



A New Step Forward for Joint Ventures

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WORKING PAPER

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FOREWORD

This working paper is one of a series* produced by TES-MTC project discussing the problems of East-West Joint Ventures located in the CMEA countries on a country basis.

The dynamics in the process of creation of joint ventures, as well as the rapid changes in legal conditions create the need, according to the empirical studies undertaken, to compare and to follow the changes in legislation and statistics.

The end of 1988 and the beginning of 1989 was marked by new requirements and opportunities for jvs in the legislation of almost all CMEA countries. The latest working paper of the series highlights recent changes and gives some general views on the legal situation in various countries.

F. Schmidt-Bleek
Leader
Technology, Economy and Society Program

*To date, the following papers have been published:

Djarova, Julia Joint Ventures: A New Reality of East-West Cooperation (State-of-the-Art), June 1988, WP-88-054.

Benedek, Tamas Some Experiences of Joint Venture Establishment and Operation in Hungary, September 1988, WP-88-88.

Ranenko, V., Soloviev, I. Joint Ventures with Foreign Capital Participation in the Soviet Union: Experiences and Future Outlook, January 1989, WP-89-03

Soloviev, I. Guidelines of Foreign Partner Selection in the USSR, January 1989, WP-89-02

Razvigorova, E. Joint Ventures: A New Practice in Bulgarian Foreign Economic Legislation, March 1989, WP-89-026

A NEW STEP FORWARD FOR JOINT VENTURES

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1. DYNAMICS OF THE EAST-WEST JOINT VENTURE PROCESS

East-West joint ventures can be regarded as the most highly developed form of economic cooperation. In 1987 joint venture contracts represented 19,3 % of all signed cooperation agreements between CMEA countries and Western highly industrialized countries.* Thus, they rank second among all forms of industrial cooperation having a share of more than 25% (fig. 1).

The share of joint venture agreements among the total number of East-West cooperation contracts has shown a definite tendency towards growth during the last few years compared with the other well-known and world-wide forms of cooperation such as licensing, delivery of plant or equipment and co-production (fig. 2).

The substantial growth of the joint venture contracts share as of 1983 can be regarded as an indicator for the increasing importance of this new form of joint economic activity, as well as a sign for the greater attention paid to it, both by Eastern and Western parties (fig. 3).

Despite the fact that the number of joint ventures and their distribution by branches and business activities varies in different countries, the general statistics show that the biggest part of the foreign joint venture capital is invested in industrial branches. This fact can be noticed most strongly in the USSR and in Czechoslovakia.

The distribution of the foreign investment made in Hungarian joint ventures is estimated at 33% in services and at 32% in industry. In all CMEA countries a certain percentage of joint ventures belongs to trade, agriculture and food industry.

Not only the dynamics of the joint venture process in different countries vary, but also the investment location into the branches and the economic activities are different due to differences in the countries' and the partners' priorities and specifics.

Rumania was the first CMEA country initiating the process of joint ventures establishment. Several big joint ventures were created in the 1970s. Those five which are still existing represent the large, but substantially decreasing share of Rumania in joint venture capitalization. Due to this fact Rumania is not included in the statistics of this chapter of the working paper. In the early 70s Hungary became the most active country in promoting joint ventures. Only recently the Soviet Union took a more active part in the process followed by Poland, Bulgaria and Czechoslovakia. Due to its economic capacity and huge market it represents, the USSR is presently becoming the driving force (fig. 4). The growth rate of the Soviet Union's share in the total number of East-West joint ventures located in the CMEA countries is changing rapidly even by month (fig. 5, fig. 6).

*Since the German Democratic Republic has not had any legal provisions for foreign capital investments in the country up until the examinations for this working paper were finished, this country is not taken into consideration. The GDR has created its first joint venture in Spring 1989 with a Soviet company building a factory for five millions roubles to produce computer spare parts (Source: Die Presse, Vienna, April 3, 1989, page 9, "DDR - Premiere bei Joint Ventures"). The contractual joint venture has been established with the West German Company, Salzgitter Industriebau for building a food flavouring factory for Miltis Chemical Enterprises near Leipzig (Financial Times, 23.9.1988, "East-European Markets").

