentage of its profits in the joint venture.

Control Data has also encountered problems specific to the field of electronic data processing. Because of swift changes in technology, initial product lines of card punchers and drum-type printers proved to be nearly obsolete for Western markets by the time full production was reached. The joint venture was forced to concentrate its sales effort on the market for EDP products in the CMEA, with the result that the profits hoped for were not obtained.41)

Officials of Renk, a gear manufacturing subsidiary of West Germany's Gutehoffnungshütte (GHH), seriously doubted whether the joint venture with Romania's ICMR Machine Works would ever turn out the industrial gears foreseen when the agreement was signed in 1973. Even though GHH enterprises had sold products and services worth DEM825 million to Romania over the previous 12 years and knew their partners well, the negotiations to establish Resita-Renk (RRR), the jointly owned limited liability company located at Resita in southwest Romania, were exceptionally difficult. Setting up a manufacturing enterprise operating on capitalist principles in the midst of a state-owned economy involved breaking a lot of new ground. Romania's socialist government did not want to create something that would disrupt other parts of its system, and Renk wanted to be sure that it would make a profit from its DEM10 million investment.

Most of the problems were finally overcome, and the plant was officially opened in October 1976. The volume of business was targeted at DEM30-40 million, and the plant staffing called for 300 workers plus 90 white-collar employees, 12 of them West Germans. It was planned that 50% of the output would remain in Romania, 25% would be shipped to other CMEA countries and 25% to the West. All sales were booked in hard currency.

The commercial director of RRR is a West German and the technical director a Romanian. Three members of the board of directors are Romanian and two West German, but the West Germans cannot be outvoted because all important decisions must be by a two third majority. The Romanians put up 51% of the basic capital of DEM 20 million and the West Germans 49%. Of Renk's 10 million share, DEM7 million was in cash and the balance in capitalized know-how. Renk's share of the profits can be repatriated but is subject to a Romanian profit tax of 30% and a tax of 10% on the amount actually transferred.

Being outside the national plan has protected the new company from interference by Romanian government authorities, but at the same time it has made the domestic procurement of raw materials and semi-finished products difficult. Enterprises working under the plan have first call on domestic production, so RRR has to make special efforts to fulfil its need. Since it operates exclusively in Deutschemarks. it can buy raw materials and other items abroad, but of course at greater cost. When RRR buys something in Romania, it pays the FTO or other supplying organization in D–marks. For the FTO, a sale to RRR is similar to an export, deal for which it is credited by the Foreign Trade Bank at the tourist exchange rate.

The raw materials problem has never been satisfactorily solved for RRR, and the Romanian side has repeatedly suggested that the company be brought under the national plan. But this has been adamantly opposed by the West German side.

Another difficult problem in getting the company established and operational was to find a mutually acceptable basis for pay–scales for the workers. The Romanians insisted from the beginning that, although RRR was a Romanian company, it could not hire workers at the equivalent in D–marks of the prevailing local wage level. Instead, it was required that wages be set at an average "world market level," obviously considerably above the Romanian level. Payments are made in D–marks by the company into a special fund managed by the Romanian government. Charges are then made against this fund for social insurance, health benefits, subsidized housing and other social benefits normally supplied by the government to all Romanians. What is left, which is about 40% of the original D–mark payments, is paid to the RRR plant workers in local currency.

GHH executives have privately expressed their disillusionment and said they would not consider further joint ventures until there are major changes in Romanian practices. Thus, they refused to participate in the joint establishment of a DEM700 million machine tool plant in Timisoara.42)

In the 1970s some other JVs were set up in Romania. Only two of them, Olt–Cit, with a French partner, and Rifil, with an Italian partner, have remained in business.

Oltcit, registered in 1977, was set up for the manufacture and distribution of small passenger cars. The partners are the French Citroën, with 36% of the Ffr 500 million capital, and the Romanian Industrial Central for Truck & Passenger cars and the Romanian FTO Auto–Dacia. 43) This JV has just managed to survive. The Romanians complain that the French partner obliges them to sell the jointly produced car at a loss, while the French criticise the Romanians for their low productivity. Furthermore, this venture, which was designed to produce 100,000 car annually, has been able to produce only 20,000. 44)

Rifal, registered in 1973, was set up in Savinesti for the production of acrylic fibres. The partners are the Italian Romalfa, which holds a 48% share of USD 2.3 million , and the Industrial Central for Synthetic Fibres. Production was started in 1974. 45)

Some other JVs, which were set up in Romania in the 1970s, failed.

Problems encountered by the Japanese Dai–Nippon in its Roniprot joint venture serve as a clear warning: although pioneer joint ventures are likely to receive privileged official encouragement, unexpected pitfalls may double the time needed for plant construction. Work can fall far behind schedule even though experienced company officials may think they have anticipated all possible delays when negotiating the contract.

In 1974 Dai Nippon established the joint venture Roniprot with the Romanian Industrial Central for Pharmaceuticals, Dyes & Paints. Total investment, including land, construction and Japanese know–how, was valued at approximately USD 11.6 million, 42.6% of which was provided by Dai Nippon. Processing facilities were to be constructed in Curtea de Arges for the production of protein rich yeast from crude oil as a basis for livestock feed.

Initial plans called for plant construction to be completed and production to begin no later than the spring of 1977. Yet, despite continued intervention by high officials of Dai Nippon, construction lagged to such an extent that the original production target date was written off as completely unrealistic. In late 1979 Romanian officials described the project as still "in the investment stage" but expressed cautious hope that production might start in 1980. 46)

A year after the production started, in late 1980, Dai–Nippon sold its share to the Romanian partner while continuing to supply technology to the plant for the production of protein rich yeast made from crude and used oil as a basis for livestock feed. Explaining its reasons for withdrawing from the joint company, the Dai–Nioppon executives at the time cited the lack of adequate educational facilities for the large number of Japanese children present near the plant site where their parents were employed. 47)

After four years of negotiations, The Dutch–West German VFW–Fokker aerospace group and Romanian authorities signed a major joint venture in July 1977. The general accord established a joint manufacturing company. Rom–Avia SRL, capitalized at

DEM20 million, with VFW-fokker holding 45% of the total equity and the Romanian industrial central Grupulu Aeronautic Bucuresti the remaining 55%. The contract provided for licensed production of a minimum of 100 VFW 614 jetliners specially designed to transport 44 passengers on short-haul routes.

The contract was signed at a time when only 16 VFW 614 jetliners had been sold elsewhere on the world market. The opportunity of supplying the joint venture with three aircraft plus components to produce the following 27 units meant that the Western plants had a much better chance of reaching the profit point. Without the Romanian deal, it was not certain whether this would have been a realistic expectation. As one Dutch financier commented,

> "The agreement with the Romanians removed a millstone that had been hanging around the neck of VFW-Fokker since it launched this particular aircraft."

However, this agreement was never carried out. With sales of the VFW 614 limping along in an unsatisfactory manner, the Western partner eventually abandoned it altogether. The Romanians, in turn, made a licence deal with British Aerospace for the production of BAC 1-11s in early 1980 to meet their needs.

It would be wrong to conclude that the fault in failed agreements always and exclusively lies with the Romanian side. One of the main stumbling blocks is the fundamental difficulty of cooperation between partners coming from diametrically opposed economic systems. Another is Romania's chronic shortage of hard currency and their need to drive the hardest possible bargain. Finally, it is fair to say that the financial soundness and standard of business practices are not the same among all Western firms.

A pioneer French-Romanian joint venture was duly concluded and registered, but eventually collapsed. The joint venture, Elarom, was founded in late 1974 by the French company L'Electronique Appliquée and the Romanian Industrial Central for Electronics & Data Processing Techniques. The Romanian side held 51% of the equity and the French 49%. Elarom was to manufacture electronic heart pace makers and monitoring equipment for use in Romania and other socialist countries.

Production never reached the stage of marketing, however. According to the Romanians, the failure was not due to shortcomings of the Romanian work-force or the enterprise's inability to produce and market complex medical equipment. A spokesman for the Industrial Central in Bucharest contended that the Central's production line had a favourable reputation in Eastern Europe and pointed out that no Western manufacturer would have linked up with the Central if it were not satisfied with the quality of the work done there.

The Romanians maintain that the project collapsed because of the French partner's financial weakness. Electronique Appliquée entered into bankruptcy December 9, 1976, only two years after signing the joint venture contract. The Romanians claim they had difficulty obtaining technical documents from the French firm, and no Romanian technicians were trained at Electronique Appliquée headquarters in France despite provisions in the joint venture contract for such instruction.

According to the Industrial Central's spokesman, the joint venture undertaking contributed in no way to the insolvency of the French company. The Central itself invested a large sum of money to make the joint venture a viable business operation. Once Electronique Appliquée's bankruptcy was registered, it proved impossible to preserve the joint venture under the sponsorship of other Western firms. Companies that purchased the major assets of Electronique Appliquée have not been willing to assume the obligations connected with the Elarom contract.

Austria's Granz Kohmaier and the Industrial Central for Metallurgical Tools & Lifting Machines registered a joint venture in 1975 for the production in Sibiu of precision roller chains and conveyor elements. Kohmaier was to contribute 40% of project equity, or Sch 58.8 million of the total initial investment of Sch 120 million. However, the project never reached the production stage. Differing interpretations of the terms of the agreement led to charges and counter-charges. The project eventually collapsed. 48)

3.4.1.3. Outlook of FDIs in Romania

Romania can be described to have been extremely unsuccessful in attracting Western FDIs into the country. Only four JVs set up in the 1970s were still functioning in the late 1980s (Romcontroldata, RRR, Oltcit and Rifal). In the 1980s nothing new has been set up in the JV-sphere.

The Western consulting firm "Business International", which closely watches the CMEA-market, lists the following difficulties in negotiating JVs with Romanians on the basis of companies' experience.

One US company actively considered signing a joint venture, but after months of discussions with the Romanians decided to break off negotiations because of major difficulties. Summerized below are the lessons learned:

Excessive demands. The US firm concluded that the prospective Romanian partner wanted to receive more than it was willing to give. Although Western partners may hold only a 49% minority share in the capital of a joint venture, the US company calculated that the actual ratio of its contributions to the Romanian enterprise would have been two to one. The Romanian partner agreed to contribute land, building and personnel, while the US firm was to provide the technology, know-how and technical assistance, as well as all manufacturing equipment.

Working capital. The Romanian negotiators fixed the required working capital at a level that the US firm considered greatly exaggerated, and the Western partner was to provide 49% of this oversized working capital in hard currency.

Wages. As in other joint ventures in Romania, wages of both Romanian and Western staff were to be calculated in hard currency. The US firm, however, felt that Romanian pay demands were too stiff. The issue was complicated by the fact that the Romanian staff would have received only small salaries paid in local currency while the rest would have gone to the government. Thus high pay seemed to bring no additional incentive to the actual work force.

Problems with CMEA. What the Western company did not anticipate was the surprisingly negative reaction of other CMEA countries to its joint venture plans in Romania. Other CMEA FTOs made it clear that rather than using hard currency to buy a product from Romania, they would purchase it from the West – even though at somewhat higher prices. Thus a basic lesson learned by the US firm was that a foreign company must check out the attitudes of other EE countries before entering into a Romania joint venture that was going to supply the whole EE market.49)

The complete standstill in FDIs in Romania in the 1980s can be explained by additional factors to those mentioned above in negotiating JV-deals. Romania has used up the political goodwill it had in the West by applying ultra-nationalistic policies vis-a-vis ethnic minorities in her territory. In the economic policy Romania strictly follows the traditional, centrally planned economic system, which does not create a favourable business environment for FDIs. There have been serious disturbances in the Romanian balance of payments resulting in the rescheduling of Western debt in the first half of the

1980s. Although Romania's creditworthiness has been reestablished in the second half of the 1980s by extreme internal austerity, the confidence in the long-term stability of the Romanian economy has not been reestablished in Western business circles. Obviously, Romania has been in disarray with the IMF on economic policy matters. Nobody in the West takes the possibility of reaching lei convertibility in the near future seriously, although the IMF-membership presupposes the aiming at making the monetary unit convertible. In addition, no amendments have been made to the JV-regulations in order to give more incentives to Western FDIs.

Romania has also continued the verbal war against Western economic units and institutions using traditional marxist-leninist terminology. For example, the following quotation is from a propaganda book published in the West:

> "An indecently large share of the world's trade is held by the MNCs. The returns of some MNCs exceed the national income of many developing countries. President Ceausescu says that with this enormous power they try to increase their profits at the expense of the peoples' sovereignty and national interests, which arouses strong antagonisms even in the developed capitalist countries". 50)

Thus, it can be concluded that the psychological, institutional and economic atmosphere is extremely hostile for Western FDIs. A radical change is needed, in order to attract more viable JVs from the West.

It is striking, that Romania, which is commonly classified as a LDC and the poorest member of the European CMEA area, has got more FDIs in the Third World than any other CMEA-country, including the Soviet Union. As the total number of these investments by CMEA-countries is some 170, Romania with 45 accounts for about one fourth of them all. Most of the Romanian FDIs in LDCs are in Africa (30). Natural resources prospecting and development (10) and the agriculture & food industry (9) are the main branches of activity in Romania FDIs in the Third World. 51)

In the OECD-area Romania has hardly any FDIs. The best known example of Romanian FDIs is the Frankfurt Bukarest Bank AG in West Germany, in which the Romanian Foreign Trade Bank has a 52% share. 52)

A complete turnaround is needed in Romanian economic policy, in order to attract Western FDIs in any reasonable scale. Money spent abroad for FDIs is needed on the home market, in order to improve Romanian infrastructure and market supplies. Special incentives should be given to potential investors in taxation and other terms. Legislation concerning JVs should be liberalized and majority stake possibility should be given to the foreign partner.

The results of the 1980s in JV activity show that Romania is not even seriously interested in acquiring FDIs from the West. This is true: in 1989 President Ceausescu announced that JVs have no future in Romanian economic process, because this form of property is not in harmony with socialist principles. Following these statements, one of the still existing JVs, Rifal, was closed down. It was predicted that this case was not going to be the only one. Thus, the Romanian JV era seemed to come to an end. 53) However, shortly after the closing down of Rifal the Ceausescu dictatorship was brought down.

3.4.2. Hungary

Amongst the countries under review Hungary is the one which has the most narrow raw material base, and thus, the highest dependence on foreign trade. As a consequence, the traditional CPE–system has been extremely unsuitable for a country like Hungary.

It is thus no accident that Hungary started reforming her economy relatively early, in 1968. The Hungarian road to "market socialism" has been in many senses uneven, though there appears to be little chance of returning to a centralised, strictly planned economy. At the end of the 1980s, it was evident that Hungary was taking some decisive steps towards a mixed economy with strong market orientation.

Without going into details on the Hungarian highly interesting economic reform process, it can be maintained that Western FDIs fit into the overall reform scheme. It can be assumed that direct investments from abroad tend to advance competition in the home market. This is especially important when one considers the position of large economic units with monopoly and quasi monopoly positions inherited from the pre–reform period.

Hungary allowed foreign direct investments virtually at the same time with Romania. Motives, however, have been clearly different. Hungary has pursued a remarkably low profile in external policy and economy during the reform process maintaining that a new economic mechanism (NEM) is not an export item. Only after the mid–1980s has

Hungary been advertising the reform more outspokenly as being on the same lines as the Soviet perestroika.

There are marked differences also between Hungary and Romania as far as dealing with the external debt problem is concerned. Hungary has been able to avoid rescheduling its debts, unlike Romania, although the situation has been critical throughout the 1980s. Hungary has refused to tackle the debt problem by domestic austerity. Pursuing that policy of maintaining or even raising the standard of living as well as servicing the CC debt has meant that Western FDIs are vital or even essential for the Hungarian economy.

Therefore, it is understandable that Hungary has regularly amended the regulations concerning FDIs. With time the Hungarians have also learned, that not only the legal framework, but also the whole economic environment is important in attracting FDIs into the local economy.

As pointed out earlier Hungary has been talking about the possibility to make her monetary unit, the forint, convertible. In November 1981 Hungary applied for membership in the IMF explaining that this move was in the line with Hungary's overall strategy of integrating itself into the global economy and enlarging its possibilities of financing.

The membership in IMF was given soon after the application (May 1982), whereby it was stated that the consequent drive towards economic reform in Hungary was a decisive factor for acceptance. 54) Since then there has been no conflict between the Monetary Fund and Hungary. The newcomer has already used IMF stand-by credits and has been following the Fund's economic recommendations in her economic policy. 55)

However, the Hungarian currency is still inconvertible, although certain preconditions for convertibility have been fulfilled. The price level has been moving towards equilibrium, as subsidies have been reduced. The exchange rate of the forint vis-a-vis CCs has also moved towards the equilibrium rate by repeated devaluations.

In the 1980s Hungary has thus taken important steps towards creating an atmosphere favourable for FDIs. Also the rules of FDIs have been strongly modified in order to attract Western direct investments.

3.4.2.1. The development of Hungarian regulations concerning FDIs

In the 1980s Hungary's attitude towards joint ventures has been the most liberal in the CMEA area. The original JV decree passed by the Ministry of Finance in 1972 excluded production from the JV area of operations. 56)

After 1972, the JV decree has been amended several times whereby the point prohibiting production JVs has been lifted. In addition, in 1982 a joint decree of the Ministry of Finance and the Ministry of Foreign Trade on economic associations with foreign participation established custom–free zones in respect of JV activity. 57)

The Hungarian JV decree lists five various forms of JVs (unlimited general partnership, public limited company, limited liability company, joint enterprise and limited partnership) in its first article.

The first option mentioned (unlimited partnership) seems unattractive, as each member is jointly and separately liable with their entire property. The second possibility (public limited company) is recommended, if a large turnover is expected in the JV, as in the case of banking activities. In this case the shareholders (stockholders) are only responsible for the liabilities of the company with their shares. The third option (limited liability company) is obviously meant for smaller units. In this case each member has to make an original contribution as well as other material contributions as determined in the Memorandum of Association. The members bear in other respects no responsibility for the liabilities of the company. The minimum amount of the original capital is FT 50,000 and each member's contribution a minimum FT 5,000. 58)

In the fourth case (joint enterprise) eventual losses must be covered primarily from the reserve fund. If the latter is not sufficient each member will be liable for the company debts jointly, as sureties, in proportion to material contributions. In the Deed of Association or by a unanimous decision of the Managing Council, it may be provided that the members must make supplementary payments to cover the losses, in proportion to contributions. Such additional payments are not to be higher than the member's original stake. In the fifth case (limited partnership) the partnership is liable for its debts with the full amount of its property. 59)

Of these possible company forms the second (the public limited company) and the third (the limited liability company) seem to be the most suitable ones. The fifth (the limited partnership) is appropriate when really small–scale operations are envisaged.

The Hungarian JV decree also stipulates (art.1) that

> "economic associations with foreign participation may be established only with the participation of a recognized firm of sufficient means, that has reliable business management and possesses adequate export knowledge in the economic or technical field relating to the object of the association".

By this rule, the Hungarian side hopes to prevent unstable Western enterprises from taking part in JV activities.

In Hungary, it is possible for a foreign partner to have a majority share in a JV, The decree stipulates (art.4):

> "In the total sum of the contributions (share capital) to be fixed in monetary terms the participations of the foreign partner(s) should generally not exceed 49 per cent. Departure from the latter condition may be granted by the Minister of Finance in the range of finances (banking) and services, as well as in warranted cases in other fields."

Hungarian JVs are obliged to set aside a risk fund from profits. At least 15 per cent of the annual profit has to be allocated for this purpose. The risk fund must be continually set aside each year until its sum is equal to the percentage of the capital for the JV as determined in the Memorandum of Association. This sum may be between 10% to 20% of the capital (art.5).

In the 7th article of the JV decree it is mentioned that JVs are obliged to pay Corporate Tax to be paid out of annual profits and reduced by the sums to be set aside for the Risk Fund and Sharing (bonus) fund. The rate of the Cooperate Tax is 40%.

From 1 January 1986, a number of measures have been taken to improve conditions. The measures have sought to increase the founder's share of the renevue in the form of tax concessions in the case of production joint ventures or in "priority fields". Thus in the case of commodity producers and hotels built and operated jointly – if the stock capital is over 25 million forints and the foreigners' share over 30 per cent, the corporate tax rate is 20 per cent of the net profit instead of the present 40 per cent in the first five years, and becomes 30 per cent from the sixth year.

If they reinvest 50 per cent of one year's profit – but at least 5 million forints – they will be eligible for a 50 per cent tax reimbursement. If the joint venture reinvests the whole annual profit – but at least 10 million forints – the reimbursement of tax can be as much as 75 per cent.

During the preparation of the sixth Five–Year–Plan (1986–1990), a list of priority fields was drawn up. In these fields the additional tax reduction beyond the common deduction offered was closely connected with the ideas and investment purposes of the Plan. Joint ventures do not have to pay tax in the first five years and tax on the net profit is only 20 per cent from the sixth year.

The priority fields:
- electronics (manufacture and system development)
- vehicle accessories manufacture with Western firms
- manufacture of agricultural and food industry machines
- component manufacture
- development of packing technology
- manufacture of medicine and fertilizers
- development of textile and wearing apparels of high quality
- development for processing food products
- industrial investment in order to reduce imports accounted in foreign exchange as well as promoting the exports of agriculture and the food industry
- development of the protein base
- production and turnover of propagating and breeding materials
- technological development in order to save materials and energy
- development promoting tourism. 60)

For Western companies interested only in making use of Hungary's low labour costs and favourable geographic location, two decrees published in 1982 granted joint ventures the right to establish themselves in custom–free zones and conferred extra–territorial status on the employees of joint ventures. These off–shore JVs carry out accounting in Western currency and all contracts must be concluded in CC. Off–shore ventures are treated in Hungary as foreign companies. They pay no import duties on input for use of the JV, but customs tariffs are payable, when end–products are sold in Hungary. 61)

The Hungarian Parliament enacted a new enterprise law in the autumn of 1988, which came into force at the beginning of 1989. This Act VI/1988 on economic Associations (Company Act) 62) is meant to be an important step towards a real mixed economy in Hungary.

The Company Act VI/1988 covers economic associations of natural persons and of legal personalties. It establishes rules for unlimited and deposit partnership, union, joint enterprises, limited liability companies and companies limited by shares. The Act is indifferent to the type of ownership, whether it is private, state–owned or mixed, domestic or foreign. Therefore, the legislation of foreign ownership is mentioned specifically only when it differs from that of domestic ownership. The Company Act does not affect the existing regulations relating to state enterprises, state farms, or co–operatives in agriculture.

The Hungarian company Act is unique in the CMEA area. It accepts that private citizens as entrepreneur and legal entities (state enterprises or cooperatives) have equal conditions for competition. The two enterprise forms most common in market economies – limited liability companies and companies limited by shares – are possible now in Hungary. Private persons will be able to form or participate in limited liability companies and companies limited by shares.

The Act VI/1988 allows private enterprises and persons to invest their money as capital, which means that private capital investment without personal participation is possible. Private persons and enterprises (domestic and foreign) will be able to buy shares and bonds in other private and non–private enterprises.

As domestic and foreign natural and juridical persons are equal according to the Company Act, a foreigner can establish a fully–owned entity in Hungary. The joint permit of the Ministry of Finance and the Ministry of Trade is necessary for companies with majority foreign ownership. If the application is not handled within 90 days, the permit can be considered granted. Enterprises with foreign minority participation only need to be registered.

The Company Act stipulates (Chapter 1, Section 10) that an economic association which has exclusively natural persons as members may not employ more than 500 people. This provision, however, does not apply to economic associations owned in full or in majority by foreigners. A foreigner as an entrepreneur in Hungary is thus more equal than his colleague from the host country.

The foreigners' interest (stake) in an economic association enjoys full protection. Profits due to the foreigner from an economic association are freely transferable abroad, without a permit from the foreign exchange authority, provided, that the money cover is available within the association; the transfer is to be effected according to the foreigner's relevant instructions and in the indicated currency (Chapter 1, Section 9).

Some limiting provisions are also included in the Company Act VI/1988. The primary stock of any limited liability company cannot be less than one million forints. Every member entering this form of a company must invest at least 100,000 forint as a primary stake. Upon foundation, at least 30% of the primary stock, and not less than 500,000 forints has to be paid up in cash.

A one–man company limited by shares can only be founded by a legal personalty. The registered capital of any company limited by shares cannot be less than 10 million forints. The pecuniary contribution upon foundation may not be less than thirty per cent of the registered capital, or at least 5 million forints.

It is further stipulated in the Company Act that only share holding companies can be involved in banking and insurance activities. A company with foreign majority cannot acquire a controlling interest in another company limited by shares in Hungary.

In spite of these limiting factors the new Hungarian company law can be regarded as a major break through on the path towards a mixed economy with the door opened for entrepreneurial activity. As far as Western FDIs are concerned, the liberal spirit is obvious: fully foreign–owned companies are allowed.

The same document has one extremely interesting novelty: it makes portfolio investments in shares possible for foreigners. However, this possibility is more of a theoretical than practical nature. As long as the forint remains inconvertible, there cannot be much interest in portfolio investments in Hungary from abroad.

Hungary is the only CMEA country with some sort of a capital market. Bonds have been issued since the early 1980s. Treasury bills appeared on the Hungarian market in March 1988. These bills with nominal values of 5,000, 10,000, 50,000, 100,000 and one million forintss are sold to finance the budget deficit. 63)

Hungarian banks offer various account forms for their clients. For example, the joint bank, CIB, offers a "Euro–Call Account" designed for corporate and private clients seeking tax free money market interests on their deposits. Secret, confidential and attentive personal service is promised in this context. 64)

After the issuing of the new Company Act (Act VI/1988) it has also been possible to invest in shares in Hungary, as pointed out above. This option is open for everybody, for domestic and foreign natural and legal persons.

From early 1988, a "stock exchange", was first open every fortnight but by late 1988 it was in daily operation in Budapest. 65) This marketplace, which been dealt in various bonds and treasury bills, will also begin to trade shares in the 1990s, when the new company act show results.

The development of money and capital markets is of extreme importance for the investment climate of FDIs. Companies fully or partly foreign owned thus have the opportunity to look for various methods of operating their cash reserves, and they can also reinvest their profits in securities, if they wish to do so.

It is naturally possible that also international portfolio investors will take an interest in Hungarian securities. In the case of stocks, a portfolio investor examines many economic indicators in addition to the nominal and current value of stocks. Product, market share, profitability, tax and other regulatory conditions, etc. are examined before the purchase of stocks. For this purpose, the mandatory publication of the results produced by companies must be carried out so that the available information can be compared with international norms.

Naturally, the portfolio investor is not only interested in return on his shares, but also in an increasing market value of his holding, in order to receive a speculative profit. Convertibility of the local currency with a relatively stable exchange rate is an important precondition.

However, even if it is assumed that no big rush of portfolio investors can be expected in Hungary after the enforcement of the new company law, the Hungarian business environment is moving into the right direction making Hungary more attractive for Western investors than her CMEA neighbours.

In Hungary the Company Act of 1988 defined clear rules for FDIs. In spite of that, the Parliament enacted a separate law on the investments of foreigners in 1988 (Act XXIV of 1988 on the Investments of Foreigners in Hungary) 66).

The new Act reiterates and confirms formerly existing guarantees and benefits for foreign investors. In comparison to the Company Act of 1988 it establishes few novelties.

The essence of the Act XXIV of 1988 is that foreigners in Hungary come under the same terms as Hungarian nationals. They may become partners in existing companies or establish new ones. In this field, they enjoy equal treatment with the Hungarians. It is underlined that companies may even be fully foreign–owned. There are only two restrictions in this area. The first one is that, in case of the foreign share exceeding 50%, the joint permit of the Ministries of Finance and of Trade is required, while in the case of a share not exceeding 50%, the firm will simply be registered by the Court of

Registration. The other limitation is that a company limited by shares, in which the foreign party has a majority stake, may not acquire a controlling interest in another (Hungarian) company limited by shares.

A separate chapter (Chapter IV) deals with off–shore companies. The essential feature of the relating provisions is that such firms qualify as foreign companies from the point of view of foreign trade, foreign exchange and banking rules. These firms conduct their business in any of the CCs; they may freely contract loans either inland or abroad.

Some interesting details can be discerned from the Act XXIV of 1988. Section 12 defines that the foreign party is obliged to pay his pecuniary contribution in a freely convertible currency – unless an international agreement provides otherwise. A non–pecuniary contribution may consist of any kind of assets having an assessable value.

This means in actual terms that pecuniary contributions in TR or in the national currencies of CMEA–countries are basically not welcome. In this respect there is a clear difference to the Polish JV law of 1988, which explicitly welcomes the two latter form of contributions (see the equivalent Polish chapter).

Section 28 states that the labour–law status of the employees is to be governed by the Code of Labour, and – within the framework of the former – the company statutes and the employment contract. The subsequent Section mentions that the statutory rules relating to the regulation of wages and the material interest system of those in leading position is only to apply to such companies in which the size of the foreign stake is lower than 20%, or, five million forints.

In practical terms these sections of the law mean that foreign companies are able to give special incentives to leading personnel (also Hungarians) by offering, for example, part–payment in CC. This freedom only concerns companies in which the foreign party owns more than one fifth of the equity.

Any share due to the foreign party from the profit of the company is freely transferable abroad, provided the company possesses the proper CC cover (Section 32). This point makes one of the key questions absolutely clear: profit repatriation in CC form is only possible, when the company has the equivalent amount of CC at its disposal.

Furthermore, the Act XXIV of 1988 contains clear rules for taxation. The companies with foreign participation pay the same entrepreneur's profit tax (EPT) as other Hungarian firms. The rate of the EPT amounts to forty per cent of the tax base not exceeding three million forints and fifty per cent on the part exceeding that amount (Section 14).

However, the law grants substantial tax benefits to foreign investors. Firstly, if the foreign stake in the company's property at foundation reaches 20 per cent or 5 million forints, the company is entitled to a tax allowance of 20 per cent of the calculated tax; secondly, if more than half of the company's sales receipts derive from the production for hotel construction, or if the company's property at foundation exceeds 25 million forints out of which at least 30 per cent is from the foreign party, then the company is entitled to a tax allowance of sixty per cent in the first five years and forty per cent from the sixth year onwards. Thirdly, if conditions specified in the second point are fulfilled and if the company at the same time carries on an activity of special importance for the host country economy, the company is entitled to a five-year tax holiday, and can receive a sixty per cent tax reduction from the sixth year onwards (Section 15). Special tax benefits are given, in the case where the foreign party reinvests his dividends.

Economically important points in Act XXIV of 1988 show clearly that Hungary has tried to give real incentives to foreign investors. Legislation since 1972 has been subject to fundamental changes.

3.4.2.2. Hungary's experience with FDIs

In Hungary, the economic results in attracting Western FDIs in the 1970s were almost catastrophically thin. The first rules covering JVs were regarded by Western companies as inadequate. Therefore, only a few JVs were set up, and even some of them failed. In the 1980s with the amendments of JV–rules the investment activity of Western companies clearly revived making Hungary undoubtedly the most interesting area amongst the small CMEA countries as far as FDIs are concerned.

According to the JV register of JVs the first JV in Hungary is Sicontact Limited Liability Co, in which the West German MNC Siemens is the Western partner. 67) Siemens' Hungarian contact go back several decades. The electric installation of the first underground railway built in Budapest in 1896 were supplied by Siemens. Siemens had its own manufacturing plants in Budapest in 1913. These plants were nationalized after World War II. 68)

Business contacts of Siemens with the socialist Hungary began in the late 1950 and accelerated in the 1960s. The first cooperation agency agreement was signed in 1968 by the Hungarian FTO Interco–operation. Siemens started negotiations concerning a JV in Hungary right after the first JV decree was issued. In mid–1974, Sicontact Ltd started operating with a 51% Hungarian (Interco-operation) and a 49% West German participation. 69)

The basic activities of the Sicontact JV include cooperation and the servicing of Siemens computers installed in Hungary. In some areas, Siemens has an extremely important role to play in the popularization and transfer of new technologies. 70)

After the experimental period of the JV, an important step was taken in 1980. Two new Hungarian partners (Remix Manufacturing Co for Electronic Components and Electromodul, Hungarian Trading Co for Electrotechnical Components) were taken in and the basic capital of Sicontact was increased from the original forints 5 million to 62.5 million. In 1986, the basic capital was further increased, to some forints 80 million, whereby a new Hungarian partner (Financial Computer Techniques Institute) was accepted. Also after these two events Siemens has remained in minority shareholder position, owning only a 49% stake in Sicontact. 71)

The first paid-in capital increase was realized by licence transfer and leasing in the manufacturing of passover electronic devices. Under this agreement, Remix started manufacturing modern polyethylene and polypropylene condensers and later layer condensers and layer resistances. The production capacity ensured by Remix also provided export possibilities, besides catering for Hungarian needs. 72)

In connection with the capital increase in 1986 a new computer for the Sicontact service department was aquired in order to help find disturbances in the Siemens equipment operating in Hungary. For testing and simulating of disturbances a new software workshop was established, which provides services for the home market and export. 73)

In 1988, Sicontact employed 115 people. Between 1985 and 1987 turnover was doubled. This JV pays yearly dividends of some 20% of the capital, and looks likely to remain profitable. 74)

Sicontact is undoubtedly a success story among JVs in Eastern Europe operating with Western equity participation. However, the German party has also some critical remarks to make. The German manager, R. Schöning, points out, that the limited foreign trade rights of Sicontact are hampering business. Western currency shortages can lead to disturbances in service activities, especially when spare parts are not immediately available. 75) However, expansion of Hungarian operations, including production JVs, is not excluded by Siemens, 76) Sicontact operations are on a relatively modest level concentrating on various services and technology exchange, but it is profitable.

The Swedish car–maker Volvo, was among the first Western companies to set up a JV in Hungary.

The Volvo joint venture, Volcom, was founded in 1975 to produce Volvo's Lapplander four–wheel drive, crosscountry vehicles. The equity was split as follows: 48% Volvo; 26% the FTO Mogürt; and 26% the Cseppel Automobile Works, one of whose plants housed the production line for the Lapplander.

Unfortunately, at the time production was beginning in Hungary, Volvo was making a number of adjustments to the Lapplander that added to the difficulties inherent in merging two radically different conceptions of management and production discipline. Adjustments to the model were further delayed by administrative problems. Tools and machinery necessary for production could be used only after import permission had been granted for each separate piece.

As a result of these problems, mass production began over a year late – and even then fell well below the target of 1000 units per year. In addition, the long delay involved in getting production started meant that the Lapplander missed a number of marketing opportunities: when production problems were finally ironed out the vehicle was not competitive in its class, and sales were disappointing.77)

Consequently, the project was closed down after a few years and the company transformed into a marketing agency for Volvo products.78)

Corning International's (USA) JV to manufacture medical apparatus had a similarly disappointing start. The JV Radelcor (49% Corning; 41% the electrochemical instrument manufacturer Radelkis; and 10% the FTO Metrimpex) failed to start the production of blood gas analyzers as arranged in 1976 because a rapid rise in world prices pushed the price of the necessary machinery above the sum Corning had put at the JV's disposal. While permission to spend more was negotiated, component parts, which had to be paid for, remained unprocessed and therefore unsold in the warehouse.

Though the company subsequently made a small profit, the experience of these early JV's helped convince Hungarian legislators that new legislation was required if JVs were to become significant in Hungary.79)

The Hungarian JV register still includes the name Radelcor with the remark that operations are suspended at present.

At the end of the 1970s, which as a decade certainly was not a very successful one in Hungary's JV history, an exciting new venture in the financial field was established. The first joint bank with East–West participation operating in the CMEA was established.

Central–Europe International Bank Ltd. (CIB) is a dollar–based off–shore bank established on the 9th November, 1979, in Budapest. In operation since 1980, the Bank's majority shareholders are leading European and Japanese financial institutions. The Bank started its business with an authorized and paid–up capital of USD 20 million and a subordinated stand–by loan of USD 15 million from its shareholders.

The Bank is registered under the Hungarian Company Law of 1875 with the approval of the Government of Hungary and is empowered to conduct international banking business of any kind in and outside Hungary. On the basis of its licence of operation granted by the Hungarian Minister of Finance, the Bank enjoys special off–shore privileges such as:

Exemption from
- the Hungarian foreign exchange laws and regulations
- all Hungarian central bank requirements.

Authorization to
- deal directly with Hungarian enterprises and organizations, but excluding transactions in forints or in transferable roubles,
- maintain its books and make up its balance sheet in US dollars instead of forints,
- have its books audited by international auditors appointed by the shareholders.

The Bank is a profit making venture and serves no national interests of any of its shareholders' home countries. Based on its off–shore privileges, the Bank conducts business in a geographically neutral manner, influenced only by consideration of the risk and return of particular business transactions and its business policies.

The Bank's profile is essentially wholesale banking with retail business limited to exchange and deposit services. The latter involves the handling of deposits of private and corporate clients in convertible currencies, providing them with tailor–made account relations.

Within its wholesale activities, the Bank focuses its attention on financing international trade irrespective of the origin or destination of the goods involved.

Activities on the primary and secondary international loan market, as well as financing projects in Hungary and outside, also represent an important sector in the Bank's lending activities. 80)

Altogether, in the 1970s only four JVs were set up in Hungary of which two actually failed. Alongside the development of the economic reform and liberalisation of the JV rules, however, in the 1980s FDIs increased considerably. 81)

The JV activity in Hungary shows some highly interesting features. Western companies setting up JVs in Hungary have chosen almost exclusively to establish operations "onshore", to act within the Hungarian economy. "Off-shore" JVs in duty-free zones have failed to catch on although this option has been pushed strongly by the Hungarian authorities. JVs in the Hungarian economy can be used by Western companies as a vehicle to penetrate the Hungarian market. Only onshore JVs can perform this function. Those operating in duty-free zones are treated as foreign companies for customs purposes and must do their accounting and cover their local expenses in hard currency. 82)

Denmark's Flexplan, which produced prefabricated housing, was the first Western partner in an "off-shore" joint venture, making use of low-cost Hungarian labour and a Central European location to produce entirely for non-Hungarian markets in Central and Southern Europe. 83) This JV went out of business as the Danish parent company went bankrupt. 84)

More joint banks have been set up in the 1980s, which unlike the first joint bank CIB, operate onshore. This means that these financial institutions are authorized to carry out commercial and investment banking activities in any freely convertible currency, as well as in Hungarian forints.

Citibank Budapest Ltd was founded in 1985 a with registered capital of HUF 1 billion (the equivalent of USD 20 million). The Citibank N.A. New York has a 80% share in this venture, and the Hungarian partner, Central Bank of Exchange and Credit Ltd, only 20%. 85)

Unicbank, was established in Budapest December 10, 1986 as a consortium of the German Cooperative Bank (Deutsche Genossenschaftsbank), The Austrian Cooperative Bank (Genossenschaftliche Zentralbank AG, Wien) and The International Finance Corporation (World Bank affiliate) as foreign partners having 15% of the HUF 1 billion equivalent to USD 20 million) capital each. Of 6 Hungarian banks Unicbank is fully authorized to carry out commercial and investment banking activities in any CC as well as in HUF. The main activities are lending to corporate entities, providing bank services related to international trade, and retail banking for non–residents. 86)

The establishment of joint banks in Budapest shows that the international banking community has confidence in the Hungarian economy. The two joint banks set up in Hungary in the 1980s on the onshore basis refer to the hope that the Hungarian forint is believed to became convertible in a not so distant a future. An especially interesting detail in Unicbank is that The International Finance Corporation, which is an affiliate of IBDR, is a shareholder.

Some well–known Western companies that have brandnames as one of their most important intangible assets, have invested in Hungary. These companies have chosen the onshore option, because their aim obviously is to conquer the local market with their trademark labelled products.

In the first month of operation, the joint venture shop (formed in the mid 1980s), owned by Adidas of West Germany (51%), the Foreign Trade Bank (15%), Tricotex (15%), Hungarocoop (10%) and Artex (9%), got local currency sales of over DEM1 million. The shop has imaginative and animated window displays. The Western influence in shop design in itself makes the outlet stand out, even if many of the goods inside are in fact "made in Hungary".

Adidas' venture into retailing followed a number of years' experience in both buying and selling in Hungary. In the late 1970s and early 1980s, Adidas made regular and substantial sales to Konsumex for retail through the Intertourist hard currency chain.

The joint venture now sells for forints under a formula which allows imports of Adidas goods to the amount of up to 50% of all increases in Adidas purchases of Hungarian goods. This has resulted in a 30% boost in Adidas' buying in Hungary, although most of this comprises goods made in Hungary carrying the Adidas brand.

Some Hungarian authorities are not very pleased with this arrangement. They claim that instead of expanding exports, the deal is siphoning off production of trademark products from the local market and encouraging more imports.

At least for the time being, officials seem prepared to tolerate the Adidas arrangement, particularly in view of the popularity of the Budapest retail shop. With demand for the brandname goods far outstripping the present supply, production of existing lines is likely to be expanded, and the firm is reportedly considering local manufacture of tennis rackets and other sporting goods. 87)

Levi Strauss has had business relations with Hungarian enterprises for a decade. The May 1st Garment Factory and Hungarotex Hungarian Trading Company concluded a co-operation contract in 1977 under which the manufacture of jeans was begun in Hungary using the know-how of the Levi Strauss firm. The greater part of the amount manufactured was sold in the domestic market while the rest was bought back by the American partner for its own distribution. The agreement expired in 1987, and it was then that the idea was raised of establishing a joint venture based in Budapest for the manufacture of the whole Levi Clothing range. According to plans, an independent shop chain is to be established for marketing in Hungary.

The Knitwear Factory of Kiskunhalas in Central Hungary, a manufacturing hall with a floorspace of 5000 square metres has been taken on lease by the joint venture. This is where the modern manufacturing lines and equipment to be supplied by the American partner will be located. The machines are worth some 1 million dollars. With the new workers numbering some 200, a one-year contract will be concluded, and an extension will only be negotiated if the labour force have proved their skills. American organizers will direct the installation of the machinery, so that the arrangement of the places of work will comply with the requirements of the technology. The joint venture will receive finished products not only from the Kiskunhalas plant, but from other Hungarian factories. Levi Strauss - Budapest Ltd. will also endeavour to buy the basic materials - as far as possible - from Hungarian suppliers.

The Hungarian denim will be sold not only in the Hungarian market. As previously the European network of the Levi Strauss firm will buy back a large amount of jeans. It also intends to take over significant amounts of articles made of Hungarian basic materials. But apart from clothing items, the Levi Strauss firm wants to increase its purchases from other manufacturers in Hungary. 88)

The internationally well-known furniture firm IKEA of Sweden spent two years negotiating a Hungarian joint venture before it was approved. The delay was due to reluctance on the part of the Hungarian furniture industry, which is reported to be adverse to IKEA's price and quality competition. Hungarian manufacturers prefer to supply the domestic market with its present range of products, according to IKEA. 89)

In December 1987 the agreement on IKEA JV (Burtorker-IKEA Einrichtungs - GmbH) was signed. The HUF 25 million capital is shared on a 50-50 basis. IKEA, which has been buying from Hungary on the basis of contract manufacturing goods to the value of SEK 30-40 million yearly, intends to increase purchases from Hungary's JV to SEK 180 million by 1990. A new furniture shopping centre will be erected in Budapest with a huge selling area of 11,000 m^2, where articles will be offered. The aim for annual sales in Hungary is HUF 1 billion out of the local furniture market of Hungary of some HUF 12–14 billion. Aggressive marketing in Hungary as planned by the IKEA JV is based on the promise of producing a positive convertible currency balance in its activities. 90)

When JV–approvals are given by the Hungarian authorities (Ministry of Finance), a positive balance in CC activity of a JV is presupposed. However, a working permit can also be given, if the JV is able to contribute to convertible currency import substitution. 91)

The latter case, important import substitution, can be demonstrated by the Kemipur JV, in which the West German chemical giant BASF is the Western partner via her subsidiary Elastogram. Kemipur was established in 1984 with the original capital of DEM 4.4 million, of which the Western partner had 49%. Kemipur was set up to manufacture polyurethane foam compositions for application in shoe sole making, for insulation in refrigerators and building industries, for the manufacture of bumpers in the vehicle industry. 92)

In 1988, this venture still had to import all the raw materials from the West, while the local demand for the end–product seemed endlessly high. Although Elastogram had agreed to export 20% of Kemipur's production, virtually no exports have taken place because of the high local demand. Development of local raw materials is, therefore, under consideration. Kemipur plans to invest DEM1.5 million, in order to enhance the capacity. 93)

Hungarian authorities have continuously pointed out that in the sphere of tourism there are various possibilities for joint ventures. The country has a population of 10.6 million, but it is visited by 17 million foreigners yearly. One fourth of them come from the West leaving around USD 0.5 billion in Hungary. Eastern tourists, in comparison, spend around 0.5 billion roubles in Hungary. 94)

So far, however, JV activity in tourism has been rather modest. It is worth mentioning that international hotels in Budapest (Hilton, Intercontinental, etc.) are run on the basis of franchising deals.

In 1985 Club Tihany JV was established to construct and run a recreation centre on the lake Balaton. In this venture Western shareholders are from Austria (three) and Denmark (one), who altogether own only 30% of the venture. Club Tihany Ltd comprises 161 bungalows, and a luxury class hotel with 220 rooms and 12 restaurants. 95)

A highly interesting JV was set up in 1980, which has been active in gambling since 1981. Budapest Gambling Casino Ltd runs a casino in the Budapest Hilton hotel and since October 1984 also in the treatment hotel Heviz near lake Balaton. The Austrian state-owned gambling organization (Österreichische Spielbanken) is participating in this venture with a 40% shareholding. Also three travel agencies, two of which have Austrian and one Italian partners have been set up. 96)

In the summer of 1988 an agreement concerning a new treatment hotel joint venture was signed in Budapest between Danuvius Hotel and Spa Company and the Finnish construction firm Rakennuskunta Haka. The new JV will construct and run jointly a treatment hotel with more than 500 beds in Budapest on the Danube. The basic capital of the JV is HUF 650 million. The hotel will start operations in mid 1990. 97)

Not all JVs are successful, however. The story of the Bramac joint venture goes back to 1984 when the Austrian company agreed with VAEV, a building materials cooperative in Veszprém, to produce roofing tiles using Bramac machinery and technology. The deal seemed logical enough; since Hungary was annually importing some 40 million of it total requirement of 135 million roofing tiles, the JV's planned output of 20 million tiles would offer prompt import substitution. Indeed, Bramac itself had shipped about 3 million tiles to Hungary in 1983 and looked forward to sales of 10 million in 1984.

But the cooperative VAEV had been in financial trouble for some time; in 1985 losses reached Ft 300 million (over USD million). Miscalculations in overseas contracts had brought considerable losses. When in early 1987 no further credits were available to keep the enterprise afloat, the Hungarian Credit Bank, acting under the new bankruptcy law, simply applied for VAEV to shut down. Officials agreed, setting the stage for Hungary's first major bankruptcy case, involving 2,300 workers.

A key weakness of the JV itself was its unreadiness to handle any large-scale sales promotion within Hungary. As long as the construction industry enjoyed a boom, sales took care of themselves. But when a slump in major investment projects hit, the JV's inventories of roofing tiles soared, at one point reaching a seven-month stock. The Austrians pressed for marketing efforts in order to supply tiles for smaller projects. VAEV agreed to offer discounts and free delivery. But the shift from a few larger to many smaller customers brought accounting problems for the JV. At the same time, payment morale in Hungary began to lag and cash-flow problems grew.

Finally, exchange rate differences undermined the joint venture's profitability. Although the JV reportedly turned a Ft 90 million profit in 1986, the 38% devaluations of the forint against the Austrian shilling took a major bite out of profits. Bramac appealed to the Finance Ministry in Budapest.

Bramac claims that the JV's problems can still be overcome; the firm has declared its intent to continue with the JV, not surprising in view of the air-conditioned computer-controller plant built in Veszprém. The state has since taken over the Hungarian share, and the new partners plan to introduce new tile designs. 98)

Tuomo Halonen Oy (THOy) is a Finnish company producing foodstuffs processing and liquid packaging machines. In 1986, THOy set up a JV with the Hungarian dairy organization TVT. The JV aimed at manufacturing liquid packaging machines and foodstuff processing equipment to complete the product range of THOy. It was decided that JV products will be marketed in Hungary, as well as in the Third World, together with THOy.