Although, the number of enterprises with foreign capital participation in CMEA countries is growing remarkably, the capital invested is still rather small. Total capitalization amounted to roughly 1,87 billion US\$ by the end of 1988 and to roughly 2,5 billion US\$ by the end of February 1989. However, we should not ignore the fact that this figure, as well as the number of joint ventures trippled in 1988 compared to 1987 (fig.7, fig. 8). The average joint venture equity came up to some 3,6 million US\$ in 1987 and to 3,7 million US\$ in 1988.

The recent development of the joint venture process is characterized also by national differences in the size of enterprises. In Hungary, for instance, many small joint ventures exist so that their share in total capitalization is diminishing relative to the Soviet Union's share, where big companies are more dominant. Concerning the foreign share in joint ventures capitalization the total foreign investment can be estimated roughly at 242 million US\$ by the end of 1987 (fig. 9). It has increased to some 634 million US\$ by the end of 1988 (fig.10) and by approximately 900 million US\$ at the end of February 1989. Hungary being the leading country until 1988 concerning foreign capital acquisition experience, is replaced now by the Soviet Union which attracted approximately 550 million US\$ already in the earlier stage of the process.

The participation of Western countries in joint ventures is also different. In 1987 when the process was completed with all CMEA countries the FRG took the leading part with respect to the number of companies in which it participated (fig. 11). In the rapidly growing process in the USSR the FRG, Finland and Italy have been the most active countries at the end of 1988.** Previously existing relations between the partners often result in further establishment of joint ventures. Thus, there are many joint ventures with Austrian partners in Hungary. The typical tendency to form joint ventures based on the steady evolution of the partners' initial relations continues to dominate.

2. NEW CONDITIONS AND OPPORTUNITIES FOR EAST-WEST INVESTMENT

The end of 1988 and beginning of 1989 was marked by the adoption of new legislation on joint ventures in almost all CMEA countries: Hungary, USSR, Poland, Czechoslovakia and Bulgaria. There are several common characteristics in the reforms currently introduced which are the following:

1. In all countries more and new opportunities for foreign investments are open now.
2. Originally existing limits in foreign capital share have been removed and foreign citizens can now be appointed managers in all countries.
3. The reforms in Hungary, Bulgaria and Poland have provided a legal ground for different legal forms of companies with foreign capital participation.
4. The changes in joint venture legislation acts in Bulgaria and Hungary are aimed to equalize the economic conditions with those of the national companies.
5. In most of the CMEA countries the recently introduced joint venture provisions are part of the legislation which is further liberalizing the business environment of the countries.

The new substantial changes in the conditions for establishment and operation of joint ventures concern all their functions and are presented in this paper structured by countries and key issues as follows:

**see WP-89-03 by Soloviev and Ranenko

- Legal forms of companies with foreign participation
- Application and establishment
- Capitalization and ownership
- Finance
- Operation
- Personnel and labour
- Management

2.1 BULGARIA

The process of establishing East-West joint ventures started in Bulgaria when Ordinance No. 535 was adopted in 1980. To date, there are 20 joint ventures with Western partners (16 have been registered by 1 January 1989) and others are in process of establishment.

Recently, Ordinance No. 56 regulating the economic activity in the country was adopted by the State Council of the People's Republic of Bulgaria. Subsequently, regulations on the implementation of Ordinance No. 56 were passed by the Council of Ministers. The main goal of these new documents is to equalize the conditions for economic activity of all business organizations in the country including those with foreign participation.***

The new legislative document which annuls the legal strength of Ordinance No. 535, as well as the rules for its application, provide the following main opportunities:

Legal Forms of Companies with Foreign Participation

Under the Act No. 56/1989 of the State Council of Bulgaria, companies can be founded in a number of different forms. Companies with foreign participation or fully foreign-owned ones can basically be limited liability companies(LLC) and companies limited by shares(CoLtd). Foreign legal and natural persons can establish their own companies in the country, their branches, subsidiaries, etc.

Application and Establishment

Application

All kind of companies have to be registered with the Court on the basis of the following documents:

- Foundation Act - depending on the form of the company:
 - for a state company - Act of the Council of Ministers or of another state body
 - for a regional company - Act of the legal administrative body
 - for a company's branch (or subsidiary) - Act of the company

***see IIASA WP-89-026 by E. Razvigorova

– for a joint company - agreement of establishment

- Company's statute and some other documents depending on the form of the company.

To register a CoLtd the following requirements exist:

- the statute to be adopted
- distribution of all shares
- 30% of the capitalization fund to be available
- all other requirements in the acting regulations to be fulfilled

Company's initial documents

In the statute of CoLtd companies the following points have to be defined:

- name and location of the company
- type of activity
- capitalization fund
- number and nominal value of the shares
- procedures to involve personnel in the decision making process
- conditions of establishing the whole amount of the capitalization fund
- distribution of the profit, covering losses, dividends identification, as well as conditions of payment
- issues concerning the General Assembly of the shareholders
- issues concerning the Managing and Auditing Committees, their mandate and liabilities
- procedures in case of increase or decrease in the capitalization fund.

LLC companies can be established by not less than two legal persons on the basis of an agreement - a statute adopted by the partners.

In the statute the following points have to be defined:

- name and location of the company
- type of activity
- capitalization fund and shares
- conditions and time periods in case of termination of the company.

Permission for CoLtd and LLC companies

In case the foreign share in a limited liability company amounts to more than 49% or more than 20% in a company limited by shares a permission by a competent state body is required. In all other cases such a permission is not needed.

The foreign persons have to pay the whole amount of their shares if entering in a company limited by shares.

Permission for independent foreign activity

Foreign persons can undertake economic activities in the country independently (under their own name) with a permission of a competent state body. The competent state body defines those activities where such a permission is not needed.

A bank branch can be opened with a minimum capitalization fund of 10 million levas.

The branch has to be registered with the Court on the basis of an application which includes:

- name and location of the branch
- type of activity
- information about the foreign person such as: name, location, registration, type of activity and capitalization
- capitalization fund and private property contribution
- persons representing the branch.

Foreign persons can open trade agencies in the country under two main conditions - permission from the competent state body and 50% (as a minimum) of the employees being Bulgarian. The trade agency is not considered as a legal person.

Capitalization and Ownership

Foreign share

There is no limitation regarding the share of foreign capital participation (100% is possible).

Capitalization fund

Any kind of monetary and non-monetary contribution (in levas and in foreign currency) can be made into the capitalization fund. This point is subject to agreement by the partners.

In case of a company limited by shares the minimum value of the capitalization fund has to be 1 million levas. The minimum value of one share is 1000 levas.

In case of a limited liability company the capitalization fund has to come up to at least 50.000 levas.

Finance

Funds

All companies are obliged to establish Research & Development funds; the minimum amount is defined by the Council of Ministers. This fund is established after taxation of the profit.

Concerning any other kinds of funds the company is free to decide upon.

Taxation

Case A: When the foreign share is more than 49% and more than 5 million levas in convertible currency or more than 50 million transferred roubles in a limited liability company, and when the foreign share is more than 20% in the company limited by shares

the following taxes exist: tax on the profit, tax on the dividends, value added tax, local (regional) taxes.

Case B: When the foreign participation is below the figures mentioned in case A the following taxes exist: tax on the profit, tax on the dividends, value added tax, excises, rent tax, regional taxes, tax on the salary fund, customs.

In order to promote foreign participation in case A the basic tax on the profit is 30%. In all other cases the companies are treated like all Bulgarian companies and the profit tax is 50%.

The dividends in case of companies with foreign participation are taxed 10%. Should the dividends be used to buy shares in the country they are exempt from taxation.

The profit out of an independent economic activity of foreign persons in the country is basically taxed 40% and other kind of profits resulting from dividends, shares, author's license remunerations are taxed 15%.

Companies with foreign participation and fully foreign-owned ones located in Bulgarian free trade areas will enjoy a five-year initial tax free period and will pay basically 20% tax on the profit after that period.

If the economic activity of a company in case A is concentrated on high-tech branches defined by the Council of Ministers the company will be exempt from profit taxation during its initial period of five years.

Some other reductions and exemptions from taxation can be defined by the Council of Ministers for companies to which case A applies, as well as for those belonging to case B.

Goods which have been imported by a foreign person are exempt from customs duty, if they are intended for production of export products.