It was agreed between the JV partners that no profits could be paid out during the first five years of its operations. The intention was to quadruple the JV resources by investing all possible profits. 99)

Shortly after presenting this promising JV case in the 15th International Small Business Congress in Helsinki, August 1988, Tuomo Halonen withdrew from the JV by selling his share to the Hungarian partner. Obviously, the reason for that was that the Western part tried to repatriate his profit by using transfer-pricing, when certain components of the end--product were sold to the Hungarian joint venture. The Hungarian side found this out by making international price comparisons.

Hungary has also been relatively active in participating in JVs outside the country. Under a decree issued jointly by the Minister of Foreign Trade and Finance in 1975, Hungarian enterprises can draw on substantial state financing for establishing JVs abroad. Ownership and management may be shared by the Hungarian and foreign participation, with no mandatory ownership proportion. To encourage Hungarian enterprises to venture abroad important tax credit advantages have been also granted. 100)

According to the Hungarian Chamber of Commerce guide-book on JVs

> "economic associations with foreign participation are becoming increasingly popular in the course of the international division of labour. JVs have proved more advantageous, not only as simple sales transactions, but also than such types of business like trade with intellectual property and licences or production and marketing

> cooperation deals even more effectively and flexibly in respect of exploiting comparative advantages and promoting the international flow of the factors of production. This particular advantage has long been recognized in Hungary. Hungary operates almost 150 companies abroad throughout the world with Hungarian capital outlay. The establishment and activities of such companies have provided basic experience. Founders have become aware of the need to acquaint themselves above all with the economic and legal system of the host country, as only awareness of and adapting to the local environment and customs can ensure successful operation." 101)

In the late 1980s Hungary had over 200 JVs outside the country. 102) Obviously, the big bulk of these outlets are mere marketing organizations selling Hungarian goods in the West and in the Third World. Two Hungarian Banks, Central Wechsel- und Creditbank in Vienna, established in 1918, and Hungarian International Bank Limited in London, founded in 1973, operate in the OECD-area. 103)

Alongside with the Hungarian Bank in Vienna, there are also two production units under Hungarian ownership operating in Austria, which have been established before World War II. The light bulb manufacturer Tungsram has one factory on its own name and the subsidiary, "Patria", producing in Austria. The pharmaceutical firm Enzypharm was established in Austria in 1948 by the Hungarian FTO Medimpex. The steel enterprise Metex is owned via two holding-companies in Liechtenstein by Hungary. 104)

Tungsram is certainly an extremely interesting socialist enterprise which is obviously more internationalized that any other manufacturing unit in the CMEA-area. It produces electrical lighting products together with the equipment required for their manufacture. As one of the largest in this branch in the whole world, it runs 17 factories located in Hungary, one in the USA (Action-Tungsram) one in Pakistan (also an electric company) 105) and two in Austria.

Tungsram established a new production unit in Ireland in 1980. The electric light bulb production capacity came on stream in April 1982. However, the company ceased operations in February 1984 for reasons related to over-capacity and supply difficulties. 106)

In Hungary, Tungsram is running a JV together with Schreder from Belgium. In this venture, which produces lighting for streets and industrial facilities, Tungsram has a 40.5% share, the Hungarian Aluminium Corporation 20% and the Western partner 40%.

The JV was established in 1983 and production went on stream in 1984, when turnover already was HUF 22 million. In 1988 turnover reached HUF 150 million. Tungsram point out that the decisive factor in signing the JV contract was that no licence deals for street lamp production were for sale on the international market. 107)

3.4.2.3. Overall results of JVs in Hungary in the 1970s and 1980s

Hungary has been by far the most successful small CMEA–country in attracting FDIs. According to information from the Hungarian Chamber of Commerce, the number of JVs licensed till December 1988 was over 270. In the first quarter of 1989 there were 184 joint ventures in operation. 108)

Data given by Hungarians contains many details . Capital invested in each JV case is mostly given (although in 5 cases it is missing). All partners involved are listed, as well as the activity of the JVs. Turnover or profits, however, are not mentioned.

Information compiled on the Hungarian JV register allows a comprehensive analysis on FDIs in Hungary. According to the register from 1989, a total of 29 units were established before the year 1985. In year 1985, 18 new JVs were founded, and also the following year 18 new units saw daylight. In 1987 already 40 new ventures with foreign participation came into being. In 1988 the corresponding figure was 77 units.

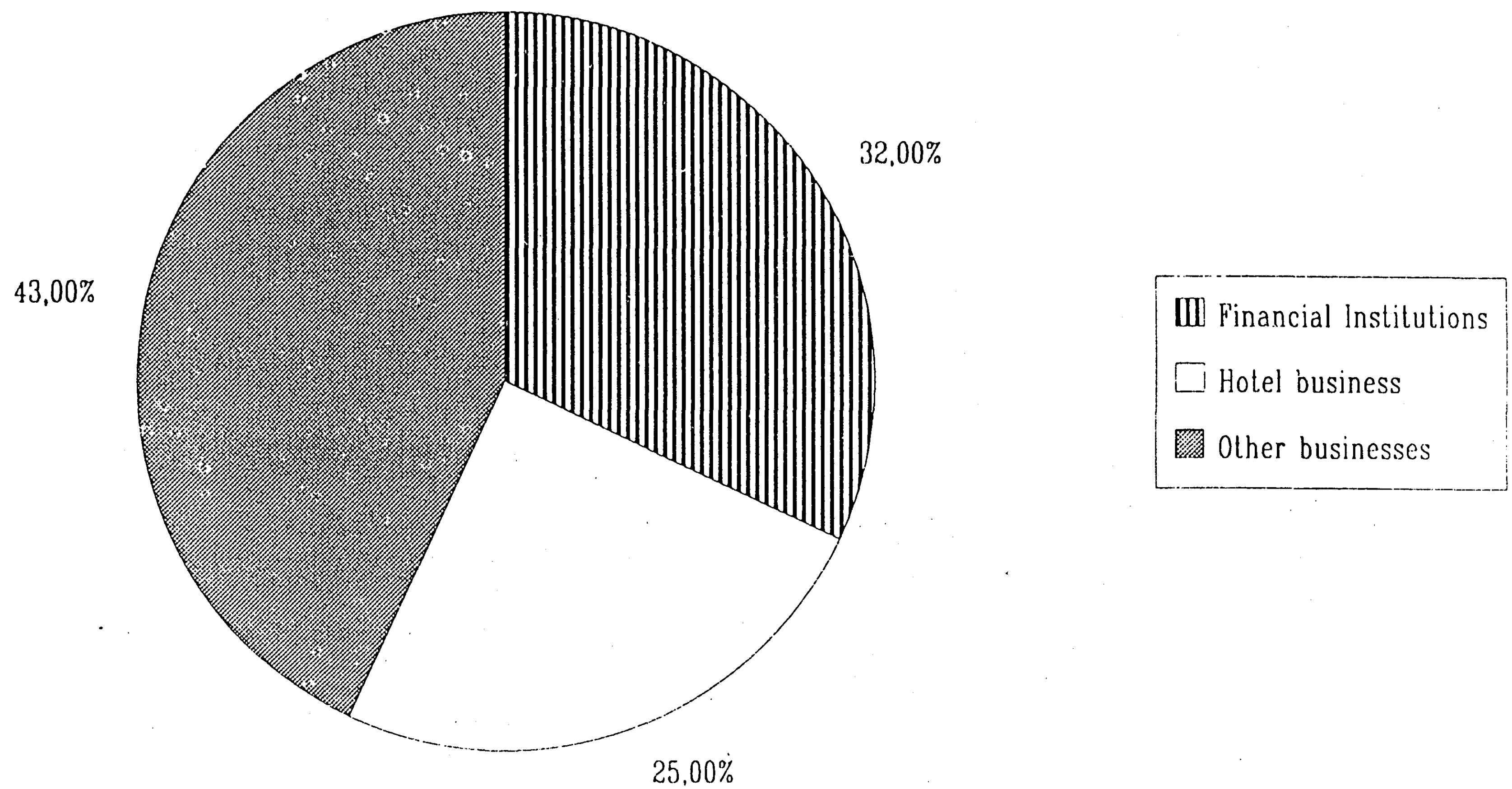
From these figures it can be concluded that Hungary has been able to attract foreign direct investments with an accelerating speed during the second half of the 1980s, when there has been remarkable amendments into JV legislation. Obviously, the advancing economic reform has also contributed to the increasing number of JVs.

However, the capital invested in Hungarian JVs is still relatively modest. In the 179 cases in which the invested capital is given, the total equity amounts to 31.4 billion forints, which is the equivalent of USD 523 million. 109) From this sum about one–third (Ft 10 billion or USD 167 million) is invested in joint financial institutions. Ft 7.8 billion or USD 130 million is invested in the capital–intensive hotel business accounting for up 25% of the whole investment bulk.

In joint ventures outside the hotel and banking business the total invested capital is thus only some Ft 13.6 billion, or the equivalent of USD 227 million, which is less than the half (about 43%) of total JV equity sum. Of this sum about half is invested by foreign partners, who thus have brought only slightly more than USD 100 million outside of the banking and hotel spheres into the host country.(See figure 1/3.4.2.3.)

Figure 1/3.4.2.3.

Hungarian J.V. capital distribution among major branches (%)



Source: Own calculations based on Hungarian JV list

Figure 1/3.4.2.3.

Total 179 J.Vs, invested capital 31.4 billion FT (523 million $)

Enterprises with small capital predominate the scene among Hungarian JVs. 54 units or 30% out of 179 JVs, in which the starting capital has been revealed, have less than Ft 20 million (One third of a million US-dollars) as equity. Almost half (47%) of all Hungarian joint ventures are situated in the equity brackets of Ft 20.1 million to 100 million. These units have a starting capital of between 0.33 million and USD 1.67 million. Fourteen enterprises have equity between Ft 100.1 million and Ft 200 million (USD 1.67–3.3 million), thirteen over Ft 200 million, but less than Ft 500 million (USD 3.3–8.3 million), and fourteen have over Ft 500 million (over USD 8.3 million). (See figure 2/3.4.2.3)

The 138 joint ventures, in which the invested capital is Ft 100 million (USD 1.67 million) or less, account for no less than 77% of the total. Only 14 units (7.8% of the total) have an equity of more than Ft 500 million (over USD 8.3 million).

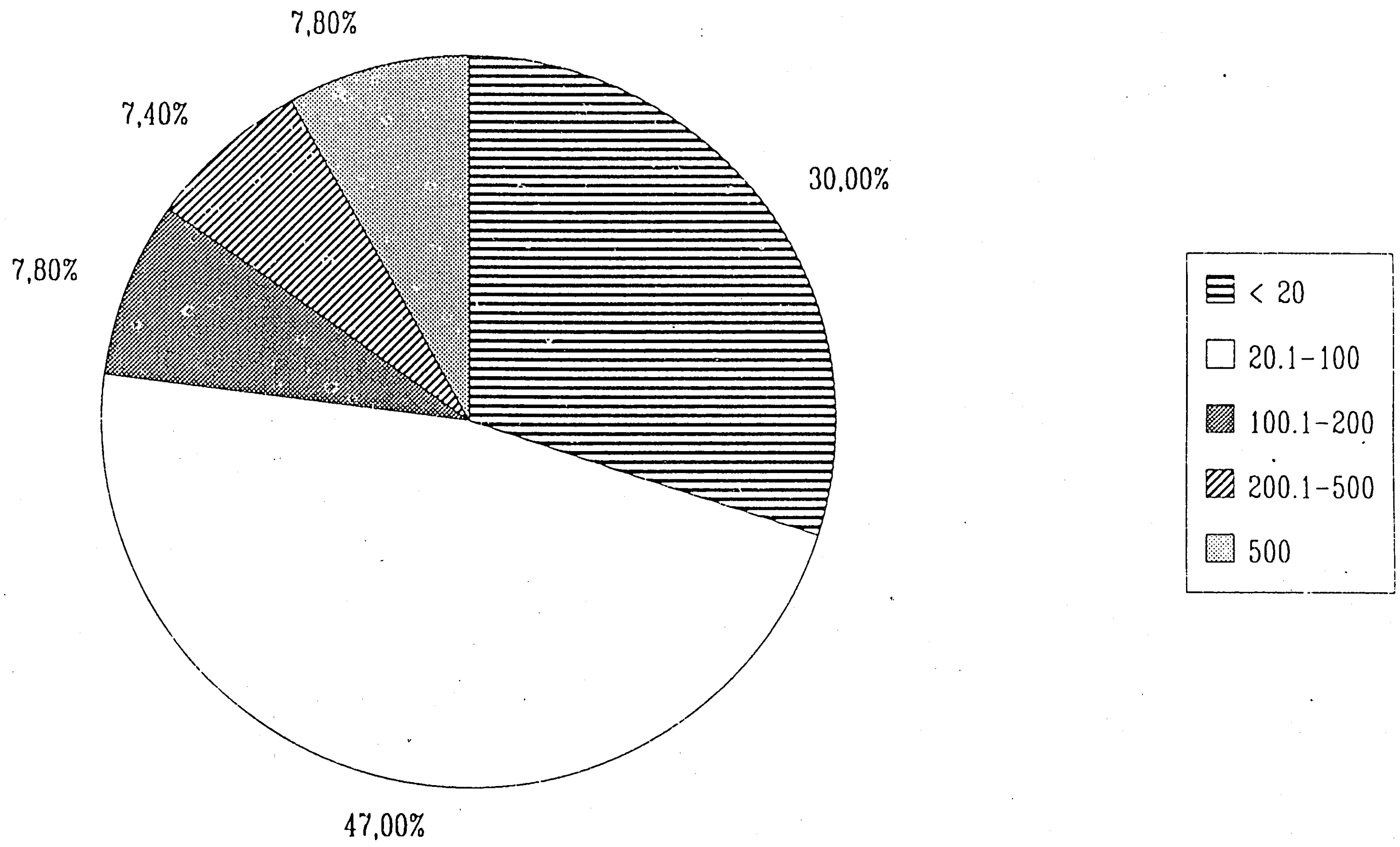
In the category of large units (equity over Ft 500 million) financial institutions and hotels are predominant position. In addition to C.I.B. (Ft 1.2 billion equity), Citibank Budapest Ltd (Ft 1 billion) and Unicbank Ltd (Ft 1 billion) mentioned in the previous section, two other major financial ventures have been established in 1988. Central-European Credit Bank Ltd went on stream with a Ft 1 billion capital. In this venture C.I.B. has a share of 92.872%, and it is listed as the Hungarian partner. All the OECD-country participants of CIB are shareholders in the new bank with a share of 1.188% each. In 1988 Investrade Co started operations with an equity of USD 100 million (Ft 6 billion). In this venture, which provides services of specialized financial institutions for foreign trade, consultancy in economic cooperation and market research, the foreign partner is Daewoo from the Republic of Korea. It shares the highest JV investment in Hungary with Magyar Hitel Bank (Hungarian Credit Bank) on a fifty-fifty basis.

The same Korean Daewoo has also established a joint venture called "Saint Steven" Hotel Co with the same Hungarian partner. This also has an extraordinary by high capital of USD 90 million (equivalent of Ft 5.4 billion). Also in this case capital is shared 50–50% among the partners. According to a CMEA-bulletin, this company has bought Budapest Hilton and is building a new hotel in Budapest. 110)

The Swiss company Hafina Bau AG established a joint venture in Budapest 1988, in order to build and manage a spa hotel. This venture, in which the Western partner has a share of 38%, has an equity of just under Ft 1 billion. The spa hotel with the Finnish participation (Haka), mentioned in the previous section, has an equity of Ft 650 million.

Figure 2/3.4.2.3.

THE STARTING CAPITAL OF JOINT VENTURES IN HUNGARY (mili.FT, total 179 JVs)



Source: Own calculations based on Hungarian JV list
Figure 2/3.4.2.3

Thus, five banks and three hotel enterprises comprise eight out of fourteen large JVs (with equity over Ft 0.5 billion), or 56.1 per cent of this big enterprise group. Only six major entities are therefore active in manufacturing.

Videoton Automation Joint Enterprise, founded in 1988 has the highest capital among non-banking and non-hotel joint ventures. This unit has a starting capital of under one billion forints (Ft 945 million or USD 15.8 million), of which Simera AB from Liechtenstein owns 31.2%, and Hungarian Videoton Electronic Works the rest. Activities include development, production, sales of computer peripherals, industrial robots, robot controllers, and flexible manufacturing systems. The Japanese-Hungarian company Agroferm has an equity of Ft 882 million (USD 14.7 million). Two Japanese firms own 20 per cent together and IFC 14.5 per cent of this unit, which is establishing and running a lysine plant. The end product is an important feed additive protein.

In 1989 Videoton established a joint venture with Thyrsus Trading from Cyprus to produce consumer electronics (Hifi). This venture has an equity of Ft 572 million (USD 9.5 million), of which the Western partner has a share of 30.07%.

KBC Manufaktur Koechlin from West Germany has established a textile printing factory with Hungarian partners. This unit has a starting capital of Ft 568 million (USD 9.5 million), which is shared 50–50% among the host country partners (39) and the Western participant.

Selectronic joint venture was originally established between Standard Elektrik Lorenz from West Germany, and Skala-Coop, Hungary. This JV was acquired by the Finnish company Nokia, when Nokia bought Lorenz. Selectronic, which produces and markets mainly Nokia ITT colour TV sets, has an equity of Ft 541 million (USD 9 million), of which the Western partner owns 35%.

Ikea from Sweden has obviously decided to expand its operations in Hungary, because the equity given in the 1989 JV register of Hungary for Butorken-Ikea is Ft 528 million (USD 8.8 million). This is about twenty times more than the original figure in 1988.

Five financial institutions, three hotel businesses, and the six other units mentioned make up the 14 JVs with equity over 500 million forints (USD 8.3 million). Two of them operate off-shore, the CIB and Investrade, both of which are financial institutions.

Altogether, only 28 Hungarian JVs operate on the off-shore basis, which is 15.2% of the 184 units registered. The overall capital invested in off-shore units is relatively high, altogether Ft 8.2 billion (USD 137 million). This high figure, however, results mainly from two off-shore financial institutions, CIB and Investrade, which together have an equity of Ft 7.2 billion. Obviously, CIB has been thinking over its role as an off–shore unit, when Citibank and Unicbank were established on the on–shore basis. It can be assumed, that the CIB established Central–European Credit Bank in 1988, which is 92.872% owned by CIB and which operates on–shore, in order to be fully competitive with other joint banks in Hungary.

Among the off–shore units there is one more financial institution, the International Investment Agency, in which an Austrian bank and an enterprise from Liechtenstein are the Western shareholders (33.3% each). This unit, which provides stockbroking services, investment banking consultancy and assistance in international financial matters, has a capital of a mere USD 210,000 (Ft 12.6 million). Therefore, the International Investment Agency is obviously more of a financial consultancy than a full–scale bank.

Alongside with the CIB also the Hungarian Gambling Casino, which was established 1981 together with the Austrians, can be regarded as a pioneer in Hungarian off–shore business. This unit has an equity of DEM 5 million (Ft 150 million).

If the capital of these four units, two banks, one financial consultant and one casino, is deducted from the over all off–shore capital, it can be seen that only Ft 815 million (USD 13.6 million) are invested in other off–shore units. Of these units there are 23 whose capital is known. They have an average equity of Ft 35.4 million (about USD 0.6 million). From the over all non–banking JV capital these Ft 815 million account for 3.8%.

Of the 23 off–shore non–financial institution joint ventures 9 have a capital less than Ft 20 million. Twelve of them have an equity between Ft 21 million and Ft 100 million.

The biggest of these two, Metab Metal Working Ltd Co with an Austrian partner produces zinc plating, plastics coating and the lacquering of rolled steel products, as well as building elements. Metab has an equity of ATS 44 million (USD 3.15 million), of which the Western partner has 42.5%.

The other off–shore unit with a capital over Ft 100 million (USD 2 million) is TNT–Malev Express Cargo Ltd, which flies express cargo transport five time a week at night from Budapest to Cologne and back, and provides charter cargo activities on request. The Western partner is TNT World–Wide Air Express (UK), which has a 40 per cent share in the venture.

It can be concluded, that the off–shore activity in the Hungarian JV scene has not been developing too dynamically. Mainly small enterprises have used this opportunity outside the banking sector. In 21 cases out of 23 (91.3%) the enterprise capital is less than Ft 100 million (less than USD 1.7 million).

Of all the joint ventures active in Hungary 120 units are active in the production sphere (two thirds of the 184 units). Classification is difficult, because in some cases the activity of the enterprise is not entirely clear.

Tourism, as is well known, is a big business in Hungary. Among the joint ventures 13 are involved in tourism (7% of the total). When joint venture hotels are counted into the total JV equity, the tourist units have a total capital of Ft 8.1 billion (USD 13.5 million), or 26% of total JV capital. For the non-banking JV capital, tourism accounts for as much as 38.5%. A considerable part of these JV tourism investments aim at the development of treatment travelling. (See figure 3a/3.4.2.3.)

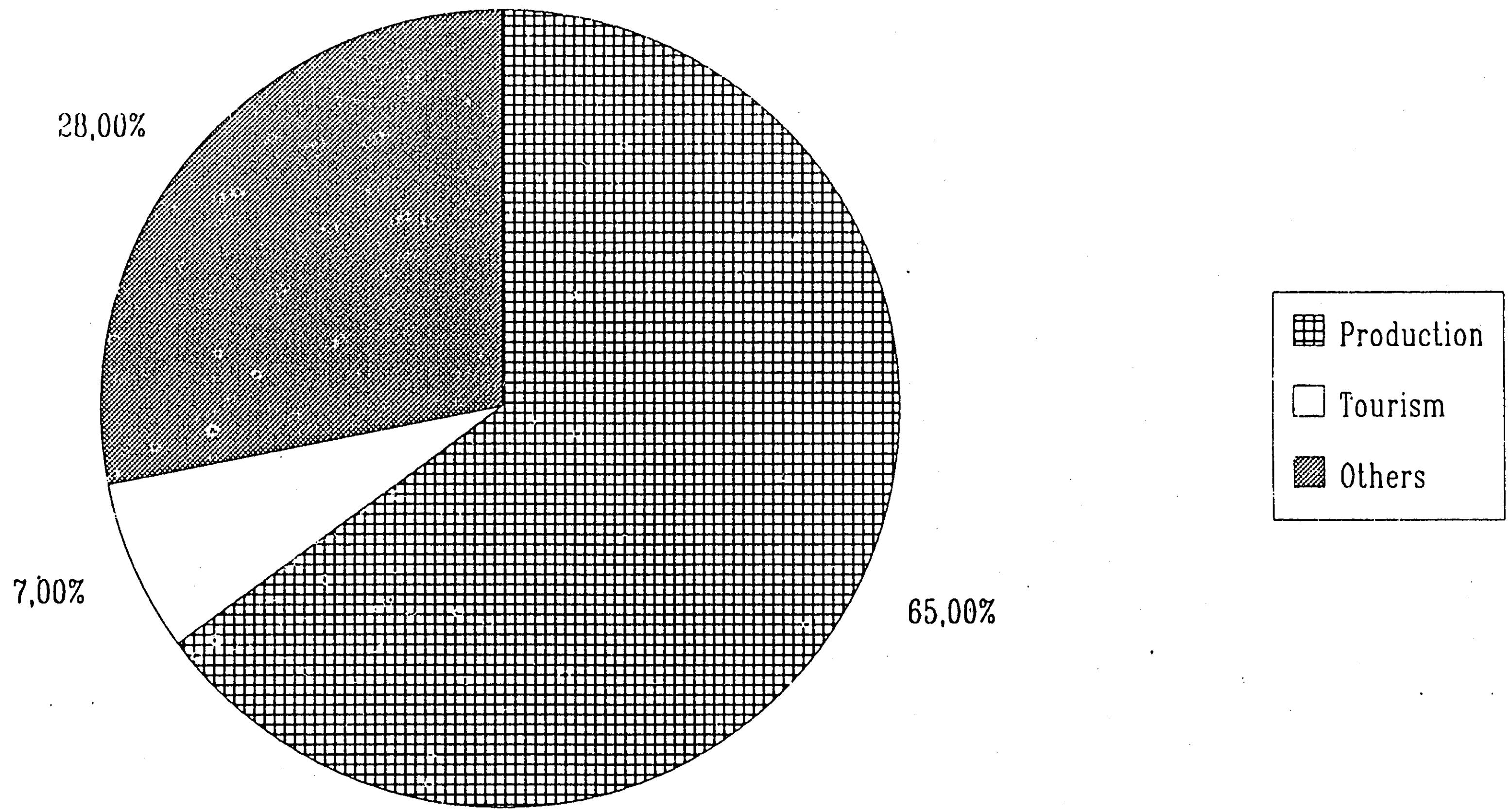
Construction material production is the most popular activity of Hungarian JVs in the production sphere. This branch accounts for 24 of the 120 productive units (20%). The chemical industry, agro-business and food processing and engineering and equipment comprise 17 cases each (14.2% each). The electro-technical and electronics branch has 13 cases (10.8%) and textile and clothing 11 (9.2%). Non-classified cases comprise 21 ventures, including book printing and bicycle assembling.

In high tech areas the picture of Hungarian JVs is rather interesting. Many of the small units are active in computer software, but some solid investments in high tech have also taken place. Videoton Automation Joint enterprise produces computer peripherals, industrial robots and flexible manufacturing systems. This enterprise, in which Simera AG from Liechtenstein is the Western partner with a 31.2% share, has an equity of Ft 945 million (USD 15.8 million). Behind the Liechtenstein company is probably some bigger Western firm. Nokia's TV and video production unit has an equity of over half a billion forints. Videoton produces consumer electronics together with Thyrsus from Cyprus in a joint venture, in which the equity is also over half a billion forints. Videoton also produces discs and data bearers and data storing equipment together with a Dutch company in a joint venture with a Ft 250 million equity (USD 4.2 million).

It is not surprising that in the agro-business and food processing the Western interest has been relatively high, resulting in 17 joint units. The same can be said about the chemical industry in which joint ventures have been concentrated especially in light chemicals (pharmaceuticals).

Figure 3a/3.4.2.3.

THE SPHERE OF ACTIVITY OF JOINT VENTURES IN HUNGARY (Total 184)



Source: Own calculations based on Hungarian JV list
Figure 3a/3.4.2.3.

The machine and equipment building branch has more joint ventures (17) than textiles and clothing. The relatively poor performance of the latter (11 cases) shows, that in the labour-intensive area of textile and clothing it is not easy to attract FDIs, although labour costs are relatively low in Hungary. Investments in this area can find still more advantageous costs in developing countries. (See figure 3b/3.4.2.3).

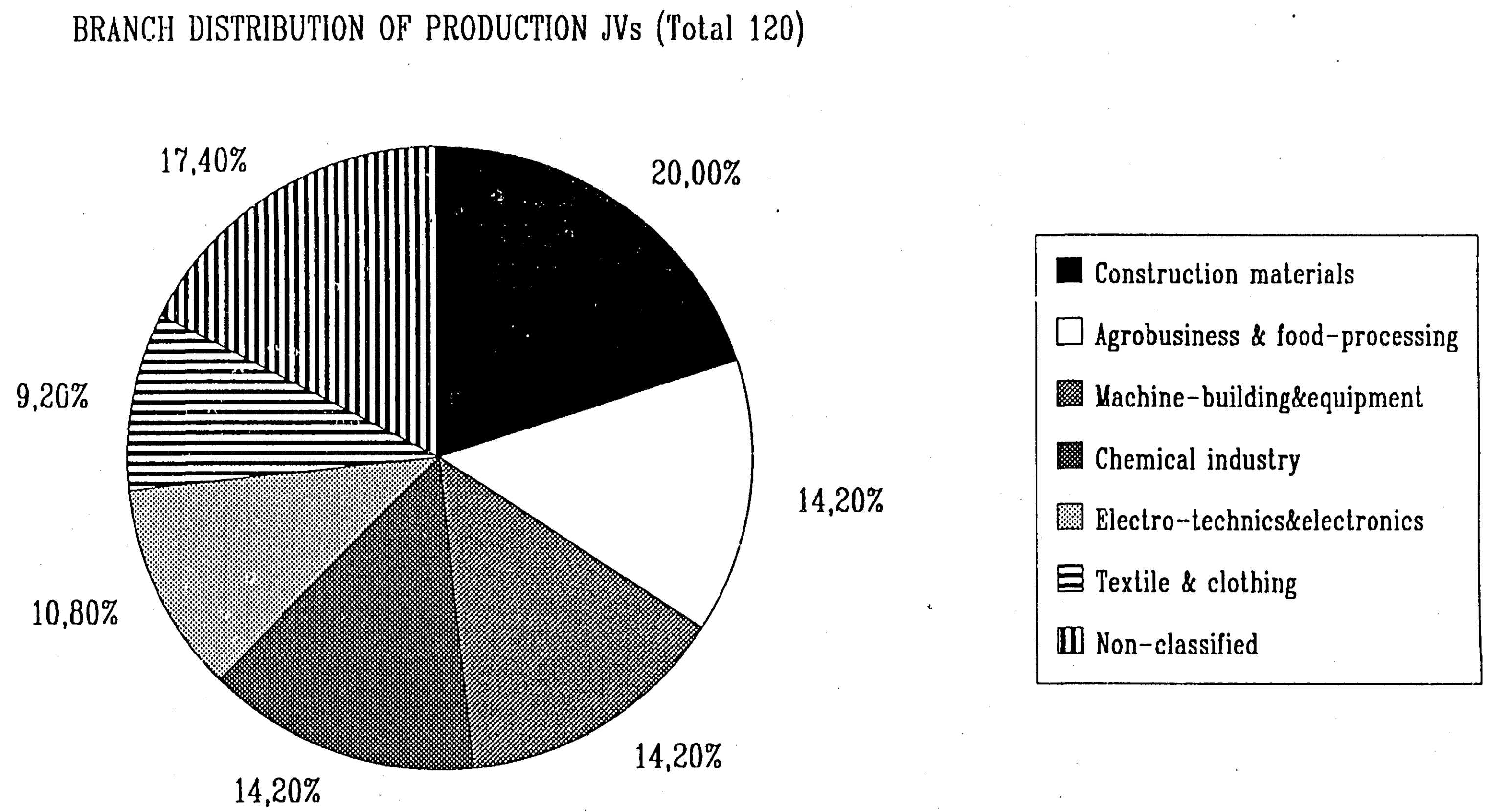
Foreign partners in Hungarian JVs come overwhelmingly from Western Europe. Companies from Northern Europe (Scandinavia) have not shown very great interest in investing in Hungary, but still this area is represented in 8.7% of Hungarian JV cases. Thus, Western Europe taken together is involved in about every four cases out of five. This involvement is actually even higher, because in the most of those JVs, in which there is more than one foreign party, the alien firms are West Europeans. North America has a small, six per cent share only. Asia and the CMEA are both represented with a small share of 2.2%. Latin America has scored 0.5% of the cases by one participation from Panama. (See figure 4/3.4.2.3.)

Altogether, 203 Western companies participate in the 184 joint ventures active in Hungary. Neighbouring Austria has been the most active among Western investors participating in 51 cases (28% out of 184). After Austria is the Federal Republic of Germany, which is a part of 36 Hungarian joint ventures (including one from West Berlin). Both also participate in other joint ventures, the partners of which are from more than one country (Austria 9, West Germany 7).

Austria has invested a total sum of Ft 1,616 million (about USD 27 million) into the Hungarian economy. This result must be rather disappointing for Hungarians, who have been expecting high input from their Western neighbour. In average, the Austrian capital share per JV unit is a mere Ft 28 million (less than half a million dollars). The banking sector is excluded from these figures.

Only in three cases the Austrian capital contribution in Hungarian joint ventures exceeds Ft 100 million (USD 1.7 million). The highest Austrian investment has been made into VEAV–Bramac enterprise, in which the Austrian partner Bramac Dachsteinwerk owns 49 per cent out of the total capital of Ft 299.5 million. This unit, which mainly produces concrete roof tiles, has been in difficulties, because of the bankruptcy of one of the Hungarian partners (see previous section). Probably because of that, a new JV was set up by Bramac, in which Veszprem county construction work is no more a party. The new JV, Duna–Bramac Building Materials Ltd Co also produces roofing tiles, with an equity of Ft 202 million, of which the Western partner owns 30.01%. It is not known whether both JVs are in operation.

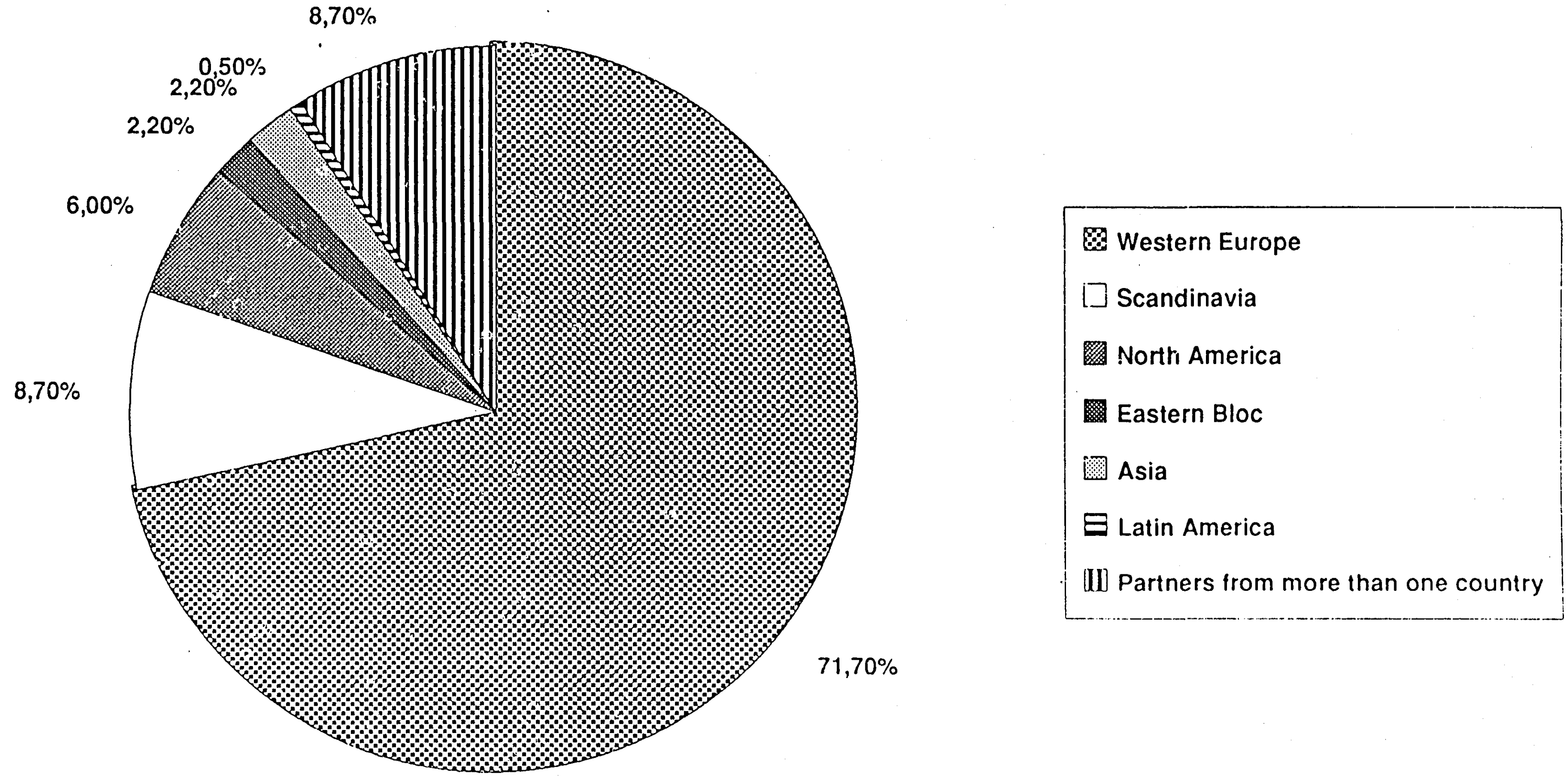
Figure 3b/3.4.2.3



Source: Own calculations based on Hungarian JV list
Figure 3b/3.4.2.3.

Figure 4/3.4.2.3

THE ORIGIN OF PARTNERS OF JOINT VENTURES IN HUNGARY (Total 184)



Source: Own calculations based on Hungarian JV list
Figure 4/3.4.2.3.

The second most important Austrian investment is in the hotel business. Stuag Bau–AG from Austria owns 40% of Hotel Liget Public Ltd Co, which has a total capital of Ft 295 million. The aim of this JV is to build and operate a three–star hotel in Budapest.

Metritechnic Commercial and Servicing for Automation Co Ltd is an Austro–Hungarian JV, in which the Austrian company Festo Maschinenfabrik has a 55% share of the Ft 211 million capital. This unit, which was established in 1982, represents Festo's products in Hungary, but is also involved in the designing and production of pneumatic and electronic systems.

West German companies have invested a total amount of Ft 1,073 million (USD 17.9 million) in Hungarian JVs, excluding the banking sector. This makes a capital contribution of only Ft 25.5 million, per JV participation which is even less than in the Austrian case. These figures can hardly be satisfying from the Hungarian point of view.

In addition West Germany has only three cases, in which the Western capital share exceeds Ft 100 million. The biggest single investment has been made by KBL Manufaktur Koechlin, which together with Hungarian partners runs a textile printing factory. This unit has a capital of Ft 568 million, of which the Western partner owns 50 per cent (Ft 284 million or USD 4.7 million).

Artificial yarns are produced in Sopilen Chemical Fibre Work Ltd, in which the West German Geco has a 52% share of a Ft 310 million (USD 5.2 million) capital.

Two German companies S.E.S. and Deuma together own 49% of MD Engineering and Commercial Ltd JV with a capital of Ft 222.6 million (USD 3.7 million). This venture produces dividing doors, but is also involved in designing and construction of buildings and structural engineering.

From Western Europe Switzerland participates in 19 Hungarian JVs, Sweden in 10, the Netherlands in 8, Great Britain in 5, Finland and Italy in 4 each, Denmark and Liechtenstein in 2 each and others (France, Belgium, Portugal, Greece) in one each. Some of the countries are involved also in joint ventures in which the partners are from more than 1 country.

According to the Hungarian Joint Venture register, the United States are involved in 16 Hungarian joint ventures. This information is in so far misleading, as three cases of IFC involvement (International Finance Corporation), which is a World Bank affiliate, are included. US companies are thus involved in only 13 cases, of which only in 11 cases they are the sole foreign partner. The far most important American investment is in banking, as Citicorp Overseas Investment Corporation from the USA owns 80 per cent of the Ft 1 billion capital (USD 17 million) of Citibank Budapest.

Outside the banking sector the US firms have invested a total sum of Ft 285 million (USD 4.75 million). When this sum is divided by the number of participations (12), the average US capital contribution in Hungarian JVs is only Ft 24 million or USD 0.4 million. This figure is even lower when compared to Austrian and German investments.

The highest capital contribution among US joint ventures in Hungary is by the Schwinn–Csepel Bicycle Company, in which two US companies together own a share of 51 per cent out of total capital of Ft 158.4 million (USD 2.6 million). In Qualiplastic Co Ltd Joint venture with a total capital of Ft 142 million (USD 2.4 million) ALM Holding Corporation from the USA has a 49 per cent (Ft 70 million) share. This unit, which was established in 1982 produces thermo–plastic basic material and packaging material out of them. The third most important US investment in Hungary has been made by McDonald's Restaurant operations. This joint venture with a Ft 120 million (USD 2 million) of which McDonald's has 50 per cent, produces raw materials required for the fast food chain, and runs a Hamburger restaurant in Budapest.

Technology exchange between the USA and Hungary in the framework of JVs is thus almost nonexistent. Corning Medical Corp obviously only uses its Hungarian JV established already in 1975 for selling and servicing instruments manufactured by Corning. In the 1980s no new high tech units with substantial capital have developed between Hungary and US.

Japanese companies have been reluctant to invest in Hungary. Japan is involved in only five JV cases, two of which are in the banking sector; two Japanese banks are shareholders in CIB and CIB's subsidiary bank, Central–European Credit Bank. Actually, there is only one JV in which Japan is the sole foreign partner.

All three non–banking Japanese JVs in Hungary are in production. Poli–foam Plastic Processing Co. Ltd produces specialized lattice–polyethylene foam strips. This venture, in which there are two Japanese shareholders, has an equity of Ft 160.4 million (USD 2.7 million). Foreign partners together have only a 14.3% share of the capital, or about Ft 23 million (less than USD 400,000).

Agroferm JV, which produces feed additive protein, has a Ft 882 million (USD 15 million) capital. Two Japanese companies together have a 20.5 share of it, which makes Ft 176 million or USD 2.9 million. IFC is involved with a 14.5% share.

In respect of the Salgotartjan producing glass wool venture three Japanese companies together own 26% of the Ft 390.3 million (USD 6.9 million) capital. IFC is a co-owner with a 17% share.

In the last case the Japanese share is Ft 101 million, and thus, the Japanese contribution in these three non-banking JVs add up just to Ft 300 million (USD 5 million). The average JV contribution of Japanese companies is therefore much higher (Ft 100 million per case) than that of Austrian, German or US JVs.

Nevertheless, Japan has been extremely cautious when investing in Hungary, which can be seen in the number of JV cases. Also the involvement of IFC as a shareholder in two out of three cases is a sign of caution.

By far the most interesting case among Hungarian JV partner countries is South Korea, which in 1988 enacted two huge investments in Hungary; the financial institution Investrade has with Ft 6 billion (USD 100 million) a much higher capital than the previous joint banks. Hotel venture "Saint Steven" with Ft 5.4 billion has a more than 5 times higher capital than Thermal Hotel Aquincum, which was set up with a Swiss partner with an equity of Ft 980 million.

Joint ventures with Korean participation have thus a capital sum of Ft 11.4 billion (USD 190 million), which is more than one third (36%) of the total capital investment in Hungarian joint ventures. From this huge cake the Korean side has just one half, or Ft 5.7 billion (USD 95 million).

Interestingly enough, Hungarian joint ventures with the Soviet Union are listed in the same catalogue. The USSR has four joint ventures in Hungary. No other socialist country participates in JV activities in Hungary.

Intermos Microelectronics Ltd plans, develops, produces and sells electronic products. The capital of this venture is Ft 55.8 million, which is divided between Hungary and the USSR on a fifty-fifty basis. Thus, the Soviet contribution is Ft 27.9 million (less than USD 0.5 million).

Also in the Mikromed JV, which produces medical and other electronic devices the capital is shared 50-50 between the Hungarian and Soviet side. In this case the equity is essentially higher, Ft 474 million (USD 7.9 million). The Soviet contribution is Ft 237 million (USD 3.95 million).

In energy machinery there is the Soviet-Hungarian JV Energotechno with only a Ft 25.1 million capital, of which the foreign partner has 49% or Ft 12.3 million (USD 0.2

million). Small capital of Ft 23.5 million is also involved in the fourth Soviet–Hungarian JV GSFV Marketing of Diamond and Tools Ltd Co. The Soviet side has 49% of this unit.

Thus, only one of the Soviet Hungarian ventures in Hungary seems to have some substance estimated on the basis of capital invested. Mikromed with a capital of just under half a billion forints is one of the bigger production JVs in Hungary.

In these four cases the Soviet Union is involved in only 2.2% of the Hungarian joint ventures. The total capital invested in their four ventures is Ft 578.4 million (USD 9.6 million), which corresponds to 1.8% of the Hungarian JV capital stock. From the non–banking sector JV capital stock the equivalent percentage is 2.7%. (See figure 5/3.4.2.3.)

Some further information can be extracted from the Hungarian JV catalogue. In most of the cases listed in the booklet, there is more than one Hungarian partner involved (in 104 out of 184 or in 57% of the cases). The Western partners however, prefer to be the only foreign party (in 154 cases or 84%).

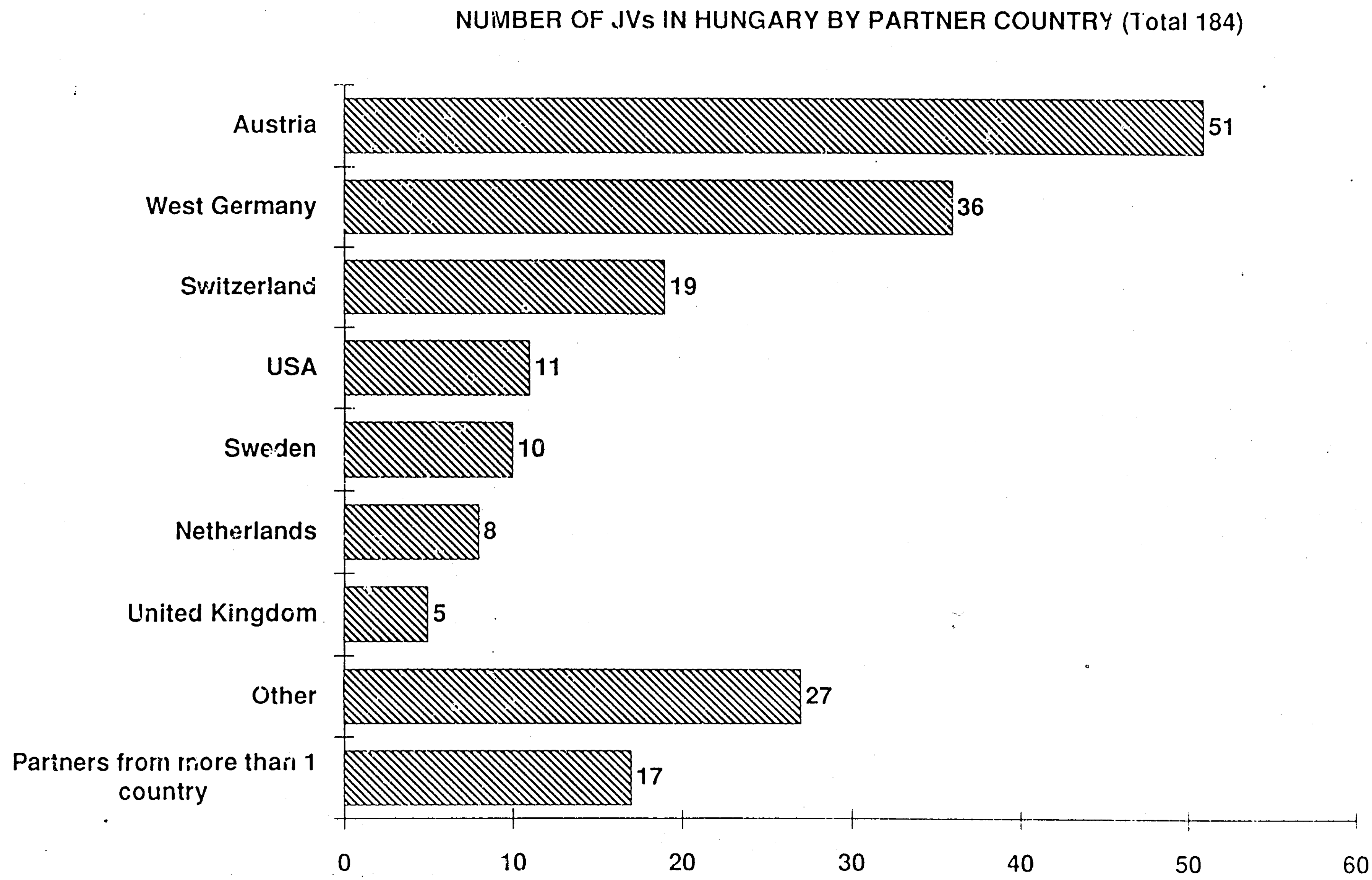
Hungarian banks have been active in promoting JVs with foreign partners. They have frequently participated in JVs as shareholders also in the non–banking sector, as well as in all JV financial institutions.