Operation

A foreign person can transfer his profit earned in foreign currency in the country abroad, as well as his share in case of liquidation of the company.

There is some relief concerning the repatriation of the profit when it is in Bulgarian levas earned from the economic activity, fulfilled under contracts with state bodies, as well as in case of compensation for expropriated foreign investments in the country or in case of liquidation of the company. In those cases the levas are equally transferred into the desired foreign currency according to the exchange rates at the Bulgarian Foreign Trade Bank.

Personnel and Labour

Foreign citizens can be managers of companies in Bulgaria (not only in cases of companies with foreign participation). The labour relations between the employees and the company with foreign participation are regulated in the contract of employment. Free bargaining on the employees' salaries is possible especially concerning the part of the wages paid in foreign currency which is permitted, irrespectively of the employee being a foreigner or a Bulgarian citizen.

The companies in case B apply existing legal labour regulations valid for other Bulgarian companies.

2.2 CZECHOSLOVAKIA

Czechoslovakia was considered to be the slowest country in the process of creating particularly legislation regulating the establishment and the functioning of companies with foreign participation. The limited number of joint companies operating before 1989 were treated case by case and according to the laws regulating the economic activities of other Czechoslovakian companies.

The legislation which is in force as of January 1, 1989 has been introduced in order to set up special conditions for the creation of enterprises with foreign participation on CSSR territory. Still relevant are legal documents like the Law on Companies Limited by Shares, Law on Legal Relations Arising in International Business Transactions, Czechoslovakian Tax Law, Administrative Procedures Act, Czechoslovak Commercial Code, Civil Procedure Code Act.

Regarding the new legal documents which are presently in force, the following provisions should be mentioned as the most important ones:

Legal Forms of Companies with Foreign Participation

Types of companies

Enterprise must be a legal person; either company limited by shares (according to Law No. 243/1949) or "association" (according to Law No. 101/1963).

Entitled to participate are:

1. Czechoslovakian persons: At least one party has to be Czechoslovakian; only legal entities domiciled in Czechoslovakia may participate in a joint venture;
2. Foreigners: legal entities and natural persons domiciled abroad;

Application and Establishment

Application

The Czechoslovakian side has to apply for an authorization to sign a joint venture contract. The application has to be submitted to

- the respective central authority of state administration (ministry) being competent in the suggested branch of activity
- concerning banking operations the authorization shall be granted by the Czechoslovakian State Bank

The application has to contain:

- name, seat and type of business activities of the Czechoslovakian party;
- data characterizing the foreign participant(s), (an opinion on the financial standing of foreign partners obtained through a Czechoslovak Commercial Attache's Office abroad might be helpful);
- purpose and aims of establishing the joint venture;
- subject of business activities, legal form, seat and name of joint venture;
- initial capitalization, proportion of equity shares with regard to partners, forms of capital invested and currency in which the shares will be paid;

- method of distribution of earnings and coverage of losses;
- minimum amount of reserve fund;
- provisions on the participation of individual party representatives in the managing bodies of the joint venture;
- draft contract of establishment;
- technical and economic assessment of the envisaged project (also with regard to international competitiveness).

Permission for a Joint Venture

Permission will not be given, if the intended economic activity is incompatible with national security and defense.

The decision on the application also depends on the following criteria:

- contribution of the proposed enterprise to the development of the Czechoslovakian national economy;
- probability that the proposed enterprise will carry out its business activities properly
- proposed ratio of the equity shares (However, the law does not indicate what the preferred ratio might be).

A decision (permission or rejection) has to be taken within 3 months from the day of submission of the application.

Capitalization and Ownership

Share of foreign participation

Foreign majority ownership is permitted.

Forms of capital invested

Cash or non-monetary contributions are permitted. The contributions are evaluated by the parties themselves.

Finance

Prices

Sales prices derive from the prices of comparable products in developed market economies. Cost prices on purchases from Czechoslovakian legal entities have to be negotiated individually****.

****according to a discussion of the authors with Dr. B. Klein - Director, Legal Department in the Czechoslovakian Chamber of Commerce

Profit

The net profit is equal to profit minus taxes.

Earnings resulting after deduction of funds allocations from net profit can be distributed among the participants.