Hungarian banks have a share altogether in 42 JVs (23% of all cases). Normally, they participate with a relatively modest share, but bank investment can also be substantial. For example, in the "Saint Steven" Hotel enterprise the only Hungarian partner is Magyar Hitel Bank (Credit Bank) which has invested no less than USD 45 million.

A new economic phenomenon has emerged with the participation of Hungarian banks in the JVs as shareholders. Hungarian financial institutions have thus collected for themselves portfolios of shares, which make them co–owners of enterprises outside the banking sector.

Foreign trade organizations (FTOs) in Hungary have previously had a monopoly position in business contacts with foreign firms according to the general socialist dogma of the state monopoly of foreign trade. They have now, thanks to decentralisation in the 1980s, been looking for new business opportunities. Hungarian FTOs have been developing as a kinds of trading houses, which perform an intermediary function in respect of commercial foreign trade deals.

One of the new activities of FTOs is to bring potential JV partners together. Often Hungarian FTOs have even participated as shareholders in JVs established in Hungary.



Source: Own calculations based on Hungarian JV list
Figure 5/3.4.2.3.

FTOs participate that way in no less than 64 JVs out of 184 units. Thus, they are shareholders in more than one third (35%) of the Hungarian JVs in operation.

In these cases normally the capital contribution is small and the share of FTOs low. However, FTOs may be contributing valuable marketing know-how. It is possible, that the FTO, which is shareholder in a JV, has special knowledge eg. in respect of some LDCs, where the Western partner is not active.

Many well-known international companies can be found among Western JV partners in Hungary, eg. Siemens, Volvo, Nokia, McDonald, Levi-Strauss, Adidas, McCann-Erichson Advertising, Voest, IKEA, Citibank, Henkel, Schwarzkopf, etc. Many of them bring in the Western commercial culture including important brand names.

JV activity in Hungary is relatively highly concentrated in the capital city, Budapest. Almost two thirds (64%) of the Hungarian joint ventures operates only in Budapest, which thus hosts 118 partly foreign-owned companies. Some (eleven) of the remaining 66 JVs have an office in Budapest, while their main activities are elsewhere.

At the end of the 1980s the joint venture scene in Hungary was very interesting. 184 companies with partners from 24 different countries produce a variety of goods from deep-frozen bull sperm (Bos Genetic Ltd with a partner from FRG) to Walt Disney's Micky Mouse (Egmont-Pannonia Film Publishing Ltd with a partner from Denmark). Hard currency credits and hamburgers are provided by joint ventures. Levi Strauss jeans "made in Hungary" are available. Western commercial culture has become more and more visible via joint enterprises with Western firms.

However, the overall economic substance of investments in joint ventures in Hungary is still rather meagre. Only a bit more than half a billion dollars are involved, of which approximately one half is foreign capital. If investments in financial institutions and the hotel business are excluded, the capital invested in JVs is pretty narrow, and the majority of the units very small.

It can thus be concluded, that international companies have not moved parts of their activities into Hungary in such a manner as to allow the Hungarian company to become an integral part of the company's global strategy producing certain products or components on a large scale for the world market.

It seems to be obvious that Western companies are not using JVs in Hungary as bridgeheads to jump to East-European and Soviet markets. Information on this point is still scarce, but the CMEA bilateral trading network and the TR payment system is a stumbling bloc in this strategy: Western subsidiaries in Hungary can hardly get involved in socialist bilateralism.

There is unfortunately no possibility of estimating how much of the JV capital brought in by foreign partners is apported to machinery and know–how, and how much of it is in cash. Obviously, in financial JVs the contributions are in the form of money . Other joint enterprises cannot be judged in this matter.

The estimated total value of imported JV capital in Hungary is some USD 200–250 million, some of which is apported machinery and know–how. This sum must be compared with the Hungarian net CC debt, which was USD 16 billion at the beginning of 1989. 111) If imported joint venture capital was at the same time some USD 200 million, it is the equivalent of 1.25% of the net debt.

This Western debt was accumulated in the 1970s and in the early 1980s. At the same time little attention was paid to attracting FDIs. This is evidenced by the very poor JV results. A better balanced capital import between FDIs and bank loans would have been economically feasible. In the late 1980s CC debt servicing posed serious problems, while the macro–economically important FDIs were still scarce. Had FDIs been favoured since the early 1970s, Hungary would be much better integrated into the global economy than it is now.

Ideological considerations have certainly played a major role in the development of this bias. According to common belief in the CMEA area, bank loans were regarded as the best solution for technology imports, because credits create – according to this belief – less economic dependence than FDIs. This belief has had a high price in economic terms.

3.4.2.4. The outlook of JVs in Hungary

In Hungary, better than elsewhere in the CMEA–countries, it has been recognized that the intensification of participation in the international division of labour is indispensable for the realization of the transition from extensive to intensive economic growth. This is only natural, because Hungary has low autarky endowment due to her scarce natural resources. 112)

It has been widely realized in the 1980s that Hungary is not a country of economic miracles, although the reform process starting in 1968 brought about plenty of goodwill for Hungary in the Western media in the 1970s. The decade which has passed since mid–1970 has been a critical period in the Hungarian economy. Between 1975 and 1978 the accumulated debt of the country in CCs advanced in excess of the total debt increase during the previous 30 years. After 1978, when economic policy had to stop the avalanche of indebtedness, longlasting stagnation set in for the first time in the history of the planned economy while domestic consumption decreased considerably. Real wages have declined and the investment rate has fallen drastically. These processes meant a drastic change from the golden age of growth, which followed the 1968 reform. 113)

Without going into further details on Hungarian economic development and economic policy, it can be stated, that in the second half of the 1980s it has become more and more evident in Hungary that large scale foreign credits cannot be acquired as previously, and thus, that there is no other way of receiving capital than through FDIs. Liberalization of joint venture rules, therefore, must be regarded as a major element of economic policy–making in the 1980s.

Joint venture regulations are, however, only one side of the coin. The second, very important one is the business environment, in which JVs are actually run. In that respect, remarkable changes have been taking place in the late 1980s.

On January 1, 1987 a comprehensive banking reform was launched. The banking sector was substantially transformed and a two–tier banking system was established. A major objective of the banking reform was to introduce greater competition into the financial sector by allowing a broader range of financial institutions to compete in the mobilization and allocation of financial savings. The two–tier banking system allows the National Bank of Hungary to focus on macro–economic policy issues, leaving credit allocation to commercial banks. Customers have free choice among different banks, which forces banks to compete for business. Thus the relation between banks and clients became considerably more flexible. The variety and quality of services improved and the credit assessment function became more efficient. In this regard, banks forced many firms with low efficiency to restructure their business, thus contributing to the enforcement of the new bankruptcy legislation. 114)

At the beginning of 1988 the Ministry of Foreign Trade and that of Internal Trade were merged. At the same time a decree was issued allowing virtually all economic units to become involved in foreign trade independently, if they wish to do so. In this context it is, however, extremely important to realize that the state currency monopoly has been maintained. In the case of imports economic units must still apply for the right to use currencies. 115)

Altogether, the institutional reforms and the monetarization of the economy are certainly favourable for JV development in Hungary. Certain institutional innovations are directly aiming at helping the establishment and running of JVs.

In 1987 a special joint venture club was founded under the auspices of the Hungarian Chamber of Economy (previous the Chamber of Commerce). This club (JVC) has regular meetings with Hungarian or foreign managers involved in the JV business.

JVC has been operating as a lobby of JVs vis–a–vis local authorities. JVS has already been helping the JV community to solve everyday problems like car registering for foreigners, payment arrangements in forints for services, which are normally paid for in CC by foreigners, tax matters etc. 116)

Hungarian Creditbank (MHB) has created a subsidiary (VszVTL) to help organise and finance JVs. This outlet can provide consulting services for Hungarian as well as foreign firms, that intend to enter JV activity. 117)

Undoubted, the increase of JV activity in Hungary during the 1980s, and especially in the second half of that decade is remarkable. At the same time, it is worthwhile noticing that the overall sum invested by Western companies (some USD 200 million) is relatively modest. 118)

The Hungarian market is not very large. Therefore, the potential Western partners think in terms of overall CMEA markets proposing to use the Hungarian JV as a bridgehead. This is, however, only in exceptional cases possible when clients in the CMEA–area are ready to pay in CC for JV products. 119)

These limiting factors overshadow the future of Hungarian JVs. However, in the internal economy Hungary was advancing towards a real mixed economy at the end of the 1980s by launching the new enterprise law. In the autumn of 1989 the ruling Hungarian socialist Workers' Party changed its name and renounced its communist past in preparation for free parliamentary elections in 1990. At the same time, there were plans to discontinue bilateral trade enacted in TR with the Soviet Union, in order to cut down production of "soft items". This means that trade with the Soviet Union is scheduled to go over to a CC basis, presumably by some kind of step by step method.

Taking these factors into account, at the end of the 1980s the investment climate experienced radical change. This new situation may cause a considerable boost of FDIs in Hungary during the 1990s.

3.4.3. Poland

Poland's socialist economic history is a sort of trial and error game of crises and reforms. Only some main points of that interesting history in the 1970s and in the 1980s can be mentioned here.

After Gomulka had been forced to resign in December 1970 because of the failed attempt to restrict consumption, the new leadership under Gierek resorted to foreign indebtedness in order to finance investment as well as consumption increases, and to avoid a reform of the centrally planned economy. 120)

The core of the Polish problem seems to be the continuous tendency to over-investment. This problem was analysed in the late 1950s by M. Kalecki, the most prominent Polish economist. He concluded that growth had been held in check by a number of barriers. In particular, these were the limited scope for imports, the shortage of a number of raw materials and the shortage of trained personnel in the construction industry. As a result, a number of major investment projects remained half finished or unusable. This had catastrophic repercussions throughout the industry as the output from these new projects had been counted on for other parts of the economy. A lower level of investment would therefore have prevented a great deal of this waste of resources and thereby enabled the economy to grow more rapidly. 121)

The economic policy of the Gierek years did not, however, lead to change in the command–rationing system of management. The existing economic structure was perpetuated, due to the undertaking of new investment in the metallurgy, fuel, energy and electrical engineering industries. In the 1970s the acceleration of growth under inefficient management meant pumping enormous investment outlays into an inefficient and wasteful system, which reacted with the creation of absorbtion barriers and lower effectiveness of investment projects. Due to over–investment, internal disproportions in the economy, upsetting of cooperation links and lavish use of imported and domestic means acquired through the directive allocation system, the rate of growth slowed down and since 1979 the national income has started to decrease in absolute terms. The crisis fully erupted in August 1980, leading to the downfall of the Gierek leadership.122)

In the turn of the decade 1970–1980 the Polish debt problem emerged. The fundamental causes for the balance of payments difficulties lie in the mistakes committed in economic policy in the 1970s which were responsible for borrowing exceeding safe limits and irrational use being made of a part of the foreign credits. The situation was seriously aggravated by the socio–political commutations of 1980–81, which led to a growing destabilisation of the economy. One of their effects was a steep plunge in CC earnings: from USD 8 billion in 1980 to USD 5 billion in 1982. The credit-unworthiness of Poland was established. 123)

In the early 1980s economic reform was announced, but it began with the system's retreat towards traditional solutions. The reform programme had been elaborated, and new acts on self-management of enterprises put into force in consultation; but under martial law it now became a reform imposed from above. It began to be fully controlled by the state political authorities and by the central administration. Despite the formal validity of legal regulations on autonomy and self-management of enterprises, these regulations did not enter into economic practice. This was due to the militarisation of the most important branches of the economy. 124)

After the Party conference in the spring of 1986 the reform seemed to be dying; in their speeches the leaders again stressed the role of central planning. The provisional regulations of the martial law regime – mainly the instrument of governmental orders – were to have become lasting elements of a more centrally controlled economy. However, the documents of the X Party Congress in Summer 1986 and the Plenum of the Central Committee in December 1986 indicated a turn in the leadership's intentions, namely the speeding up of the reform process and the restoring of market equilibrium – the so-called second phase of reform. 125)

Economic reform was needed to overcome the stagnation trends in the economy in the mid-1980s. The newly received membership in the IMF and the World Bank called for economic reform, in order to qualify for credits from these institutions. Economic reforms, also had wide support among the population, including legal trade unions, the Patriotic Front, the Polish Economic Association and even some Party groups, influenced by the new Soviet leadership under Gorbachev. 126)

However, in the late 1980s confidence in successful economic reform in Poland diminished. One experienced specialist on Polish affairs made the following statement in the middle of 1988:

> "The failure of the concept of a second stage of the economic reform must be anticipated. Briefly, the concept encompasses, initially, price and income policy measures for restricting private demand, and only after the achievement of market equilibrium are substantial systemic changes to be introduced. That concept had already been defeated in November 1987, when a plebiscite failed to muster a qualified majority. Workers in particular feared a further worsening of their real incomes. The government, instead of forgoing the socially rather

> problematic measures and first introducing systemic changes, reacted by slightly softening and deferring the planned price increases and accordingly postponing the truly substantial measures. One of the most important reforms – to facilitate state, cooperative and private economic activities by dismantling bureaucratic barriers – was postponed from March 1988 into the indefinite future". 127)

After the reshuffle of the Polish government in the autumn of 1988, in which key positions were given to reform–minded individuals in Rakowski's cabinet, there was once more some optimism among Western observers concerning the continuation of Polish economic reform. 128)

Obviously. it is extremely difficult to judge, on the basis of the experience of the 1980s, whether the economic reform will succeed or not in Poland. Thus, it is also virtually impossible to foresee what kind of investment climate for FDIs is going to take shape in that country.

However, it is good to bear in mind that Poland is the most populous CMEA country and the largest in area next to the USSR – endowed with great economic potential for activity in primary, secondary and also tertiary sectors of the economy. Therefore, Western FDIs in Poland cannot be excluded, even if the socio–economic situation continues to be unstable.

3.4.3.1. Polish rules for FDIs

In the 1970s the Polish strategy of economic miracle relied heavily on foreign credits which made possible large–scale imports of capital goods, new–technologies and supplies for means of production and for consumption. Maximum growth was not separated from the optimum growth in practice, only in the theories of Kalecki.

Alongside with borrowing from the West, JVs have legally been possible in retail trade services and handicrafts since 1976 and in manufacturing industries since 1979. However, when Western companies saw the regulations, most of them backed off. A separate law for the so–called Polonia–companies was passed in 1982. 129)

The actual JV law was passed on April 23, 1986, after several years of preparation. Obviously, the delay was caused by ideological discussions raised by orthodox party members. However, the law was finally accepted, as it became clear that JVs provide virtually the only potential possibility of obtaining Western technology, when the credit-unworthiness of Poland continued. 130)

JVs in Poland can choose the form of limited liability or stock company (art. 2.). Transfer of shares or stock between partners on the accession of a new partner to the company, require a permit (art.5.).

A permit for a JV is granted when it introduces modern technology and management in the national economy, supplies goods and services for export, and improves the supply of modern quality goods to the domestic market (art.5.). This means that all JVs are obliged to participate in export business.

In the Polish JV law of 1986 it is stipulated that the host country partner must have the majority stake (51%) of equity. In certain cases exceptions from this rule can be allowed (art.8.). Contributions to the company's capital may be made both in cash or in kind, which is usual in all JV laws in the CMEA area.

It is further stipulated that the JV manager, as well as board president, must be Polish citizens and permanent residents of Poland (art.17.). JV employees elect one member to the supervisory council of the company, which must be appointed (art.18.).

Financial provisions of the Polish JV law have some tricky points. According to article 21–22, profits can be transferred if they have been earned in hard currency, but only after 15–25% of the total of the hard currency earned income has been changed into zloty. It is also stipulated (art.22.) that CC earnings must be divided between partners according to their equity share. The Polish partner may only keep a portion of CC earnings. The rest must be remitted to the state. All JVs are obliged to maintain a reserve fund to cover possible losses; 10% of the annual net profit must be transferred to this fund, until the reserve fund equals 4% of the annual total operating costs (art.19.).

JVs are due to pay 50% income tax on their profits. The tax rate is decreased by 0.40% for each 1% of the value of production or services exported by the company. Exemption from this income tax is allowed on that part of the profit which is reinvested.

It is visible from the JV law text how eager the Polish authorities are to earn CC for the host economy via Western FDIs. At the same time, it is hardly recognisable, what incentives are given for Western partners to invest in the Polish economy.

A new law concerning FDIs was prepared in Poland relatively shortly after the JV law of 1986. The new legal document was published in December 1988, and came into force on January 1, 1989. The new law states (article 53) that the law of April 1986 is repealed. 131) At the same time (December 23, 1988) with the law on FDIs a law on economic activity was adopted by the Polish parliament making the conduct of business possible for all Polish citizens.132)

Economic activity may be undertaken by foreign companies, banks, foundations and other organizations with a legal status and domiciled abroad, as well as natural persons domiciled abroad.. A Polish citizen permanently domiciled abroad is also a foreign investor. The law establishes the same principles for investors from the West and the East. The contribution of a foreign party domiciled in a member country of the CMEA may also be made in TR, or in the national currency of one of these countries (Article 16).

A foreign investor can establish a limited liability company in which he holds 100 per cent of the shares, or he can participate in a limited liability or joint stock company with the equity contributed by the founders (Polish or foreign) jointly (Article 2). A foreign party can also, together with other foreign and/or Polish parties, establish a joint stock company, with equity raised through a public subscription of shares (Article 8). Interestingly enough, a foreign party can also enter business in Poland through the acquisition of shares or stock in the existing Polish limited liability or joint stock companies. If these companies did not have foreign shareholders, the purchase of shares or stock by foreign parties is conditional upon the increase of the equity of these companies (Article 41). After such an increase in the company's equity the provisions of the 1988 law apply to these companies.

It is underlined by Polish legal experts that limited liability companies and joint stock companies with foreign involvement are formed under the provision of the Commercial Code of 1934. The regulations in this code are based on the classical models of both kinds of companies, shaped in continental Europe between the two World Wars. Both kinds of companies have a legal personality. 133)

Companies with foreign participation do not have to pay corporate income tax, which the law of 1988 sets at 40 per cent of taxable income (investment outlays and donations for social purposes are deducted from the taxable income). A company is exempt from corporate income tax during the first three years of its business activities (Articles 27–28).

These provisions have certain improvements in comparison to the 1986 rules, in which the corporate income tax was set at 50 per cent and tax holiday at two years. The point in the 1986 law, that the tax rate is decreased by 0.40 per cent for each 1 per cent of the value of sales exported by the company, is maintained in the 1988 law.

The 1988 law defines that the income of a foreign shareholder is subject to an income tax of 30 per cent, unless international agreements concluded by Poland provide otherwise (Article 29). This extra tax on profits to be repatriated is not mentioned at all in the 1986 rules.

According to the new rules, companies with foreign participation are still obliged to sell part of their CC earnings to a Polish bank. Previously (1986), the percentage was defined as 15–25% and now it is 15% of the export proceeds. This inconvenient rule is still there, now only in clearer form than before (Article 19).

Altogether, the new law of 1988 cannot be accused of bringing about excessive financial incentives for the foreign investor. The tax burden is still high and the compulsory CC exchange is rule still present. Article 28, however, stipulates that the tax holiday may be extended for an additional three years if the company enters one of the preferred sectors of the economy.

In this context it is worth while looking at Article 35 of the 1988 law, which defines that the company has to pay the tax for the exemption period, if the company is dissolved during the tax holiday or within three years after such a period has expired. Quick, short–term, tax–free profits are thus disallowed.

Article 17 of the 1986 law, which says that the company's manager, and in the case of a board of management its president, should be a Polish citizen the permanent resident of Poland, is omitted in the 1988 rules. This is a considerable improvement of the FDI legislation in Poland.

From the point of view of concrete business operations of a company with foreign participation, Articles 23–24 of the 1988 law are of importance. Article 23, paragraph 1 states that a company may purchase goods and services for foreign currency on the domestic market from the licensed entities; paragraph 2 mentions that a company may sell goods and services, within the scope of its business, on the domestic market wholly or partially for foreign currency, after it obtains a foreign exchange permit.

Thus, Article 23 of the new Polish law concerning FDI's in principle allows "internal imports" and "internal exports": a company registered in Poland can effectuate business operations in CC. The 1986 JV law stated only that in particularly justifiable cases the company might obtain a foreign exchange permit to effectuate foreign currency purchases on the domestic market (allowing "internal imports" in special cases). "Internal export", ie. the selling on the domestic market for CC, was not mentioned explicitly in the 1986 law text.

Companies with foreign participation purchase raw materials and supplies in the domestic market in accordance with the regulations applicable to socialized economic entities. That is stated in Article 24.

These two Articles (23, 24) of the new law are obviously contradictory to each other. A foreign party presupposes that his company is entitled to receive supplies on the home market against payments made in zloty, as local enterprises generally, when he reads Article 24 in the 1988 law. However, the previous Article (23) gives him the possibility to pay in CC.

In the latter case he may be satisfied, because making payment in foreign currency (CC) probably gives him preferential treatment in deliveries in short supply. However, the company with foreign participation may have excess zlotys, and is thus eager to spend it on local supplies. In that case the local supplier, who is normally eager to earn CC by "internal export", might refer to Article 23, which allows the company with foreign participation to clinch the deal with a CC payment. The client can refer to Article 24 asking for "normal" (zloty payment) treatment. Material for serious conflict situations is thus provided by the law.

The Polish 1988 FDI law contains some further interesting details. Article 5 lists the wishes of the host country in FDI context including the introduction of modern technology and management know–how, improved export performance and better home market supply. These points have also been listed in the 1986 law, but the new version contains one more detail; protection of the environment. The traditional CPE system in Poland has not only created serious economic biases, but also environmental damage to be mended by Western FDIs.

A special Foreign Investment Agency responsible for the setting up and guiding of FDIs was established by the 1988 law. Obviously, it is intended to give the impression that red tape has been cut down by establishing this special agency to deal with foreign direct investments.

Companies with foreign participation may sell foreign currencies at the foreign exchange auctions, according to the 1988 law, Article 23. This is a novelty in the law, as are the currency auctions, which started in 1987. In these auctions the supply of CC has been meagre, and thus, exchange rates vis–a–vis the zloty high. Therefore, this point of the law is favourable for foreign investors, in cases where the zloty is for some or other reason needed, local money is available approximately at the black market exchange rate in the auctions.

In sum, the 1988 law is a clear improvement in comparison to that of 1986. Especially the permission to have wholly foreign owned entities in Poland led by foreign managers forms an entirely new bases for Western FDIs. Also the possibility of acquisition – the allowing of foreign persons to purchase shares of, or ownership interests in existing Polish companies – is an important qualitative novelty of the 1988 law.

However, some questionable points have been included also in the new law. Transfer of shares or ownership interests in the company requires a permit (Article 5). The foreign investor must define the duration of his activity when applying for a permit. A reserve fund must be formed from after–tax profit.

In the economic sphere incentives for foreign investors have been slightly improved. Corporate income tax has been dropped from 50 per cent (1986) to 40 per cent. The tax holiday has been prolonged from 2 to 3 years, with the amendment that in special cases, which are important for the Polish national economy, a supplementary 3 years' tax freedom can be provided for.

However, the foreign shareholder is subject to an income tax of 30 per cent by the 1988 law, a point which is missing in the 1986 rules. In case the foreign investor is domiciled in a country with which Poland has an agreement on avoiding double taxation the rate varies between 5 and 15 per cent depending on the content of each convention. Poland has tax conventions with 21 countries. 134)

Compulsory selling of CC export proceeds to a Polish foreign exchange bank has been maintained in the 1988 law. This point, which is clearly disliked by foreign investors, has only been clarified in comparison to the 1986 law. The old law defined the rate as 15–25 per cent, whereas the new law sticks to 15 per cent, only. It would have been advantageous to drop this point altogether from the new law.

3.4.3.2. Experience of FDIs in Poland

The Polish intention, when the legislation of 1976 was enacted, was to get ethnic Poles of foreign nationality to invest in Poland. Thus the name Polony firm. The interest in this form of business, however, was small at first; only 19 firms of this type existed in 1979, 68 in 1981. Therefore, the regulations were amended in 1982 allowing investors of all national origins to start business in Poland. The operations of these firms are restricted to small scale production, but this restriction has been interpreted liberally. The capital share of foreign investors may be as high as 100%. 135)

In the 1970s only a few FDIs were made in Poland. The Kore International Trade and Investment Co (US), headed by M. Koblinski, concluded a USD 50 million hotel deal in Warsaw. The equity share of the Western partner was only 3%. Other deals concluded in the 1970s were jeans–wear manufacturing and a retail outlet with a Canadian partner, an Austrian zipper producer and a self–adhesive label manufacturer and an automatic car wash firm with a West German owner.136)

In the second half of the 1980s there were altogether some 700 firms in the Polony sector. Constant changes in legal and fiscal regulations as well as routine attacks in the national press have contributed to undermining the confidence and business security of enterprises owned by foreign capital in Poland. Under the guise of closing legal loopholes and blocking opportunities for profiteering, Polish authorities have systematically tightened regulations covering the activities of this sector. In 1983, Polony companies were suddenly obliged to share 50% of their CC earnings with the Polish state. In 1985, the income tax was raised from 50% to between 75–85%. Companies were obliged to reinvest at least one third of their annual profits if they wished to get the three–year tax–holiday promised to them for the first three years of their activities. 137)

All this has contributed to the worsening of the investment climate in Poland, also having repercussions on investments to be made on the bases of the 1986 JV law. The first JV under that new law came into being that same year. The new company, LIM JV, brings together the Polish airline LOT, the Austrian construction company Ilbau GmbH and Marriott the US hotel chain. The venture's capital is worth Sch 15 million (about USD 1 million) with LOT holding 52% and the two Western partners 24% each. 138) Probably, the initial capital is much higher, Sch 1.2 billion.139)

LIM will complete the LOT terminal and hotel in Warsaw, and then run the terminal and hotel complex, with a casino. Construction will comprise the finishing of the 40 storey skyscraper, which has been uncompleted since the early 1980s, when the Western builder, Cementation International (UK) pulled out of the project following non–payment of invoices. 140) This project corresponds directly to the hopes of Polish authorities, when they passed the law for "true" JVs, that Western investors could make use of Polish "investment ruins", left over from the Gierek era. 141)

The first production JV, established in the second half of the 1980s, is Tecnodiamant which produces special machine tools to handle hard materials. The Western partner in this venture with a 45% equity share is FCT et Metaux (Belgium), which itself is a JV where Polish FTOs DAL and Impexmetal are shareholders. In this venture the capital share of the Western partner is only 28 million zlotys (USD 116,000). 142)

In mid–1988 the Polish officials announced that altogether 29 JVs had been established after the passing of the 1986 JV law. As three of them were established with Soviet partners, only 26 are between Poland and the West. 143) In at least three other cases alongside Technodiamant, there are Polish enterprises which are registered in the West among the Western partners. In the JV Interhothin A.J. vos en Zen and Agropol, both Western partners are Dutch. The latter, Agropol, is an international trading house which is a Polish JV, marketing Polish foodstuffs. Agropol is a shareholder also in the Polish JV Voukpol together with the Dutch firm Vouk Food. Voukpol is in the dairy business.

Anglodal is a trading house active in London and owned by several Polish FTOs. It is marked as a Western partner alongside with Active Technologies (UK) in a JV called Digital Laboration in Poland. This JV, which is active in computers, has shared the capital on a 50–50% basis. In another JV, also active in computers (software), the Western partner from France, has with 51.25%, the majority share of the equity. Obviously, this branch is regarded so important from the point of view of Polish economic development, that an exceptions from the 1986 law main rule on the Polish partner having at least 51%, has been made.

Many of the first JVs (8) are active in the foodstuff sector (one of them in cattle transport). West German partners appear in the list of Polish JVs more often than firms from other countries, accounting for nine cases. There are among Western partners also firms from Austria, the Netherlands, USA, the UK, Switzerland, Sweden, Finland, France, Denmark, Belgium and Liechtenstein. It is noticeable that no well known MNCs with famous brands are involved in Polish JVs. Marriot, which is a partner in the LIM hotel project, is the best known firm name investing in Poland.

Polish FTOs have been active in setting up joint ventures abroad, especially in Western Europe. In West Germany there are over 50 (53) companies wholly or partly owned by Polish companies, which is more than any other CMEA country. Also in the UK and Sweden the Polish companies is in the lead over the CMEA competition as far as the number of companies are concerned. In the Third World Poland is participating in 24 ventures, which is less than Romania (45), the Soviet Union (34) and Hungary (32). 144)

Most of the Polish ventures abroad are just marketing outlets promoting the sales of Polish products in the world market. Business International gives a good mark for some of these ventures, like Agropol in Japan, Canada and the Netherlands, by saying that they work flexibly and efficiently. This is based on the feedback coming from the clients. 145)

Hardly any manufacturing outlets have been built up by Poles abroad. In USA, Polish machine tools are constructed with a local partner in a JV called Megatool. Manufacturing JVs are also operating in Kenya, Iran and Nigeria. 146)

3.4.3.3. Outlook of JVs in Poland

The Polish economy suffered with many sorts of malaise in the 1980s. The Polish authorities tend to put the blame for the outbreak of the crisis on Western sanctions and credit restrictions, ignoring the fact that these measures were taken only when Poland had already lost her creditworthiness. 147)

One of the main questions in solving the economic malaise in Poland is naturally, how the debt problem (some USD 35 billion net debt in 1989) can be settled. The liquidity squeeze hampers the development of export branches, which in its turn hampers the solving of balance of payments problem. A vicious circle is evident.

One theoretical solution can be found in the "debt for equity" method. If a part of the debt is transformed into ownership of shares of Polish enterprises, in accordance with the new Polish JV law, interest payment obligations are transformed into profit transfers. The burden of servicing the debts is reduced, whereas the new problem of profit transfers becomes a burden of joint responsibility. Of course to be efficient this solution via JVs, requires suitable systemic solutions. 148)

In other words, the debt for equity strategy calls for clear incentives for FDIs in the legislative and economic sphere, in order to be efficient. Advantages needed for JVs are not in sight: Polish authorities obviously try to maximize the short–term benefits of JV activity for the State ignoring incentives for foreign investors.

A. Müller counts a number of difficulties confronting foreign entrepreneurial activity in Poland resulting from:

1) Negative reactions on the part of other socialist countries;
2) Strong resistance of internal pressure groups (the political, military and economic establishment and the state administration);
3) Attitudes of large enterprises and producers' associations enjoying a monopoly position in the economy. They fear both the loss of their position and direct confrontation with the foreign sector which would be more competitive than the Polish firms are;

4) The possibility that the best employees would move to foreign firms if the latter operated more effectively and guaranteed higher wages than the domestic enterprise;
5) On the other hand, it should be recognized that, in its present shape, the Polish economy is not an interesting area for FDIs.

The reasons are numerous: inadequate economic infrastructure in transport, repair and maintenance service, etc; insufficient capacity of local enterprises to cooperate with foreign firms; the foreign firm's distrust of the policy of socialist countries. The MNCs who undertake FDIs desire huge complementary projects which should be financed by the host countries. Poland is not able to put up appropriate outlays for the benefit of those firms, and therefore, there is no great hope for FDIs to Poland. 149)

The first point made by Müller is of special interest. Indeed, there is a certain amount of antipathy against Poland in the CMEA area deriving from the feeling that a part of the economic bill caused by the Polish crisis is being presented to the brother countries for payment. Some authorities in the CMEA countries openly express the opinion that the Polish debt problem is worsening their possibilities for acquiring Western credits, by creating an attitude that socialist countries generally are unable to take care of debt servicing.

The last point made by Müller is noteworthy. Poland is certainly only in a very limited manner able to take care of the development of her infrastructure. This is a strong disincentive for the flow of FDIs to Poland.

Also the Polish newspaper Polityka maintains that Poland is not offering enough incentives for FDIs. The paper mentions the lacking creditworthiness of the country, outdated industrial structure, the low level of technology, and the relatively high level of corporate tax as disincentives for FDIs. Further Polish enterprises seem rather reserved as far as JV cooperation with Western firms is concerned. It is more convenient and also more profitable for them to operate only for the home market. In an opinion poll organized by the Polish Chamber of Commerce among Polish firms asking whether they were interested in JV activity, out of 1500 enterprises only 200 cared to answer. Not all the answers had a positive attitude toward JVs. 150)

A new political situation emerged in Poland, when the opposition won the election in the summer of 1989, and a new coalition cabinet with a non–communist Prime Minister was set up. Although this new political situation has been welcomed in the West, and some economic help is being provided by market economies, economic uncertainty prevails making foreign investors cautious.

Even if a new kind of crisis management and introduction of a market economy is promised by non-communist forces in Poland, no rapid improvement of the investment climate can be expected. The difficult negotiations to form a new government after the 1989 elections indicate that a political impasse situation with socio-economic repercussions cannot be excluded in the medium-term perspective.

Potential Western investors are waiting for economic stabilization, while in Poland Western investments are regarded as an important partial solution to curing the Polish disease. Thus, for Poland at the end of the 1980s there seems to be the chicken and the egg problem – which one comes first?

3.4.4. Bulgaria

Bulgaria is the smallest country under review with less than 10 million inhabitants. Traditionally, socialist Bulgaria has relied on the Soviet connection in her external economy. For example, in the years 1985–87, Bulgaria's exports to the Soviet Union amounted to some 6.5 billion roubles (appr. USD 9 billion) per year, while exports to the West were only about 1 billion USD a year in the same period. In the trade with the West there is a tendency towards deficits (over USD 1 billion yearly in 1985–87), and therefore, the net CC debt has grown, reaching some USD 5 billion, the equivalent of 5 years' exports to the West. 151)

In Bulgaria there is thus an economic need to attract FDIs from the West, because the deficit financing of trade is growing more difficult. JVs have been possible since 1980, but only in the late 1980s has their importance been realized.

During the 1980s Bulgaria has been experimenting with economic reforms originating in the project for a New Economic Mechanism (NEM) drawn up in 1981.

The basic reform document is the so called "Regulations for Economic Activities", a decree by the Council of Ministers. The first version, adopted in 1981, was subject to major amendments only two years later. The next version, prepared for 1985 and never published, was apparently rejected and never actually passed. Around the mid-1980s official criticism (also headed by Todor Zhikov himself) became more poignant. It was aimed at the inadequate performance, lack of efficiency and poor quality products of the Bulgarian economy (joined, in this last respect, by unexpected Soviet criticism). It blamed the "conservative" behaviour of State and Party bureaucracy as well as of management organs. The practical failure of earlier reform attempts was officially admitted and calls for radical change became obvious in 1986. Milestones of this were a plenary session of the BCP's Central Committee, the 13th Congress of the Bulgarian Communist Party (preceded by major government reorganizations and personnel reshuffles in top Party and government ranks), the adoption of a new Labour Code, laying the foundations for self-management institutions in the economy, and a new version of the "Regulations for Economic Activities", that came into force at the beginning of 1987. Its main importance was that it indicated a change in line of reform policy towards more clearly pronounced features of market-orientation motivated by the failure of earlier reform attempts to improve economic performance, by the "Gorbachev effect" and certainly by internal political considerations, where outside observers have to rely on speculations. 152)

The main lines of current economic reform attempts may be outlined as follows:

1) Decentralization – the enterprise is to become the basic decision-making unit, endowed with enlarged rights to choose suppliers and outlets at home and abroad, and to organize JVs with Bulgarian and foreign partners; enterprises are to be put on a self-financing basis, including foreign currencies, and subject to bankruptcy; they are to have more say in price formation and investment decisions; competition between enterprises is to be enhanced (including split-ups of monopolistic structures).

2) Self-management within economic units – directors are subject to election by the enterprise staff and subsequent appointment by the State organs.

3) Abolition of central plan directives for output (to be replaced by State "contracts" for a transitory period and for a limited range of products), gradual elimination of central allocation of input to be replaced, in the longer run, by a wholesale trade system.

4) Increasing economic state guidance as opposed to administrative instruments, a strategy supported by efforts to streamline central administration.

5) Domestic price formation to take international prices into account, which requires the establishment of an economically sound exchange-rate system.

6) Tighter linkage of wages to performance leading to growing wage differentiation.

7) Increased control and guidance functions for the banks (in the course of the reform of the banking system).

8) Revival of private and cooperative forms of economic activity. 153)

A number of non-specialized commercial banks, planned to be independent and profit-oriented, were established in Bulgaria in 1987. The competences to grant investment credits have been transferred from the Bulgarian National Bank (BNB) to the commercial banks.

The National Bank will continue to perform the following commercial operations: it will be the only bank holding the current accounts of enterprises; it will perform banking operations with the service sector; extend working capital credits; and settle payments between the commercial banks.

Bulgarska Bunshnoturgovska Banka (Bulgarian Foreign Trade Bank) will remain the only bank settling payments resulting from foreign trade. In 1987 the bank together with Bayrische Vereinsbank, München, established a new bank called Bayrisch-Bulgarische Handelsbank. It is situated in Munich.

Banking services for the population will continue to be supplied exclusively by Darzhagna Spestovna Kasa (State Savings Bank) and by savings cooperatives and savings associations.

The commercial banks can extend credits to enterprises and accept enterprise deposits in both domestic and foreign currencies. Commercial banks are even allowed to place foreign currencies in banks in the West and to accept convertible currency credits from Western banks. But minimum and maximum rates of change in liabilities and assets are given to the banks annually by the National Bank.

The National Bank influences the volume of credit extensions by commercial banks through prescribed ranges of change in the total assets of the commercial banks, and in net assets in convertible and in non-convertible currencies. The National Bank will also prescribes minimum and maximum rates of interest to be applied by the banks. The National Bank influences the volume of bank liability through refinancing credit. It seems that the share of National Bank refinancing in bank liabilities is even larger in Bulgaria than in Hungary, which makes changes in the volume of re-financing a very powerful National Bank policy instrument.

To summarize, in contrast to Hungary, in Bulgaria commercial banks are burdened with administrative functions, and National Bank control over the credit extension of banks is stricter than in Hungary.154)

3.4.4.1. Bulgarian rules for FDIs

Bulgaria issued the basic decree governing JVs in 1980 (Decree 535/1980). This decree was supplemented by the Council of Ministers decree 31/1987 and the State Council decree Nr 2242/1987 concerning economic activities in free trade zones. 155)

JV Decree No 535 mentions two possible forms of JVs in Bulgaria: a partnership, which is not a juridical person and a partnership which is a juridical person. The first form is not clearly defined in the decree.

The Bulgarian Chamber of Commerce guidebook on JVs clarifies the difference between these two partnership forms. The first one (partnership which is not a juridical person) is a company in which the partners have unlimited liability, whereas the second form (partnership which is a juridical person) is a limited liability company. The guidebook flatly states that only the latter has any meaning in practical life. 156)

Decree 535 allows JV activity in virtually all spheres of economy, in production and services, tourism included. The joint activity can be carried out in Bulgaria or in other countries (art.2).

Material as well as immaterial values can be capitalized in the JV capital. It is mentioned in the first JV decree that the share of foreign participation may exceed 50% (art.9).

The chairman of the management board and the chairman of the board of directors must be Bulgarian citizens (art.10) The decisions of the partnership bodies are taken unanimously (art.35).

It is also stipulated in the Bulgarian JV law that a reserve fund must be formed, without, however, mentioning the size of that fund (art. 24). The annual profit is taxed at the rate of 20%. The profit share of the foreign partner is taxed at the rate of 10% if it is transferred abroad (art. 37). Tax holidays may be given for 1–3 years for JVs (art. 38).

Decree 31/1987 is virtually only a restatement and clarification of decree 535. The need for this new decree No 31 originates obviously from the internal economic reform which defines the economic units in Bulgaria as "self–managing economic organizations" (SEO).

Decree 31 emphasizes the need dor feasibility studies when SEOs enter into JVs with foreign firms. Full self–support in levas and in CC must be ensured and possible competitive offers of foreign companies investigated (art. 8). To make this certain, another article (10) underlines that economic activity with foreign investment participation is organized and effected on the basis of self-financing in CC and levas.

Decree 31/1987 also includes an interesting article, which can be seen as a special incentive for JVs (art. 23). It stipulates that

> "when new construction for the JV's economic activity, and other needs is called for, the respective people's council's executive committee give priority to the Bulgarian JV participant".

In plain language this means that JVs have a priority position when internal resources are allocated.

In the same 31 decree, there is also one article which is potentially harmful for JV activity: art. 25 stipulates that

> "when concluding contracts with the JVs, the Bulgarian economic and other organizations may stipulate payment in foreign currency for goods and services."

The economic result of articles 23 and 25 may, thus, be that priority is given for JVs in resource allocation, but only in the case that payment is effected in CC. The delivering SEO has the right, according to decree 31, art 25 to ask for payment in CC when supplying a JV, which is, therefore, obliged to use CC even in Bulargian internal business.

The issuing of decree No 2242/1987 in Bulgaria means that the Hungarian idea of off-shore JV activity has been copied. The off-shore rules comprise virtually all economic activities, including banking and insurance (art. 17). Off-shore activity can be created by special marking in Bulgaria.

All off-shore activity is effected in CC (art. 5). When an off-shore outlet exports or imports something, it is exempted from Bulgarian duty (art. 13). When an off-shore JV sells its goods or services to Bulgaria, import duty must be paid (art. 14).

In the West, the Bulgarian JV rules have been regarded as relatively liberal and progressive, especially the point that a foreign company can have a majority stake in a Bulgarian JV according to the original FDI rules. However, JV activity in Bulgaria has not been especially lively.

In January 1989, Bulgaria adopted a new decree on economic activity, which meant the beginning of corporatism in that country. This complicated and lengthy document, which is published with regulations for its application, is in its core and spirit comparable to the Hungarian company law of 1988. 157)

In official Bulgarian interpretation this new State Council Decree No 56 supersedes the initial Decree 535 on economic cooperation between Bulgarian juridical persons and foreign juridical and physical persons from 1980, and Decree 3420 of 1987 regulating JV taxation. 158)

The new Decree establishes a variety of property forms for those entitled to engage in economic activity; they can be state-owned organizations, cooperatives, JVs (associations), foreign firms, individual citizens and joint-stock companies. All have equal rights under the law. 159)

The Decrec authorizes the establishment of state and public firms, joint-stock companies, limited and unlimited liability companies, cooperatives, and individual citizens' firms. Economic activity in Bulgaria is opened to foreign firms which can set up their subsidiaries (branches) and participate in JVs with local companies. 160)

Foreign persons can perform economic activity on their own with permission from the appropirate state body. This body decides which activities do not require a license. Before embarking on economic activity in Bulgaria, foreign persons are required to submit a declaration. But when the activity is performed jointly with a Bulgarian firm or other juridical person, it is the duty of the Bulgarian partner to secure the license and submit the declaration. Foreign entities can also set up their subsidiaries with the permission for the appropriate state body. These branches are juridical persons which can perform only the economic activities indicated in its license; they are registered at the district court of their permanent seat. Commercial representations can also be set up by foreigners in Bulgaria. Permission is needed from the state body in question, whereby it must be shown that at least one half of the employers are Bulgarian citizens. Representations are not juridical persons. 161)

Foreign persons are entitled to acquire personal shares and set up joint-stock companies in Bulgaria. When foreign participation exceeds 20 per cent, permission is required. When foreign persons hold shares in a Bulgarian joint-stock company, it is also possible for foreign nationals to be on board of management. It is also stated that foreign citizens can be presidents of management boards and managers of the state and other firms. 162)

The new Company Decree of Bulgaria also allows issuing of bonds by local companies. These bonds may be bought by Bulgarian physical and legal persons and transferred between them. Bonds may not be taken out of the country. 163) Consequently, a foreign legal or physical person, who has become a legal person in Bulgaria, may acquire Bulgarian bonds that cannot be exported.

> "One or two years ago it would have seemed almost blasphemy to associate stock shares with the Bulgarian economy. But today there are both shares and bonds."

This is written by D. Deliiski commenting on the new company decree 164). He also states that foreign legal and physical persons are granted alleviations, mostly in taxation. Their profit tax is much lower than that for Bulgarian companies and tax free if they decide to reinvest the profit. Moreover, part of the salary of Bulgarian employees in companies of foreign persons is paid in CC. The companies' revenues from the sale of goods in the Bulgarian market in levs will be paid to them in the respective CC at the international market exchange rate. 165)

The writer does not specify the difference in taxation between various legal entities. Neither does he give details of CC payment arrangements for the local work force, nor about lev conversions into CCs.

Supplementing the State Council Decree 2242, which ruled into existence free economic zones on Bulgarian territory, the Council issued an ordinance in November 1988, for the adaptation of regulations on the administration of the Vidim and Rousse free economic zones. These territories are set aside for the handling of duty-free goods, imported into the zones and intended for export. Trading is allowed within the free zone, and this involves, agencies, organizing the manufacture of goods. and performance of services, transport, procuring cargo for ships on international voyages, as well as the performance of banking, crediting and other financial operations and insurance. These activities can be performed by foreign juridical or physical persons and by Bulgarian organizations through JVs with foreigners. 166)

Payments for goods and services within the zones or from the zones to the country are effected in CC, also concerning payments under contracts of Bulgarian economic organizations. Administrative services and control are carried out by the administrative boards which exercise customs control and supervision, maintaining public order, issuing permits for the stay of foreign citizens, registering enterprises, firms, and banks, and exercising financial and tax control. Customers of the zones are provided upon request with the necessary workers, electric power, water, steam and office materials. The customers of the zones are expected to pay contract-specified wages in CC to the zonal administration for Bulgarian workers. By agreement with the zonal administration, the customers can also employ foreign citizens who are qualified specialists, up to one third of the total staff of specialists employed in one given activity. 167)

It is quite clear that the Bulgarian officials have been dissatisfied with the FDI results achieved in the 1980s. Therefore, it was correct to improve incentives for foreign investors. Especially the Company Act, which seems to be an important, decisive milestone in Bulgarian economic reform, means a qualitative improvement in investment climate by giving leeway for local and foreign business initiative.

Direct investments can now according to the new rules take a variety of forms, including portfolio investments in shares and bonds. Rules concerning foreign management have been liberalized and free-zone activity clarified.

Thus the legal framework for FDIs in Bulgaria was, roughly speaking, as liberal as in Hungary at the end of the 1980s. In both countries it is underlined that foreign investments stand on an equal footing with local investments. An exception from this rule is mentioned in the Bulgarian case, in which the company decree stipulates that foreign persons and firms of foreign individuals' cannot participate in an unlimited liability company (Article 41) 168) This point has hardly any practical meaning, because foreigners certainly have no interest in this company form.

3.4.4.2. Bulgaria's experience with JVs

The first JV in Bulgaria was set up shortly after the passing of the JV law in 1980. The Japanese company Fujitsu Fanuc invested half of the L 700,000 (L 1 = USD 1.06) capital in Machinex company which service numerically controlled (NC) machine tools built with Japanese technology in Bulgaria, in other East European countries as well as in Yugoslavia, Greece and Turkey. In the second year of operation, the JV activities were expanded to engineering and system design services for plant automation. Additional components were built under Fanuc licences in Bulgaria, with the JV handling project engineering. 169)

Fanuc Machines invoices its maintenance services for NC machine tools in other CMEA countries in CC. In this way the JV generates sufficient CC income to pay licence fees to the Japanese parent company for technology transferred to Bulgaria. A part of this CC income is also repatriated as the Japanese partner's share of the JV profit. On the other hand, the engineering services provided by the JV to local enterprises are bought in levas to be used to cover local input and operating costs. 170)

The Tangra JV was established in 1981 by Tangra Ltd (Switzerland) and Neftokhim Burgas and the FTO Khimimport in Burgas. It produces utensils as well as plastic and metal products, imports goods necessary for their production, and exports the finished articles. The original production goal was 15 million ballpoint pens a year for the local market and exports to Western Europe and the Middle East, with projected expansion to 53 million pens a year. The Swiss firm has a 20% share of the capital, with the other 80% held by the Bulgarian partners. Each partner has one representative on the three-man board, and the managing director is Bulgarian. Production equipment has been delivered by Swiss and Italian companies. The marketing is done by the Swiss partner. 171)

In mid-1982 Mitsukoshi Ltd, the largest Japanese department store chain, and a Japanese trading house concluded an agreement with 11 Bulgarian enterprises for the production of new-style consumer goods in Bulgaria. The Japanese are supplying the know-how and helping streamline the Bulgarian distribution system. The Bulgarian enterprise produces the consumer goods. The Japanese side reportedly provided 49% of the USD 100,000 working capital. Sofia Mitsukoshi emphasizes that its charter is extremely flexible, allowing it to engage in jobbing contracts, trading services and other activities on behalf of the Western and Bulgarian trade partners. 172)

Set up in early 1984 between Dow Chemicals (US), Khimimport and Khimkomplekt, Chimtrade is a rather unusual JV operation in that the framework for joint activities was set up, with only a nominal capital investment, before any specific activities had been designed. Chimtrade was established with the right to engage in practically any field of activity of potential interest to the two partners. These fields included production, trade, import, export, technical assistance, engineering, marketing and representation activities in the chemical, pharmaceutical, agricultural, construction, commercial, transportation and service sectors. All these are specifically included in its JV contract and have been approved by the Bulgarian Council of Ministers.

Both sides have hinted since the JV's inception that it would eventually take on some production duties, possibly involving catalysts or other small-tonnage chemicals. So far however, the JV appears to have restricted itself to trading activities. 173)

Honeywell (US) (40%) formed the Systematics JV in 1984 together with three Bulgarian partners in the chemical industry: FTOs Khimimport and Khimkomplekt and the Ministry of the Chemical Industry's management and computer science center – at the time called GIIZ (and now operating under the name Sistemkhim). Honeywell views the JV as an extension of its cooperation agreement signed with Bulgaria in 1979.

Through Systematic, Honeywell has succeeded in expanding its marketing, engineering, technical assistance and training activities in Bulgaria, not just in the chemical industry but also in automation projects and systems control for the steel sector, food, tourism, cement production and other areas.174)

In this JV activity there are also problems. The Western side complains that Bulgarian clients do not make proper cost–benefit calculations when ordering services. They have the tendency to opt for the cheapest, conventional solution which is not always the most profitable one. It is, however, hoped by Systematics specialists that this problem will be overcome alongside with the economic reform, which underlines profitability, and thus, making full–service deals offered by Systematics more attractive from the point of view of client firm managers. 175)

Futex was established in 1984 between Fukazawa Chemical Laboratory (Japan) and the FTO Tehknika. The JV was organized in order to manufacture the additive "Aboil" for liquid fuels for marketing in Bulgaria and third countries. It was also supposed to participate in marketing of other products, including raw materials, machinery and equipment. However, very little has been heard about this venture in the meantime. The crash in world market oil prices may have caused the partners to postpone the project.

A JV project formed in 1984 between Sormel (France), the FTO Elektro–impex and the Elprom combine, ESE engages in engineering activities for complex automation of assembly processes in electrical engineering and electronics, tool–making and related activities, including engineering studies, complete supply, assembly and commissioning of equipment, staff training and other service and commercial activities.

APV–Bioinvest is one of only two Western majority–owned JVs in Bulgaria, with 55% belonging to APV International (UK) and the remaining share belonging to Bioinvest, the Bulgarian FTO for biotechnology. The JV has been having a bit of trouble starting up, but it is planning to begin producing filtration and ultra–filtration equipment, energy–saving evaporation and refrigeration machinery and other food and pharmaceutical industry technology. The APV's initial investment came to only GBP 100,000, but the firm hopes that in the long run operations can be expanded, leading to exports of biotechnical equipment not only within Bulgaria but also to the USSR, other CMEA countries and LDC markets. 176)

APV is, so far, an unusual Western company in that it has JVs in two separate CMEA countries, in Bulgaria and in Hungary. Both offsprings were born in 1985 by capitalizing British know–how, but they are run exclusively by host country personnel. According to the Western side, the Hungarian JV has been working excellently, while there have been problems in Bulgaria. The difference is in management: it was easy to find suitable persons with technical skills in Hungary, but in Bulgaria previous FTO-people were set in. According to APV management, a high-tech firm cannot be run by people without technical knowledge.177)

Medicom was established in 1986 as a JV between Tokyo Maruichi Shoji (Japan), the FTO Tehknika and the Institute for Technical Cybernetics and Robotics at the BAN/Bulgarian Academy of Sciences. Tokyo Maruichi, already involved in the Sofia Mitsukoshi JV listed above, is contributing its marketing and other resources to this new project. Medicom conducts research and production of equipment, apparatus and software for the medical field. Aside from sales of equipment, the JV is also involved in technology transfer, technical assistance, services and other back-up operations.

FESTO-Machinex was established in September 1987 as a JV between FESTO Maschinenfabrik (55%) of West Germany - through its Vienna office - and four Bulgarian organizations: the Khidravlika trust of Kazanluk (30%), the TsNIKA/Technological Centre for Complex Automation in Sofia (5%), the Bulgarian Foreign Trade Bank (6%) and the FTO Mashinoeksport (4%). In early 1988 the JV partnership was expanded, as the Sistemkhim management centre (partner in the existing Bulgarian-US JV Systematics) purchased a 3% share from the Bulgarian Foreign Trade Bank. The JV's initial capital is L800,000 or Sch 13 million, and each partner's initial investment is in the form of a financial contribution in either hard or soft currency. 178)

It is extremely interesting to see that in the list of 15 JVs, active in Bulgaria, four are with Japanese partners. 179) Three UK companies are involved, and two US companies. Switzerland, France, the Netherlands, Austria, Germany and Belgium are a party in one JV each. Especially striking is the weak interest by West German firms, which normally are quite active in East-West trade and cooperation.

It is not clear how many of the Bulgarian JVs are actually involved in production. Obviously, the main activity is in technical services. Really big investments have not yet taken place in JV operations.

It is also striking that no JVs have come up in tourism so far. There are Western built hotels in Bulgaria, but they have been erected without Western equity investments.

Bulgaria's investments abroad in the West, of which there are some 50 cases, follow the general line of the strategy in the CMEA countries: most of them are just marketing outlets of Bulgarian export goods. However, Bulgaria has also been involved in certain takeovers of Western production units, which has occasionally had spectacular features.

In 1983, Bulgaria bought together with a West German company, an aluminium car wheel factory in Alsace, France, in a 50–50% partnership deal. 180) In a total acquisition Bulgaria took over Neunkrichner Schraubenwerke, an Austrian screw factory. 181) In Hamburg, Bulgaria bought a majority stake in a company, which produces machines for soft drink production and employs some 500 people. 182)

Occasionally, there is political opposition to Bulgarian takeovers. The best known case was probably the Bulgarian attempt to buy Fenwick Manutention (France) in 1983. Bulgaria's Balkankar was interested in acquiring Fenwick, the leading French forklift truck manufacturer, in order to gain production technologies and expand its marketing in France. French political interest proved adamently opposed to the idea of a socialist state gaining a controlling interest in such a large firm, however, and another rescue attempt had to be organized for the endangered company employing 2000 people. 183)

Bulgaria frequently acquires firms that are in bankruptcy proceedings or otherwise close to failure, in order to gain the technology, the business contacts and other advantages at a low buying price. The problem has proved to be that not all rescue operations by Bulgarians have been successful, but valued out companies have found their way back into bankruptcy. However, the Bulgarians have argued that operating a Western Company exerts a valuable influence on Bulgarian economy as a whole. By tying the newly purchased Western firm to Bulgarian sub–suppliers, the suppliers are made acquainted with the quality needs, deadlines and technical specification required under Western market conditions. This, in turn helps them adapt their production skills to the requirements of other Western organizations. In addition, the Western production facilities serve as a useful base for introducing Bulgarian managers to management conditions in the West. 184)

Bulgaria has not been especially active in FDIs in the Third World. According to information from 1985, Bulgaria is participating only in 14 JVs in LDCs. Three of them are in manufacturing. 185)

3.4.4.3. Outlook of FDIs in Bulgaria

According to official statements, all JVs in Bulgaria formed with Western firms are very much alive, either in full operation or in the process of starting up. 186) No failures are among the few JVs set up in Bulgaria in the 1980s.

Bulgarian officials are relatively reserved as far as information about JVs is concerned. This is especially so in comparison with Hungary. For example, equity shares are not completely disclosed in JVs already registered.

In Fanuc–Mechines and in Futex (both with Japanese partners) equity is shared on a 50–50 basis. In APV Bioinvest (with a British partner) the Western company has a majority. In other cases listed in the ECE–study, in which equity share is given, (4 cases) the Western partner is in a minority position, in the Tangra–case with only a 20% stake. 187)

It is, therefore, difficult to conclude that the Bulgarian original legislation, which since 1980 has allowed a Western majority share in JVs, is offering a vast incentive for Western companies to invest in Bulgaria. Obviously, more incentives are needed in order to speed up JV activity. Clear success in economic reform may speed up Western interest.

In the second half of the 1980s Bulgarian officials realized that attracting FDIs calls for institutional innovations. Issuing off–shore regulations for JVs in 1987 goes in that direction. It is, however, too early to judge, whether the off–shore option, which in Hungary has been of very modest meaning, will attract Western investors.

In decree 31/1987 article 29 paragraph 2 stipulates that

> "by agreement between the participants in the JV the share of the foreign participants' profit may be paid (entirely or partially) with goods and services of the JV's economic activity or through the purchase of other goods and services."

This point can be taken as a supplementary incentive. Goods or services for export can be bought and paid in Levas that have been earned in a JV supplying the local market. This, however, is an attractive option only in the case that the Bulgarian economy is becoming more competitive offering a wider range of products saleable on the Western markets.

The new rules for company activity in Bulgaria at the end of the 1980s show clearly, that there is need to revitalize economic reform and attract Western FDIs in the new, Hungarian manner. At the same time, it became clear in 1989 that Bulgaria would start to pursue political reforms on Polish and Hungarian lines. This reformism in economy and policy is a good combination when Western FDIs are sought for Bulgaria.

3.4.5. Czechoslovakia

The Czechoslovak economy entered a period of stagnation in the early 1960s causing a reform discussion. This discussion led to the formulation of reform measures, better known in the West as the "Prague Spring" (1966–68), which was crushed by Soviet intervention in August 1968 after some conservative opponents of the reform within the leadership of the CSSR communist party had appealed to the Soviets for help. The "normalization" policies of the Husak leadership turned the CSSR into a highly centralized economy with intensive trade links with the CMEA.

In the early 1980s the Czechoslovak economy experienced a clear stagnation once agian. During the period of "normalization", when special cooperation treaties were signed with the Soviet Union, the terms of trade of the country deteriorated considerably. At the same time, the share of Western trade in the foreign trade of the CSSR dropped considerably, from over 22% in 1970 to some 15% in the mid–1980s. 188) Czechoslovak economy had become alongside with Bulgaria the least open to the West.

In the mid–1980s the Czechoslovak situation was highly interesting. Internal economic pressure for economic reform was evident, and at the same time, Moscow started a far–reaching economic reform. Gorbachev's plea for supporting his reform measures at the working Summit meeting of the CMEA Party leaders in autumn 1985 brought also the Czechoslovak Party leader Husak on the side of those who advocated the introduction of reform measures tailored according to the Soviet example. In 1987 a document on the comprehensive reconstruction of the economic mechanism to be introduced by stages was drawn up. 189)

The concept envisaged requires a newly defined relationship between the economic centre, represented by the government and its functional and sectorial bodies, and the enterprises. The old relationship of subordination of the enterprise sphere under the directives of the planning machinery should be exchanged by a division of tasks and functions. 190)

At the same time with the launching of the new reform programme, important changes in the leadership have taken place. Experienced Western specialists in the Czechoslovak economy are extremely cautious when they judge the reform–mindedness of the new Party leader. Friedrich Levcik, for example, writes:

> "The conservative core within the leadership was strengthened by the dismissal of G. Husak as Party leader and the installation of M. Jakes, one of those who invited the Soviet Army in 1968". 191)

At the October 1988 plenum of the Central Committee of the Czechoslovak communist Party, Prime Minister L. Strougal, who was reputed to be the most ardent advocate of reform in the leadership, submitted his resignation and also left the Politburo. This event was assessed as a clear victory of the conservative forces with the CSSR's leadership by Ota Sik, the Minister of economic affairs at the time of the "Prague Spring".192)

In the opinion of Sik, Czechoslovakia has managed to avoid large Western debts, which does not mean that her economic development has been stable or effective. It only means that for many years now the CSSR has been unable to expand its exports significantly. Czechoslovak products are becoming less competitive in the world market all the time; they can only be sold at a great loss; given this state of affairs, the government has had to put a brake on imports. The result is that foreign trade with the West is relatively well balanced but the country has not been able to import the Western goods that it needs to modernize its industrial base. As a result, the CSSR's industrial base is thoroughly outdated and bears no comparison with Western industries. The country is falling behind and sinking to the level of a LDC. 193)

The reform experiment was continued in the autumn of 1988. In 1988 more enterprises were put on the self-financing principle; about 100 production enterprises were given foreign trade rights; a price reform was scheduled and a new exchange rate for the Czechoslovak crown with uniform rate stipulated; new rules for JVs were announced. 194)

The implementation of the reform programme represents, however, a big question mark. As F. Levcik puts it:

> "We have the peculiar situation that the most violent opponents of the reform in the 1960s are now charged with introduction of a comprehensive reform of the economic mechanism. This situation is casting shadows on the sincerity of the reform intentions, the more so now that the bureaucratic machinery of the planning authorities is charged with implementation of the reform measures." 195)

However, even if the fate of economic reform is uncertain, Czechoslovakia is in many senses a potentially interesting object for JVs. The country has a long industrial tradition, and thus, technical and technological skills, as well as a relatively developed infrastructure. Landscape and cultural monuments offer an excellent basis for cooperation in tourism, both in holiday and health-treatment trips.

3.4.5.1. Czechoslovak rules for JVs

In Czechoslovakia, the principles regarding the creation and activities of a JV in that country had not been codified before the mid-1980s. However, in August 1985, the so called Principles Governing the Establishment and Activities of Joint Companies were enacted. They embrace general, financial and economic principles, setting forth a framework within which such joint companies may be established and run in Czechoslovak conditions. 196)

The first JVs have also been set up in the framework of these "Principles". The main points of this document are described below.

The original document allowed JVs only in the field of industrial production. This restriction was removed on February 1, 1987, when JVs were allowed also in the sphere of tourism.

Point 1.3. of the Principles defines that the legal form of a JV can be either a company limited by shares, or an association. The latter possibility is left unclear with references to other legal documents.

Point 1.4. stipulates that relations between the partners will be regulated in the memoranda and articles of incorporation in accordance with the CSSR's legislation, mentioning, however, that a foreign partner cannot hold a share of more than 49% in the corporate capital. The foreign share may consist of practically everything having a property value.

The parties have considerable freedom in shaping the bodies and the decision making of the JV. There is only one important restriction: the leading staff of the JV must be recruited from Czechoslovak nationals (point 1.6.).

JVs must make a contribution into corporate funds (reserve fund, cultural and social fund, remuneration fund etc.) (Point II 1). Corporate tax is 50%. Dividends is taxed at 25% (Point II 4).

In addition the JV Principles stipulate that CSSR's legal rules are applied to persons employed with the JV (Point II 9). Customs duties are collected on all imports of JVs, but exemptions may be given from this rule (III 11).

The Czechoslovak Principles covering JV activity cannot be described as liberal. Therefore, it is understandable that a law on JVs taking incentives for Western capital into consideration has been drawn up. 197)

The Czechoslovak law concerning FDIs was drafted in 1988 and came into force January 1, 1989. In the law, foreign investors are given the opportunity to operate in all spheres of the economy with the exception of sectors important for the defence and security of the state. 198)

Undoubtedly, the most important change vis–a–vis previous rules is that the majority holding principle of the host country is not embodied in the 1989 law. Article 5, paragraph 4 states that the capital shares between parties are not predetermined by any rules. Article 7 mentions that when the permit is issued the respective shares of the host country and foreign parties will be considered.

This means in actual fact, that central authorities have the final say in matters of foreign participation. It is not explicitly said that wholly foreign–owned companies are disallowed, but it is likely that they will not be given the permit to operate. Therefore, the 1989 law can be defined as a JV law and not rules for FDIs in any other form.

Article 9 of the new Czechoslovak JV law defines that no obligations may be given to mixed companies operating in the CSSR, under the central economic plan. Thus, the JVs will operate exclusively on the basis of agreements between the supplier and customer. However, JVs must work in the economic environment of the host country, taking local prices regulations, etc into account.

It is defined (Article 12) that JVs must make contributions to the risk fund, cultural and social fund, a bonus (remuneration) fund. A JV may also establish a development (investment) fund, and other funds, financed from the after–tax profit, from which contributions to socio–cultural and bonus funds have been deducted. All means in the JV funds can be used by the enterprise itself independently, and these funds cannot be confiscated.

It is surprising that the JV law of 1989 does not contain any special article on tax rates, which were set very high in the 1986 decree (50 per cent corporate income tax, 25 per cent dividends). Article 11 only states that JVs pay taxes according to local legislation.

Transfers abroad are formulated in a rather liberal manner: profit repatriation, earnings of foreign staff, and payments for their insurance policies are all freely transferable in CC form. However, the law underlines (Article 21, paragraph 4) that the source of these transfers can only be the CC means of the JV itself. This point was actually missing in the 1986 rules.

The 1989 law, which has obviously been prepared over a long time, clarifies the CSSR's policy towards FDIs to a certain extent. All economic spheres, including all services, like banking and the hotel business, are now in the frame of FDI legislation. It also shows that the host country is not sticking to the majority stake rule, and does not want to allow wholly foreign–owned companies either.

No binding plan directives can be given to JVs, but at the same time they are affected by many local regulations, which are mainly unknown to potential foreign investors. The enterprise fund system, which is so typical of traditional CPEs, is applied also in Czech JVs. It is rather surprising that no tax rates are given by the law. The foreign party must go and find them out on the spot by investigating local tax laws.

Czechoslovak officials emphasize the liberal features of the 1989 law by pointing out that the ratio of capital shares is a matter of mutual agreement between the parties and a major share of the host country party is no longer prescribed; likewise, the participation of the foreign partner in the JV management is a matter to be agreed on by the two sides. The enterprise's independence is explicit in its economic functioning. Its only duty is to pay taxes to the state and contributions to the prescribed funds. The foreign partner may transfer his share of profit abroad from the CC funds available to the JV 199)

3.4.5.2. CSSR's experience with JVs

It is only natural that since the publication of "JV Principles" in 1985 the interest in establishing JVs in the CSSR has been rather weak among Western companies. The first rules were not regarded as liberal, taxes were set high for JVs and the economic environment with the "normalization" atmosphere looked unattractive. It can also been anticipated that some companies have been waiting for proper JV legislation before signing any agreements.

It can be taken for granted that inside of Czechoslovakia there has been resistance on allowing JVs with Western participation at all. Dr. B. Klein, the Director of the legal department of the CSSR Chamber of Commerce and Industry's said in the spring of 1988 that two years earlier JV had been a dirty word; a year earlier there had still been a strong division of opinion; now (in 1988) there is a kind of bandwagon effect with supporters in a majority and gaining strength. 200)

However, the first JV in Czechoslovakia, Tessed, was set up already in 1986 between Senetek (Denmark), a subsidiary of Senetek (UK), and Tesla MLP enterprise of Brno.

The Danish branch of the Senetek company, set up in the UK in 1983 as a commercial distributor of products in the biology and biotechnology field, had been a leading cooperation partner of the laboratory–instruments factory of the Tesla MLP enterprise prior to setting up the JV. The proposal to form a JV was made initially by Senetek in February 1986. Following difficult negotiations, which included an in depth assessment of cooperation to date, a JV agreement was signed in August 1986 and came into effect in October of that year.

The JV's mandate involved achieving better use of existing technology, researching the market and developing and producing new products in the field of chromatography.

Under the terms of the JV agreement, Senetek is to hold a 49% stake in the venture and be responsible for financing and equipping a research laboratory at Aarhus, Denmark. The Czechoslovak side will handle actual production. It is foreseen that development of new products will take place at the laboratory in Aarhus, with all manufacturing to take place in Czechoslovakia.

The foundation capital of the venture on January 1, 1987, the JV's official starting date, was set at USD 2 million. Tesla's share amounted to USD 1.02 million and Senetek's USD 980,000, giving the Czechoslovak side a 51% majority ownership. The contribution of the Czechoslovak side consisted of non–monetary assets, including industrial patents, buildings, equipment and know–how. Tesla's participation in the undertaking has been guaranteed by the Czechoslovak State Bank.

Tessek is to employ some 26 persons in the technical, management and commercial field, 39 production workers, seven non–production workers and eight auxiliary personnel. One Czechoslovak citizen will work with a six–man research team in Denmark. The Czechoslovak researcher's salary is paid in hard currency. Senetek will also provide a person to represent the company in Prague, but no decision has been made on how Senetek employees in the CSSR will be paid.

The remuneration of employees of the JV is covered by Czechoslovak regulations, but with certain essential differences. The basic wages are somewhat higher than in other Czechoslovak enterprises, and individual earnings depend on the fulfilment of two target indicators. The enterprise has instituted a quality–control policy whereby occasional defects are directly reflected in the payment of each individual worker. In the words of one local manager,

> "employment conditions at Tessek are rather tougher than we are used to, but good work is rewarded as it merits."

The venture is managed by a seven–member governing board, chaired by the General Director of Tesla Brno. The deputy chairman is the President of Senetek. The

Czechoslovak side has four representatives on the board; the Danish side has three. As the highest organ of the venture, the board has the right to make decisions on all matters affecting the JV.

Tesek has been placed virtually outside the national economic planning and management system, and must meet all expenses and payments through its own earnings. The JV has its own hard-currency account with the Czechoslovak State Bank, but requires a foreign currency permit to have access to this account. The bank initially required a foreign exchange permit for every single transaction carried out by the JV on its account – a very cumbersome procedure. This problem has apparently been cleared up in subsequent negotiations. 201)

April 14, 1987, Philips, Tesla Spotrebna Elektrotechnika Konzern Bratislava, and FTO Transakta formed the JV "Avex" for producing and retailing videocassette recorders and components. Under the agreement, Tesla holds a 70% stake in the venture, to be based in Bratislava, Philips' share is 20% and Transakta's is 10%. Philips will contribute manufacturing facilities and production know-how, Tesla is responsible for the industrial infrastructure and Transakta will carry out the commercial activities. The JV was registered as a legal subject in August 1987 and obtained foreign trade rights in October of that year.

Financing for the venture, at least in part, has been made possible through credits granted by the Austrian Genossenschaftliche Zentralbank. According to spokesmen for the bank, Avex now has credits in various convertible currencies at its disposal.

The JV was a logical outgrowth of successful cooperation between the partners. In 1985, Philips signed an agreement with Tesla for the regular delivery of "semi-knocked down" kits, consisting of mechanical desks, printed circuit boards, wiring, cosmetic parts and packing materials, for assembly at Tesla's plant in Bratislava. These kits would be used at Philip's production site in Vienna. Supply was based on normal delivery contracts, with payment in hard currency. 202)

Tourinvest: Formed in December 1987 between Warimpex (Austria) and the Czechoslovak state tourist authority, Cedok, for building or renovating hotels in the country. Warimpex is to hold a 49% stake in the venture, with Cedok to hold 51%. Under the terms of the deal, worth an estimated USD 80 million, four projects will be carried out. The first concerns renovation of the old Palace Hotel in downtown Prague. Construction is to take 18 months and cost between USD 23–25 million. The other projects include the renovation of the 70-room Sova Mills hotel near Prague, modernization of the stable and residence at Hluboka and Vltava, Southern Bohemia, and the construction of a new 600-bed hotel in Prague. The new hotel is expected to be finished by 1990. The firm has previously constructed and financed two hotels in Prague: the Panorama which opened in 1981; and the Forum, in June 1988. 203)

Hotelinvest: Set up in February 1988 between the Campenon Bernard group, a subsidiary of Générale des Eaux (both French), and Cedok to construct a 750-bed, four-star hotel in Prague and renovate a 360-bed hotel in Bratislava. Under the terms of the JV agreement, the French firm is to have a 40% equity stake in the venture, with Cedok to hold the remainder. The French Banque de l'Union Europeenne also took part in the negotiations. Foundation capital was set at Ffr 75 million. The total estimated value of the two hotels has been set at about Ffr 1 billion.

Balnex: Formed in February 1988 between the Austrian firm Warimpex and the Czechoslovak health-resort authority, Balnea, for constructing and renovating health spas in the country.

Recoop Tour: Set up in March 1988 between the Grassi company (Austria), the state agency Tradex and the Rekrea cooperative travel agency to build a hotel and air terminal near the Leninova subway station in Prague.

Luwex: Formed between an unidentified Austrian company and the Czechoslovak Manufacturing Work of Air Engineering Installations at Milvesko for producing air-conditioning and ventilation equipment.

MSZ: Set up between a West German firm and the Dolni Nemec cooperative farm for breeding livestock.

China-Czechoslovak Ocean Shipping: Formed between a shipping line of the People's Republic of China and Czekoslovenska Namorni Plavba (Czechoslovak Ocean Shipping) 204)

If Czechoslovakia, as a late-comer into the JV business, is compared with Romania and Hungary in the 1970s, when those two countries started allowing JVs, the beginning is not too bad. However, FDIs were not macroeconomically significant in the last few years of the 1980s.

Czechoslovakia has not been investing abroad very actively. In Austria, there are only 6 firms with Czechoslovakia equity holding, including the pen factory Koh-i-Nor, which has been inherited from the pre-war period. In West Germany there are only 12 units with Czechoslovak participation, all in the trade or agency branch. In Great Britain there are only 9. In developing countries there are no more than 16 Czechoslovak JVs, three of which are in production. 205)

In the summer of 1989, there were 20 JVs registered in the CSSR. Actually, very little information is available about these units. Just half of the existing JVs are active in hotel and tourism, which was excluded from FDIs until February, 1987. 206)

There are two good reasons for the concentration of JVs on tourism. Firstly, Czechoslovakia offers excellent conditions for foreign visitors in city-holidays, winter tourism and health-treatment trips. Secondly, tourism offers a convenient way to earn hard currency on the spot from Western visitors. Among the 17 million foreign tourists visiting the CSSR annually, only 7 per cent (1.2 million) are from the West. Thus, there is certainly much potential to develop the CC tourism considerably by providing more and better hotels and other services.

Seven out of ten JVs active in the hotel and tourism business have their Western partner from neighbouring Austria. The Austrian firm Warimpex, which was the first Western party to invest directly in Czechoslovak tourism by establishing the Hotelinvest JV with Cedok, is also in the Balnex JV, active in spa tourism. Grassi from Austria is the Western party in no less than three JVs operating in Czechoslovak tourism. Genossenschaftliche Zentralbank (Cooperative Central Bank) from Austria is in two similar units.

The French enterprise CBC is in three separate Czechoslovak JVs, active in the tourism business. Thus, ten JVs active in the CSSR's tourist business involve only four Western partners, one from France and three from Austria.

The first productive JV established after the pioneer enterprises Tessek and Avex is Luwex, which produces air conditioning. Among the three Western partners, all of whom are from Austria, are Warimpex and Grassi. Obviously, these enterprises have needed this production unit in the CSSR, in order to supply their hotel and restaurant projects with air conditioning.

Only two West German firms are involved, one producing and trading in metal products, one in animal production. Alongside Senetek from Denmark, the Western partner of Tessek, a Danish firm (Naturgas Syd) produces plastic pipes together with a Czech partner.

Two British firms are involved in the CSSR's JVs. One (Vitrea) is active with a Yugoslav firm in the construction company Pozimos, which aims at CC financed projects in the host country. The other is a party in the Flatex JV, which produces special textiles for the furniture industry.

A firm from Belgium (Belevo) participates in chemical production in the CSSR. An Austrian firm has a 30 per cent stake in Inko JV producing ceramics.

Altogether, the invested capital in Czechoslovak JVs was no more than the equivalent of some USD 30–40 million, of which the host country owns more than half. Thus, FDIs in the CSSR have a total value of only some USD 15–18 million.207)

This sum is extremely low. One of the reasons for this is that the CSSR is a late–comer among CPEs in JV activity.

Investors from only seven Western countries have participated in the CSSR's JV activity. Japan and USA are absent.

Concentration of FDIs on hotel and tourism has not brought about high capital input in the CSSR's JVs. Units active in this sphere obviously work mainly with borrowed money. High FDIs, as in Hungary in this sphere, have not taken place. No JV financial institutions were set up before the summer of 1989.

3.4.5.3. The future of JVs in the CSSR

Czechoslovakia is not a very populous country with only some 15 million inhabitants and it does not have plentiful natural riches at its disposal. However, as an old industrialized country it certainly has some attraction for Western investors, provided, that JV rules are liberalized and economic reform gains strength.

Radical changes took, place in the CSSR's political life during the last months of 1989 after mass demonstrations against the stringent party rule. In December 1989, the Communist party expelled its former hard–line leader, M. Jakes from its ranks, due to gross political mistakes in tackling social tensions. At the same time, the party ordered the rehabilitation of thousands of reformers, including A. Dubcek, the party leader in the "Prague Spring", who were evicted after 1968. 208)

Mr. L. Adamec resigned as Czech premier December 8, 1989. The next evening the old President Gustav Husak – installed by the Soviet invasion of 1968 – went on TV to say he would resign as soon as a new government was formed. In the new cabinet the communists still have ten places against eleven for non–communists. But two or three of the communists – most notably Mt. Komarek, a rebellious economist who is deputy prime minister – are little more than nominal members of their party. 209) A new era of reform started in the CSSR in the turn of the decade 1980–1990.

One extremely important factor in this context must be taken into consideration. Soviet–Czechoslovak trade, like Soviet trade with other CMEA countries as well, entered a new phase in the late 1980s. The decrease of energy prices in the mid–1980s is affecting the intra–CMEA trade scene with a time–lag resulting from the price formula agreed upon in 1975. This phenomenon is likely to improve the terms of trade of the small CMEA–countries vis–a–vis the USSR. In actual terms it means that there is no more the need to export as much to the Soviet Union as in the early 1980s in quantitative terms to balance the trade. This does, however, contain the danger of spare capacities in the production spheres which are not very competitive.

Therefore, there is one more incentive to restructure and modernize industries in the CSSR (and in other CMEA countries as well), in order to be able to find other export markets than the Soviet one. The extensive growth, on the basis of deteriorating terms of trade is no longer possible.

The CC debt of Czechoslovakia (some USD 4 billion in 1988) has always been well under control, as pointed out previously. Therefore, economic reform can be backed with technology imports from the West by credit financing without immediately catching the Polish disease. At the same time, there is naturally no urgent need to maximize CC earnings via JVs.

Summing up, it can be said that Czechoslovakia is certainly not going to be of little interest to Western investors in the 1990s. Much depends on the economic policy, in which there are several options open, when the whole socio–economic and political scene is under reconstruction.

3.4.6. The Soviet Union

The Soviet economy has always been highly centralized and rigid until the mid–1980s, although several reforms attempts have previously been launched. The continuation of the extremely wasteful, cost–insensitive system has been possible because the Soviet Union is the richest country of the globe, as far as resource endowment is concerned. This fact has allowed the country to apply an extensive means of economic growth without causing a serious balance of payments problem.

Furthermore, the Soviet Union is undoubtedly one of the winners of the two oil–crises. Even if the USSR has never been a member of OPEC, it has been able to profit from the oil price hikes in the 1970s and early 1980s. The windfall profits derived from the improvement in terms of trade have been impressive allowing considerable import hikes without critically increasing the CC debt.

However, the mid–1980s earmarks an interesting turning point in the Soviet economy. The new and dynamic Party leader, M. Gorbachev, decided to revitalize the economic management with his economic reform, or perestroika. At the same time, the situation on the world energy market changed radically, when the oil price started to slip down. Soviet export earnings, especially in Western trade, experienced a severe blow.

During the first years of perestroika and glasnost it has become quite obvious that the foreign trade structure, especially in Soviet–Western trade, is primitive, as far as exports are concerned. Exports to the West consist almost entirely of raw materials and some semi–manufactured goods. In imports from the West foodstuffs have a large share.

Thus, it is understandable that the new leadership in the Soviet Union, which is emphasizing intensive economic growth, and therefore, modernization of the Soviet industry, also mentions the need for increasing competitiveness and improving external economic links. It is thus understandable that Western FDIs have been allowed. Large-scale technology purchases on a turnkey basis are no longer as easy to make as during the years of high oil price.

Western companies are fascinated by the large Soviet market and by the local natural resources. This interest has been increased by Western media coverage of the economic reform in the USSR. Decreasing tension on the East–West political scene is, on its part, helping to create a favourable climate for Western FDIs in the Soviet Union.

In the early 1990s it is still impossible to judge what the ultimate outcome of Gorbachev's perestroika will be. It has been advancing very slowly in practical life during the first five years of the new leadership. Therefore, it is likely that JVs to be established in the Soviet Union, will be confronted with a business environment, which has peculiar features consisting of predominantly centralized administration methods mixed with some market elements.

Talk of reaching Rouble convertibility in the near future is premature, even if it has been declared to be an official goal of Soviet economic policy. In the meantime, Western companies planning JV operations in the Soviet Union, must face the problem of double-money dealing with CC and the inconvertible Rouble at the same time. "Hard currency self-sufficiency" in JV operations is a major aim of the Soviet side.

In the early 1970s, when Romania and Hungary had issued their first rules on JVs, the Western business community expected a similar opening in the Soviet Union. In that period Soviet officials vehemently and aggressively denied the possibility of allowing Western direct investments in any form ever in the Soviet Union. Some one and a half decades afterwards the Soviets issued the first rules covering Western FDIs.

3.4.6.1. Soviet regulations governing Western FDIs

By a Decree of the USSR Council of Ministers dated January 13, 1987 (decree No 49) on the Establishment in the Territory of the USSR and operations of JVs with the Participations of Soviet Organisations and Firms from Capitalist and Developing Countries, Western FDIs are allowed in the USSR. In addition, a Resolution of the Central Committee of the CPSU and the USSR Council of Ministers dated September 7, 1987 on Additional Measures to Improve the Country's External Economic Activity in the new Conditions of Economic Management (decree No 1074) introduced some supplements to the January decree. Both decrees together form the first legal framework of JVs in the USSR. 210)

The January decree (No 49) stipulates (clause 2) that foundation documents, including a feasibility study, have to be submitted by the Soviet organizations concerned to the Ministries and government agencies, under which they operate. Ministries and government agencies of the Union Republics must submit such proposals to the Council of Ministers of their Republics. These organizations have to agree on the proposals with the USSR State Planning Committee (Gosplan), the USSR Ministry of Finance and other Ministries and agencies concerned. JVs must be registered with the USSR Ministry of Finance (clause 9).

The aim of JVs has to be satisfying domestic needs for products more fully, attracting advanced technology, management expertise, and additional material and financial resources to the USSR and expanding exports, as well as reducing imports (clause 3).

The share of the Soviet side in the JV capital is not be less than 51% (clause 5). No provisions are made on possible exceptions from this rule.

Contributions to the JV authorized fund may include material, as well as immaterial values. Money assets in any form are also accepted (clause 11).

JVs are governed by a Board consisting of persons appointed by the partners. Its decision-making procedure is defined by the founding documents. The operational activities of a JV are governed by a Management Board consisting of Soviet and foreign citizens. The Chairman of the Board and the Director-General have to be citizens of the USSR (clause 21).

Clause 22 of decree 49 stipulates that a JV is not allowed to enter into relations with central state authorities of the USSR and of the Union Republics through authorities superior to the Soviet partner in the JV. However, a JV is independent in developing and approving its business operation programmes. State bodies of the USSR are not allowed to fix any mandatory plans for a JV nor do they have to guarantee a market for it products (clause 23). Thus, a JV operates outside the planning system.

Foreign trade transactions of a JV can be transacted independently, but licences (permits) for them are needed according to the legislation of the USSR. These operations may also be effected through Soviet FTOs (clause 24).

JVs operating in the Soviet territory must be "self-sufficient" in CC terms. All foreign currency expenditure of a JV including transfer of profits and other sums due to foreign partners and specialists have to be covered by proceeds from sales of JV products on foreign markets (clause 25).

Decree No 49 stipulates that all business transactions on the local market have to be effected via Soviet FTOs using the rouble as a means of payment. Prices used must be world market values (clause 26).

JVs are required to form a reserve fund. Deductions from profits must be added to this fund until the latter totals 25% of the JV capital (clause 30).

Decree 49 guarantees that the foreign partner's share of the JV distributed profit is transferable abroad in foreign currency (clause 32). In this context one must bear in mind the provision of clause 25 which states that all foreign currency expenditure, including transfer of profits, must be covered by proceeds from sales on foreign markets.

The JV tax rate is 30% of the profit remaining after deductions to the reserve and other funds. The two first years of operation are tax-free. The Ministry of Finance can reduce the tax and allow tax holidays (clause 36). In addition, the part of the profit due to a foreign partner in a JV must be taxed, if transferred abroad, at the rate of 20% (clause 41).

The personnel of a JV must consist of mainly Soviet citizens, who are paid on the basis of collective agreements with the trade union organization formed at the JV. The contents of these agreements including provisions for the social need of the personnel are defined by Soviet legislation and by the foundation documents of the JV (clause 47).

Decree 49 does not provide for too many outright incentives for foreign investors. However, clause 34, which covers the construction needs of JVs, stipulates that orders from JVs must receive priority both as regards limits on construction/assembly work to be carried out by Soviet organizations, and as regards material resources required for the construction.

The September Resolution (decree No 1074/1987) introduces some interesting amendments. The approval procedure of JVs has been simplified by significantly reducing the number of bodies required to be consulted. The September Resolution provides that the ministries and departments of the USSR and the Councils of Ministers of Union Republics are granted the right to take decisions independently on setting up JVs.

The practical effect of this provision is that JVs, in which the local partner is subordinated to one of the all-union industrial branch ministries, only needs approval from that ministry; in cases where the Soviet partner is subject to republic subordination, the approval is required from the Council of Ministers of the Union Republic concerned.

It is also worth mentioning that the September Resolution emphasizes JV activity in the sphere of services by mentioning the fields of science and technology, trade, finance, services, tourism and advertising, design, repair, purchase of shares, bonds and other securities, their issue and floating. It can be concluded that, for example, establishing a joint bank is allowed under these rules.

Clause 26 of the January decree (no 49) has been revised by the September Resolution (No 1074). It defines that a JV by agreement with Soviet enterprises and organizations has to determine the kind of currency to be used in settlements for products sold and goods purchased. The JV must also determine the procedure for selling its products on the Soviet market and for shipping goods from this market. In practice, it means that the JV must not use Soviet FTOs as intermediaries in business deals on the local market and that CC and rouble payments can be used when dealing with Soviet organizations. A JV may buy and sell on the Soviet domestic market either through a FTO or directly with the Soviet supplier or end-user concerned. Such sales and purchases may be made in foreign currency if the parties so agree.

These provisions of the September Resolution allow a JV to possibly increase its CC earnings by "internal export", and thus, enhance its chances of profit repatriation. However, the January decree (No 49) stipulates, as mentioned, (clause 25) that all CC expenditures by a JV, including profit repatriation, must be covered by proceeds on foreign markets.

Obviously, it is a matter of bargaining, whether or not the CC income from "internal export" can be counted as "real" CC revenue for JVs to be used for profit repatriation. The valid rules (decrees 49 and 1074) do not give a clear-cut answer to that point.

Anyhow, the September Resolution gives a clear supplementary incentive to Western investors by stipulating that it is possible to exempt JVs from paying tax on profits during the first two years from the moment they show declared profits. The January decree offers tax holiday on JV profits during the two initial years of operation (clause 36). If now, say, the first two years bring losses, and then, say, the following two years bring profits, the tax-free time, according to the September decree, is altogether four years. 211)

Obviously, Soviet authorities are willing to develop further the legal base of JVs, with imperfections still pushing away some potential Western investors. 212) For the time being, for example, in the Soviet Union there is no corporate law in effect. No special legal forms–joint stock company or limited liability company are provided for either in decree No 49 or in general Soviet legislation. However, it seems possible that a corporate law will be elaborated in the USSR in the near future. 213)

On December 2, 1988 the Council of Ministers of the USSR issued a resolution (postanovlenie) on the development of external economic links. 214) In this document it is stipulated that in order to activate JV business in the Soviet territory relative capital shares of partners are negotiable. This point means the abandonment of the previous requirement that foreign partners cannot take a majority share in a JV. Furthermore, it is allowed for a foreigner to become the chairman of the board, and managing director of a JV.

In addition to these two extremely important points, the same document stipulates that the principle questions concerning the JV activities must be solved in the board unanimously. In labour management relaxation is foreseen: hiring and dismissing workers as well as bonus systems are negotiable between partners. Reduced customs tariffs on JV imports are offered. Payments made in roubles for alien workers are allowed in order for them to be able to cover their local expenses.

Tax consessions are offered for JVs to be established in the Far East regions. The Ministry of Finance has the right to reduce JV taxes in certain cases.

Potentially important for foreign investors is point 28 in the December 2, 1988 resolution. It stipulates that Soviet construction firms are allowed to participate in bids in the Soviet territory, when projects are carried out with CC allocations by the state. The most favourable offer, foreign or not, will be selected. If under these new circumstances a JV located in the Soviet Union is regarded as a Soviet constructor, this point 28 may give a boost for FDIs in the construction branch. A project getting CC allocation can be located via JV better than directly from the West. Bids containing Western engineering and Soviet labour under JV management might be highly competitive.

Rules concerning JVs were amended in a very important manner in March, 1989 (postanovlenye Sovieta Ministrov SSSR ot 7 marta No 203). 215) This Ministerial decree, which is mainly concerned with the registration of foreign trade rights, customs and licensing (permitting) certain import and export items, states clearly (Article 8) that JVs in the territory of the USSR may only export products (work, services) which are created within the JV activity, and import items (work, services) only for their own need.

In plain language it means that Decree 203 prohibits JV trading activities. The aim of these new rules is to prevent speculation in foreign trade, as the specialist G. Petrov from the Soviet Ministry of Foreign Economic Relation states. Western firms regard this new Decree as a serious set-back for JV activity. After these regulations it is no more possible to help Soviet clients, who are willing to buy JV products for CC to earn this. If a JV is, for example, providing equipment for the pulp industry, it is no more able to mediate pulp exports to the West, in order to help the client to earn the necessary CC. 216)

Discussion on Free Economic Zones (FEZ) has been going on in the Soviet Union after the issuing of the Decree allowing FDIs. Basically, a positive attitude towards FEZs has been taken. There are for example, comments that FEZs in various forms are pretty common in the global economy: 30% of global output is produced in about 2,500 FEZs. 217)

The Soviet Union is naturally interested in the experience gained with FEZs in other socialist countries. The relatively good results in China have been mentioned, but the CMEA–countries of Europe have had only very narrow experiences in the 1980s. 218)

Ivan Ivanov, who is in charge of relations with OECD–countries in the GVK, represented a paper in mid–1989 on FEZ in the Soviet Union. It can be assumed that this paper will form a basis for future FEZ rules in the USSR. Therefore, the main points of Ivanov's paper are worthwhile listing here. 219)

In the first section of Ivanov's paper it is stated that FEZs normally have weak links with the national market and are predominantly export oriented. This model is only partially applicable in the USSR, which is seeking solutions to national economic problems rather than specific problems of external economics.

Thus, it is stipulated that a FEZ would work for the internal Soviet market by contributing to its supply of modern technology and high–quality consumer goods and provide managerial skills and new forms of economic organizations. Accordingly, such zones should be created and operated as an integral part of the Soviet economy. It is further suggested that several types of FEZs should be created.

Section two deals with the establishment and status of FEZs. In it is suggested that the basic elements of the economy of zones should be unified for the whole territory of the country and codified in special legislation. Individual zones would be created on the basis of a special decision of the Council of Ministers, which would take into account the legal regime, the specific economic objectives and policies of respective regions.

Realistically, Ivanov's paper states, that the size of the territory selected for the zone should be sufficiently large and should be provided with adequate infrastructure, availability of labour resources, local construction materials, convenient internal and international communication facilities and well established links with the rest of the Soviet economy.

The FEZs are economic rather than political entities, as Ivanov's paper states. This point can be interpreted as implying that capitalists can invest their money in Soviet FEZs, but are not allowed to transplant their political system into the zones. To be sure that this does not happen, it is stated that all–union and respective republic legislations are applied within the zones; legislative exceptions relate only to economic and social issues. To make this point quite clear, it is stated that FEZs are territories subordinate to national level also in economic terms. A market economy cannot be brought in by Western investors either, without the acceptance of the all–union administration, if Ivanov's point is understood correctly.

The third section, which deals with the economic mechanism of the zone is highly interesting. Firstly, it is defined in general terms that a FEZ functions as an autonomous self–accounting entity. Its relationship with the state plan and budget, as well as the requirements of self–financing and self–accounting, are determined for the zone as a whole. In its external relations, the zone operates as a territory which is open to all kinds of foreign economic activity in which the most favoured treatment for JVs and foreign investments is provided. The state and the Republic (region) where the zone is located should provide back–up support to its operations. The zone's orientation towards the solution of national and regional problems is to be ensured through economic methods.

These general definitions of Ivanov's paper concerning the economic mechanisms of FEZs allow some important conclusions. Firstly, the FEZs are seen as economically independent units, which however, are part of the national economy. Secondly, the zones aim at providing the most favoured treatment for JVs and foreign investments. This indicates that, not only JVs, but also FDIs wholly–owned by foreigners will be allowed. Thirdly, administrative regulations and interference are going to be minimized in the zones, because economic levers are emphasized in the section on FEZ management.

However, it is further stipulated, that as a part of the Soviet economy, the zone is centrally prescribed to adhere to: volume and structure of state order; funds and allocations of supplies, state investment and construction works; rates of taxation and currency deductions to the state budget. It is recommended that the overall share of the state order should not exceed 50 per cent of the volume of production of individual goods. In addition, it is stated that, material supplies are to be allocated to the zone in volumes and structures specified by Gosplan and Gossnab. With regard to the rest of its needs, the zone is to be covered by contractual arrangements with Soviet suppliers, through its own production and imports.

These quotations from Ivanov's paper show clearly how difficult it is to create models for FEZs in an economic environment which is still mainly based on CPE principles. It is, on the one hand, stated that the zones should be managed by economic methods, but, on the other hand, there is the need to integrate them into the planning system via state orders and centrally planned supplies. For potential foreign investors these proposals are rather confusing.

Section four of Ivanov's paper deals with economic incentives listing first those which are common to the Soviet and foreign economic residents of the zone:

- exemption of exports and imports of the zone from customs duties and non–tariff restrictions

- reduction of customs duties imposed on imported products of the zone by the internal market of the USSR

- assurance of material supplies from centralized (regional) funds

- supply of labour force and introduction of simplified recruitment and dismissal procedures

- provision of infrastructural services and determination of amortization periods

- application of free market prices in marketing products within the zone

- utilization of insurance schemes for protection against commercial risks existing in the zone

- exercise of the right to participate in the management of the zone.

Some comments on these points are needed. The first one is clear: FEZs in the Soviet Union are going to be custom free areas in the traditional sense fo the world. The second point means, that while the FEZ is not directly a part of the internal market of the host country territory, the host country's protectionism treats FEZ products in a more favourable manner than actual imports from abroad. In materials and labour input the zone's residents are in a better position than average Soviet enterprises. Amortization periods can obviously be handled flexibly.

The last point on the list is of special interest. It states that enterprises located in FEZs have the right to participate in the management in the zone. This point is clarified in section six, paragraph two, which suggests that the administration of a FEZ will include, in addition to Soviet citizens, foreign experts including those recommended by business circles of the zone. If this recommendation is carried out, it means that alien persons will be involved in Soviet administration on the local level.

An extra incentive list concerning only foreign investors in the zone is also prepared in the Ivanov paper:

- exemption from taxes on the repatriation of profits made in the zones;

- additional investment protection measures including provision of guarantees of conversion of the rouble component of profits which are not covered by hard currency self–financing, into foreign currency at the market rate of a zone bank of the zone;

- introduction of a simplified procedure to enter and reside in the zone to be provided for foreigners;
- provision of guarantees in the USSR market for products manufactured against state orders;
- free selection of financial sources for its operations in the FEZ including attracting funds from the international money market;
- provision of additional measures to protect industrial property.