Funds

5% of the annual net profit have to be allocated to the reserve-fund to cover possible losses or business risks, both in local and in foreign currencies until this fund reaches the amount specified in the contract of establishment.

Other funds to be established and financed from net profit are:

- cultural and social fund (according to generally binding rules of law)
- remunerations fund (according to generally binding rules of law)

The enterprise is free to establish other additional funds.

Funds cannot be taken from the joint venture . As long as the company stays within the frame of purpose that the fund has been created for it is entitled to freely dispose of it.

Accounting

Accounts and books have to be kept according to the generally binding legal provisions. Exceptions may be granted by the Federal Ministry of Finance.

According to generally binding legal provisions the joint venture has to supply the respective authorities with accounting figures and statistical data.

The joint venture is free to open accounts in local or foreign currency with the Czechoslovakian Foreign Exchange Bank. With a foreign bank accounts may be opened only in foreign currency. It is also free to take credits in foreign currency from the Czechoslovakian Foreign Exchange Bank. Foreign exchange credits from a foreign bank have to be approved by the Czechoslovakian State Bank.

Auditing

Annual balance sheet as well as financial statement shall be subject to an approval by two auditors. The Federal Ministry of Finance will define generally binding rules of law on the auditors' duties and on their appointment.

Foreign currency earnings

The company is exempt from the duty to sell foreign currency earnings to a foreign exchange bank. It has the right to dispose freely of these amounts, provided that such a disposal is related to the approved subject of the business.

Operation

Profit repatriation

The foreign participant is entitled to transfer abroad

- his annual foreign currency profit share
- profits derived from liquidation or sale of shares in foreign currency, provided that the joint venture holds sufficient foreign exchange funds.

Repatriation of invested capital

The foreign partner is entitled to transfer those amounts of money abroad which he obtained

- by selling his shares
- by liquidation of the company provided that the same currency is transferred that has originally been paid in.

State Plan

No tasks may be imposed on the joint venture by the State Plan of Economic and Social Development.

Guarantee of foreign partners' investment share

Expropriation or limitation of joint venture property rights is only possible in accordance with the rules of an act. If such measures are taken, the foreign participant will immediately receive a compensation corresponding to the value of the property affected at the time of enforcement of these measures. The amount of compensation will be freely transferable abroad in foreign currency.

Relations to other Czechoslovakian enterprises

The joint venture is entitled to freely organize its relationships to other Czechoslovakian legal persons. The Czechoslovakian Commercial Code provides the relevant legal framework.

Bankruptcy

If the debts of the enterprise exceed its assets, it shall be wound up by means of liquidation under the provisions of Sec. 352 - 354 of the Civil Procedure Code (Act No. 99/1963).

Liquidation

The date when liquidation starts has to be registered with the Companies Register, as well as the name of the liquidator. From that date on the liquidator shall have the power to act in the name and on behalf of the enterprise. There is no legislation on insolvent companies in CSSR except the regulations provided by the joint venture law. Turn-over tax has to be born by the consumers.

Customs duty

Imports are subject to customs duty. However, it is possible to apply for an exemption from customs duty for a certain period of time when starting the business. This application should be submitted to the Ministry of Foreign Trade.

Taxation

The basic profit tax is 40%. Exceptions may be granted by the fiscal authorities.

Generally, the tax on dividends is 25%. However, Czechoslovakia signed agreements with several other countries including Austria in order to avoid double taxation of dividends.

The employer's contribution to social insurance amounts to 50% of wage sum (wage fund).

Turnover tax has to be born by the consumers.

Personnel and Labour

Czechoslovakian laws are applicable as far as it concerns employment, conditions of labour, social insurance of employees and the functions of trade unions. The Ministry of Labour and Social Affairs will pass and publish special regulations amending those laws as far as this is found necessary for joint ventures.

Foreigners may be employed.

Salaries

Foreign employees are free to transfer their income abroad. The amount of foreign currency which is needed for that purpose has to be covered exclusively out of the foreign exchange funds of the joint venture itself.

Social insurance

Contributions to the social insurance of foreign employees may be transferred abroad. The amount of foreign currency needed for that purpose has to be covered exclusively out of the foreign exchange funds of the joint venture itself.

Management

The Law contains no regulations. The conclusion may be drawn that this issue is left up to the partners to decide and should be mentioned in the contract of establishment.