The first proposal in this list means that if Ivanov's paper is put into practice, there is a clear incentive for FDIs to choose FEZs as a location when investment decisions are made. The second proposal is of fundamental importance, if it is carried out in the final legislations concerning FEZs. By this proposal as it stands, the obligation for Soviet JVs to earn CC is cancelled. Rouble profits too can be repatriated, after converting them into CC.

However, this proposal must be read carefully. It says the conversion of the rouble component of profits into CC must be made at the market rate of a bank of a FEZ.

The December 2, 1988 resolution concerning foreign economic links in the Soviet Union (mentioned above) stipulates that currency auctions can be organized. Ivanov's paper is hinting at that point: rouble conversion is made at the market rate of the bank of the zone.

Thus no economic unit operating in Soviet FEZs will be able to foresee the real value of rouble profits to be repatriated. If a foreign investor offers roubles in an auction organized by a zone bank, there is no guarantee that anybody will offer a conversion into CC. If somebody does offer that kind of conversion, the exchange rate will not necessarily have anything to do with the official exchange rate. It is likely that a potential foreign investor who offers roubles for sale in currency auctions will get an extremely low exchange rate, because in FEZs there will be no real incentives for any economic units (local or foreign) to offer CC for conversion. At the same time, it is likely that roubles in large amounts will be offered for sale.

Ivanov's proposal further deals with currency and customs regimes as well as management of FEZs. It is noteworthy that primarily rouble transactions are proposed, although all the economic units of a zone will have the right to have CC accounts. Every FEZ is supposed to have its own bank, in which Soviet and foreign banks can be shareholders. It is mentioned that the Bank will be involved in buying and selling CC at official rates and in auctions at the market rate of the rouble.

The work done for Ivanov's paper is a clear sign that the Soviet Union is seriously interested in the FEZ idea. Prolonged preparation of rules concerning them has certainly hampered FDI into the Soviet economy, because presumably many potential investors have waited for the ultimate creation of FEZs.

It is assumed that the first such zone is to materialize between Vyborg, near Leningrad and the Finnish border. Other areas, for example in the Far East and on the Black Sea coast, are under consideration.

The development of Soviet rules concerning FDIs has been a trial and error process. One Soviet observer, A. Polyukhov writes, that few countries have no laws governing their foreign economic activity. The USSR is one of them. Resolutions and other acts are not taken seriously in the West. In his opinion, business always involves a certain amount of risk, but real businessmen are not willing to take stupid risks: show us the law, they say, which formally lays down the legal status of a foreign entrepreneur in the USSR and of the special economic zones on the Soviet territory, and then we shall think about cooperation. 220)

The same writer adds:

> "Bureaucrats have assured us that as soon as we open the door to the West by as much as a crack, Western millionaires would come rushing in to help build socialism in the USSR at their expense. No such invasion seems forthcoming, although the door has been flung open". 221)

Even if comments made by Polyukhov describe the Soviet situation concerning FDIs in the late 1980s by and large correctly, there has been considerable interest among foreign investors to utilize the opened door policy, although final legislation including FEZ rules has been missing.

In the autumn of 1989 Ivan Ivanov stated that the Soviet Council of Ministers (government) has taken the decision to establish three FEZs in 1990. One of them will be in Nahodka (Far East), one in Vyborg and one in Novgorod. In each region mentioned the local authorities and population support the new idea of FEZ. It is also stated by Ivanov, that experience collected in the three regions mentioned will constitute a first phase, whereafter more similar zones will be established.222)

3.4.6.2. Soviet experience with Joint Ventures

Of the 18 JVs formed with Western partners in the USSR by the end of 1987, the 11 industrial undertakings have a relatively high capitalization compared with JVs established elsewhere in the CMEA area in recent years. For example, the joint company set up by Sandoz A.G. of Switzerland with the Union of Soviet Dyes Factories (Soyuzanilprom) has an equity capital of SF 10 million.223)

A Soviet–Italian JV, Sovitalprodmash, formed by the FATA European Group of Turin and the Soviet production association Volzhskprodmaxh, has an initial equity capital of USD 30 million, of which 85 per cent will be borrowed from a consortium of Italian banks. The joint undertaking plans to produce industrial refrigeration and deep–freezing equipment. 224) By comparison, the Soviet–French JV Technicord set up by a subsidiary of CEA Industries and a Soviet institute has an initial equity capital of FF 4.0 million. It plans to have an annual turnover of FF 25 million from the sales of hot metal spraying systems.225)

The flexibility in managerial arrangements permitted by the Soviet legislation is evident in the JV by Finnair and Intourist. The Finnish partner's desire to maintain a high standard of service led it to negotiate the right to appoint line management for the hotel, including the hotel and restaurant managers, the kitchen chef, and the managers for marketing and reservations. As the Soviet partner has a 51 per cent shareholding, it appoints the majority of the board and the general manager. 226)

According to the FATA agreement, each side is required to invest only 12 per cent of their nominal equity; the balance will be borrowed in the name of the joint company from the USSR Bank for Foreign Economic Relations, which thus takes most of the risk of financing the formation of the JV. It should be added that the USSR Bank for Foreign Economic Relations and the USSR State Bank have set up a joint working group with several west European banks to examine the possibility of establishing a jointly–owned bank in the USSR for lending to East–West JVs. 227)

The initial capital of some JVs in the service sector is of a considerable magnitude. The joint enterprise formed by Finnair and Intourist to refurbish and operate a hotel in Moscow has an authorized capital of 10.2 million roubles. 228)

Finnair based its initial calculation of return on its 40–45 million Finnish markka (FIM) capital on an eight–to–ten year period. 229)

One of the first Finnish–Soviet JVs is between Sadolin (a subsidiary of Nobel, Sweden) and Estkolhozstroi in Estonia. Sadolin has some 10 years of experience on the Soviet market. In 1984, Sadolin sold the production licence and production line of various wood impregnation agents to Estonia. This production line is now put at the disposal of the JV, on a leasing basis. 230)

Sadolin has 40% of the JV capital. The annual general meeting consists of the management board, which has four members from each side. Responsible to this Board is the Directorate, which is equivalent to a Board of Directors in a western–type joint stock company. This structure may be considered more efficient in managerial terms because a relatively small number of key executives from each side, operating at two levels of decision–making, replace the more cumbersome annual general meeting. 231)

Homatek JV was established by Ordzhonikidze Machine Tool Factory in Moscow and the West German Heinemann in 1987. These partners had previously cooperated for many years. In 1988, Homatek started manufacturing metal–working machine tools, producing 20 pieces in 1988 and 50 in 1989. A new production building will be erected for the JV. 232)

Two long–standing partners, the January Uprising Heavy Crane Factory in Odessa and the West German Liebher established their JV in the autumn of 1987. A new building for assembling high capacity cranes is under review. 233)

Lenwest is a JV in Leningrad, in which the well–known West German shoe–factory Salamander is the Western partner. The agreement was signed in 1987, and after that an old plant in Leningrad has been modernized and production started in 1988. In the same year Salamander concluded the second Soviet JV agreement. 234)

The Soviet–Italian R & D firm Sinion has been formed in Moscow. Its founders are the Giprokauchuk research institute, the Sintez–Kauchuk production amalgamation, and the Italian Press–industria, an old trading partner of Soviet FTOs.

Sinion is to develop and improve ecologically clean production processes, special equipment for petrochemical synthesis and, particularly, equipment for manufacturing synthetic rubber.

The Bakmil JV has been set up to meet the requirements of the consumer goods market; its partners are the Bakkonditsioner production amalgamation in Baku and the Italian design firm Merloni Progetti, a division of the Merloni group. Bakmil is to manufacture modern, rather scarce household electric appliances (mincing machines, food mixers, coffee grinders) and small electric motors for articles of this kind. The JV has all the prerequisites of success: Bakkonditsioner's experience and export of household electric appliances and Merloni's ability to manage the manufacture and marketing of this kind of product.

The Baku works – their new workshop will come into operation at the beginning of 1990 – will annually manufacture 1.5 million micro motors and 750,000 compact household electric appliances. The JV's share capital is as follows: Bakkondisioner contributes 72% and Merloni Progetti 28%. Moreover, the Soviet partner will supply the site and ensure the factory's construction, and the Italian firm will deliver the production lines for the complete manufacturing cycle, organize production and train personnel.

Guidance documents have been signed with the Italian firm Rest–Ital to set up a JV in Alma Ata to produce and export fashionable astrakhan clothes.

Soviet–Canadian mutually beneficial economic cooperation has resulted in the JV Tavria Magna. Its partners are AvtoZAZ, the Zaporozhye motor vehicle production amalgamation and Canadian Magna–International. Tavria Magna is to produce and market medium– and large–sized moulds for plastic products and apply the latest technology, advanced management methods, material, economic and moral incentives to its work. The Canadian firm's experience in management, manufacturing and marketing moulds should prove to be a great asset.

AvtoZAZ's share is an industrial and office building, basic and auxiliary equipment and financing in roubles.

Magna–International is to invest in the purchase and delivery of manufacturing equipment, transfer know–how and train personnel.

Agreements have been signed to set up a Soviet–Swiss JV, Diaplus, in Moscow with a view to manufacturing and marketing medical instruments for immunity diagnosis. Its founders are the research and production amalgamation Biotechnologia of the USSR Ministry of Medical and Microbiological Industry and the Swiss Hoffman la Roche. The purpose of the JV is to improve the methods of diagnosing some diseases. It will manufacture immunity diagnosis instruments to protect mother–and child health and fight against cancerous and infectious diseases. 235)

Negotiations on establishing the first joint bank in the Soviet Union started in June 1988; and an agreement concerning the creation of International Bank of Moscow was signed in February 1989. In this first joint financial institution on the Soviet soil there are five participants from the West, all of which are from Western Europe:

- Credit Lyonnais (France)
- Banka Commerciale Italiana (Italy)
- Creditanstalt-Bankverein (Austria)
- Bayerische Verensbank (West Germany)
- Kansallis-Osake-Pankki (Finland)

All the five Western banks participate in the joint bank's basic capital of Rbl 100 million with an equal share of 12%. In addition, there are three Soviet banks as shareholders, Vneshekonombank with a 20% stake, Promstroibank and Sberbank with 10% each.

International Bank of Moscow will be dealing with roubles,as well as with CC. 236) Therefore, the first join bank in the Soviet Union can be described as an on-shore bank, unlike the first joint bank in Hungary (CIB) which started business on an off-shore basis.

The basic joint bank capital of SUR 100 million (some USD 150 million) of which SUR 40 million will be immediately paid, is extremely high in comparison to the average capital of the other JVs established in the Soviet Union in the late 1980s. 237) This is not surprising: also in Hungary financial institutions established with foreign partners have much higher initial capital than JVs in average.

Two interesting further observations can be made in connection with the first joint bank on Soviet territory. Firstly, the Soviet side is in minority position among the shareholders. Secondly, not only the VEB (Vneshekonombank), which has the monopoly position in CC dealings, in the Soviet Union is among the Soviet shareholders, but also the Bank for Industrial Construction holds shares. In fact the Soviet banks are looking for new ways, in order to get involved in the CC business. Joining JV-banks provides an opportunity for that.

3.4.6.3. Overall assessment of the first FDIs in the USSR

The Soviet economic weekly "EG" has published lists of established JVs in the Soviet Union. In January, 1989, 200 JVs were already established.

This result, after only two years after the coming into force of the first Soviet JV rules, is rather encouraging. Compared with Hungary, the most successful small European CMEA-country in JVs, the Soviet results in the first two years are striking; in Hungary it has taken almost two decades to attract about 200 FDIs, during which the legislation has been radically improved.

However, among the first 200 units in the USSR small units are in a predominant position: 42.5% of the JVs have an equity less than one million Roubles (USD 1.56 million). 238) About one third of the Soviet JVs have a starting capital of Rbl 1–5 million (USD 1.56–7.8 million). In almost one fourth of them the equivalent figure is over Rbl 5 million. In cases of JV–partners coming from other CMEA–countries the equity is given in TR; these cases account for 2.5% of the total equity of the first 200 Soviet JVs (See figure 1/3.4.6.3).

Among the 200 cases there are 26 units (13%), in which the founding capital is Rbl 10 million or more (over USD 15.6 million). The highest single investment is Rbl 47.7 million, in the Homatek machine tool venture, in which West German Heinemann has a 32% stake. After that there are two units a with Rbl 30 million equity; in one of them, Usolyefarm, the foreign partner is from Bulgaria (chemicals), and in the other, Altair, from France (machine tools).

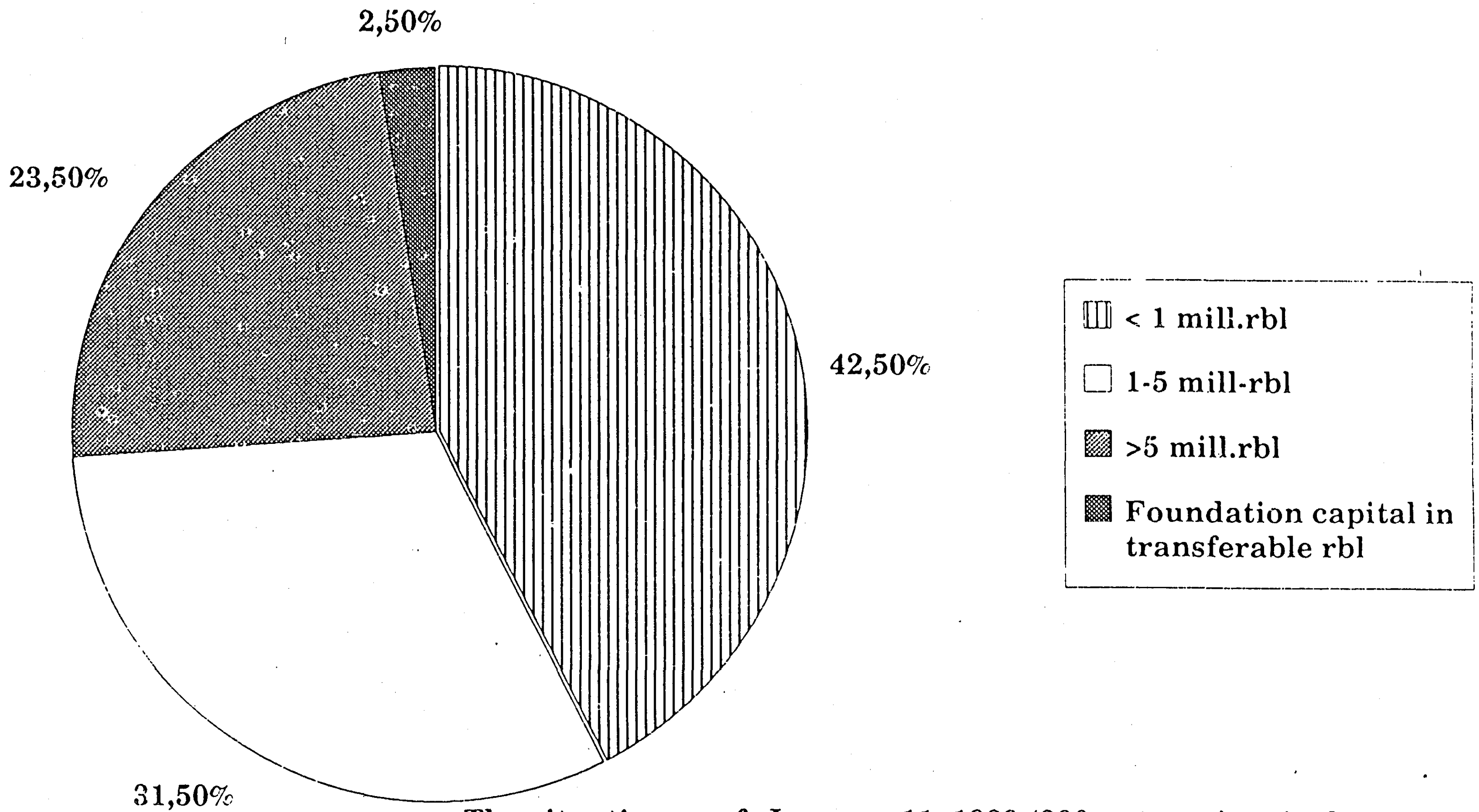
There are in addition to these three ventures six more with a founding capital of over Rbl 20 million (USD 32 million). Sovplastital with Rbl 23.6 million involving Alma Rose from Italy (22%) is active in plastic consumer goods; Pilenga Godo. JV, in which the Japanese firm Hokne Godo, participates in fish processing with a 49% stake. This JV has a capital of Rbl 21.6 million; The Sedin–Shiss engineering company, with the West–German party Schiess AG (49%) has a starting capital of Rbl 20.5 million; Volmag JV, also in engineering, has a capital of Rbl 27.8 million, of which MAG from Austria owns 30%; Sovpolijuplas, a plastic consumer goods unit, has a capital of Rbl 28.6 million, 49% owned by Yugoslav Pancevo; Sovbutital JV is 30% owned by Italian Pressindustria, and produces chemicals with a starting capital of Rbl 38.3 million.

The average size of investment in the first 205 Soviet JV was Rbl 1.63 million (USD 2.5 million). Only around 30 of them were known to be fully operating in mid–1989 239).

In almost half (99 cases) of the 200 first Soviet JVs the foreign party had a stake of less than 49%, which had been the maximum foreign share before the December 1988 Decree. It is rather amazing that in about half of the cases the foreign partner has been satisfied with less than this 49% of the equity.

In one case, the foreign party has a clear majority (54%), in the Varian JV, which is partly owned by the Pravets combine from Bulgaria. In three more cases the capital is shared fifty–fifty; in two of them the foreign party is Bulgarian, and in one case Polish.

The Foundation Capital of Joint Ventures in the Soviet Union



The situation as of January 11, 1989 (200 enterprises incl.)

Source: Own calculations based on Soviet JV list

Figure 1/3.4.6.3

Most of the Soviet JV partners come from Western Europe. Out of 200 units 121 (60.5%) partners are from this area. Scandinavian companies are involved in 29 cases (14.5%). (See figure 2/3.4.6.3.)

Two West European countries, West Germany (26 participations), and Finland (25) have had the most active companies involved in establishing JVs on Soviet territory. These two countries have traditionally been the most important Soviet trading partners among the OECD-countries, alongside Japan. (See figure 3/3.4.6.3.)

Quite clearly German and Finnish firms have been confronted with difficulties in their exports to the Soviet Union in the second half of the 1980s, when oil price cuts have negatively affected Soviet purchasing power. This negative tendency has been especially clear in Finnish-Soviet trade, which traditionally is conducted on a bilateral clearing basis.

Thus, it is only natural that German and Finnish firms have been intensively looking for new methods to develop their Soviet business. They are trying to maintain their competitive positions through direct investments.

A bilateral clearing payment system is certainly not optimal for international factor mobility. This has been experienced by Finnish companies in JV activities on the Soviet market.

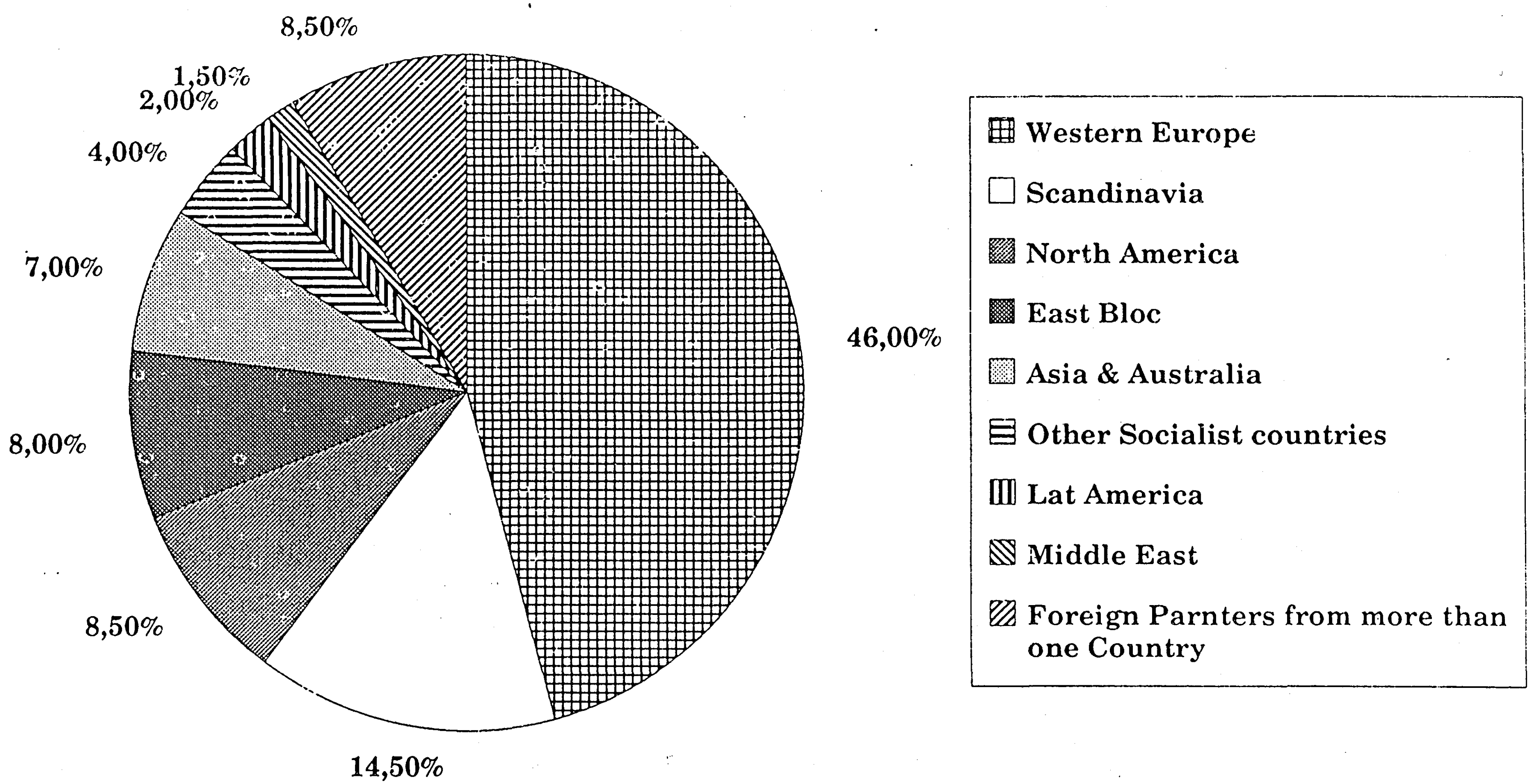
According to the rules of the Bank of Finland (Central Bank), FDIs in clearing countries need authorisation. In permit applications three points must be considered: firstly, the capital share may either be transferred in the form of CC or via the clearing account, or in natural form, whereby a combination of these is allowed; secondly, JV products exported to Finland must be paid for via the clearing account; thirdly, repatriation of profits must in all cases take place in CC form. The same is true when the capital share is repatriated or sold to a third party and capital brought back to Finland. 240)

The authorities in Finland maintain that capital transfer from Finland to the USSR is allowed in CC, in spite of the clearing arrangement between the two countries. If at the same time CC exports to Finland from a Finnish-Soviet JV is allowed on a CC basis, the result would be the subversion of the whole clearing system.

From the point of view of the Finnish companies these rules of the Central Bank are naturally unpleasant. Exports to Finland from JVs operating in the Soviet Union add nothing to the CC account of the JV, making profit repatriation a difficult task. The Finnish-Soviet JVs must therefore earn CC either by internal export or by exports to third markets, in which payment is in CC form. One additional possibility is naturally to

Figure 2/3.4.6.3.

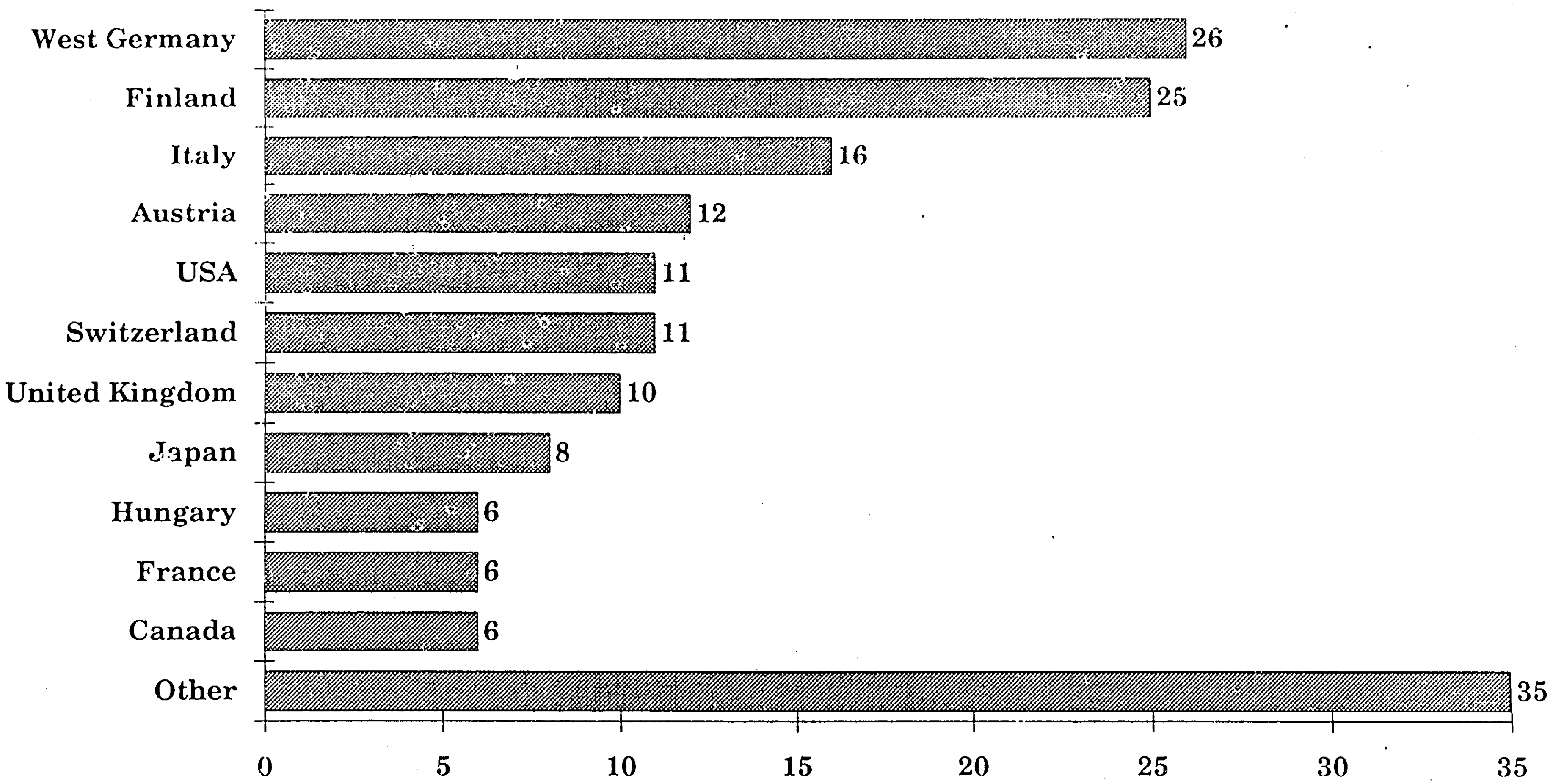
The Origin of Foreign Partners of JVs in Soviet Union



The situation in 11.01.89 (200 enterprises incl.)

Source: Own calculations based on Soviet JV list
Figure 2/3.4.6.3.

Number of JVs in the Soviet Union by Partner Country (as of December 31, 1988; 172 JVs included)



Source: PlandEcon op.cit.

Figure 3/3.4.6.3.

use transfer pricing: the Finnish parent company buys cheaply from the Soviet subsidiary, or the parent company sells dearly to her Soviet JV. In both cases the Finnish participant of a Soviet JV may get the calculated profit in proper form (FIM).

In the Finnair hotel case mentioned before, the method of internal export is used. JV hotel capacity will be sold to Western business people, mainly from Japan, who pay in CC. Thus, the clearing problem can be avoided.

Rauma–Repola is one of the most international firms in Finland. It has established Lenraumamebel JV in Leningrad together with Sevzapmebel. This JV has started operating a furniture factory in Leningrad, in which the total investment is over Rbl 30 million. About 80% (Rbl 25 million) of the investment is financed by bank loans. The capital of the venture is Rbl 5.4 million.

Machinery for Lenraumamebel is provided by Swedish Kährs Maskiner, which is a subsidiary of Rauma–Repola. End–products of the JV – furniture components – will be partly sold to Sweden, probably to IKEA. No exports to Finland are under consideration. 241) This case shows how international operations come into picture, when Finnish companies invest in the USSR, aiming at profit repatriation in CC form.

After the December 1988 Decree on Soviet foreign trade currency auctions are possible in the USSR. Thus, there is a theoretical possibility for the Finno–Soviet JVs to sell earned Finnish–Soviet clearing against CC in deals with other Soviet firms. Experience from these auctions is still meagre. The big question in this context is, who in the Soviet Union is ready to exchange CC for anything else, that is, for any other medium of payment. If this theoretical case materializes, it is clear that the price of Finnish–Soviet clearing is certainly not favourable to the seller, when the exchange rate vis–a–vis CC is formed under the influence of supply and demand.

It is, thus, understandable that investments made by Finnish companies in the Soviet Union are mainly small ones. The Finnair hotel has the highest capital, over Rbl 10 million. Raute and Schaumann produce plywood in Novgorod in a JV with a Rbl 6.3 million capital. Lenraumamebel, the third largest unit, and Nokia's cable unit both have a capital of over Rbl 5 million, while the other 21 JVs have a really small capital.

West German companies, which participate in 26 of the first 200 Soviet JVs, have also made only a few large investments. Heinemann's outlet, mentioned before, with about a Rbl 48 million capital is the biggest among them. Schiess AG has a share in a company with Rbl 20.5 million. Mineralöl–Rohstoff Handel is a party in a chemical JV with Rbl 9.4 million capital and Dürkopp Werke in a engineering venture with a Rbl 7 million capital. It is thus obvious that also German firms are reluctant to start JV business in the Soviet Union with a high capital stake.

Among the German–Soviet JVs there is one special case worth mentioning. It is called Mezhnumizmatika, in which the "Western" party is Ost–West Handelsbank in Frankfurt, which is a wholly Soviet owned financial institution. In Mezhnumizmatika, which obviously provides services for those who collect coins and banknotes, Gosbank has a 45% share, Vneshekonombank 50% and the "German" party, Ost–West Handelsbank, 5%.

After West Germany and Finland of West European countries Italy (16 JVs), Austria (12), Switzerland (11), and the UK (10) have been the most active in establishing JVs in the Soviet Union (regarding the first 200 cases). France (6), Luxemburg (3), Liechtenstein, Cyprus (2), Sweden (2), Denmark (2), the Netherlands (1), Ireland (1) and Spain (1) have also invested directly in the Soviet economy.

Italian firms have a stake in several relatively big investments, such as the biggest Italian JV Sobtutital in Tynmen with a Rbl 38.3 million capital, of which Pressindustria SpA owns 30%. This venture is active in the chemical industry.

There are also some Austrian firms in some larger projects. JV Volmag, which operates in engineering, has a starting capital of Rbl 27.8 million, of which the Austrian company MAG has 30%.

The highest starting capital in a Soviet JV with a Swiss partner, is Sadko in consumer goods production. The equity is Rbl 17.6 million, of which the Western party, Hopf Ltd, owns 49%. Firms from the UK are not participating in any bigger equity ventures. For example, Rank Xerox JV has a starting capital of only Rbl 0.7 million.

Both the USA and Japan have been investing in Soviet JVs very modestly. The former non–European country is a partner in 11 cases and the latter in 8 cases among the first 200 Soviet JVs.

Combustion Engineering (US) has a 40% stake in a chemical venture, in which the starting capital is Rbl 5.15 million plus USD 8 million, or altogether some Rbl 10.5 million. Management Partnerships International (US) has a 21.8% share in a Soviet electronics venture, in which starting capital is Rbl 15.4 million. The fast food giant McDonalds is participating in a Rbl 15 million venture in Moscow, but in this case the partner is the Canadian subsidiary of McDonalds.

Japan has been remarkably slow in starting JVs in the Soviet Union. From 8 ventures the two biggest ones are active in fishing and fish processing, one with a Rbl 21.6 million and the other with Rbl 7 million starting capital. For the host country the Japanese investments have been disappointing in quantitative, as well as in qualitative terms; no clear high-tech areas are involved in Soviet-Japanese JVs.

From non-European OECD-countries Canada is involved in 6 and Australia in 2 cases. From NIC and the developing countries Singapore, India, Syria, Kuwait, Venezuela, Panama and Brazil have invested in the Soviet Union. Brital from Brazil is involved in the medical field in two Soviet JVs, both of which have a considerable starting capital: in one case USD 15 million (about Rbl 10 million) and in the other USD 20 million (about Rbl 13 million).

From the other CMEA countries Bulgaria has been the most active in the Soviet JV business, participating in seven outlets out of 200. It has been mentioned above that a chemical JV with Bulgarian participation is one of the biggest JVs with a Rbl 40 million starting capital.

Hungary has a stake in six cases, of which none are spectacularly big judged on the basis of starting capital. Sovventekstil JV with a 33% Hungarian share has a starting capital of Rbl 7.2 million.

Poland is involved in two cases and the CSSR in one. All three cases are extremely small, with starting capital less than Rbl 1 million in each.

Yugoslavia, China and North Korea are also parties among the first 200 Soviet JVs, Yugoslavia in 6 cases and China and North Korea in one each. Yugoslav investments are relative large, the largest being the polyethylene factory for consumer goods mentioned before with starting capital of almost Rbl 30 million.

In addition, there are 17 cases in which there are partners from more than one foreign country. In 33 (16.5%) cases there is more than one foreign party participating in a Soviet JV, and thus, in 16 cases there are two or more partners from the same country.

Among these cases there are highly interesting ones, in which enterprises from both socialist and capitalist countries share the foreign stake in a Soviet JV. Hungarians especially are involved in these combinations, being a party in four JVs together with a Western partner. Internationalization of capital is really advancing in all possible combinations.

It was already mentioned that the Soviet owned bank in Frankfurt is the "Western" party in one Soviet JV. In the Finest Hotel Group, an JV in Estonia, there are three parties from Finland, Arctia (a hotel chain), Suomen Rakennusvienti (a constructing company) and Saimaa Lines (a travel agency). The last one is a Soviet owned Finnish company. In Sherhotel JV (Moscow) there are parties from France (2), Belgium and the UK. The UK party is Moscow Narodny Bank, the Soviet owned financial institution in London. These cases give evidence of the internationalization of the global economy, with Soviet economic organizations outside of the country participating in JVs inside the USSR.

It is extremely difficult to classify the field of JV activities in the Soviet Union on the basis of local information. The following picture, however, cannot be far from the truth. The consumer goods branch (including food processing) is in the lead with 17.5% of the 200 cases under review. This branch has, naturally, a huge, endless demand on the Soviet market, and therefore, the leading share is understandable. (See figure 4/3.6.4.3.)

Second place is taken by projects, consulting and education. This group with 13.5%, as well as the next one, "other services" with a 13% share, include a multitude of activities, not, however, including computer software and hotel and restaurant services.

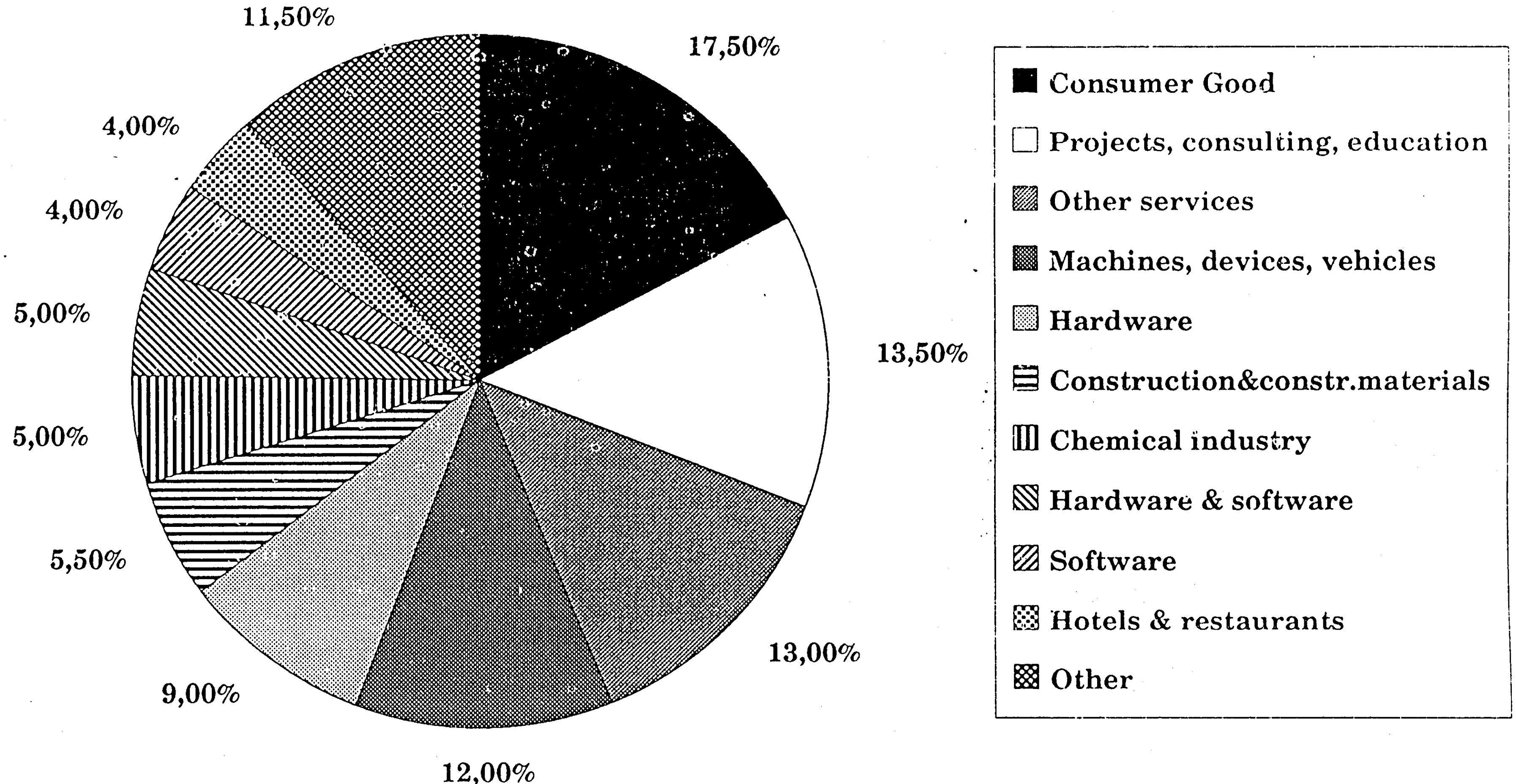
Engineering is certainly a field where cooperation is very much hoped for by local authorities. This branch is rather well represented with 12% of the JVs. As was pointed out above, large, solid enterprises have been created among Soviet JVs in this important branch.

Electronics and various computer services seem to be a favourite branch of joint venturing in the Soviet Union. Hardware accounts for 9% of the JVs, combined hard and software activities for 5% and software alone for 4%, which makes 18% altogether. It must, however, be beared in mind, that these figures are counted on the basis of JV units. A considerable number of these units are small, and with little economic substance judged on the basis of the capital invested in them.

Construction and construction materials are branches which form bottlenecks in the traditional Soviet economy. These branches account for 5.5% of Soviet JVs. The reason for this relatively small share seems to be obvious: in the internal market the prospects for construction with CC financing have deteriorated since the mid–1980s with the oil price drop; construction materials are expensive to transport; the Soviet labour force is not easily transferred to export markets. Taking these points into account, one can say that the JVs active in this sphere have no easy task to earn CC income.

Figure 4/3.6.4.3.

The Sphere of Activity of Joint Ventures in the Soviet Union



The situation as of January 11, 1989 (200 enterprises incl.)

Source: Own calculations based on Soviet JV list

Figure 4/3.6.4.3.

The chemical industry is surprisingly thinly represented among the first 200 Soviet JV, with only 5%. However, in this branch the investments are relatively large, in average over Rbl 11 million, in comparison to the Rbl 1.6 million average equity overall.

The chemical industry has naturally a tremendous potential for joint venturing, when the Soviet raw material base is combined with foreign capital and know-how. It was pointed out earlier that in technology exchange between West and the Soviet Union, the chemical branch played a leading role before the JV era, normally taking the form of direct compensation (buy-back) deals. Large, multimillion dollar projects were carried out in this way.

Extremely large deals have been under discussion in the JV business, for example, with A. Hammer's Occidental Petroleum. Final JV agreements in these large projects have, however, not been signed during the first two years of validity of the Soviet JV regulations.

Previously, there was no really active and visible environmentalist group in the Soviet Union. Now under perestroika and glasnost the opposite is true: various groups have emerged and writings about the protection of nature have appeared in the Soviet press. A part of these writings is directed against the Western capital ready to participate in the exploitation of Soviet natural riches just in the field of the chemical industry.

An excellent example of these writings is provided by the famous novelist Valentin Rasputin, who points out:

> "The West is glad to curtail energy consuming and ecologically hazardous production in their own countries, while turning the USSR into a world supplier of polymer raw materials and the Tynmen Region into a world toilet. None of the industrialized countries are major exporters of polymers, because of the unprofitability of exporting them... Europe and America, by the way, are scrapping all such production and large-size petrochemical plants and moving them further away from their own borders. But we, by offering a warm welcome to them, have made ourselves vassals and demonstrate our inability to look into the future and consider the well-being of generations to come". 242)

This quotation shows clearly that the previous gigantomania in the Soviet Union is becoming old-fashioned, or at least, that it is not shared by everybody any more, while the environmental lobby is gaining importance. It is not possible to go into detail in discussing the issue of Soviet environmental problems here. It is sufficient to point out that, according to an opinion poll made in the USSR, pollution is considered the most burning problem by Soviet citizens (by 87% of the interviewed), coming before shortages and bad quality of foodstuffs, and accommodation problems. 243) Thus, V. Rasputin is not alone with his critical remarks, which are directed against huge FDIs in the chemical field.

Economist V. Sheetov brings up a similar viewpoint to Rasputin's in the magazine New Times:

> "Addressing the congress of People's Deputies of the USSR (parliament), writer Belov read out a letter from the voters in which they asked him to submit legislation to the Supreme Soviet asking it to abolish all the deals on leasing out parts of the Soviet territory to foreign and joint companies, on banning such deals in the future and abolishing all concessions and leaseholds" 244)

Sheetov himself is in favour of FDIs, but the example given by him shows that there is popular resistance against all FDIs in the Soviet Union.

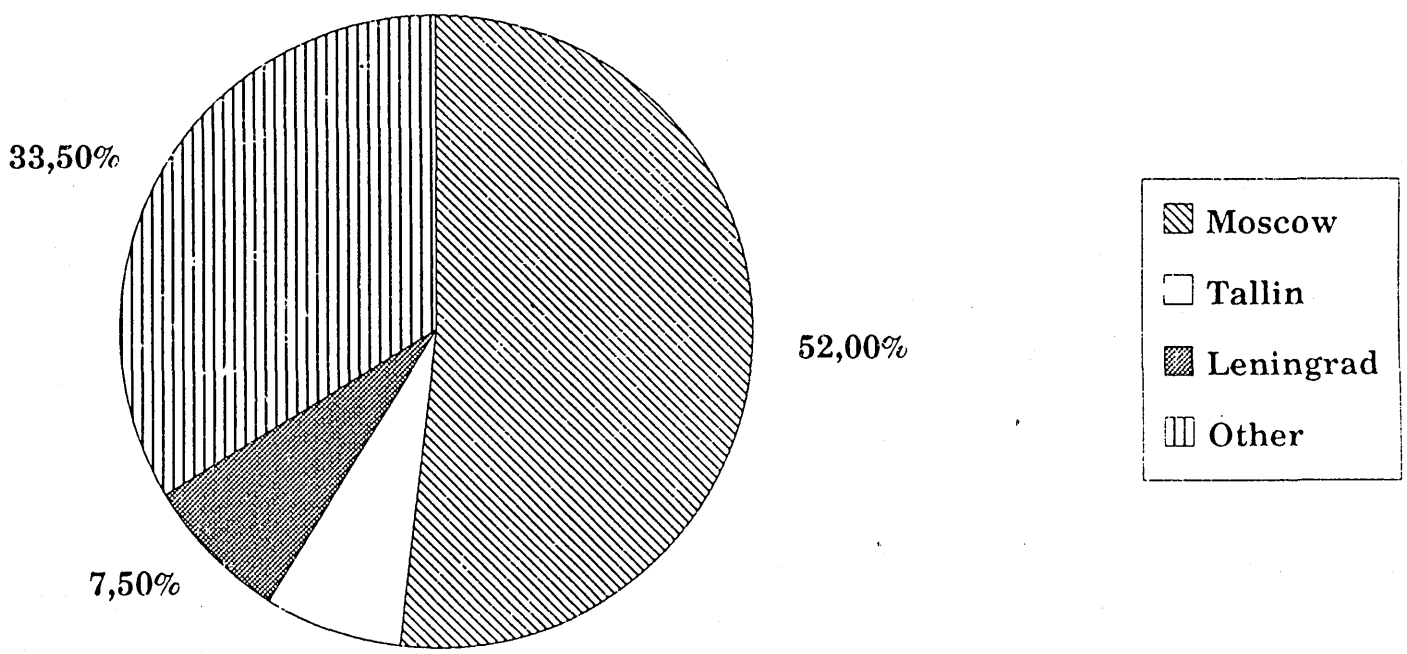
Hotels and restaurants are represented with a surprisingly low percentage of only 4% among the first 200 Soviet JVs. Some of these ventures have a relatively high starting capital (McDonalds about Rbl 15 million and Finnair about Rbl 10 million), but no really huge sums are involved like in certain Hungarian cases. It can be assumed that ventures in this branch are thus relying heavily on credit financing. It can also be assumed, that this field has had a slow start, but that revival is to be expected, because in the hotel and restaurant business the huge advantage of being able to earn CC conveniently is given.

The geographical distribution of the first 200 Soviet JVs shows clear concentration in the capital city of the USSR: 52% of the JVs are active in Moscow. Leningrad, the second most important industrial centre, has been able to attract only 7.5% of the first 200 JVs. Tallin, which is in the Soviet framework a relatively small city with some 0.5 million inhabitants, comes next with 7%. Here the special cultural and linguistic link between Finland and Soviet Estonia has played a decisive role. Almost all the JVs in Tallin have a Finnish partner. (See figure 5/3.6.4.3.)

The Soviet writer D. Blagutin has received similar results by analysing the first 207 Soviet JVs. 245) According to him, 99 JVs are operating in Moscow, and 14 in

Figure 5/3.6.4.3.

The Locality of Joint Ventures in the Soviet Union



The situation as of January 11, 1989 (200 enterprises incl.)

Source: Own calculations based on Soviet JV list
Figure 5/3.6.4.3.

Leningrad. Other parts of the European RSFSR have 22 units, Baltic republics 21 and Ukraine 12. The Far East and Siberia have only 10. (See table 1/3.6.4.3.)

Table 1/3.6.4.3.

Region	Number of JVs
Moscow	99
Leningrad	14
European part of the RSFSR	22
Baltic republics	21
Ukraine	12
Far East and Siberia	10
Georgia	9
Uzbekistan and Azerbaijan	3 each
Armenia and Byelorussia	2 each
Kazakhstand and Moldavia	1 each

Source: D. Blagutin: The Technological Spectrum of JVs on Soviet Territory. Foreign Trade (Soviet) No 4/1989

Blagutin has a slightly different grouping of the activity of JVs. His analysis shows also that electronics, informatics and computers have the highest share, 19.3% of all. Mechanical engineering and the light industry account for 12.1% each. The food industry is taken into the same group as restaurants, giving 11.6% for this branch. The chemical industry's relatively low share of 8.2% is visible also in his statistics. (see table 2/3.6.4.3.)

Table 2/3.6.4.3.

	Group	Number of JVs in a group	Percentage of the total number of JVs
1.	Electronics, informatics and computing machines	40	19.3
2.	Mechanical engineering and metal-working	25	12.1
3.	Chemicals and petrochemical industries	17	8.2
4.	Light industry, manufacture of consumer goods, leisure-time and sports industry	25	12.1
5.	Construction and manufacture of building materials	22	10.6
6	Food industry, national-cuisine restaurants	23	11.6
7.	Mediatory after-sales and publishing services	55	26.6

*Based on the List of Joint Ventures Registered with the USSR Ministry of Finance (207 ventures as of January 17, 1989)

Source: D. Blagutin: The Technological Spectrum of JVs on Soviet Territory. Foreign Trade (Soviet) No 4/1989

The same Soviet observer points out that two thirds of the JV partners come from Western Europe. Socialist country partners are involved in 13.5% of all the 207 cases. (see table 3/3.6.4.3.)

Table 3/3.6.4.3.

Group No	From W.Europe	From EEC countries	From CMEA countries Yugoslavia PRC, DPRK
1	25	15	11
2	21	13	3
3	11	6	4
4	19	12	4
5	15	4	1
6	12	7	1
7	36	19	4
Percentage of the total number of JVs	67.1	36.7	13.5

Source: D. Blagutin: The Technological Spectrum of JVs on Soviet Territory. Foreign Trade (Soviet) No 4/1989

Blagutin complains that some Western partners are not willing to transfer the most progressive technology as their contribution to JVs. This attitude causes, according to him, complications when JV products are sold on the world market. As a potential solution he recommends that export responsibility be placed on the Western partner. However, he remarks that his solution cannot be universal, because exporting JV products is already experienced as problematic by Western partners, small and medium-sized above all. 246)

Undoubtedly, the main problem of Soviet JVs has been touched here. The highest possible levels of know-how are wanted by the Soviets, whereas the Western partner is supposed to take over the responsibility for CC earnings of the JV. No optimal and general solution is in sight for this dilemma as long as the inconvertibility problem of the host country money exists.

The first comprehensive Western study of Soviet JVs was made by the American firm PlanEcon. 247) Some interesting details are included in this study.

Firstly, PlanEcon registers a clear acceleration of JV registration in 1988, and expects a further acceleration for 1989. However, it is estimated that at the end of the 1st quarter of 1989 no more that 20–30 JVs were fully operational.

For the first 205 JVs the average size of foreign investment was Rbl 1.63 million (USD 2.7 million). This average size has tended to decline with time. According to PlanEcon only three JVs among the first 258 registered before February 16, 1989 involved Western investment in excess of USD 20 million.

Of the 205 JVs registered, the majority – 162 (79%) – were with OECD countries, while 24 (11.7%) were with partners from socialist countries (including Yugoslavia), 12 (5.8%) with partners from the Third World and 7 (3.4%) involved partners both from the developed West and socialist countries, or from the developed West and the Third World. 248)

PlanEcon has calculated that in terms of size, JVs with socialist countries were typically of above–average size both in terms of average capitalization (Rbl 6.0 million) and average size of foreign investment (Rbl 2.6 million), while the corresponding figures in JVs with Western participation were Rbl 4.3 million and Rbl 1.6 million respectively. It is correctly stated that exchange rates are distorted undervaluing Western capital contributions in terms of hard currency as compared with socialist country investments in TR. 249)

PlanEcon has developed its own sectorial/industrial branch classification for Soviet JVs. Focusing on JVs involving Western partners (including those from the Third World and Yugoslavia), of the total of 172 JVs concluded as of December 29, 1988, the largest (19) number was in business services (consulting, organizational services, forwarding, export–import operations, advertising, etc.), followed by engineering services (13), general engineering (13), manufacturing of computers and related equipment (12), chemicals and petrochemicals (11), design and production of computer software (10), construction services (10), manufacturing of miscellaneous consumer goods (9), food processing (9), leather, fur and shoes (9), tourism services (8), public dining (6), miscellaneous consumer services (5), etc.

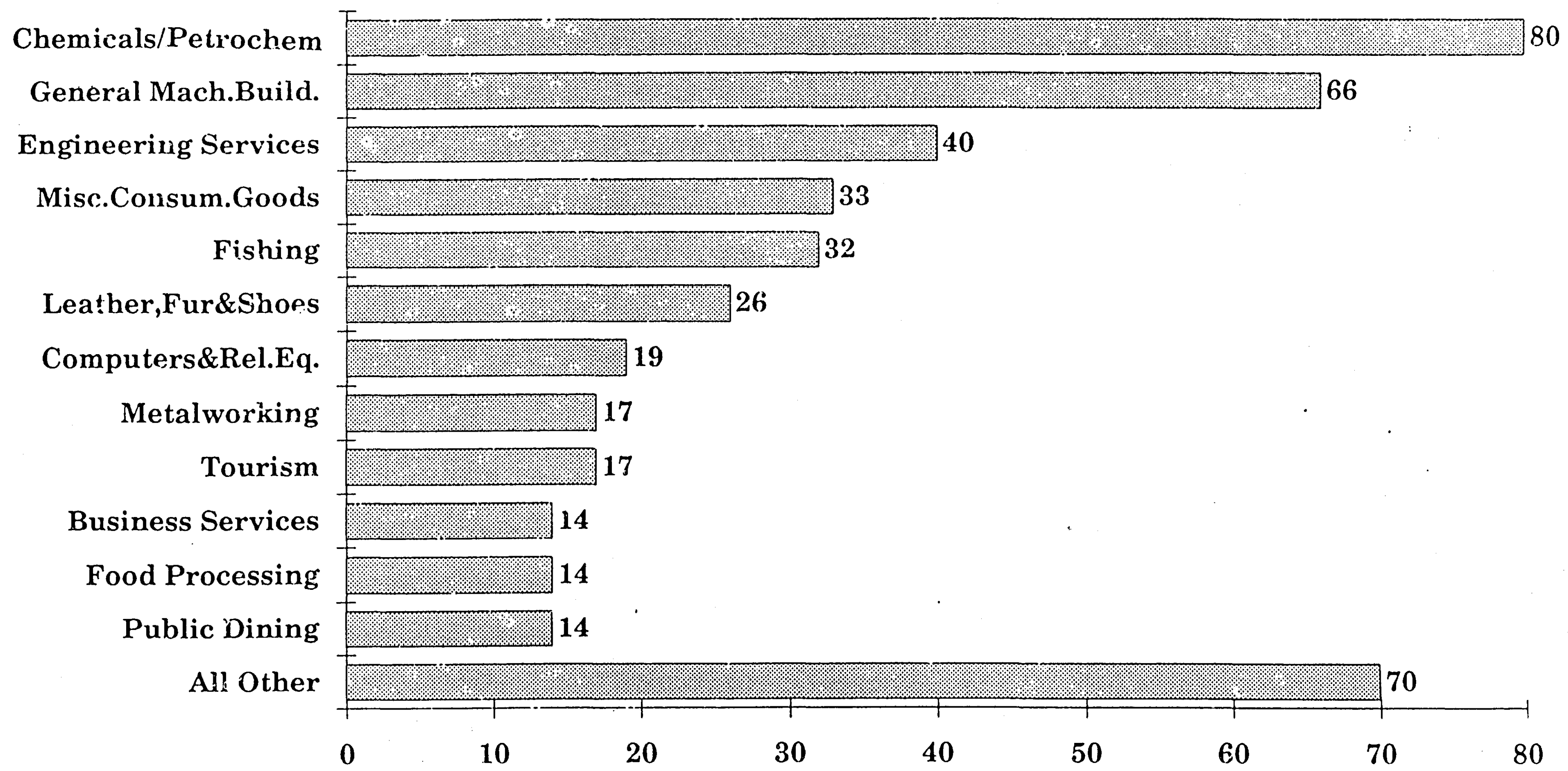
According to the calculations of PlanEcon focused on Western investments totalling USD 441 million, the largest portion went into chemicals and petrochemicals, followed by general engineering. (See figure 6/3.6.4.3.)

The average size of Western investment per JV was highest in metal–work followed by fishing and chemicals. 250)

There is some confusion in PlanEcon figures, when countries of origin of Western FDIs are tabulated. In particular, the figure for Austria seem to be overestimated with 26 cases tabulated. The list of JVs given by PlanEcon includes Austria only in twelve cases. Highly interesting is the calculation in terms of value of FDIs in Soviet JVs by partner country. The largest source of FDIs is West Germany, followed by Italy.

Figure 6/3.6.4.3.

Value of Western Direct Investment in Joint Ventures in the Soviet Union by Sector/Industrial Branch (in million dollars as of December 29, 1988; total = $441 million USD)



Source: PlandEcon op.cit. **Figure 6/3.6.4.3.**

Finland, which has approximately the same number of JV participations as West Germany, has invested only USD 36 million altogether. Thus, the Finnish investments are in average only about the half of the size of West German capital contributions.

When analysing the regional distribution of Soviet JVs, the PlanEcon study finds it very surprising that the bulk of them – 141 out of a total of 191 -- were concluded in the Russian Republic. The poor showing of the Ukraine is regarded as a real surprise. It is maintained, on the bases of regional data, that the real entrepreneurial spirit in the Soviet Union lies above all in Estonia and Georgia. When the average for the USSR as a whole was one JV per 1.48 million people, in Estonia there was 1 JV per 110,000 people and in Georgia 1 JV per 660,000 people. (See figure 7/3.6.4.3.)

PlanEcon draws some conclusions from the analysed data. Firstly, the initial capital of some JVs is rather low by design, as most of the capital is raised through borrowing: indirect Western investments supplement FDIs.

Secondly, it is noted that the initial capitalization in a JV is a very imperfect measure of the JV. Gross revenue earned would be a better measure of size, especially if one could also obtain information on employment and gross asset value. Thirdly, the JV activity of individual Western countries corresponds closely to the relative importance of these countries in Soviet trade, with the notable exceptions of Japan and the US.

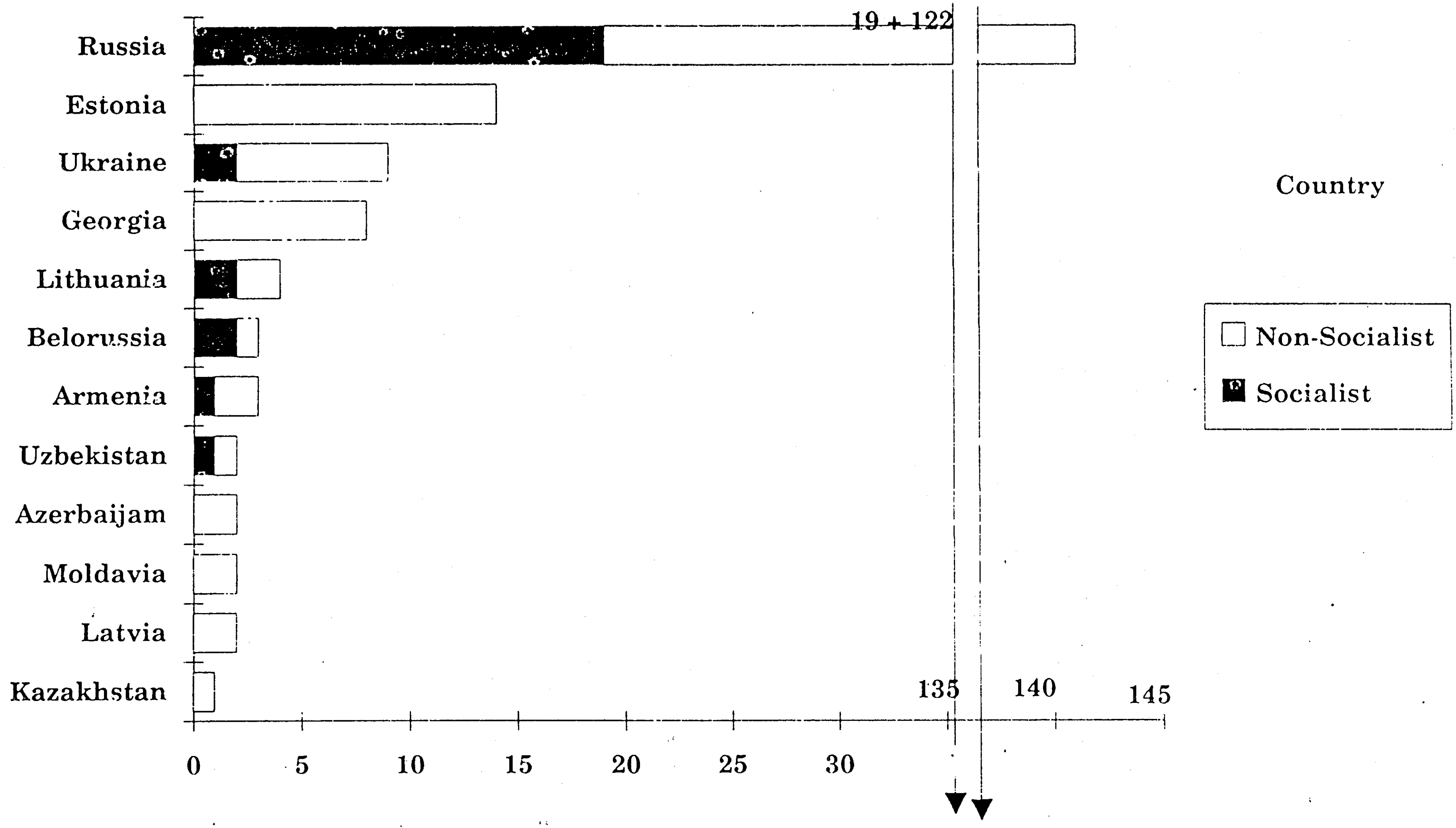
In connection with the last point, PlanEcon assumes that Japan and the US tend to negotiate relatively large JVs with the USSR needing more time for negotiations, and that they will, in the long run, start catching up with West Germany. No clear evidence is provided, however, to support this hypothesis.

At least one book on JVs has been published in the Soviet Union in 1989. This book 251) which has listed almost 300 Soviet JVs, is more a juridical guide–book than an economic analysis of JVs. At the end of the book it is stated that socialist countries have a relatively small share in the number of JVs established on Soviet territory. The author sees the main reason for the reluctance among socialist countries to make FDIs in the lacking harmonization of the tax systems. The obvious main handicap, the lack of convertible currency in the CMEA payment system, is entirely disregarded.

From the material available on Soviet JVs at the end of the 1980s it can be concluded, that the number of JVs has been increasing fairly rapidly since 1987, when the first rules for FDIs were released. One of the main reasons for this positive development certainly lies in the large market of the Soviet Union with nearly 300 million people fascinating

Figure 7/3.6.4.3.

JOINT VENTURES IN THE SOVIET UNION BY SOVIET REPUBLIC



Source: PlandEcon op.cit.

Figure 7/3.6.4.3.

many Western companies. Perestroika and glasnost also seem to be factors, which will improve the business climate between East and West.

An interesting study among Western companies about their Eastern business deals has been made by HR & H Consensus Research International. In this study altogether 688 companies in ten different OECD–countries were interviewed. 75 per cent of the companies questioned trade with the Eastern Bioc at present, and over 80 per cent of companies have had some trading experience. 252)

Some details of this HR & H study are of utmost interest from the point of view of the present topic. Firstly, a vast majority of Western companies (over 80%) see that the changes will improve the overall prospects for trade in the 1990s, while just 17% see the changes as actually inhibiting business. Glasnost is seen as an positive factor by 29% of the companies. (See figure 9/3.6.4.3.)

The Soviet Union is regarded as the most important trading partner in the East. About 30 per cent of the companies which trade with the East, expect trade with the USSR to increase over the next two years, just one per cent expect it to decrease. Confidence in other Eastern markets is not as high. (See figure 10/3.6.4.3.)

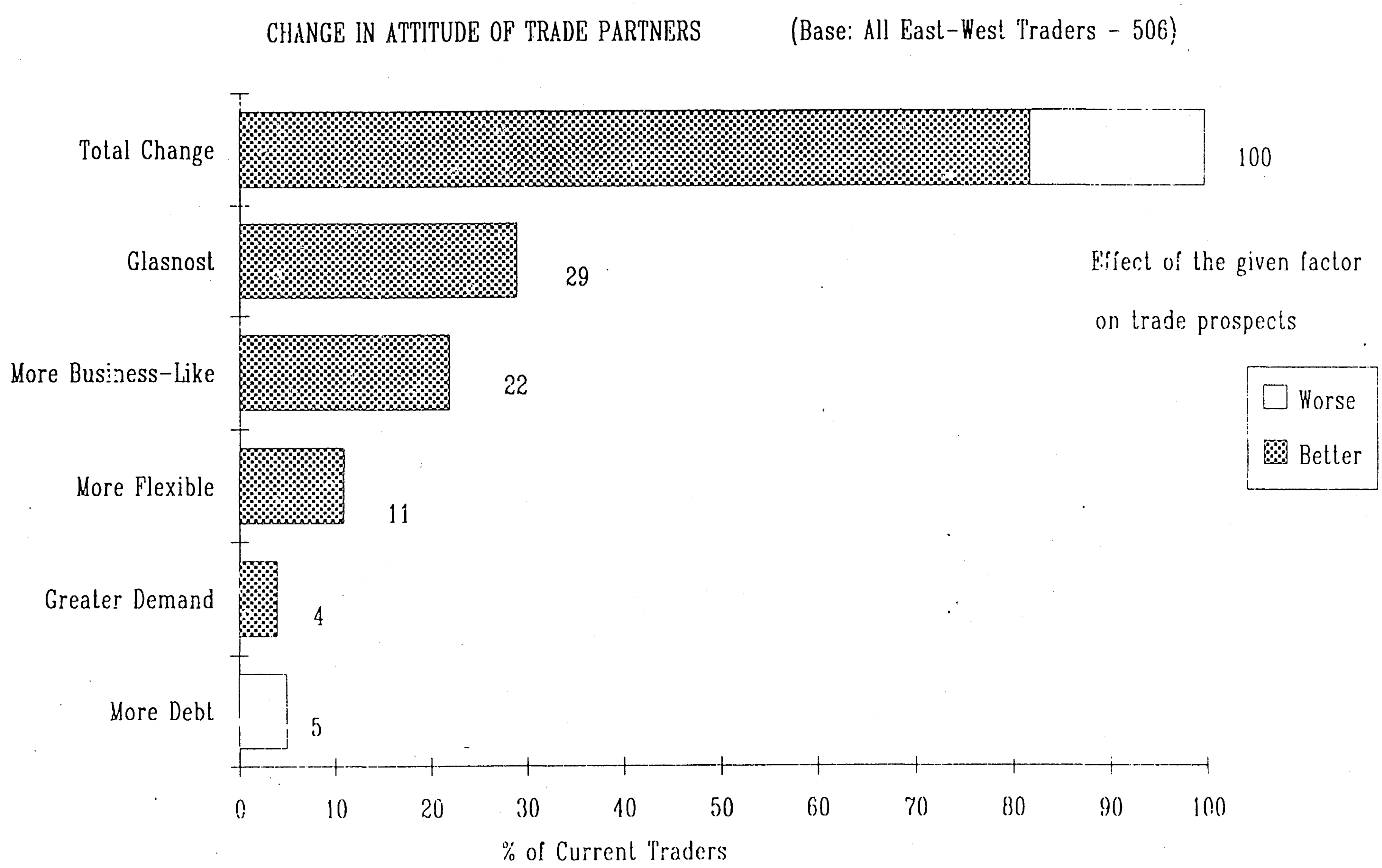
The most interesting part of the HR & H study deals with business methods used in East–West trade. The most common form is personal visits, followed by appointed agents, licence agreements and corporate offices. Out of 506 actual East–West traders 11% currently use JVs in their business dealings with the East. 15% of the same sample have business contacts in the East via their corporate offices. (See figures 11/3.6.4.3.)

When these Western companies with actual business deals with the East were questioned what new methods they were considering in their economic links with the CPEs, nearly 40% mentined joint ventures. Figure 12/3.6.4.3. shows clearly that a JV is considered the far most important alternative among fresh ways in dealing with CPES.

These quotations from an empirical study show that Western companies have more confidence in the development of the Soviet market than that of other Eastern partners. It is also a remarkable finding that 39% of Western companies active in Eastern business consider the JV a suitable alternative way of developing business. The much easier method of technology exchange – licencing – is considered suitable by only 16% of the companies. (See figure 12/3.6.4.3.)

It was mentioned above (section 3.3.) that some Soviet economic outlets were established in the West during the first few years of Soviet power. Some of the mixed

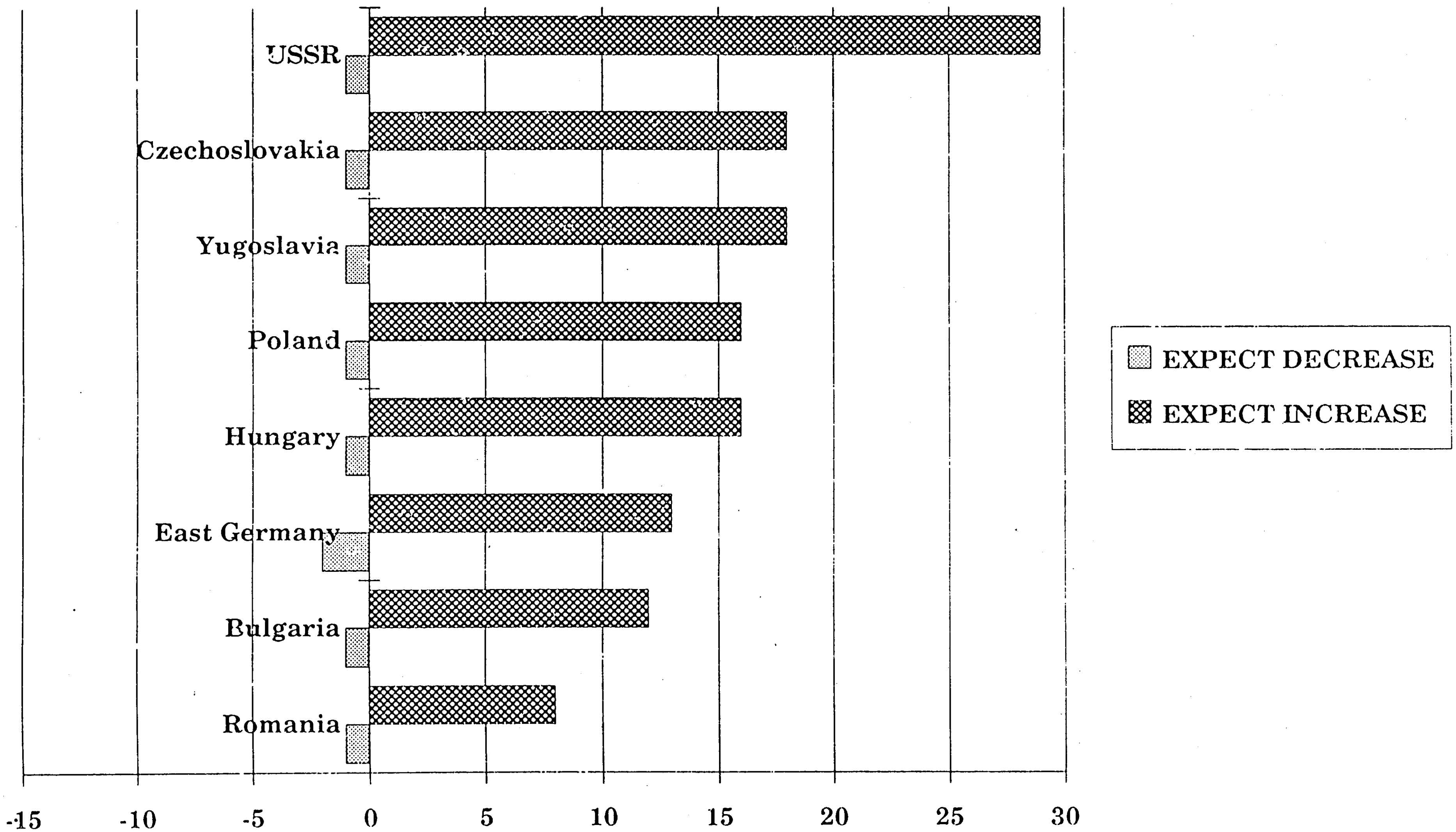
Figure 9/3.6.4.3



Source:HR&HConsensus op.cit. **Figure 9/3.6.4.3.**

CHANGE IN THE LEVEL OF TRADE BY 1990

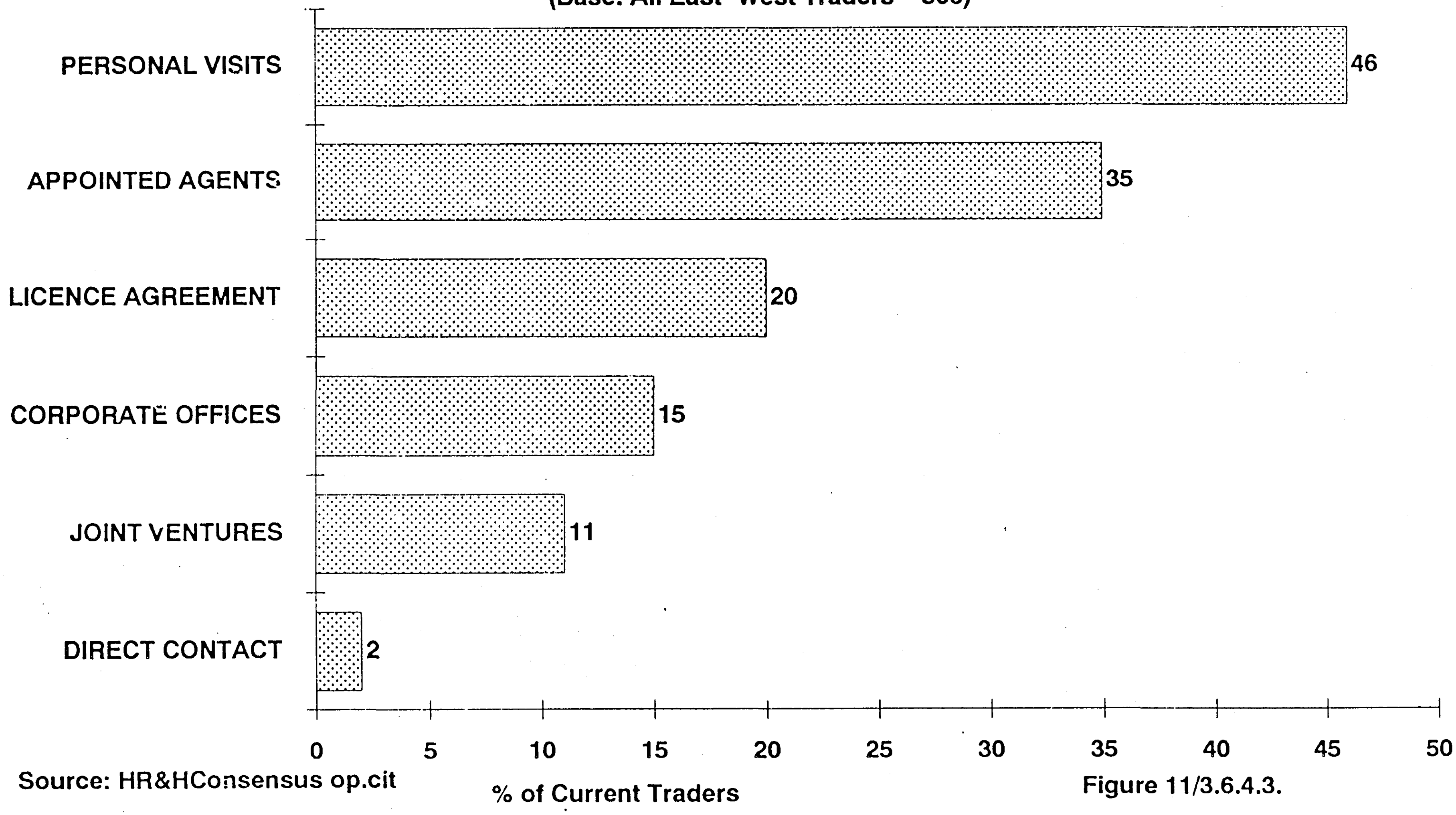
(Base: All Respondents - 688)



Source:HR&HConsensus op.cit. **Figure 10/3.6.4.3.**

Types of Business Dealing with the East

(Base: All East-West Traders - 506)

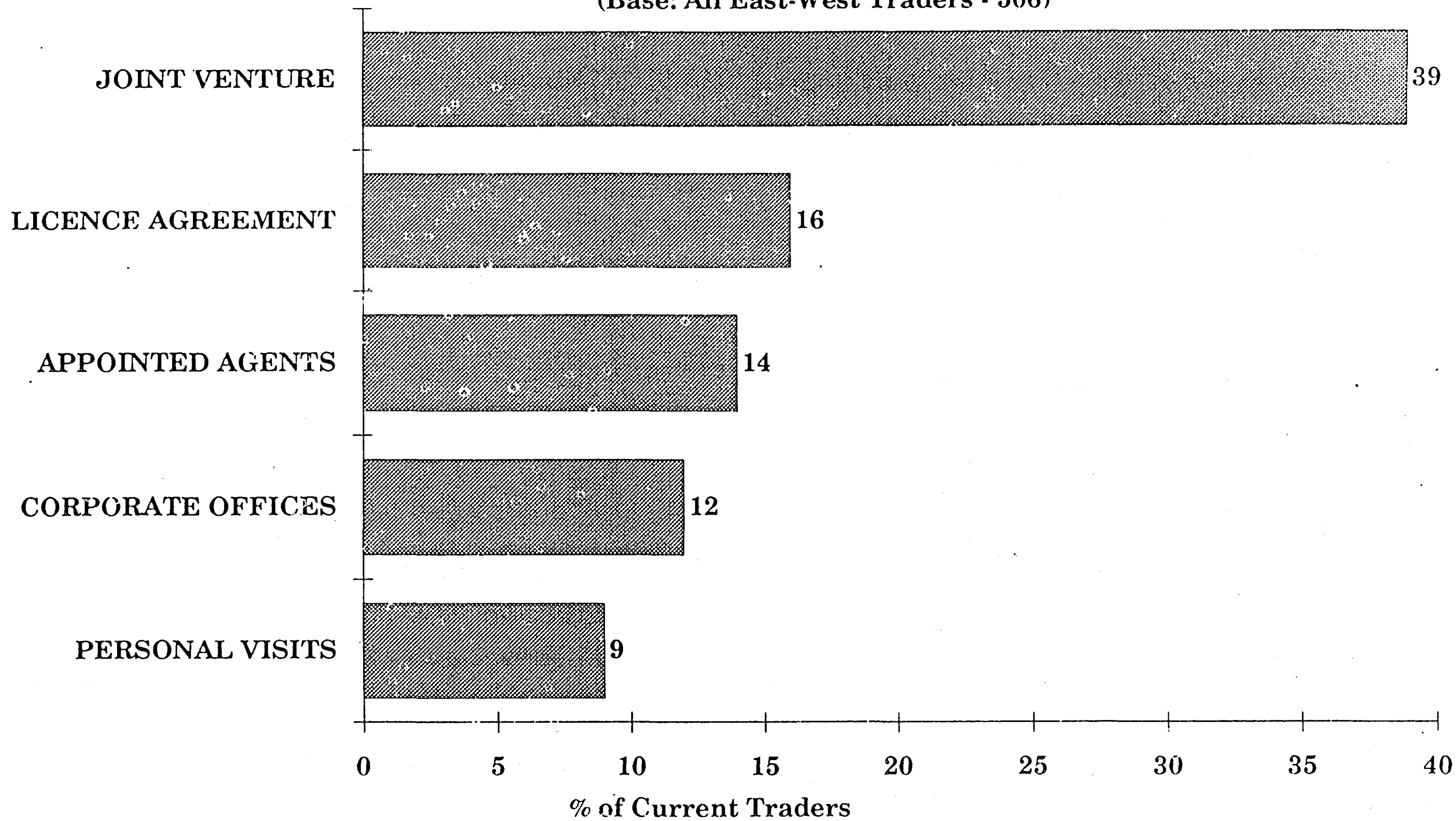


Source: HR&HConsensus op.cit

Figure 11/3.6.4.3.

OTHER ARRANGEMENTS CONSIDERED

(Base: All East-West Traders - 506)



Source:HR&HConsensus op.cit. Figure 12/3.6.4.3.

companies set up abroad in the 1920s, like Russian Wood Agency, Anglo–Soviet Shipping, Moscow Narodny Bank, etc., still exist today.

In the late 1980s, the USSR was involved in 125 companies in 35 different countries. More than a third of them (45 units) are wholly Soviet owned, and in an additional third (43 units) the Soviet side has a majority share. In 19 cases there is parity participation, and thus, in only 18 cases (14.4%) the Soviet side have a minority stake. (See table 4/3.6.4.3.) 253)

Table 4/3.6.4.3.

Participation of Soviet Economic Organizations in the Capital of Mixed Companies Abroad
(as of December 1, 1988)

	Share in capital under 50%	Parity partici–pation 50–50%	Share capital over 50%	Fully owned (100%)	Total
Number of companies	18	19	43	45	125
Proportion (per cent)	14.4	15.2	34.4	36.0	100

Source: N. Dracheva: Going Shares with Foreign Partners. In: Foreign Trade (USSR) No 8/1989 p. 42–45.

Information on Soviet investments abroad has normally not been easily available in Soviet publications. Thus, professor Natalia Dracheva's comprehensive article on this topic in "Foreign Trade" is an encouraging sign of glasnost. According to her up–to–date information, most of the Soviet ventures (105) abroad are situated in Western industrial countries, mainly in Europe (FRG 13, Great Britain 11, Italy 10, France and Belgium 9 each). Only 20 units are thus in LDCs, 55 per cent of which are set up by Ministry of Merchant Marine and Ministry of Fishing. 254)

Prof. Dracheva states that the overwhelming majority of the Soviet ventures abroad is engaged either directly in the promotion of Soviet export products or they help realize them. The production sphere is mainly represented by the catching and processing of fish. (See table 5/3.6.4.3.) The first production venture in an OECD–country was set up in 1988 in Australia to manufacture vermiculite with Soviet equipment. 255)

Table 5/3.6.4.3.

Types of Mixed Companies Abroad with the Participation of Soviet Economic Organizations
(as of December 1,1988)

Principal type	Number of companies	Percentage of the total
1. Commercial activities	57	45.6
2. Trade in scientific and technical knowledge	5	4.0
3. Services including transportation and forwarding operations	33	32.0
4. Extraction and processing of raw materials	14	11.2
5. Financial transactions	9	7.2
Total	125	100.0

Source:N. Dracheva: Going Shares with Foreign Partners. In: Foreign Trade (USSR) No 8/1989 p. 42–45.

The same writer points out that there are 28 Soviet engineering companies abroad, including 12 units dealing in transport vehicles and tractors; 10 based on machines and equipment; 5–6 for consumer durables; 19 sell raw materials; 6 of which are involved in oil and oil products; 5 in wood and wood processing industry products and 4 in selling chemicals. In recent years companies selling oil and oil products have accounted for about 85% of the total turnover of Soviet outlets abroad. 256)

Prof. Dracheva lists advantages of using Soviet companies abroad:

> "They make for a better study and use of market conditions, establish contacts with local firms and firms in third countries, organize advertising activity, obtain fuller and more trustworthy commercial information, draw on the services of foreign partners, who orientate themselves in local conditions better than others; all this no doubt tends to raise the level of commercial activity." 257)

Altogether, the internationalization of the Soviet economy is in the light of figures given by Dracheva extremely primitive. The total number of Soviet companies abroad is very low, and the majority of them are involved in the marketing of Soviet made goods. The lion's share of turnover in these companies is taken up by primary products (oil) and semi–manufactured goods. Actual manufactured goods sold by these companies have thus only very marginal importance.

In the sphere of financial institutions only the Soviet–owned companies abroad have some substance. The London based Moscow Narodny Bank with branches in Beirut and Singapore is ranked at about 250th in the world banking league in terms of total assets. 258) The Soviets have banks also in Frankfurt, Vienna, Zürich and Teheran. Insurance companies are active in Vienna (Garant–Versicherungs AG), in London (Black Sea and Baltic General Insurance Company), and in Hamburg (Schwarzmeer– und Ostsee Versicherungs AG). 259)

Prof. Dracheva is well aware that the USSR has not been using FDIs in an optimal way:

> "Although the effectiveness of our companies abroad primarily depends on the manufacturers of export products, nevertheless, a great deal may be done to improve the work of these companies and their management. Soviet participants are in need of greater economic independence. They should be granted the right to risk, thus giving them flexibility in using the changing market situation so as to raise the effectiveness of their export transactions. It is perhaps necessary to reduce the excessive number of plan indicators and compulsory extensive book–keeping". 260),

This statement makes it clear that the traditional Soviet system has been responsible for the extremely low internationalization of the Soviet economy, and that perestroika with decentralization of decision–making may improve the situation. It is, however, clear that risk–taking in the sphere of FDIs cannot increase rapidly, although Dracheva, clearly hopes for this to happen.

She makes a couple of interesting points about the recent development of Soviet FDIs. Firstly, she mentions the first Soviet production unit in Australia. Secondly, she states that until recently the USSR has set up only wholly–owned banks abroad, but in October 1988, the first JV bank was established in Zürich. In this joint bank, Eurasco Zürich AG the shareholders are: Vnesheconombank (30%), the Austrian Donaubank (wholly Soviet owned bank in Austria 30%), Länderbank Rheinland–Pfalz FRG (20%) and the Swiss Züricher Industriekredit AG (20%). Thirdly, she makes a highly interesting proposal by asking Soviet companies abroad to seek Western partners willing to enact FDIs in the Soviet Union, especially in port areas, whereby improved products could be turned out and marketed together in the West. 261)

The last point is of special interest. Dracheva sees FDIs as a two-way road, in which Soviet companies abroad could gather information concerning Western business methods, and at the same time, find out, how these methods could be taken into consideration in joint production on Soviet territory. After that, joint marketing of the improved products could be enacted, and the structure of Soviet export thus improved.

According to two radical Soviet economists, Nikolai Shmelyov and Vladimir Popov (both of them are also MPs at present), optimists estimate that only 17–18% of the Soviet manufactured goods are competitive on the world market. Pessimists estimate that the corresponding figure is only 7–8%. These two observers of the Soviet economy also mention that the "Lada" car, one of the leading export articles of the Soviet export industry, has been found to be the qualitatively worst car among the 73 cases tested in the West German market. 262)

New ideas put forward by N. Dracheva are badly needed if the Soviet Union wants to play a major role in the global economy economy as perestroika stipulates. At the end of 1980s, the actual state of the Soviet FDIs abroad answers the question asked in the title of the book by G. Hamilton referred to several times (Red multinationals or Red Herrings?): Soviet FDIs abroad are more of red herrings than mighty red multinationals.

3.4.6.4. The future of JVs in the Soviet Union

> "You can't stay out of a country the size of the Soviet Union and stay
> a major international marketer"

said Donald M. Kendall, former chairman of Pepsico, in the autumn of 1987. Pepsico has 19 bottling plants in the Soviet Union on franchise agreements, and is planning JVs. 263) Many Western company executives agree with this opinion of a veteran in East-West business. The size of the Soviet market holds considerable fascination.

The second important incentive for Western FDIs in the Soviet Union is the resource base of the host country. Especially, in the chemical sector there are huge possibilities for JVs, as pointed out the in previous section.

The Japanese company Tariku Trading has set up a JV near Irkutsk for timber processing. In the 1970s Japan participated in the development of the Siberian wood processing industry on a buy–back basis by providing machinery and credits and taking timber as compensation. The Soviet chemical industry, as pointed out above, was developed in the same manner, especially with the help of American companies, above all Occidental Petroleum.

The JV activity of the late 1980s does not differ essentially from the direct compensation deals of the 1970s. In both cases the Western partner provides technology and other means of production, and the host country natural resources. Jointly produced, goods normally with little value added, serve as a meedium of payment, for the Western partner's efforts. Only the terminology of the 1980s is different.

It was pointed out in the previous section that discussion on the indirect effects of investment has started in the Soviet Union. Contributions by Rasputin to this discussion give ample evidence of how aggressive arguments can be used, in order to protect the environment from the effects of investments in the USSR. It is naturally extremely difficult to judge, how much influence these new, critical arguments have. One can state that warnings about turning Soviet territory into the toilet or backyard of the industrialized world do not improve the investment climate for FDIs.

"Internal export" provides certain special opportunities in the Soviet Union, as well as elsewhere in the CMEA–region. This possibility has been realized by some Western companies.

For "normal" JVs, however, matters look a bit different. The most important, if not the only one, is the inconvertibility of the rouble. This problem of currency is universal in the CMEA area, but in the case of the Soviet Union it is of special importance: as the leading economic power of the CMEA area the Soviet Union should make its currency convertible.

This problem has clearly been recognized in the Soviet Union. A. Aganbegyan, who is one of the most important architects of perestroika and an economic adviser of Gorbachev writes:

> "The absence of a convertible Soviet rouble complicates the organization of JVs. For various countries and goods different exchange rates have been set. But the great number of these rates and the intricacy of the calculations makes matters difficult and complicated."

After that statement, however, he continues with an optimistic statement:

> "I believe, all the same, that effective forms of JVs will gradually be found".264)

Aganbegyan also reviewed the Soviet currency policy:

> "At the June 1987 Meeting of the Central Committee, the question of the convertibility of the rouble was presented as a long-term objective. When the new pricing system has been established in the Soviet Union, it is my opinion, that this question will be addressed more closely. Firstly it will be possible to establish a convertible rouble in relation to the currencies of the socialist countries, made easier by their similar types of economies and the existing processes of economic integration. As to a convertible rouble in relation to the capitalist countries, this can hardly be resolved in the near future, since such a resolution is linked to structural changes in the development of the Soviet economy. But I believe that eventually this question also will have to be answered.."265)

After that realistic statement by Aganbegyan it can be concluded that JVs must live with the very special monetary circumstances of the Soviet economy for rather a long time.

The aim of the Soviet perestroika is obviously the substitution of direct planning command by indirect economic methods. Therefore, it is understandable that a banking reform has been carried out.

According to N. Garetovski, the Chairman of the Board of the USSR State Bank (Gosbank), the banking reform of the late 1980s is unprecedented in scope and scale. Five new specialized banks have been established. The Industrial Development Bank, the Agroindustrial Bank, the Municipal Services and Social Development Bank, the Personal Savings and Credit bank and the Bank for Foreign Economic Affairs of the USSR (the previous Vneshtorgbank, Bank of Foreign Trade). Garetovski states, that the primary task is to make the banks an instrument of powerful leverage to influence the state of affairs in the economy and thus speed up the building of an efficient economy, to raise product quality and to improve the living standard. 266)

The areas of responsibility and the scope of activities of these five banks match their specialization. Only the State Bank of the USSR does not have any specialization, but rather enjoys the status of a central bank. It is also the central bank of money issue in the USSR, which regulates credit and monetary relations in the economy. It coordinates the banking policy of the USSR, handles the planned management of the credit and monetary system and ensures a coordinated state policy in the field of monetary circulation, crediting, financing, cash payments and currency transactions. 267)

This statement of the Chairman of the Board of the Gosbank reveals two important aspects of the Soviet banking reform. Firstly, it resembles of the two-tier banking system, which has been carried out in Hungary. Secondly, the planned management of the credit and monetary system in the Soviet economy remains in force, whereby obviously Gosbank has the power to dictate the credits given by banks according to the economic plan.

However, Garetovski states, that although Gosbank does supervise the performance of the five banks, it does not order them around. Each of the newly formed banks is independent and does its work and conducts its relations with clients on the basis of full cost-accounting and self-financing. 268)

The major areas of activity of the Industrial Investment Bank (Promstroibank) are, according to the Chairman of the Board, M. Zotov, the economic analysis of the production performance by bank's clients, and the joint search for and the implementation of effective economic decisions that can intensify the production process. He states that earlier it was predominantly the bank which profited by charging interest. But now enterprises are also entitled to profit – they can lend a portion of their idle funds to the bank and receive interest.269)

Such banking operations involving credit are essential rudiments of the future commercial activities of Soviet banks. In the opinion of Zotov, banks will be able to start real commercial operations on a wide scale when, upon accumulating the necessary funds, they get down to cooperative projects on a share basis. In addition, the Soviet banks will also have the unpleasant task of declaring bankruptcies and switching loss-making firms to a special credit system. 270)

According to V. Bukato, who is the Chairman of the Board in the USSR Municipal Services and Social Development Bank (Zhilsotsbank)the former Capital Investment Bank, this bank is responsible for financial policy and investments in social infrastructure. Its clientele embraces state-owned enterprises, agencies and institutions in the service sector as well as cooperatives and individual businesses, including citizens in need of loans for housing. 271)

The Agroindustrial Bank (Agroprombank) has been built on the basis of the respective departments of the Gosbank. According to the Chairman of the Board, A. Obozintsev, the Agroprombank is in the position to grant a total of 250 billion Roubles worth of credits and other financial services, nearly two thirds of the bank loans available for the national economy. According to Obozintsev, in earlier times, agricultural debtors could hope to get more credits, while having their older ones indefinitely rescheduled; now there is no such prospect for them any longer. The Agroprombank has profit and loss accounting as its operating principle and so it cannot afford to be a charitable institution. The bank bases its relations with the farms on credit agreements. 272)

These statements of three Soviet bankers, who all lead newly established financial institutions, show clearly, that there is a tendency towards "monetarization" in the Soviet economy. How decisive the banking reform will be for the whole economic development, will be seen after some decades. It is naturally still possible that in economic units the "soft budget constraints" will continue to exist. It is still possible, that enterprises in financial difficulties will be bailed out by authorities, when unemployment becomes a real option. This bailing out has been observed by Kornai in Hungary, although intention to go over to "hard budget constraints" have been announced repeatedly in the enterprise sector since 1968.

Anyhow, in the late 1980s the financial scenery in the Soviet Union has led to some interesting novelties. Two industrial associations in Leningrad (Tekhnokhim and Energomash) have established their own, in-house banks providing investment credits and account settlements at commercial rates, as well as issuing bonds. 273) In the same city fourteen local economic units have created their own "innovation Bank" (Leningradsky Innovatsionnyi Bank, LIB) operating as a "venture capital" institution on the basis of contributions of the founding enterprises. 274)

The Lvov "Konveier" firm, which produces automatic loading systems for container transport, issued shares paying a fixed rate of dividend and offered them to "Konveier" workers, with obvious success. 275) Even if these "shares", or industrial bonds as would be a better name for them in Western terminology, were only available for "Konveier" workers, the experiment was revolutionary. It shows that capital raising in a new form is becoming possible in the Soviet Union.

JVs in the Soviet Union can get credit in roubles from Gosbank, Promstroibank, Agroprombank, Zhilsotsbank or Vnesheconombank on commercial terms. CC credit can be obtained from Vnesheconombank, or from Promstroibank, Agroprombank and Zhilsotsbank, with the permission of Vnesheconombank. CC credits can also be obtained from foreign banks or enterprises. 276) Monetary assets of JVs in CC and roubles must be deposited either in Gosbank or in Vnesheconombank. The interest of rouble accounts is paid according to Gosbank regulations and on CC accounts according to interest level on international monetary markets. 277)

These rules given in a Chamber of Commerce and Industry guidebook do not give too many exciting possibilities for JV financial managers. Obviously, there is little point in going shopping for "cheap money". Real competition must be created between the newly created banks, before there are differences in the price of the money. When a JV invests its spare monetary means, the low interest rate for deposits according to Gosbank norms is obviously the only possibility. No diversified exciting portfolio of "Konveier" shares, or other securities can be compiled.

In spite of all this, the abolition of the mono-bank system and financial innovations in Leningrad and Lvov are encouraging signs of introduction of an economy, where money plays a more active role than before. This tendency will somewhat improve the "investment climate" which in the Soviet Union is still suboptimal for FDIs as far as the monetarisation of the economy is concerned.