2.3 HUNGARY

Hungary is one of the CMEA countries where the process of establishment and operation of joint ventures with Western partners is the most accelerated. First, a special law has been introduced in 1972 and the number of registered joint companies started to grow rapidly. Changes in legislation have been introduced twice – first during the period

of 1975 - 1977 and second during 1982. Together with the expanding development towards the latest form of East-West economic cooperation a sufficient improvement of the legal conditions has been observed. In late 1988, two acts have been adopted by Hungarian Parliament. The so-called Company Law is aimed to define all possible legal forms of economic organizations (economic associations) in Hungary, as well as to equalize the conditions for their economic activity. This Act is fully applicable to those companies in the country with foreign participation. The second Law on Foreign Capital Investments in Hungary is in force as of January 1989 and aims to encourage foreign capital investment so as to promote the Hungarian economy.

This Act also supports further development of international economic cooperation and the advancement of technological development in Hungary. Above mentioned laws concern all kind of economic activities. One limitation exists regarding banking activities restricting them to joint stock companies only. Corresponding to the latest legislation in Hungary the economic key conditions for joint ventures could be defined as follows:

Legal Forms of Companies with Foreign Participation

Types of companies

Economic associations (as listed in Act Nr. VI/1988): unlimited partnership, deposit (or limited) partnership, union, joint enterprise, limited liability company (LLC), company limited by shares (Co. Ltd.); minimum capitalization: 1 mn ft (LLC), 10 mn ft (Co. Ltd.) can be established in the country.

Entitled to participate are

1. Hungarians: The state, legal entities, economic associations not possessing legal entity, as well as natural persons may participate (compare also Act No. VI/1988); only legal entities may be members of a union or joint enterprise.
2. Foreigners: Foreign persons are entitled to participate provided that they control a firm under their national laws or that they are registered with the commercial register according to their national laws. Besides, any foreign legal entity or natural person may participate as a shareholder.

Application and Establishment

Deed of association (statutes)

The foundation of the economic association requires the existence of a deed of association. Detailed regulations on this deed with reference to the legal forms are specified in Act VI/1988.

Permission to establish a company

The joint permission of the Minister of Finance and the Minister of Trade is required for the foundation of an economic association with a foreign majority or a fully foreign-owned one, for the conversion of an entity into such a company and for the acquisition of a majority foreign interest in the association. The said permission shall include the permission of the foreign exchange authority. As long as the corresponding application is not rejected within 90 days from filing, the permission shall be considered as granted. In case the application is rejected this decision must be explained. Any decision will be notified to

the Court of Registration.

In case of a foreign participation lower than mentioned above (i.e., 50% foreign share or less) neither a permission of the foreign exchange authority nor any other permission is required to establish an economic association or to participate in it. Nevertheless, generally binding rules requiring a permission for a certain business activity are relevant for companies with foreign capital participation, too.

Application for the permission

The application for the permission has to be submitted to the Minister of Finance by the Hungarian partner. In case the new company will be fully owned by foreigners, they have to apply for the permission. The application has to be in Hungarian language. It has to contain

- specification of partners (names, firm names, legal forms, seats, domiciles);
- legal form, subject, seat, and place of registration of the intended business activity;
- initial capitalization (equity)
- mode of net profit distribution
- explanation of business strategies and goals including information appropriate for evaluation

The statutes have to be attached to the application in Hungarian language.

Incorporation

The Court of Registration must be notified of an association's (company) foundation within thirty days from the conclusion of the deed of association for the sake of registration and publication. This Court exercises the supervision of legality for all economic associations.

Capitalization and Ownership

Foreign share

There is no limitation in the share of foreign participation.

Forms of capital invested

Foreigners have to make their cash contributions in convertible currency unless differently stated in an international contract. Non-monetary contributions may consist of any negotiable thing having a property value, intellectual creation or valuable right (title).

A member making a non-monetary contribution shall bear liability during five years from the date of such a contribution that the value of his contribution has equalled, at the time of deposit, the value indicated in the deed of association.

Minimum value of foreign investment

Participation in a LLC must not be less than 100 000 forint per member. The face value of a share must not be less than 10 000 forint.