Chapter 3

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4. Some economic aspects of East–West JVs

When the first CMEA countries started experimenting with Western FDIs in the 1970s, the progress was extremely slow. In the 1980s, the idea of allowing Western FDIs spread in the CMEA region and considerable improvement in rules governing JVs has taken place. However, the economic substance of FDIs was still rather thin at the end of the 1980s. In spite of that it can be maintained that Western FDIs in the CPEs have come to stay.

There is a clearly uneven distribution of FDIs among small CMEA–countries. As far as the number of JVs is concerned, Hungary is clearly in the lead with some 200 units in 1989. While Hungary leads the league of countries under review with this number, the invested capital, is much lower than either the economic potential allows, or the Hungarian government desires. 1)

However, it can also be maintained, that Poland with some 700 Polonia–firms 2) is in the lead in the number of Western FDIs. Obviously, the economic meaning of these small units is rather negligible.

A comparison between Hungary and Romania is especially interesting. Both countries started experimenting with JVs virtually at the same time, though the results are strikingly different. In Romania, which has kept to the original JV rules within the highly centralized economic system, the results are extremely poor: only a few JVs have come into operation since the 1970s. No new ones have actually come up in the 1980s. In Hungary, a clear acceleration of JV activity has been registered since the mid–1980s.

The Soviet Union with its huge market and rich resources is a special case. In September 1988, less than two years after the issuing of the first JV decree, about 100 units had been set up. 3) One year later there were already 800 units established. 4) Bulgaria, the CSSR and Poland have been rather unsuccessful in attracting Western firms to participate in JVs with local firms.

As pointed out in section 3.2., the internationalization of CMEA 5) countries' economies is still rather narrow in quantitative terms. Only a few exceptions of socialist JVs in the West are involved in production. JVs in the West are mainly marketing outlets of Eastern products. In the Third World the CMEA involvement in FDIs is also of a narrow nature.

However, the interest of CMEA countries in participating in the global economy with the help of FDIs has clearly increased in the 1980s, during which FDIs have been regarded as a two-way road between East and West. At the same time, intra-CMEA activity is under serious reconsideration. Direct links between socialist enterprises are demanded more loudly than previously. Socialist JVs are under discussion, and some have been established (chapter 3).

Therefore, it is absolutely necessary to reform the CMEA and the framework of cooperation between her members. The CMEA has already been described, and thus, there is no need to repeat it all here. It is sufficient to say here that the CMEA in its current structure is the product of a centralized command - and - central allocation model, which dominated all socialist countries. While significant changes have been made in many of the member countries, the organization itself has not undergone much of a transformation. The overall pace of economic change in the CMEA countries has not been quick but in the CMEA itself the change has been even slower. To some extend the lack of change has been determined by the conservative attitude in the Soviet Union.

In the second half of the 1980s, the emphasis of integration was shifted downwards, to enterprises, associations and other basic-level units. No genuine integration, however, will come about, unless there is genuine cooperation at the bottom, unless joint bi-state and multi-state enterprises are set up. The integrated market still remains a theoretical concept alone. This, of course, means that currency problems are the most important issue to be solved at the state-to-state level. The experience of creating East-East JVs indicates that there will not be any meaningful advance in the absence of a proper price system, currency exchange rates, and at a further stage, convertibility of national currencies.

These facts are increasingly better understood in CMEA countries. In the 43rd (extraordinary) session of the CMEA (October 1987) a new plan of integration was adopted stipulating the creation of a new monetary-, financial- and credit system, which allows cooperation at the enterprise level within the CMEA. Old methods of socialist integration based on bilateral, trade and commodity quotas defined in natural terms are regarded as outdated.6)

At the same time, economists in the CMEA area have started realizing that CPEs have lost a lot of time by making the mistakes mentioned above.

If there had been economic reforms earlier on at national and international levels, the CMEA aim of a "common market" would have been easier to reach. Only some 7–10% of products entering mutual trade are made in socialist cooperation while the equivalent figure in the EEC is 40%, The energy intensity of CMEA economies (energoyemkost) is twice as high as in the EEC, and the use of materials per production unit is 70% higher than in the West (EEC). 7) The 1980s have been characterised by the failure of finding optimal efficiency in internal as well as in external economy.

4.1. Political economy and FDIs between East and West

From the point of view of political economy the questiön of FDIs across ideological borders is extremely interesting. An essential part of Marxism–Leninism is the theory of imperialism, the highest and the last stage of capitalism. According to Lenin

> "the Bolsheviks are establishing completely different international relations which make it possible for all oppressed people to rid themselves of imperialist oppression". 8)

Capitalist FDIs enacted by international monopolies are supposed to cease to exist.

A standard Soviet textbook of political economy describes the modern capitalism in the West as follows:

> "Imperialism is moribund capitalism, it is the eve of the socialist revolution. By expanding the sphere of their influence, the monopolies tend to accelerate the development of the social character of production. This tends to run into contradiction with the monopolies' self–seeking purposes. The capitalist relations of production increasingly slow down the development of the productive forces. The contradiction between the bourgeoisie and the proletariat, between the handful of monopolies and the bulk of the population is intensifying. The contradictions among the monopolies, among the imperialist countries, and between the imperialist countries, on the one hand, and the peoples of the colonial and dependent countries, on the other, are being aggravated. Imperialism pushes to an extreme all the contradictions of capitalism and creates all the objective prerequisites for the socialist revolution. That is why it is decaying capitalism, an eve of the socialist revolution".9)

If Western capital has created contradictions in the internal, as well as in the external economy, why then, is it necessary for the socialist states to cooperate with that private capital in the most intimate form of collaboration, in joint enterprises? If capitalism is in the eve of collapsing, why are the socialist states making long–term deals with capitalist firms in the form of JVs? The political economy of socialism is hardly able to answer these questions.

In the sphere of external economic links the new approach with liberal attitudes towards FDIs is bound to run into conflict with orthodox ideology. This conflict can be shown conveniently with some references to the "New Programme of the CPSU" from 1961. This document is a suitable starting point, because it contains all the main arguments of traditional Marxist–Leninist "Weltanschauung" and is thus called "The Communist Manifesto of the 20th Century". The Programme 10) is also of special interest in context of this study, as it contains special historical importance for the 1970s and 1980s.

The topic of the first chapter of the Programme is the transition from capitalism to communism. It states:

> "The process of concentration and centralization of capital, while destroying free competition, led in the early 20th century to the establishment of powerful capitalist monopoly associations which acquired decisive importance in the economy, to the merging of bank capital and immensely concentrated industrial capital, and to intensive export of capital. The trusts, which encompassed entire groups of capitalist powers, began the economic division of a world already divided territorially among the wealthiest countries. Capitalism has entered its final stage, the stage of monopoly capitalism, of imperialism... Imperialism is a decaying and moribund capitalism; it is the eve of the Socialist revolution. The world capitalist system as a whole is ripe for the social revolution of the proletariat. 11)

In the section dealing with the victory of socialism in the USSR, the Programme points out:

> "Socialism has done away forever with the supremacy of private ownership of the means of production, that source of the division of society into antagonistic classes. Socialist ownership of the means of production has become the solid economic foundation of society.

Unlimited opportunities have been afforded for the development of the productive forces." 12)

In the section on The World Socialist System the Programme maintains:

"The development of the world Socialist system and of the world capitalist system is governed by diametrically opposed laws. The world capitalist system emerged and developed into fierce struggle between the countries composing it, through exploitation of the weaker countries by the strong, through the enslavement of hundreds of millions of peopie and the reduction of entire continents to the status of colonial appendages of the imperialist metropolitan countries. The formation and development of the world Socialist system, on the other hand, proceeds, on the basis of sovereignty and free will and in conformity with the fundamental interest of the working people of all the countries of that system... The cooperation of the Socialist countries enables each country to use its resources and develop its productive forces to the full and in the most rational manner."13)

The point dealing with the national-liberation movement in the Programme states:

"The interest of a nation calls for the elimination of colonialism, the eradication of imperialist rule, the ousting of foreign monopolies, the foundation of national industry..."14)

Chapter two of the Programme contains the famous vision of the Communist society:

"In the current decade (1961–70) the Soviet Union, in creating the material and technical basis of communism, will surpass the strongest and richest capitalist country, the USA, in production per head of population... In the next decade (1971–80) the material and technical basis of communism will be created and there will be an abundance of material and cultural benefit for the whole population... The construction of Communist Society will be fully completed in the subsequent period (1980s) 15)... It is necessary in Communist construction to make full use of commodity money relations in keeping with their new substance in the Socialist period. In this, such instruments of economic development as cost accounting, money, price, production cost, profit, trade, credit and finance play a big part.

> When the transition to a Communist form of people's property and the Communist system of distribution is completed, commodity – money relations will become economically outdated and will wither away."16)

The predictions of the 1961 Programme and the reality of the late 1980s are almost diametrically opposed to each other. The economic division of the world (first quotation) has not yet happened in the 1960 between monopolies, because internationally mobile capital is still conquering certain areas, for example, socialist countries.

The second quotation from the Programme points out that private ownership of the means of production, and thus, class antagonisms have been abolished in socialism. In the 1980s, many kinds of ownership relations are coming up in CPEs, including Western FDIs.

The third quotation is the most important one. The socialist community has not been able to develop its productive forces to the full and in the most rational way, and thus, it has become necessary for CPEs to invite Western capital to participate in the socialist economic development. Following the logic of the third quotation from the programme, this is bound to lead to the exploitation of the work force in the capital–receiving country.

The fourth quotation illustrates the economic and verbal support of CPEs to the LDCs, demanding the ousting of foreign capital from the Third World. At present, CPEs compete with each other, as well as with LDCs on receiving Western FDIs. The difference between the theoretical – ideological – approach of the 1960s and actual situation at the end of the 1980s is fundamental.

This can very well be verified by the following quotation from Financial Times at the end of 1989:

> "Mr. E. Sandiford, Prime Minister of Barbados, has welcomed the dramatic political changes in Eastern Europe. Behind this, however, Mr. Sandiford and other leaders of economically embattled developing countries fear they will be left worse off. The concern, supported by statements from officials of industrialised states and investment bankers, is that the financial support for Eastern Europe will mean less for a developing world... Eastern Europe will be more attractive for direct investments and capital flows, which will mean

> the diversion of resources from developing countries, Mr. Sandiford concurred." 17)

The fifth and last quotation contains the points of the Programme which in the 1970s and in the 1980s have proved to be embarrassing for Soviet and Eastern European social scientists. Without discussing the timetable of the advancement of communism, it is of interest here to note, that the withering away of all economic categories in the 1980s was envisioned in the 1960s. In actual fact, intensification of money–commodity relations were widely demanded in the CPEs in the 1980s, with all of its consequences of reviving all economic levers in internal, as well as in external economic matters. Some details of external economics, like FDIs and Western management know–how, are applied in order to intensify the use of economic levers on the home market.

Although the socio–economic reality in the CPEs is strikingly different from that envisioned in the Programme of 1961, the ideology, on which the Programme was based, has not been altogether abandoned. Therefore, Western FDIs in the East and also Eastern investments in the West must still be brought into harmony with socialist political economy. This is a rather painful process.

It could naturally be assumed that Gorbachev's <u>perestroika</u> has changed political economy in this respect. This was, however, not visible in the 27th CPSU Congress, where Gorbachev's speech contains the following:

> "The transnational monopoly capital has gained strength rapidly. It is seizing control of and monopolizing whole branches or spheres of production both on the scale of individual countries and in the world economy as a whole. By the early 1980s, the transnational corporations accounted for more than one third of industrial production, more than one half of foreign trade, and nearly 80% of the patents in the capitalist world.
>
> The core of MNCs is formed by US companies. This "second economy" of USA is two–three times bigger than national economies in such leading West–European powers like FRG, France and Great Britain... Presently US–transnational monopolies are real giants with economic activity which can be compared of GNPs of whole states...
>
> Contradictions between MNCs and host countries have arisen and have been aggravated. The MNCs undermine the sovereignty of LDCs and also of developed capitalist countries. They favour state–

> monopolistic regulations, when it is advantageous to them, but they do not back off from conflicts with host country government when these try to put their profits in danger." 18)

Just one year after this speech the Soviet Union invited the MNCs to make FDIs in the Soviet territory by issuing the JV decree. Obviously, the political rhetoric and the actual economy have diverging needs.

The anti-imperialistic rhetoric has continued in the Soviet Union during perestroika, but the terminology may be a little different. Instead of using "imperialism", for example "neoglobalism" is used. The USA is the target in these writings, in which it is maintained that Western countries reap extremely high profits from LDCs by using "price disparities". The USA is also profiting from the LDCs' huge external debt, according to Soviet sources. 19)

An excellent example of the old school is delivered by A. Kireyev, who raised the question of the nature of modern transnationals. They are imperialist monopolies which, to quote Lenin, have reached 'a new world stage concentrating on capital and production. They monopolize whole industries and whole spheres of activity, on the scale of individual countries and of the entire capitalist world economy... The expansion of transnational capital has conserved the developing countries' economic dependence on the former "parent states" going back to colonial times. Only the forms of this dependence have changed. By political manoeuvres, promises, bribes, military blackmail, and by direct interference in the developing countries' internal affairs imperialism has built up a new system of exploitation based on neocolonialism. MNCs employ various means of exploitation: non-equivalent trade exchange, manipulations with lending and dollar exchange rates, and various clever ploys... The MNCs have dumped most of their labour – intensive and environment – to the Third World polluting production processes, turning individual countries into their auxiliary factor shops... It is obvious, nevertheless, that such a system cannot exist forever. The MNCs will have to choose between daylight robbery and cooperation on the basis of equality with the Third World. After all, the developing countries have other foreign trade partners, too. 20)

The writer does not define what partners he means in the last sentence of his article, but it is clear that he is hinting in the direction of socialist countries. Why has this alternative been functioning so poorly, even if the possibilities for it have been apparent, is obvious: the CMEA countries have been economically too weak, in order to offer a real alternative to the Third World.

Views represented by Kireyev have until recently hardly been criticized by Soviet scholars. However, in the perestroika period these anti–imperialist dogmas are no more accepted without discussion. This kind of discussion can be observed, for example, in a book review in the periodical "World Economy and International Relations". The book under review is called "MNCs and developing countries: deepening contradictions". The book describes the MNCs as the "force of the evil" in the sense of Kireyev's article.

The writer of the review, N. Karagodin, accuses the author of the book, A. Golikov, of an over–simplified view of a complicated topic. Karagodin asks why the cooperation of MNCs and developing countries is steadily increasing and why LDCs are so eagerly attracting FDIs, if there is a sharpening contradiction between the development needs of LDCs and MNCs especially in respect of the "class character" of the latter as Golikov maintains. In reality, there is virtually no LDC without a need for FDIs and technical and organizational know–how connected to MNC–operations. Long–standing relations between LDCs and MNCs allow the host countries of FDIs to elaborate organizations and create rules, which make the FDIs mutually beneficial. This statement by Karagodin, when he counters the general contradiction argument of the dogmatic school representative Golikov, is really unorthodox: mutual benefit between Western MNCs and LDCs cannot exist in Marxism–Leninism tradition.

At the end of his review Karagodin points out that less biased views than those given by Golikov's book are presently needed on world economy, because perestroika in foreign economic relations also contains JVs between the Western MNCs and the Soviet Union. The old–fashioned cliches are no more convincing in his opinion.21)

The end of the book review is revealing: if the USSR with a long, verbal anti–imperialist tradition is entering an economic alliance with MNCs in the form of JVs, the behaviour of the partner should not be critized in the traditional manner any more, because this may hinder the hopes for cooperation.

This is an understandable attitude. As F. Gornyunov stated in the autumn of 1988:

> "There is no socio–economic task more important today than that of saturating the Soviet domestic market with goods and services. By attracting foreign capital and getting involved in joint business undertakings with foreign companies we can go a long way towards doing so. The appropriate laws, binding on all Soviet institutions and citizens, have been passed. Somehow, these laws haven't made foreign businessmen exactly thronging to make deals with Moscow. Many of

> them still have their doubts about our economy being restructured in earnest and our reforms being here to stay." 22)

A comparison between credits and FDIs in the framework of political economy is naturally of special interest. It is a well-known fact that CPEs accepted Western credits on a large scale in the 1970s. It was thought in socialist countries that credit-taking was not dangerous in terms of Western economic influence. It was said that central planning could be maintained, and the use of credit could be used to strengthen the socialist economy. Western economic influence was regarded as minimal.

However, credits bear interest, which in turn, is a means of exploitation. In Eastern sources it is easy to find hints on the LDCs desire of liberalization from the dependence on imperialism. 23) At the UN General Assembly (1988) Mihail Gorbachev proposed to limit payments of LDCs debt or to reschedule a considerable part of them until much later. 24)

Some socialist economists consider the debt problem of socialist countries being made by the capitalist countries. They did so, among other things, by adopting discriminatory measures that blocked exports from socialist countries, thus denying them a source of CC earnings. 25)

In view of this, credit-taking is a serious point in political economy. Debt creates dependence and debt servicing includes interest payment, and thus, an element of exploitation.

As far as JVs and FDIs in general are concerned, they certainly contain a higher degree of economic dependency than bank-to-bank credits. Western management is getting involved, and thus, direct influence on the socialist enterprise level is becoming a fact. In political economy terms this means that Western capital has been invited to socialist countries to exploit the local labour force on the spot.

In this context the same question as in the Soviet "concession period" arises: "we chased off our own capitalists, and now we call in foreign ones." In political economy this potential complaint is difficult to answer.

It is also relatively difficult to explain in political economy terms the exploitation in socialist JVs with Western capital participation. In Selectronic Ltd, which is a JV in Hungary producing consumer durables - mainly colour TVs - the worker on the assembly line gets wages which are equivalent of the salary of an engineer with university education with five years' work experience. 26)

Off-shore JVs with special liberties to set wages and salaries of their personnel aggravates this ideological problem. How is it possible to explain to the local population that FDIs from the West are bringing about no exploitation, but higher pay than in the national economy in average? At the same time, it must be loudly announced that FDIs can be attracted only on the precondition that labour costs are relatively favourable.

According to the Soviet economist, S. Menshikov, private enterprises hiring people are not permitted in the Soviet Union. The only exception are JVs with foreign companies, but in them the state holds over half of the capital. 27)

I. Ivanov, who is the deputy chairman of the State committee of Foreign Economic Relations of the USSR (GVK), attempted to explain the situation. 28) He admits that his task - explaining FDIs between socialism and capitalism in terms of political economy - is a rather difficult one.

Ivanov states that socialist and capitalist properties are antipodes, but in the present world of economic interdependence there must be an interaction between these antipodes. Also in the traditional trade this interaction plays a role, even if it is indirect in its appearance.

Ivanov is obviously happy to be able to refer to Lenin's writings about the concession period, in which it is stated that involvement of Western capital does not pose any danger to socialism and does not lead to any denationalization of property. On the contrary, joint entrepreneurship leads to active and vigorous competition between two methods, two formations and two economies - communist and capitalist. 29) This sounds like healthy competition between two team-mates in one and the same football team, struggling for the possession of the ball.

Ivanov points out in his reference to Lenin and the 1920s that the Soviet economy very much stronger is today than during the "concession period", and thus the danger of Western influence is smaller. 30)

It is clear that Ivanov must also ask himself the question, whether Western capital is able to exploit the labour force of the host country. Not surprisingly, his answer is negative. In the Soviet Union JVs are obliged to pay wages and social security payments according to local legislation. In addition, only a part of the surplus value flows into the pocket of the Western partner, because the USSR as a host country is able to tax the JV profit. 31) What Ivanov fails to say in this context, is that the same is true everywhere in the world, where FDIs are enacted.

Ivanov admits that foreign capital also needs some incentives. Otherwise it will not be attracted into the country. He also states that FDIs would not be needed, if the domestic economy were able to cope with actual demand. Because the Ministry of Light Industry is unable to satisfy the need of footwear, the West German shoemaker "Salamander" is needed. 32)

Ivanov eloquently points out that Soviet direct investments in the West provide the basis of modern economic links. In this pragmatic point he explains how modern export activity cannot function without supplementary actions, after-sales services, crediting, etc. In developing countries, not surprisingly, Soviet FDIs are not exploitative in nature but on the contrary, they help the host countries to resist imperialist economic forces. 33)

I. Ivanov is a typical technocrat of the perestroika era, who emphasises economics and pushes ideology into the background. This new technocracy looks for ways of integrating CPEs into the world economy.

The Canadian professor C. McMillan, who has for a long time investigated Eastern investments outside the CMEA, has summarized the present situation very well:

> "The international socialist division of labour which previously had been given emphasis, is now subsumed under a broader concept. Relations with socialist and non-socialist partners and, within the latter category, with partners from the developed West and developing South, are increasingly approached in a new global perspective, within the framework of a more general international division of labour. At the same time, this entails explicit recognition of the increased inter-dependence inevitably involved in the pursuit of these goals. Spokesmen for this new orientation of economic policy stress the mutuality of interest involved, the acceptability of the level of inter-dependence envisaged and the important benefits expected to ensue from the new relationships."34)

Also in the new atmosphere the verbal emphasis is still on CMEA cooperation, but also in this sphere new methods, especially direct links between enterprises are desired. Mihail Gorbachev summarises this point as follows:

> "We see direct links between companies and enterprises and specialization as the chief reserve and leverage for deepening our integration. It is exactly along these lines that we are restructuring our

> foreign economic activities and removing barriers preventing enterprises from finding appropriate partners in fraternal countries and deciding on their own how to cooperate with them. We are launching joint socialist companies, including those expected to meet our countries' needs for the most sophisticated goods more quickly. Such companies are being set up in services, construction and transport. The Soviet Union is prepared to offer them some lucrative orders. We are also prepared to consider the possibility of involving Western businessmen in the activities of such companies."35)

This statement by Gorbachev contains the best-case scenario from the point of view of CPEs' technocrats. Enterprise-level cooperation between fraternal countries on the basis of market demand supplemented with Western know-how whenever needed is a convenient solution ideologically.

Technology exchange in general and FDIs in particular tend to influence the living habits and lifestyle in receiving countries. Communist ideology has traditionally maintained that it is creating a "new man", free of greed and consumerism. Now, at the beginning of the 1990s, it seems that the new socialist man is one, who wears Levi Strauss jeans, eats MacDonald's hamburgers and drives a Western car. It is becoming more and more difficult to know the country of origin of these products, but consumer habits are the same.

The spreading of products and services with capitalist brand names (trade marks) is an especially interesting point in this context. In Marxism it has been customary to make a distinction between use values and market values, which might differ from each other considerably. The market value may include certain monopoly elements, e.g. a firm has a well-established brand name, which allows it to charge a quasi-monopoly price. This intangible asset is maintained by influencing the client with advertising, which will be paid by the buyer for at the end. For example the client may not want to have just any kind of jogging shoes, only Adidas will do, although an equivalent pair of shoes without the name is probably available at half the price. Western firms with well-known intangible assets are making a clear breakthrough in socialist countries by producing more and more on the spot aiming at conquering the local market and finding adaptive customers. At the same time, the erosion or even withering away of Marxism-Leninism is a fact.

The new thinking with de-ideologization of international affairs is, as pointed out, an important precondition for FDI inflow. De-ideologization in internal economics is also helpful in improving the investment climate for FDIs.

Allowing entrepreneurship in the form of cooperatives is undoubtedly one of the major achievements of perestroika. This new kind of activity, which has widened bottlenecks somewhat in certain areas, has been heavily attacked by various conservative elements of the society. In one case in 1989, all local cooperatives (322) were suddenly closed down by sessions of the local Soviets in the Krasnodar territory. 36)

When a journalist, A. Bekker from "Moscow News" investigated this local case, he was told that the drastic measures against cooperatives had been demanded by the population. "People's interests" are the authorities hobbyhorse, according to Bekker. Today they are trying to ride it again to assure people that once the trade–and–purchasing cooperatives are done away with, life will become prosperous, with plenty of goods in the shops. But, one may ask, as Bekker does, what stood in the way of prosperity at the time when cooperatives were not working. 37)

This serious incident described by a critical journalist shows clearly that de–ideologization of the Soviet society is not advancing in every sphere of economic life. If local initiative and entrepreneurship is harshly cut down by local authorities relying on the emotional support of the population, is it then not also possible that foreign enterprises will experience the same fate? Is profiteering allowed for Western business people, but prohibited for local cooperatives?

Answers to these questions are of vital importance when the investment climate in the 1990s is judged. Soviet cooperatives are legally allowed to enter foreign trade operations and JVs with foreigners. If these potential and maybe even actual JV partners suddenly vanish by arbitrary actions of host country authorities, no firm confidence on long–term cooperation in the form of JVs can emerge.

In the perestroika era much attention has been paid to activating the human factor. In this discussion especially contributions by Tatyana Zaslavskaya are of interest. 38) She argues that under modern circumstances the role of the individual must be enhanced in the economy and also in the political process. It is self–evident that the human factor is one of the key issues also in JV activity. Viable and dynamic enterprises can only be created when the motivation of people is allowed.

Alongside with Zaslavskaya, there is another theorist, Aleksandr Tsipko, who is noteworthy in this context. Mr. Tsipko, who works for the CPSU Central Committee's International Department, argues that Soviet Marxism has neglected the true nature of a human being. The traditional system of Soviet communism has disregarded material incentives by underlining motivation via enthusiasm alone. Egalitarianism and ideological conformity have strangled initiatives and innovation. The result of this neglecting of common sense is that the Soviet Union has created a graveyard for new technology and moral infantilism. The latter result is due to false treatment of the masses by the leaders. On the one hand, it is said that man is born good and pure and made to live in a collective, and that he can be corrupted only by evil circumstances and faulty economic relations; on the other hand, the citizens are not trusted, but are fenced in with bans and restrictions. 39)

It is clear that in JVs partly-owned by capitalist enterprises emphasis cannot be in socialist enthusiasm ("work hard for the JV, in order to build up socialism"), but on economic motivation. If, however, homo economicus has been killed by traditional communism, he must be reinvented by Western investors, before he can be made to function.

Recreating the Soviet man as an economic individual is probably a relatively easy task after all. If JVs are allowed to hire and fire local management and the labour force freely with much leeway in negotiating salaries and wages in terms of quantity and also quality (part-payment, for example, in hard currency), then the problem of inertia is highly likely to be overcome. Far-reaching freedom in these matters is likely to create social tensions of a macro-economic nature: in this case JVs are likely to attract the best parts of the labour force causing envy and dissatisfaction outside the JV-section.

Free economic zones (FEZ) can easily become Westernized economic enclaves in the Soviet Union with certain Western economic symbols and influence. This necessarily creates regional stratification in income structures. This may also cause political reaction: supporters of the orthodox Marxism-Leninism can point out that Westernization is spoiling whole regions of the first socialist state in the world.

If democratization and glasnost advance further in the Soviet Union during the 1990s, it is likely that environmentalist individuals and groups will gain ground. In this case the argument provided by the novelist Rasputin, that MNCs will turn the Soviet territory into a toilet of the industrialized world, must be taken seriously. Thus, there might come up popular protests especially against joint venturing in the most potential fields, in extracting industries and in the chemical industry, in which the Soviet Union obviously has comparative or even absolute advantage.

4.2. Economic need for Western FDIs in CMEA countries

It is self–evident that the socialist countries under review have not allowed Western FDIs out of ideological considerations. The opposite is true: those countries need FDIs for economic reasons, and thus, are ready to make ideological compromises.

However, the ideological decay did not begin with JVs with Western companies. Accepting international rules for technology exchange (patents, trade marks, financial rules) has meant psychological integration into the global business environment. Accepting the international mobility of capital in the form of FDIs is the end of the long road.

Naturally, one can also argue, that taking credits from the West does not ideologically differ from accepting direct investments from the West. As pointed out in the first chapter, the theory of imperialism presupposes that financial capital and industrial capital will merge in the advanced phase of capitalism. It is, thus, the same whether a capitalist banker grants credits or an industrialist makes a FDI, because it is the one and the same person.

In economic terms there is a clear difference. In the CMEA finance capital started to shy away from the risks involved in the 1980s (though the country risks were remarkably different in various CMEA countries). Therefore, the point can be made that in the 1980s there was an economic need to attract FDIs, because credit financing was growing more difficult.

It may also be argued that the development path taken in the CMEA countries is a natural one. Marx believed that the country that is more developed industrially only shows to the less developed the image of its own future. His pattern of development was intended to cover all cases, once certain preconditions had been fulfilled and primitive accumulation had taken place. 40)

The problem, however, in the socialist countries is that primitive accumulation has really taken place, mainly relying on local capital formation, but the use of capital has been extremely wasteful due to a centralized planning system which might be suitable from the point of view of capital formation, but unsuitable in allocating and maintaining capital in an optimal fashion. Therefore, market oriented reforms and learning Western management methods have become necessary. This need is also present in JV–activity.

The Polish economist, Jan Winiecki has described very well the CPEs failure in attempts to integrate themselves into the global economy by technology imports financed by CC credits. According to him it was expected that net additions to domestic resources increase investments by the whole amount of additions and, in consequence raise the rate of economic growth proportionately. The possibility of a disequilibrium threat to the consumer goods sector posed by the inflow of resources to the producer goods sector alone, was not considered. 41)

In addition, it was expected that additional investment–increasing resources not only raise the economic growth rate, but also raise efficiency, since they would be associated with more productive technologies using less input. The question of how CPEs were to accommodate to the inflow of a more sophisticated imported technology, when less sophisticated domestic technology had been accommodated to only with great delays and at higher costs than planned, was not seriously considered.42)

According to Winiecki this curious thinking generated a simplistic view that equated technology and the associated capital imports with a once–for–all shift to a higher level of efficiency. Due to the temporary inflow of additional resources, the distance between CPEs' and Western market economies was to be reduced for the indefinite period. The ability of the CPE system not only to absorb but to improve the imported technology was not considered. 43) Winiecki shows in his writing the utopian nature of the CPEs economic thinking of the 1970s:

> "Finally, no less simplistic were assessments of CPEs' ability to pay for imported technology and capital. Thus, a new foreign economic policy was to result in a significant increase in exports of more processed manufactured products, i.e. those manufactured using Western machinery according to Western licensed technology. These products were supposed to generate enough CC to pay back the licence royalties, the interest on capital and the capital itself. For some, the improved export performance was also expected to continue indefinitely on the world market; and, once again, issues like the ability to absorb (and improve) new technology, the place of imported technology along the technological life cycle, the ability to deliver licenced products on time and at the expected cost and quality on the world market, etc, were not considered."44)

The Soviet social scientist N. Shmelyov writes in his brilliant "Novy Mir" article, among otherthings, that "the Soviet light industry, trade and service sphere operating under intolerably favourable conditions which encourage lethargy. Nobody is competing with them. Imports of consumer goods are still too small to trouble them". He also states that according to the most "patriotic" assessment, only 17–18% of industrial output is up to world standards, while according to the most cautious and pessimistic assessments the figure is 7–8%. 45)

These points made by Shmelyov are of utmost importance in the evaluation of the influence of FDIs in CPEs. JVs are potentially extremely important engines of competition in reformed CPEs. All such economies have inherited a highly concentrated, monopolistic economic structure.

Thus, JVs are not only economically important as a means of importing capital, but also as a revitalizing factor of the whole business scene. If quality, and not quantity any longer is to be promoted, then this kind of competition is badly needed. N. Shmelyov is not too concerned with the set-backs in ideology, when he supports radical perestroika. He writes:

> "Let us lose our ideological virginity, which in any case only exists in newspaper editorials, which are fairytales. Despite all this virginity, people are selling and getting rich more than ever before. And it is a question of people who earn money without creating anything and without even wanting or knowing how to create anything."46)

The author of these lines is trying to demystify social life in CPEs. In addition this method can be applied to analysing JVs between East and West. The East European countries may be seen as late-comers in the industrialized world though there are country differences: e.g. the CSSR is an old industrial country. Western FDI is a crucial part of this industrial strategy. Thus, ideology, in particular the theory of imperialism, is a mere fairytale.

As far as the FDIs of CMEA countries in the West are concerned, it may be said that their number is quite modest. Most of the CMEA JVs and wholly-owned subsidiaries are just marketing outlets for export products of CPEs. Manufacturing takes place only in a few exceptional cases.

Certainly the lack of money in CC form is one reason for the poor internationalization of CMEA enterprises. 47) Generally, the CPEs have performed modestly in their external economics, mainly due to the tendency towards self-sufficiency inherent in CPEs. As to the volume of per capita exports, in the early eighties the index number of the CMEA member countries was 24.4% of that of the EEC, which is less than a fourth, 58.8% of that of the US and 41.7% of that of Japan. These figures clearly show that the involvement of the countries of the socialist community in the international division of labour is suboptimal and that their role in world economic relations is low. 48)

It is, however, worthwhile bearing in mind the unsuccessful Bulgarian bid for a French fork–lift truck factory, in which Bulgarian take–over was actually not allowed by local authorities. There are, thus, also other reasons than lack of CC for the low level internationalization of CMEA countries.

Summing up, one may maintain that in the 1980s the CMEA countries have felt the economic pressure pushing them towards more intensive external economic links. This pressure has become visible also in the sense that new methods of international business are sought: internationalization is advancing, while ideological viewpoints moving into the background more and more. In the late 1980s the movement into this direction has been surprisingly fast in Eastern Europe.

In this rapid change there have been two important background factors linked to the failure of the traditional CPEs' external economic model.

- the CPEs were unable to transplant Western technology into the inflexible, administrative economic system in an optimal way. The absorption problem concerning alien technology must be solved with the adding up of the management factor, with FDIs.
- highly efficient, non–market CMEA cooperation has turned out to be a mere fairytale. Market methods with competition, and thus, also Western FDIs are needed in order to increase living standards in the 1990s.

4.3. The future of Western FDIs in the CMEA area

There are three extremely important background factors in the economic field which will to influence Western FDIs in the CMEA area during the 1990s:

- The socio–economic and political change in every individual CPE.
- The relationship of CPEs towards Western economic organizations, above all to the EC and to the IMF.
- The development of intra–CMEA affairs towards a "common market".

Naturally, other factors in addition to these three will also have influence on investment decisions made by Western companies operating in the CMEA–area. The legal framework for FDIs may change. Possible alterations in rules concerning FDIs can not, however, be predicted. It can only be assumed that legislation covering FDIs will become more liberal as the CPEs become more market oriented

The first point mentioned above – the socio–economic and political change in every individual CPE – is extremely complex. During the last few months of 1989 considerable changes took place in the CMEA region. Only the essential features of these events can be covered here. Emphasis is put on the Soviet Union and Hungary, as these two countries are of special interest from the viewpoint of the present study.

In the Soviet Union pressure was mounting in the late 1980s to abolish the constitutional guarantee of the communist party's dominance. In December 1989 Mr. M. Gorbachev, the Soviet leader, was forced to use his full authority and powers of persuasion to prevent his new parliament from debating the monopoly rule of his Party. He only succeeded by a relatively narrow margin – 1,138 votes to 839, with 56 abstentions – after using his position as President to dominate the discussion. 49) However, in February 1990 the Central Committee Plenum of the CPSU paved the way for a multi-party system.

In December 1989, the Soviet Prime Minister, Mr. N. Ryzhkov, delivered a speech in Parliament, which was the Soviet leadership's vision of perestroika for the first half of the 1990s. It contains a sort of an emergency programme for the ailing Soviet economy with a huge switch of resources into consumer goods manufacture and food production and away from heavy industry. The Prime Minister opted for a version in which reform of the economy is supposed to come through the old central planning process. He rejected calls to introduce private property, wide-spread denationalization of state property or swift monetary reform to stop the accelating decline of the Soviet economy. 50)

This programme stipulated by Ryzhkov and subsequently adopted by the Supreme Soviet (Parliament) 51) has been heavily critized by some Western business newspapers. The Financial Times writes in its editional among otherthings:

> "His (Mr. Ryzhkov's) speech on Wednesday was presented as the official version of the perestroika process. Perestroika means restructuring: Mr. Ryzhkov's version is restructuring – but backwards. ... He is seeking once more to link the economy to the levers which can be pulled from the men in the ministries and the state planning offices... As 23 of the peoples' deputies elected from the Komsomol youth organization wrote in the movement's newspaper, his report left unmentioned the true causes of the economic difficulties – the non-market character of the economy and the lack of interest among workers and collectives in the results of their labour." 52)

"Business Week" writes in very much the same manner:

> "At the second session of the nation's (the USSR) Highest parliamentary body, Soviet Prime Minister Nikolai I. Ryzhkov unveiled a five-year economic plan that rejects private property and delays price reforms. More important, the heavy hand of state planning will rule the economy for at least several more years... Although Ryzhkov and his advisers insist that they are still on the path to a socialist market economy, foreign investors are likely to lose confidence in any state run system that delays the tough steps. That was the big problem with the first five years of perestroika, when the government couldn't choose between more state planning and a radical freeing of the economy and so kept more planning in place, Now "it seems we have chosen the plan again," says People's Deputy Pavel Bunich." 53)

These three quotations are of relevance in so far as they show that in the turn of the decade 1980–1990 the USSR is still a CPE, in which the democratisation process is advancing. Therefore, the Western investors, who want to enact FDIs in the Soviet territory must be aware of the system – specific problems of a CPE.

It has often been mentioned in connection with East–West JVs that the Eastern side needs management know–how, which is basically welcome. This intangible asset is, however, not transferable like machines.

The main worry of a socialist manager is supply, while the Western manager's headache is demand. The enterprise directors in the CPEs are used to working under soft budget constraint, as Kornai points out, while the Western counterpart has always had hard budget constraints. Entirely different management attitudes emerge in supply–led CPEs and demand–oriented Western economies.

The harmful lack of demand–orientation in CPEs and the passive role of money, which is hampering joint enterprise actions, can be demonstrated in the light of a case study. The Hungarian "Volanpak" and the Soviet "Littara" started a JV in Vilnius, in Soviet Lithuania, with the aim of producing packaging materials, which are in high demand on the Soviet market. This JV, which was established in May 1987, has experienced difficulties in getting supplies of raw materials, simple equipment and means of transport, as well as receiving office space, even if money for these purposes has been available. 54)

Supply difficulties are not only the worry of East–East JVs, but of East–West JVs as well.

> "To acquire raw materials and equipment from the Soviet market is very difficult. We are constantly in a seller's market. Unfortunately, some of our suppliers feel that quality plays no role. Yet they demand an international market price. You have to order certain things in advance – to be certain you will get them",

states the managing director of EKE–Sadolin, the Finnish–Soviet JV. 55)

Obviously, an East–West JV is normally in a better position to overcome supply difficulties, than an East–East JV. The former is more likely to be in the possession of CC means, than the latter. With that medium of payment it is easier to get supplies on the internal market, or if not possible, to substitute the missing input by imports from the world market.

There are also difficulties in solving questions of JV personnel. Cost–benefit thinking and profitability are alien to managers in the CPEs. According to the Finnish company Nokia, the Eastern side is eager to promote JVs, because it is something new and fascinating, but in reality it is the Western partner, with his capital investment, who takes all the risks and bears the responsibility for solving any problem that might arise. 56)

The problem of management has been acknowledged in CPEs in the period of economic reform, for example by the Soviet writer Yuri Shevchenko:

> "The amateurs must be replaced by educated qualified specialists. And not just a handful, or even a few hundred, but thousands of captains of industry. Where are they to come from? The answer is education, but at present the inadequate, weak foundations of the economic education only fuels the national amateurism of management."57)

The whole economic culture must be changed.

JVs operating in the Soviet Union are not only confronted with supply, personnel and managerial problems, but also matters linked with the red tape. V. Mitrofanov, who heads the JV Association in Moscow, points out that administrators try to command JVs, as if they were subordinated to them. In one case local authorities ordered the work force of a JV to participate in potato harvesting on local fields. 58)

Alongside with red tape there is also a jungle of administrative rules regulating enterprise activity. The prominent Soviet economist Nikolai Shmelyov wrote in 1988 that there is the idea of scrapping all the rules and regulations that run counter to the law on state enterprises.

> "Some 20,000 have been scrapped, but the remaining 180,000 are still in force. The law was hamstrung from the outset. How can one speak of the independence of enterprises when in most branches of industry state contracts account for 100 per cent (or even more) of their output. In the country as a whole 82% of the output of industrial enterprises is planned from the top. Of course, the remaining 18% is better than nothing, but I am not at all certain that it will last until the end of the year".59)

Mitrofanov also points out that there is no modern law on property in the Soviet Union. This fact is hampering JV activity. 60)

One Soviet observer states that his countrymen can endure everything – inconveniences, shortages and poverty – but there must be no private property, owners or exploitation. The same observer, Mr. M. Berger, writes:

> "The bill on property rights represented by the government to the Supreme Soviet envisages a breathtaking plurality of types of property: that of the whole union, separate republics, municipal authorities, cooperatives, joint stock companies, individuals, etc. However, this diversity (in effect, all are varieties of state property) contains no mention of private property in any form whatsoever, leaving aside the individual ownership of the means of production." 61)

Another observer, A. Polyukhov, writes the following about the same topic:

> "One also thinks of the clumsy experiments with the introduction of 'shares' in some Soviet enterprises which are tired of begging for state funds for expansion and are trying to raise funds on their own. These 'securities' are bought not by those who want to, but those who 'have the right' to buy them. It is unclear who has been authorized (and by whom) to grant or withhold this 'right'. The seal of an enterprise doesn't mean anything. The only authority recognised by the market is supply and demand. In addition to the right to buy, there should be the

> right to sell, and in both cases there should be freedom to instantly realize any share not at the nominal price, but at its real value... We need an organized Stock Market, we need a Stock Exchange. Without them there can be no commercial redistribution of resources between enterprises, the funds of the trade unions and industries, the state and the economy". 62)

These two quotations allow some extremely important conclusions. In the Soviet Union a bill on property is under preparation in the winter of 1989–90. The content of this bill is obviously conservative, taking the socialist ideology into consideration. No "market socialism" also containing real security markets and private property is in coming.

After about five years of <u>perestroika</u> in the Soviet Union the economic mechanism is still very much on the line with the conventional CPE–system, which can be verified by a statement made by a Soviet economist:

> "Lenin described the basic methods of exercising monopoly control of the market which include depriving competitors of raw materials, labour, marketing outlets and supply channels and beating down the prices. These and other methods are widely used in our economy as well – not by enterprises, but by the central authorities like the State Planning Committee, the State Committee for Material and Technical Supply, the State Price Committee, ministries and other government bodies, They dictate to manufacturers what to produce and in what quantities, whom to sell their products to and at what prices. Beside that, they dictate wage levels and bond supplies to consumers."63)

Summing up, it can be maintained that joint ventures in the Soviet Union require the amalgamation of two business cultures which differ from each other in a variety of important points. Success cannot always be guaranteed in this difficult task. The first failure of a Soviet JV was announced by the newspaper "Moscow News" before the end of 1989:

> "Fed up with its Soviet partner, a West German firm has decided to drop out a JV that only six weeks ago opened a popular CC store on the first floor of the Peking Hotel in Moscow. The president of the Köln–based (Cologne) company, International Processing System (IPS), accused his former partner in the venture, the Soviet cooperative group Farm, of mismanagement of the store, stealing

goods and trying to control the business to their own personal benefit." 64)

The Soviet partner in this "Interfarm" JV lodged complaints against the supply system arranged by the Western side. The chief supplier of Interfarm, "Spar", a major supermarket chain in West Germany, charged Interfarm ridiculously high prices, according to Mr. Makharadze, general director of Farm. 65)

On the basis of this statement, it can be assumed that the Western side attempted to use transfer–pricing methods for repatriating profits by over–charging the JV for Western supplies. However, no exact evidence for that hypothesis is available.

"Est–Finn", the very first East–West JV in the Soviet Union ran into difficulties at the end of 1989. The Western party, the Finnish clothing factory "Kati–Myynti", has put its share in Est–Finn on sale. According to the Finnish press, Kati–Myynti is probably sueing the Estonian partner for causing delays in building the joint production facility in Tallinn and asking for a FIM 60 million (about USD 15 million) penalty payment for breaking the JV agreement. 66)

In spite of these negative examples and of difficulties in amalgamating the Soviet and Western business cultures described above, there are some vital incentives for Western–Soviet JVs in the 1990: the large Soviet market with some 280 million inhabitants fascinates many Western firms; huge natural riches of the Soviet territory form potential business opportunities for Western investors; in certain cases cost advantages – including labour costs – can be achieved. Thus, it is not surprising that about a thousand JVs were established in the USSR at the end of the 1980s. 67)

When the future of Western FDIs in the Soviet Union is assessed, a new phenomenon must be taken into consideration: the possible independence of some Soviet republics. Especially in the Baltic area this option cannot be excluded any more in the 1990s.

Hungary, the other important object of the present study, offers in many senses entirely different starting points for FDIs at the beginning of the 1990s than the Soviet Union. Hungary cannot offer large markets or abundant natural riches. Incentives for Western investors can be found in the socio–economic and political environment, which showed remarkable changes in the late 1980s. These alterations include the renaming of the Hungarian People's Republic to the Republic of Hungary, cessation of party activities in enterprises, nomination of presidential candidates by the opposition, allowing of a multi–party system with free parliamentary elections, and disbanding the Hungarian Socialist Worker's Party; it was renamed the Hungarian Socialist Party. 68)

If this list is supplemented with the economic reforms, which were described in Chapter 3 bearing especially in mind the spirit of the new Enterprise Law of 1988, it can be maintained that Hungary is entering the 1990s as a Western–style democracy with a mixed economy containing a variety of ownership forms and developing security markets. The socio–economic environment looks fundamentally different from that in the Soviet Union. However, there is still one important similarity in the beginning of the 1990s: the Soviet rouble and the Hungarian forint are both still inconvertible currencies.

Actually already in 1989 a new era of Western FDIs started in Hungary, the era of acquisitions. In July 1989 a new law on conversion was put into force. This law attempts to regulate the methods used to transform state enterprises into private companies. 69) After the enterprise has been incorporated, foreign and local investors can identify shareholders and begin negotiations with them. Thus, if Hungarian enterprises want to attract foreign capital, their first move must be privatisation.

This activity started to take shape already in 1989. Privatisation is followed by partial acquisition of foreign investors. The following case has been brought up in the Western press:

> "IBUSZ, one of Hungary's largest travel agents, has been partially sold to an international consortium, headed by Girozentrale, Austria's second largest bank. The deal, which has proved controversial in Hungary, involves the sale of 40% of IBUSZ. It means the company will become one of the first East European companies to be listed on a Western stock exchange, possibly as early as next year (1990). It will also be listed on Budapest's fledgling stock exchange. IBUSZ, which is desperately trying to stave off mounting competition from Cooptourist, a travel company which started up over five years ago and which has since eroded IBUSZ's long monopoly over the tourist sector, will increase its share capital from its current 800 million forints to 1.2 billion forints (USD 10 million). The much needed capital will be earmarked for improving the company's services... The company intends to offer 30% of the registered shares to Western investors, while the remaining 10% will be offered to Hungarians, of which half will be kept aside for IBUSZ's 2000 employees." 70)

This quotation contains several revolutionary, or actually counter–revolutionary points. A previously state–owned company has been incorporated, and then, a stake of it sold to a foreign consortium, which is reselling shares to Western portfolio investors. In the background there is competition of various travel agencies, of which the previously state–owned monopoly intends to make small shareholders of its personnel. This is not a constellation which is typical for a traditional CPE.

Hungary is entering the 1990s equipped with a multitude of possibilities for Western investors, and can thus be called a mixed economy. Characteristics adhered to a CPE–model are weakening.

Poland is, alongside with Hungary, a special case among the countries under review. There is, however, a remarkable difference between these two countries in the turn of the decade 1980–90: the Polish economy is in a much more serious disequilibrium than that of Hungary.

In December 1989 Mr. L. Balcerowicz, the Polish Finance Minister, presented his economic package to the parliament. It aims to reduce subsidies, remove price controls, liberalize foreign exchange rules and introduce real interest rates. Mr. L. Walesa, the Solidarity leader, came out in favour of the plans, although he urged the Government to speed up the privatisation of industry, which for the moment has taken second place to the fight against economic imbalance.

Obviously, privatisation has not been advancing as rapidly in Poland as in Hungary. Thus, acquisitions as a new phenomenon can hardly take place in the Hungarian manner. However, newspapers have written about the possible takeover of the Lenin shipyards in Gdansk by Barbara Piasecka–Johnson, who is a US citizen. The US–partner, who is willing to invest about USD 100 million in the Gdansk unit, has been looking for guarantees against labour unrest. 71)

In Czechoslovakia, Bulgaria and Romania the old–guard leaders disappeared from the political scene in 1989. The dramatic events of autumn 1989 in these three countries are likely to speed up economic reforms thus improving the investment climate for FDIs. It is, however, impossible to predict whether these countries will follow the Hungarian path towards mixed economy and Western type democracy, even if this option seems to be the most likely one. In post–Ceausescu Romania it is highly probable that the dismantling of JVs will stop and new, more attractive rules for FDIs will be created.

The second point mentioned at the beginning of the present section (4.3) is the relationship of the CMEA–countries under review with Western economic organisations. This point is of utmost importance for the CMEA–countries seeking FDIs: if these countries are able to participate in the general tendency towards integration throughout Europe, and become members of the multilateral monetary system of the global economy, their attractiveness as host countries for FDIs will be enhanced fundamentally.

After the adoption of a common political declaration in June 1988 between the EC and the CMEA, four CMEA–countries (Hungary, the CSSR, Poland, the USSR) under review had signed trade pacts with the EC . 72) It was mentioned above that Romania signed an agreement with the EC as early as in 1980. Thus, by 1989 only Bulgaria was without an EC–trade pact among CPEs in the present study.

It is essential to realize that the trade pacts the EC has concluded with "state trading countries" (Hungary, the CSSR, Poland, the USSR, Romanía) are not free trade agreements, similar to the pacts signed with all individual EFTA–countries (Sweden, Switzerland, Finland, Norway, Austria, Iceland). In the former case quantitative restrictions (quotas) have been abolished (with different timetables) and in the latter case customs tariffs have also been abolished. EC–agreements with various CMEA–countries are thus "non–preferential" in nature: the EC has not been ready to abolish customs tariffs with "state trading countries", because reciprocity cannot be achieved in this case: no equivalent move can be offered from the CPE's side.

In December 1989 it was decided to start negotiations between the EC and EFTA aimed at forging what has been dubbed the European Economic Space (EES). In the long run, this may provide one of the important means for redrawing the map of Europe with the eventual inclusion of Eastern European countries in a new economic and political order. 73)

In 1989, Hungary was seeking a cooperation agreement with EFTA. even showing interest in eventual membership. EFTA has also been contacted by the USSR, the CSSR and Poland. However, there is particular resentment among some EFTA states that the free trade body should be regarded as an EC anteroom for the Eastern European economies as they become more market–oriented. 74)

It is self–evident that the CMEA countries have a vital interest in participating in the EES–process, as this process will be decisive for Western European economic development in the 1990s. If CMEA–countries fail to be a party of the EES process with or without EFTA, it will be a considerable blow for FDIs in Eastern Europe.

It has been pointed out above that several European CMEA countries are members of the IMF (Romania, Hungary, Poland). According to the IMF rules, all members must aim at convertibility of their currencies. Thus, membership of the IMF will advance factor mobility including FDIs in the long run. In December 1989 Czechoslovakia applied to rejoin the IMF, a move which may eventually end 35 years of economic isolation since the communist authorities severed links with the organization in 1954. 75)

In the Soviet Union serious discussions about establishing links to the IMF started in the late 1980s. For example, professor Georgy Skorov brings about a whole range of arguments in favour of joining the IMF. 76)

Firstly, Skorov points out that the Soviet involvement in world economic processes lags seriously behind that of major Western countries. It is they and not us, he writes, that determinate value exchange rates – which reflect the world prices – the volume and direction of commodity flows, world bank interest rates, exchange rates, that is, the numerous conditions affecting the well-being of the participants in the international division of labour, the Soviet Union included.

Secondly, the same writer states that the USSR ought to have the strategic objective of taking an active part in working out and implementing the forthcoming reform of the monetary system, in particular in respect of the IMF, as well as playing a role in determining international monetary policy. The tactical aim is to ensure the opportunity to enlist, if need be, additional financial resources at a lower interest rate than if borrowed from a privately-owned bank. To work for the former objective outside the IMF is very difficult if not impossible.

Thirdly, professor Skorov points out that in recent years the impact of the capitalist monetary system on the foreign trade operations of the USSR and other socialist countries has substantially increased. The non-participation of the USSR in the regulation of international monetary ties is already causing certain problems in economic relations within the CMEA, as some of the CMEA countries (Hungary, Poland, Romania, Vietnam) have been members of the IMF for years, unlike the Soviet Union.

It is remarkable, how openly Skorov underlines the positive factors of IMF-membership by writing that IMF credits could prove constructive in reorganizing the Soviet economic structure and raising the competiveness of Soviet products. Learning from the experience of the market economy which underlies the IMF's philosophy, the USSR could faster and more efficiently complete the development of the new monetary mechanism combining the principles of nationwide planning with a nationwide socialist market and the integrated market of the CMEA member states.

Even if this remark by Skorov is a bit oddly formulated – because the optimal mixture of market and plan is not known by anybody – it is interesting: the Soviet Union and the CMEA have something to learn from the IMF, which is in traditional socialist language stamped as an imperialist organization. Therefore, these observations can be regarded as a valuable piece of glasnost.

Professor Shenayev, who was interviewed by the West German periodical "Osteuropa-Wirtschaft", has similar attitudes favouring IMF-membership. In his opinion, preconditions for rouble convertibility must now be created, an in this the membership in the IMF is helpful. 77)

However, the Soviet discussion on joining the IMF has obviously only an academic dimension. Ivan Ivanov from the Soviet administration (GVK) states flatly:

> "Some hotheads are proposing all but immediately knocking on its (IMF) doors. Such haste is unnecessary for, first of all, we would hardly be accepted, no one has yet given us sufficiently substantial calculations as to what we can realistically receive in exchange for our contribution to the IMF. A situation can result where we will share responsibility for IMF policies without being able to influence them". 78)

It is thus clear that the Soviet Union was not willing to join the IMF in the turn of the decade 1980–90. Obviously, external interference into Soviet economic affairs cannot be accepted.

In Hungary, which has been a member of the IMF from the early 1980s, the day of economic reckoning has arrived. In late 1989 the IMF issued its prescription for dealing with the country's ills–namely soaring deficits on all fronts and a high foreign debt. An austerity programme for 1990, which includes the closure of 50 loss-making companies, a 20% cut in state subsidies and an almost balanced budget was announced. 79) In London, the Hungarian Prime Minister, Mr. Nemeth warned that the IMF programme was not getting any applause from the people:

> "There will be tension and I am not excluding the possibility of great resentment and opposition to these measures". 80)

In December 1989, Poland's negotiations with the IMF on an adjustment programme was delayed, putting into question the Government's ability to initiate its anti–inflation policies.81)

These examples have been brought up in order to show, how difficult it is to establish economic equilibrium in the CPEs with Western "demand management" methods. It is not an easy task to create preconditions for convertibility of CPEs' monetary units with the help of the IMF advice based on austerity. If, however, the goal of convertibility is reached with the help of the IMF economic policy advice, the FDIs are likely to experience a remarkable boost.

The third point mentioned above – the development of intra-CMEA affairs towards a "common market" – is of vital importance for Western investors looking for opportunities in the East. If socialist integration methods become market oriented, there will be increasing interest among Western investors to be on the inside of this big market.

The decision to create "a common market in the CMEA" was taken at the 44th CMEA Council meeting in Prague in the summer 1988. 82) This resolution has since been discussed by socialist specialists in international economics.

The Soviet economist Yury Shiryayev states, that any economist could list a sufficient number of arguments to demonstrate that an integrated market is a long way off. Before it materializes, the home markets of the member countries must be balanced, competitive enterprises must be formed in the CMEA's manufacturing industries, and mutual access to wholesale goods must be provided. That is no easy task, and dealing with it will take more than a decade. 83)

According to Alexei Antonov, Deputy Prime Minister and permanent Soviet representative in the CMEA, a great deal will depend on the renewal of the price and monetary mechanism of integration. The main aim of the price policy is to stimulate the production of articles that come up to international standards and help expand connections with the world market. This can only be achieved by reducing the difference between contract (CMEA) and world market prices and promoting the independent price formation activity of enterprises and economic organizations. The setting of real exchange values for CMEA currencies, the introduction of mutual convertibility on this basis, and the wide use of national currencies in trade between socialist countries are, according to Antonov, the main ways of readjusting the monetary and financial system. 84)

The Soviet economist A. Nekipelov represents the optimistic view that direct links between CMEA production enterprises – a topic widely discussed in CPEs in the second half of the 1980s – are gradually leading to objective price reform, and to the possibilities of converting TR into commodities, and thus, to a multilateralization of payments in the CMEA–area. The precondition for that, however, is that enterprises will be transformed from units executing plan directives to "socialist commodity producers", which are led by their own economic interests. In foreign trade within the CMEA the client must have the right to choose the economically best offer. 85)

A surprising turn to this discussion on the socialist common market came in December 1989, when the Soviet Prime Minister, N. Ryzhkov took up the topic in his economic programme speech in the Supreme Soviet. He states the following:

> "In the development of CMEA cooperation there are presently many difficulties, mainly due to incomplete cooperation mechanisms. We are now looking for solutions to this problem. The prospective aim is to create a common market in the CMEA. It is proposed to start applying current world market prices for the intra–CMEA in 1991 and to go over to CC payments." 86)

Mr. Ryzhkov is here proposing a truly revolutionary move for intra–CMEA trade deals, which will speed up the socialist common market idea in practice, if carried out as outlined by the Soviet head of the government. It means the scrapping of the whole TR system, which has been hampering the rationalisation of the socialist international division of labour.

This new "Ryzhkov model" is good news for Western investors interested in enacting FDIs in the CMEA countries. A FDI in Hungary, for example, can be used as a bridge–head to conquer the Soviet market, or vice versa, and CC payments can be applied without any special arrangement.

If applied, the "Ryzhkov model" will have severe consequences for the whole CMEA area. "Soft" goods production within the bilateral socialist trading system is likely to wither away. Surplus capacities will then become manifest.

This Soviet proposal was discussed in the CMEA's 45th session held in January in Sofia. According to M. Calfa, the new Prime Minister of Czechoslovakia, his country would be able to start the gradual transition toward the "Ryzhkov model" no sooner than in the mid–1990s. The crux of the matter is that the CSSR needs great amounts of Soviet oil and gas which it would have to pay in CC according to world market prices, while the competitiveness of Czechoslovak products is questionable. Cuba wanted no changes at all. 87) It can be assumed that Calfa's pragmatic view is shared by most members of the CMEA. Thus, CMEA is returning to the centuries–old norms of civilized economic cooperation and is ready to bury the practice when the exchange of goods between member countries resembled the exchange of goods between tribes trading three axes for five sheep, as a Soviet observer puts it. 88)

The restructuring of the CMEA economies, in which competitiveness must be closely watched, will create new opportunities for Western investors. It is likely that more acquisition activity will develop when such activities become permissible to greater extent.

In the 1990s it is likely that there will be shifts in the relative wealth of the CMEA countries measured in CC purchasing power. It is highly likely that the Soviet Union will profit from the application of the "Ryzhkov model", if it sells the previous amounts of raw materials to her allies on the CC basis and refuses to buy any "soft" goods offered by them.

In this case the Soviet Union will become a more attractive trading partner for Western countries with more CC purchasing power. The small CMEA countries will need Western FDIs more than ever: their national economies must be made competitive with all the methods available.

Summing up all the three points brought up in this section (4.3.), it can be maintained that FDIs across ideological borders are in an extremely exciting phase at the beginning of the 1990s:

- Political and thus also economic reforms are likely to experience a considerable boost in the early years of the 1990s. This trend is highly likely to improve preconditions for Western FDIs in the East.

- Country differences in the sphere of economic reforms are still obvious at the beginning of the 1990.s Hungary is clearly in the lead by applying mixed economy methods with a variety of ownership rules. The Soviet Union is reluctant to follow suit, especially in respect of reforming property rights.

- Differences in the size of the market and natural riches are also likely to affect investment decisions in the 1990s. The Soviet Union is an attractive target for FDIs as far as these two points are concerned. In this respect the other CMEA countries are unable to compete with the USSR.

- All the socialist countries under review will obviously be interested in European economic integration in the 1990s. Participation in the EES-process is regarded as important. On the Western side ideological considerations are involved: the more democratic and market economy features are applied in the East European reforms, the more likely financial help and trade policy concessions by the West will be. Hungary and Poland are the favourite Eastern countries in this context. 89)

- The ultimate goal of West European economic integration first in the framework of the EC and then also of the EES is the three-fold liberty of: free movement of goods and services, capital and labour. If these basic liberties are accepted by any CPE, it will mean the ultimate dismantling of "realsocialism" based on marxism-leninism.

- From the point of view of attracting FDIs it is essential for CPEs to become involved in the EES process. Further de-ideologization in the CPEs is needed, if they are to be a party in the All-European integration process. Hungary and also Poland seem to be prepared for this process, while the Soviet Union is hardly ready to accept the three basic freedoms at once. All the other CMEA countries are somewhere in between at the beginning of the 1990s.

- There is an obvious trend among CMEA countries towards accepting the IMF as an important institution and as an economic adviser. However, the Soviet Union as well as Bulgaria have as yet made no decision to join this organization in the 1990s.

- The membership in the IMF does not, however, guarantee the immediate convertibility of a member. Romania has been a member already for about twenty years without achieving convertibility of the lei. In the post-Ceausescu era in Romania it is likely that contacts with the IMF will be revitalised and preconditions for convertibility evaluated in the future.

- Economic links between the CPEs and the IMF seem to be painful. Stabilising austerity proposed by the IMF can hardly be popular and it can also cause revival of ideological arguments.

- Economic stability and a multilateral monetary environment, which are of vital importance in attracting FDIs, cannot be achieved without economic austerity. Serious economic policy conflicts, which harm the investment atmosphere, cannot be excluded.

- In intra-CMEA affairs modernisation seems to be advancing in the early 1990s. The likely abolishing of the TR-payment system in socialist foreign trade certainly will not harm international movement of capital.

Finally, a new special feature in FDIs across ideological border came up in the few last months of 1989. In a summit meeting with Mr. Hans Modrow, the East German Prime

Minister, and Helmut Kohl, the West German Chancellor, intensified economic cooperation between the two German states was discussed:

> "The two sides agreed to set up joint Economic and Environment Commissions, as well as a study group to improve tourism exchanges. West Germany is to increase credit lines to back cooperation by smaller industries from DEM 4.5 billion to DEM 6 billion. Another DEM 2 billion from budgetary funds is to be set for guarantees for other industrial projects. A key condition is the new East German law on JVs expected to be finalised next February (1990)". 90)

The FRG has so far been the most important Western investor in the CMEA area. One of the questions in the 1990s will be to what extent she will concentrate the FDIs on the neighbouring GDR. If capitalist investment activity in the CMEA area is a zero-sum game in the 1990s, it is possible that the lion's share of West German FDI-sum will be channelled into the GDR.

Already in January 1990 the GDR announced that a Decree on JVs has been passed. According to East German newspapers foreign partners are allowed to have a majority stake in JVs, when they are important from the point of view of the host country's national economy, or when they are small or medium sized enterprises. It is underlined that JVs must work in the framework of East German economic legislation. 91)

In sum, at the beginning of the 1990s the situation concerning Western FDIs in European CMEA-countries is fundamentally different from that in the two previous decades. The new situation is described very well by a Soviet historian,-V. Dashichev:

> "Current tendencies (the USSR's *perestroika* and East European revolutionary changes) have introduced predictability into European and world politics. Today, one can confidently predict that unification and cooperation will supersede rifts and unity, that a balance of interest will replace the balance of fear, that the security of individual states will replace bloc security, while freedom of development and tolerance will supersede hegemony and ideological Messianism."92)

According to the same observer the old situation was characterized by structural incompatibility of the market economy with East Europe's bureaucratic command economy, which created almost insurmountable barriers for economic cooperation between the two systems.93) Compatibility of economic interests on the enterprise level requires, as we have seen, several preconditions in order to be successful. Political detente is only one of them.

Chapter 4

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Conclusions

Marxism and marxism–leninism have been unable to develop a constructive and positive theory of foreign trade suitable to guide socialist international affairs. The theory of imperialism, which criticizes the capitalist development of the global economy, has been of very little help when external economic links between socialist countries of the CMEA have been created.

The socialist approach to international trade has often been called trade aversion. The basic socialist notion is that international trade should be employed to supply the domestic economy with certain necessary imports, the necessity of which is spelled out in the economic plan by the system's directors. The emphasis is on the use of international trade to acquire imports; exports serve only as the means for acquiring them.

This system which disregards the comparative cost advantages has been sub–optimal from the point of view of welfare maximisation. In addition, the socialist system of international payments based on the clumsy TR–clearing has formed an effective brake for advancing factor mobility among socialist countries.

Thus, it is actually natural that the CMEA countries have been unable to create "a parallel world market", a closed community, which is independent from global markets with economic fluctuations and capitalist dominance. Links to that ideologically hostile global market have been sought and also established.

In the 1970s the CMEA countries attempted to integrate themselves into the global economy by heavy credit–financing. The basic strategy was to borrow money from the international market and import technology on a large scale from the West. It was assumed that no essential alteration in economic decision–making was needed.

This strategy failed badly.Competitive economic units on a large scale could not be created in an economic environment in which centralized management methods were largely kept in tact.

The alternative for credit financing, Western FDIs, emerged already in the 1970s. The first attempts to attract FDIs were half–hearted and full of ideological hesitations. Results in the 1970s were bound to be extremely poor.

In the 1970s there were also serious attempts to revitalize the intra–CMEA co–operation. Huge investment projects formed the method to advance the socialist international division of labour. Difficulties in calculating investment contributions, as well as results achieved by the investors became obvious thus soon bringing the boom of joint investments to an end.

Socialist ownership arrangements together with the outdated socialist currency system have kept intra–CMEA JVs at a minimum. Only a few cases have seen daylight. These modest economic outlets cannot be compared with MNCs, which form the most dynamic part of the capitalist global economy.

Thus, it is actually no wonder that CMEA countries started advancing the idea of FDIs between East and West in the 1980s, even if the results of the previous decade were not encouraging. Results, which differ from country to country, are interesting in many senses, even if they are economically not substantial.

From the ideological point of view permitting Western FDIs to operate in socialist societies can be said to be absurd. The theory of imperialism has always been an absolute core point in marxism–leninism. Allowing MNCs to invest in socialism means economic alliance with the main agents of the monopoly capitalism. De–ideologisation of socialist societies is a *conditio sine quo non* when Western FDIs are attracted to the CPEs.

The ideological erosion of marxism–leninism experienced a stormy leap forward during the last moments of the 1980s. However, ideology did not wither away altogether, at least, not in the Soviet Union. Therefore, some special features in the host countries of FDIs must still be taken into consideration, when Western enterprises invest their risk capital into CMEA countries. Political risks in the form of a backlash toward stalinism might be relatively small, but not altogether extinguished.

Originally, the 1980s were to have been a special – a very special – milestone in socialist development. According to the Party Programme of the CPSU of 1961, the 1980s were supposed to be the first decade of full communism, during which all scarcities would have been overcome and the need of using economic levers would have become superfluous. After that all the nations of the world were supposed to follow the example given by "real socialism".

The reality of the 1980s differed fundamentally from that vision. Economic levers are badly needed in the CPEs, in order to help reestablish economic equilibrium, which is needed, among other things, in attracting Western FDIs. Socialist countries have been competing with LDCs in acquiring Western FDIs. The solidarity of the CMEA countries with the LDCs in the fight against international exploitation has lost meaning as a socialist slogan.

As far as the economic importance of Western FDIs is concerned the results were still relatively meagre in the 1980s, even if they improved somewhat in comparison to the 1970s. Country differences are striking: the Soviet Union and Hungary have received the main part of the FDIs. Motives of the investors have, however, obviously not been the same in both cases: the Soviet Union attracts FDIs mainly with big internal markets and natural wealth, while Hungary offers a reformed market oriented economic environment.

In the future it is important that the economic reform process continues and intensifies when the CMEA countries seek for Western FDIs. In addition to the reforms on the national economy level it is important for the CPEs to participate in the integration process which is taking place in the global economy in the 1990s. Standing outside of these developments would mean serious set-backs in acquiring FDIs.

The atmosphere of political detente engendered by *perestroika* creates favourable preconditions for global economic integration. However, some dangers are also looming ahead for Western investors as well as for host countries receiving FDIs.

Direct investments bring up direct economic involvement. Western companies have started already in the 1980s not only in the form of JVs in the CPEs, but also by making acquisitions. What is the price of a socialist company or the value of a share in it when it is sold to Western investors? Is it not possible or even likely that the Western investor is only interested in the best pieces of the socialist economy? What will happen to the CPEs when JVs and wholly Western-owned companies become dominant in certain branches of the national economy causing disturbances for local competitors? Will it be accepted that Western companies come and make a quick profit and afterwards pull out? Many unanswered questions remain at a time when FDIs between different social systems are becoming more important.

If Western FDIs in the CMEA region grow rapidly, the result will be the neo-colonialisation of socialist countries via direct influence of MNCs. This process may lead to neo-stalinistic tendencies in CMEA countries with a revival of anti-imperialist feelings. If Western FDIs remain thin, there is a danger that the reform process in the CMEA countries will lack economic dynamism. In this case it is likely that mass movement of labour from the East to West will take place. In the optimal case Western FDis will be important but not dominant in the CMEA countries' national economies exercising indirect influence by forcing the local economic units to become fully competitive. Only the last scenario will guarantee harmonious transformation of CPEs toward mixed economies.

Appendix 1 1)

Foreign Trade Decision–Making in the Soviet Union in the pre–perestroika period

The Council of Ministers

The Council of Ministers is the Soviet Union's highest executive and directive organ which is responsible to the Supreme Soviet. The Council of Ministers is responsible for the general management of foreign economic relations and for execution of international contracts through the agency of the state committees under its jurisdiction.

State Committees

The most important state committees in foreign trade are Gosplan, GKNT, Gossnab, Gosstroj and GKES.

Gosplan is the Planning Committee which is responsible for the preparation of plans concerning the whole Soviet economy. For the planning of international economic relations, Gosplan has three special departments of which two are responsible for trade with the West. Gosplan draws up foreign trade plans in close cooperation with representatives from other state committees and experts from the Ministry of Foreign Trade. Representatives of the latter organization in particular are in a key position in linking foreign trade agreements applying to individual countries to the general plan. Western exporters are unable to influence the activities of Gosplan very much.

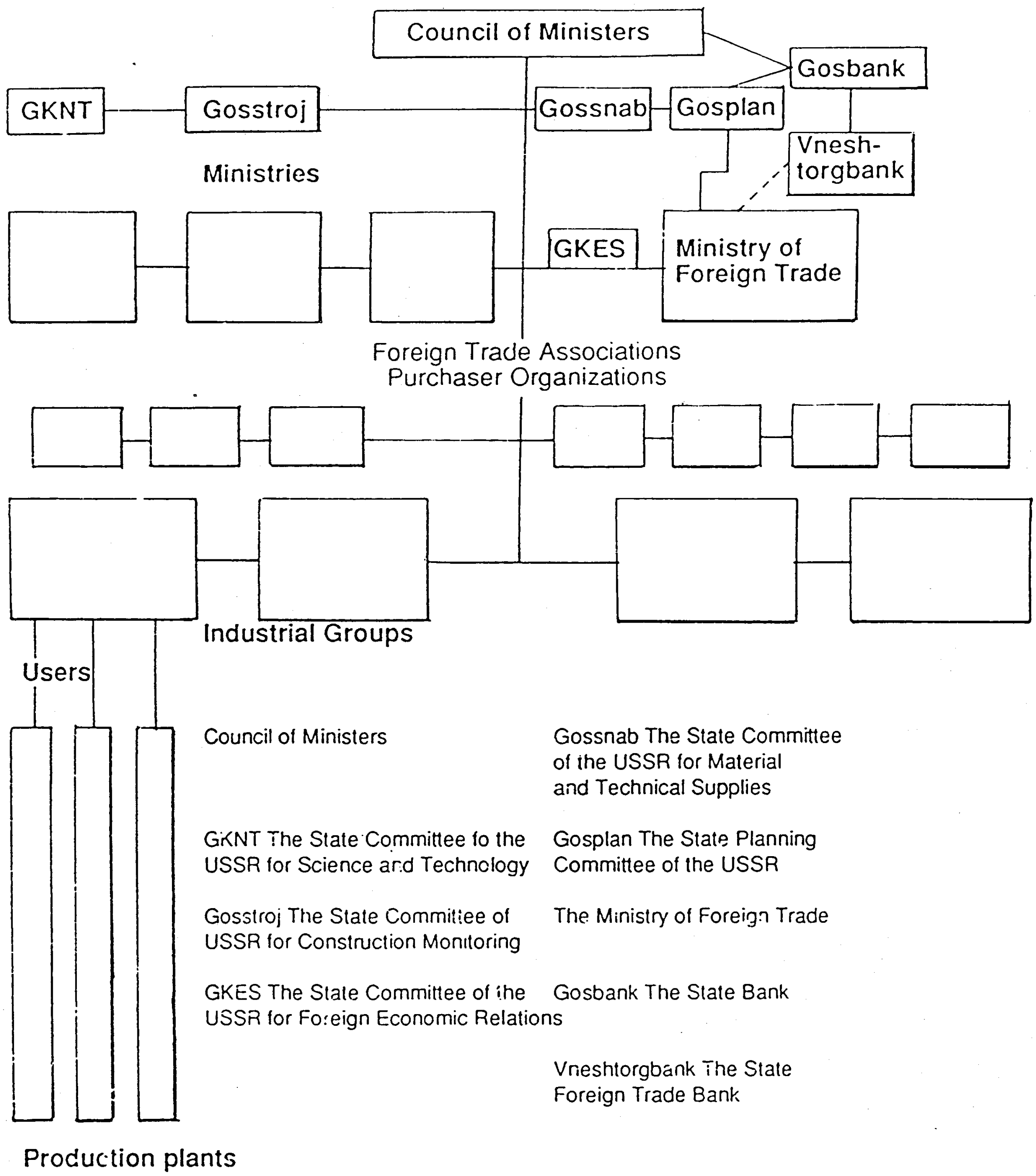
GKNT is the State Committee for Science and Technology which is responsible for the direction and follow–up of technical development.

The active efforts of the Soviet Union after technological exchange have, in the last few years, increased the significance of GKNT in foreign trade. GKNT gives recommendations and instructions about the acquisition of foreign technology. During the last few years, these recommendations have particularly concentrated on improving production efficiency and such.

The important institute VINIT, the All–Union Institute of Scientific Technical Information operates in connection with GKNT in business marketing technology. Viniti's job is to follow technical development in the world. The information which it gathers has a considerable influence on decisions concerning Soviet technological imports.

Foreign Trade Decision-Makers in the Soviet Union

The following organizations participate in Soviet foreign trade decision-making:



Council of Ministers

GKNT The State Committee fo the USSR for Science and Technology

Gosstroj The State Committee of USSR for Construction Monitoring

GKES The State Committee of the USSR for Foreign Economic Relations

Gossnab The State Committee of the USSR for Material and Technical Supplies

Gosplan The State Planning Committee of the USSR

The Ministry of Foreign Trade

Gosbank The State Bank

Vneshtorgbank The State Foreign Trade Bank

The Foreign Trade Association, Vneshtekhnika, which is responsible for product testing, is subordinate to GKNT. The suitability of machinery and equipment intended for the Soviet market are tested at Vneshtekhnika. Its report may even be an absolute requirement for continued negotiations.

Gossnab is the State Committee for Material and Technical Supplies. It maintains material stocks, and guides and supervises the flow of goods between enterprises. In foreign trade, the administrative branches of this committee, which are divided into product lines, are often the customers of foreign trade associations, especially when bulk goods are in question. Gossnab participates in the planning of material flows according to spheres of responsibility and its representatives are often present on the administrative board of the foreign trade associations.

Gosstroj is the State Committee for Construction Monitoring which handles the coordination and supervision of construction jobs under different ministries at a higher level. The increase in project imports has made Gosstroj a rather significant manager of foreign economic relations. From the point of view of Western business, Gosstroj is, however, chiefly a guiding force behind decisions made by the ministries.

GKES is the State Committee for Foreign Economic Relations which is responsible for Soviet project exports. Its main form of activity is the supplying of complete production plants on a turnkey basis chiefly to developing and socialist countries. The nine foreign trade associations operating under GKES resemble engineering offices and carry out project and realization work connected with the building of production plants.

GKE's range of activities is quite comprehensive and it has agreements on cooperation with nearly one hundred countries. Finland is one of the most important Westerns partners in this cooperation and so GKES has its own representation in Finland, in the office of the Soviet economic counsellor in Helsinki.

In cooperating with the foreign trade associations under GKES, Finnish companies have carried out considerable projects in Finland and the Soviet Union. Cooperation in third countries – principally in developing countries– offers significant potential opportunities to Finnish companies, especially in the fields controlled by GKES.

Ministries

In the Soviet planned economy the ministries listed below traditionally play an important role in decision–making. In the planning stage the different ministries inform Gosplan of their own import requirements and export possibilities. The high level organs participating in planning perform a levelling out coordination of import requirements and apportion means for payment for the use of the ministries, taking the priorities of the national economy into consideration.

Ministries of Industry

The industrial branch ministries have an important position in foreign trade decision–making. Each one of them if interested in the increasing of the capacity of their own line of activities and in making the operations of existing production plants more effective. Consequently these ministries related to particular lines of activity are important contact points for the exporter.

The planning organs have to trim the import wishes of the ministries. After this, the approved projects become a part of the foreign trade plan and means for payment are granted to the ministry concerned.

On the basis of the approved plan, the ministry gives the foreign trade associations the work of realizing concrete purchases. Thus an intent to purchase entered in the ministry's plan is a vital impulse for the materialization of trade.

These regional ministries are also interested in the new products which have not yet been included in the import plans. The presentation of new products to representatives at ministerial level is also extremely important because in this way the acquisition in question can be included in the next important plans.

Over the last few years, foreign trade departments (zagranspostavka) have been formed within the ministries of industry. Nowadays, this kind of department, which helps the ministry in the planning, realization and control of import and export operations, is to be found at virtually all the ministries of industry.

The purpose of forming the zagranpostavkas was to bring the foreign trade purchaser and consumer organizations closer to one another. The formation of foreign trade departments has helped Western importers in creating relations with decision–makers at a ministerial level.

Immediately under the ministries of industry there is an administrative intermediate authority, the so–called "obedinenie" or association level. These large units direct the operations of the actual production plants under them. The development of this authority over the last few years has not, however, led to the granting of direct foreign trade rights to production associations.

The Ministry of Foreign Trade

The real administrative central organization for the foreign trade of the Soviet Union is the Ministry of Foreign Trade. It is responsible for the management, regulations and control of Soviet foreign trade. At this moment its range of duties include:

- preparation for the development of commercial relations between the Soviet Union and other countries and general measures connected with it
- preparation, negotiating, signing and supervision of the execution of inter-governmental trade agreements
- the drawing-up of import and export plans, the planning of measures aimed at improving the quality of export and import goods
- the regulation and supervision of the operations of the foreign trade associations functioning under the jurisdiction of the Ministry of Soviet trade representatives and commercial counsellors
- tasks connected with the administration of customs affairs
- the granting of import and export licences
- tasks connected with currency and matters affairs and with foreign trade transportation
- the selection, training and placing of personnel working in foreign trade.

The Ministry of Foreign Trade is headed by the Minister of Foreign Trade and his deputy vice-ministers of foreign trade, of which there are several. The board working under the Minister of Foreign Trade is an advisory body whose decisions are effected after the Minister has confirmed them.

The Ministry of Foreign Trade is divided into the following administrative offices or departments:

- commercial policy or regional departments
- departments according to product lines
- departments formed on a functional basis.

The main function of the departments according to product line is the supervision of the realization of import and export plans. In practice they check delivery agreements made by the foreign trade associations and grant import and export licences. These departments also control the term of the agreements and see to it that the state of the market is properly taken into consideration when entering into business. The departments are also actively involved in the drawing-up of foreign trade plans, and they follow the commercial goods structure and look for new export products. The departments are contact points for the ministries divided into product lines in foreign trade.

The functional departments of the Ministry of Foreign Trade manage the special tasks of foreign trade, such as: transport, currency and law of contract questions, customs affairs etc.

A network of representatives authorized by the Ministry of Foreign Trade operates in the country's various Soviet Republics and economic regions. They are contacts between the Ministry of Foreign Trade, the foreign trade associations, ministries and central administrative boards and the various officials of regional administration. In addition to this, they supervise the realization of virtually all the tasks connected with foreign trade in their region, among other things the acceptance of imported goods and their use. The actual inspection of goods lies with the Soviet Chamber of Commerce and Industry.

All-Union Foreign Trade Associations - The Practical Trade Partners

Principles of Operation

The state's monopoly in foreign trade can be seen in practice in the centralization of import and export activities in special All-Union foreign trade associations. These associations are juridically independent state organizations operating on the principle of profitability. Regulations have been established for the associations in which their rights and duties are defined as well as their trading goods and regions.

The foreign trade associations are, as their name implies, specialized in foreign trade tasks, they do not practise productional activities. They operate as agents between Soviet production plants and other organizations and foreign business. The majority of the associations is based on the line of business. There are also associations whose operations are regionally demarcated or who manage certain special tasks (e.g. insurance, advertising, transportation, licence trade etc.)

The foreign trade associations are, apart from a few regionally limited associations (e.g. Lenfintorg/Leningrad), situated in Moscow. Representatives of the foreign trade associations work at Soviet Trade Representations abroad, one person may represent several associations.

The number of foreign trade associations has varied with economic reforms and the pursuit of efficiency. Nowadays there are approximately seventy groups. Of these the great majority work under the Ministry of Foreign Trade.

The Organization of the Foreign Trade Association

The organizations of the foreign trade associations are generally similar, even if the economic reforms carried out in 1978 affected their internal structure to some extent.

The leading people of the foreign trade associations are experienced and high level foreign trade experts. In staff training much stress is put on the developing buying skills, in addition to a general knowledge of foreign trade.

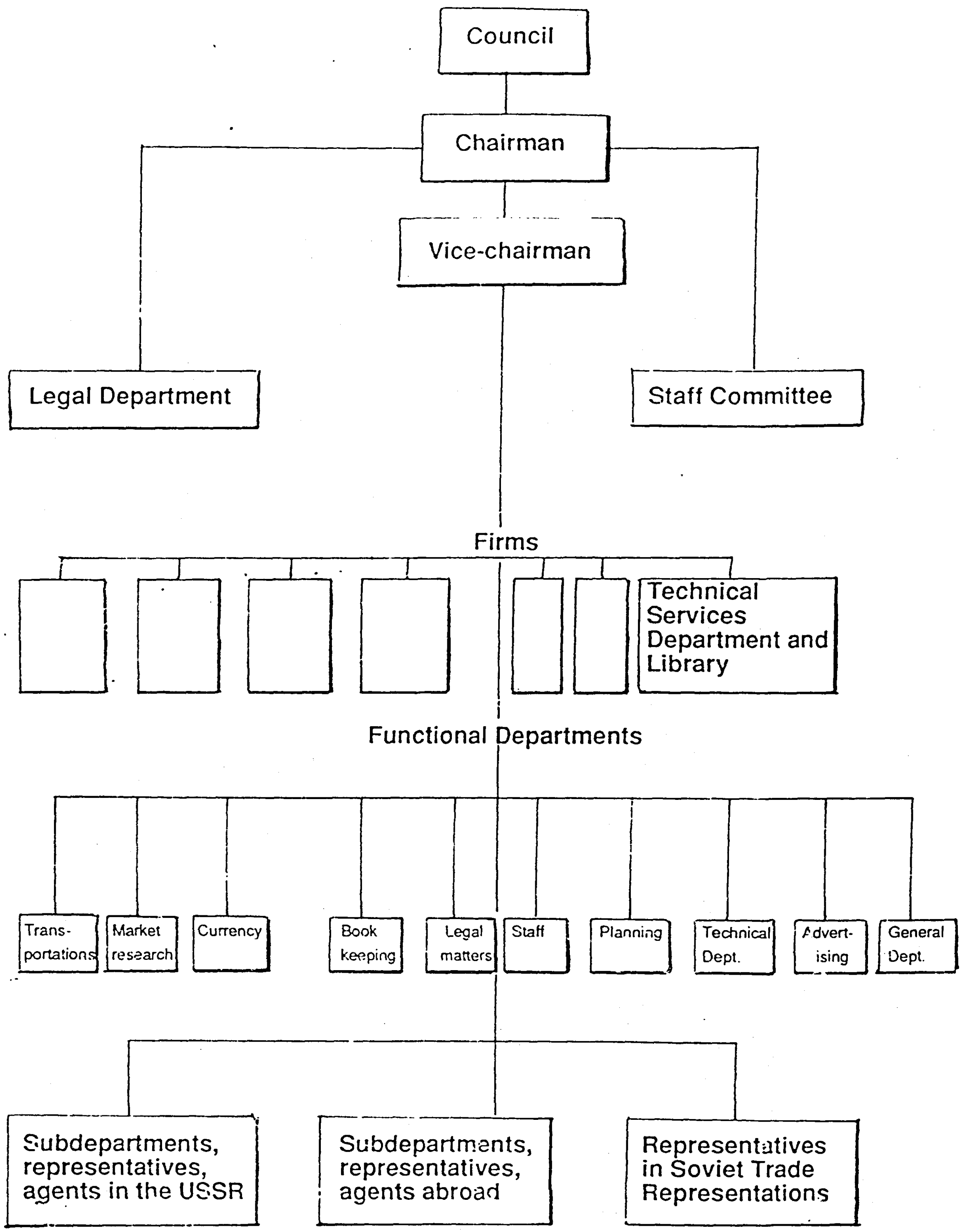
A council, which meets quarterly, is as the highest organ in the association, of which half represents the association's personnel and the other half the organizations (e.g. Gossnab, GKNT, industrial associations etc.) which the association serves. The number of members on the council is always even. In an equally divided vote the chairman (group leader) has the casting vote.

In the Soviet Union the formation of these councils is considered a significant reform, which is aimed at improving cooperation between the buyer and end user.

The leader of an association is appointed by the Ministry of Foreign Trade if the foreign association in question comes under the jurisdiction of the Ministry of Foreign Trade. The leader has two deputies, one of whom is a representative of the Ministry of Foreign Trade and the other of the Ministry of Industry.

Actual operational activities are realized in the firms of the foreign trade associations. Usually there are 5–10 of these firms which are divided according to product groups.They are independent profit centres, but not juridical entities. Thus contracts are signed in the name of the association although executives of the firms can appear as the signatory party. Earlier only the association's executives were authorized to sign on behalf of the association.

In addition to the firms, several departments formed on a functional basis work within the foreign trade association. They attend to routine matters and the production of the data needed to back up decision–making.


Council
Chairman
Vice-chairman
Legal Department
Staff Committee
Firms
Technical Services Department and Library
Functional Departments
Trans-portations
Market research
Currency
Book keeping
Legal matters
Staff
Planning
Technical Dept.
Advert-ising
General Dept.
Subdepartments, representatives, agents in the USSR
Subdepartments, representatives, agents abroad
Representatives in Soviet Trade Representations

Appendix 2

The Joint-Stock Company "Haldex" 2)

When in April, 1959 Hungary and Poland founded Haldex with a 50–50 per cent participation as a joint stock company, the legal form was inherited from the capitalist practice was applied in such a way that each country designed one of its enterprises as a "shareholder", and the shares were made out in the names of the two holders. The company was formed and operates according to the rules of Polish civil law. Its supervision, however, is exercised by the two competent ministries of Hungary and Poland.

The accounting of investments and current outlays had to be fitted into the system of bilateral payments as it was practiced between CMEA countries. Thus, Haldex shareholders settle their mutual accounts in terms of clearing roubles.

At the same time, formally the registered capital of Haldex consists of zlotys. Such commodity supplies of the Hungarian party as were considered advanced capital were taken into account in a highly complicated manner.

The exchange rate between the zloty and the clearing rouble is the basis of calculating investments and current outlays between the two shareholders of Haldex. But, for this purpose, neither the official exchange rate between the clearing rouble and the zloty, nor the rate between clearing rouble and the zloty prevailing in Soviet–Polish trade could be applied. Instead, starting from the clearing–rouble prices (and in the absence of such from prices prevailing in other foreign trade relations) special clearing–rouble/zloty coefficients were agreed on for each cost type. The "investment coefficient" was obtained as a weighted average of all these. The following table shows the coefficients 3) (The coefficient still expresses the rate between the "old" clearing rouble and the zloty.) by major cost types that had been applied when calculating the investment outlays connected with the first Haldex plant located in Michal, Poland. Similar methods were applied also in connection with the second plant constructed in Szombierk.

The table clearly illustrates the vast work connected with this type of conversion and bookkeeping, due to the lack of a currency able to function as genuine money.

The component applied in calculating the "investment coefficient" for the purpose of the Polish–Hungarian common investments in Michal, Poland.

Denomination	Prices in zloty/kg	Prices in rouble/kg*	Coefficient (zloty/rouble)
Technological machines and equipment:			
Iron construction elements	6.30	1.35	4.667
Machines	20.70	4.55	4.55
Conveyor belts	21.00	3.60	5.834
Runways	12.00	1.80	6.66
Pipe ducts	6.60	1.90	3.474
Pumps	12.60	4.20	3.00
Dust extractor	16.00	4.00	4.00
Average coefficient			5.482
Power supply and electrical equipment:			
Central costs (60 per cent)	.	.	9.3x0.6 = 5.58
Electrical equipment (40 per cent)	.	.	4.7x0.4 = 1.88
Coefficient of overhead costs	.	.	7.46
Power supply	.	.	2.54
Average coefficient			5.527
Construction works:			
Wages**	.	.	12.9
Materials***	.	.	5.22
Services:			
performed by machines	.	.	(9.8)
transport services	.	.	(16.9)
average coefficient of services	.	.	(12.9) 5.97
Overhead costs:			
Wages (46.3 per cent)	.	.	12.9
Services: (13.0 per cent):	.	.	(9.88 = 0.64)
of machines (6–5 per cent)	.	.	(16.9 = 1.10)
average coeff.of services	.	.	(1.74)
Other costs (40.7 per cent)			(3.05)
Average coefficient of overhead costs	..		10.76
Average coefficient	.	.	8.448
*Costs of railway construction****			
Average coefficient	.	.	8.003

Costs of transports and storage

a) Costs emerged up to Dec.31,1960:			
Storage and custody	.	.	11.67
Railway transport	.	.	6.8
Other transport costs*****	.	.	6.809
b) Costs emerged in 1961:			
Wages	.	.	12.99
Railway transports	.	.	6.8
transport by trucks	.	.	16.9
Average coefficient	.	.	8.195

Projecting costs: average coefficient	.	12.9
GENERAL AVERAGE FOR INVESTMENTS	.	6.424

* (Old) clearing rouble

** According to the Polish Hungarian bilateral agreement of 1957 concerning payments, this was the general coefficient, to be applied also to wage payments. Later, a general agreement of CMEA countries (Prague 1963) established uniform multipliers for application in non-commercial payments and since then the uniform multiplier is being applied also in the Haldex account concerning current wage outlays.

*** Since it was not possible to establish comparable prices for some of the materials used, these coefficient was calculated from prices covering about 90 per cent of the materials used, this coefficients were assessed for each construction object and for each type of operation; the final average resulted from these

**** Similar to construction costs, also the costs of railway construction comprise of partial coefficients for wages, materials, services and overhead costs. They arre identical with those applied for the construction costs, with the exception of the one regarding the materials.

***** This average results from five partial coefficients calculated on the basis of the balance sheet, namely:

Railway costs	6.8
Truck transports	1.9
Business trips abroad	3.159
Telegraph costs	1.78

Also the summing up and accounting of current (operational) costs takes place on the basis of similar methods. In order to illustrate this, let us here present the coefficients applied to the costs of laboratory researches and of overhead costs which had emerged at the time of constructing the Michal plant, but were entered as current costs.

Laboratory costs:

Wages, social assurance	12.9
Materials and fuels	43.46
Office requisites	10.00
Laboratory materials	24.45
Transport services	24.45
Repair of offices	12.9
Travel costs, taxes and duties	7.5
Average coefficient	12.777

Costs of the central office:

Wages, fees, social assurance	12.9.	According to interstate agreement
Amortizations	13.6999	According to the zloty and rouble values in the inventory of Dec.31,1960
Fuels	43.36	From zloty and rouble prices of petrol and oil
Office requisites	10.0	From documents of the Polish foreign trade enterprise PAGED
Wear and tear by machines equipment in offices and official quarters	11.58	From zloty and rouble values in the 1960–inventory
Services performed by machines	7.5	
Transport costs	16.9	Appendix of the balance sheet of 1960
Repair of motor cars	12.9	The wage coefficient
Repair of office premises performed by outsiders	8.517	Equals the investment coefficient regarding offices and warehouses

Costs of business trips abroad:

Emerging in home currency	1.0025	Zloty/rouble rate at which the Ministry of Finance allocates roubles to the enterprise for travelling purposes
Emerging in foreign currency	3.159	Appendix of the 1960 balance
Others	7.5	Inland fares and other material expenditure according to the general coefficient of "other costs"

Other costs, taxes and duties:

General coefficient	7.5	Most of these costs consisted of notarial fees involved by the foundation. As a matter of fact, the "investment coefficient" should have been applied but this was not yet known at the time, so the somewhat higher coefficient of "other costs" was accepted.

Postal and telephone costs:

General coefficient	1.78	Appendix of the 1960 balance (in conformity with Poland's international postal accountancy in gold francs)

Funds for representation purposes:

General coefficient	7.5	As for "other costs"

Other costs:

General coefficient	7.5	

The weighted average obtained from these coefficients amounted to 9.289 – regarding the two-year period form July 1st, 1959 to June 30th, 1961, that is, according to the proportions between cost types prevailing in that period.

According to the accountancy based on these coefficients of investment and current costs, Haldex has proved a lucrative undertaking.

For the investment costs of the first plant (in Michal) the Hungarian shareholder was charged 566,000 clearing roubles. Against this stands the net gain determined by (a) the difference between the production (and transport) costs of the coal obtained and the world market price of a similar quality (b) the difference between this world market price and the Hungarian inland price based on the production costs of Hungarian coal mines.

In 1963 the average production costs of Haldex coal amounted to 5.20 clearing roubles per ton, to which transport costs amounting to 0.46 rouble had to be added in order to make it comparable with the average world market price of the same coal quality; the latter was about 11.30 clearing rouble per ton in 1963. An additional gain (in forints) was derived from the fact that the Hungarian inland price was higher than the forint equivalent of the world market price. Thus, the inland sales of this coal ensure a considerable net gain for the Hungarian shareholder – most of this, however, is "skimmed off" by the Hungarian Ministry of Finance.

If we take into consideration (a) the natural advantages of open–cast mining against deep working, (b) the difference in the quality of this coal in comparison to the home–produced one, (c) the relatively short distance of transport *, it is likely that the advantages demonstrated by this exceedingly sophisticated and laborious method of accounting do really exist. No doubt, in this special case the accounting was much simplified since, at least, the product of the process was homogeneous and easy to valuate; moreover, the Hungarian shareholder could transfer his gain in the form of coal.

The difficulties of accounting techniques would grow immensely (under the conditions of the present international mechanism), if also the products of the common venture were of a complex nature.

Finally, it is worth noticing that the "gain" of the Hungarian shareholder deriving from the joint venture is skimmed off by the Hungarian Ministry of Finance, so that his concern is purely formal.

*Transport costs are borne by the Haldex.

Appendices

1 Source: Soviet Trade Guide. Skopbank Group. Vammala (Finland) 1986. pp.14–22. The original text in Finnish language by T. Tiusanen, in: Neuvostoliiton kaupan opas. Skopbank, 1985.

2 S. Ausch: Theory and Practice... op.cit. Appendix 14, pp. 276–279.

3 The coefficient still expresses the rate between the "old" clearing rouble and the zloty.

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