Issuing of shares

Foreigners are only entitled to buy registered shares. Bearers' shares have to be transformed into registered ones before selling them to foreigners.

Finance

Within the framework of Hungarian legislation and the deed of association the company is entitled to freely dispose of its assets. Foreign and local currency operations have to be executed according to generally binding rules of law. The exchange rate set by the Hungarian National Bank is relevant for any exchange between forint and foreign currencies which is related to the establishment, operation, or termination of the company.

Prices

Prices are in principle set by market conditions. Besides, the provisions against unfair business activities and unfair price setting are relevant. The competent authority is entitled to define prices for certain goods through legal provision.

Profit

Profit is equal to sales minus expenses, including depreciation ('amortisation'); net profit means profit minus income tax.

Funds

No funds to be supplied from net profit are mentioned in Act No. XXIV/1988.

Accounting

Accounting and provision of statistical data to the authorities according to generally binding rules. Assets have to be entered in amounts of forint.

Auditing

It may be provided in the deed of association that the control of the management be entrusted to an auditor instead of or in addition to the Supervisory Board. The appointment of auditor(s) in addition to the Supervisory Board is compulsory in case of a Co. Ltd., a one-man company and a LLC with more than 50 million forint capitalization. In order to be appointed auditor, a person must be inscribed in the list of chartered accountants.

Foreign currency authorization

In case the foreign share in the company is not more than 50% no authorization is required. Otherwise the authorization will be granted together with the permission to establish the enterprise.

Repatriation of profit and capital invested

The foreign partner is entitled to transfer those amounts of money abroad which he obtained:

- as dividends
- by selling his shares
- through the liquidation of the company provided that the company disposes of sufficient foreign currency to cover these payments.

Finance

The company may raise credits and transfer money according to generally binding regulations.

Guarantee of foreign partner's investment share

Foreign capital invested in Hungary is fully protected. Foreign investors have to be compensated without delay for losses deriving from nationalization or expropriation of their property. Compensation is to be paid in the currency which has originally been invested by the foreign participant.

Operation

Supply and Marketing

Here the Hungarian provisions on product turnover and market organization are relevant.

Trade

The company is entitled to do foreign, wholesale and retail trade according to generally binding rules of law.

Land

The company is entitled to purchase and possess real estates which are necessary for the business activities defined in the deed of association.

Taxation

The company with foreign capital participation has to pay profit tax. Profit tax is 40%, as long as profit does not exceed 3 million forint. The amount of profit exceeding 3 million forint is subject to 50% profit taxation.

The company will enjoy all tax benefits which apply to local economic associations. Apart from this, the following profit tax benefits for companies with foreign capital participation exist:

- a) as long as the foreign participation is not less than 20% or 5 million forint profit tax will be reduced by 20%;
- b) If more than half of the company's profit results from production or from operating a hotel that has been constructed by the same company, if furthermore equity exceeds 25 million forint and the foreign participation is not less than 30%, 60% of profit tax will be refunded during the first 5 years of operation, later 40%.

- c) If the company fulfills the conditions mentioned in b) and operates in a field of priority to the Hungarian economy (see attachment to Act XXIV/1988), the company will be exempt from taxation during the first five years of operation. Later only 40% of the normal profit tax will be charged.

If a company fulfills the conditions mentioned under a) and operates in a field of priority, the Council of Ministers can grant, by decree, even more favorable tax benefits. Paragraphs 16 and 17 of Act XXIV/1988 contain regulations on further tax benefits.

Preferred business activities (with regard to income taxation)

Electronics; machine and vessel components; machine tool production; production of machines for agriculture, foodstuff industry and forestry; packing technology; production of medicaments; technological developments for more efficient utilization of resources; communication services; tourism; biotechnology.

Value added tax

The standard rate is 25%, but reduction and even exemption is possible for different products.

Exemption from Customs Duties

Subject to exemption from import duty are

- means of production which are contributed by the foreign partner as part of his investment share (non-monetary contributions);
- means of production or other investment goods, as well as components which are needed for the business activities of the company and are paid out of the cash contribution of the foreign participant.

Liquidation

In case of persistent insolvency the appropriate provisions of liquidation procedure have to be applied. Title 5 of Act.VI/1988 contains regulations on this procedure concerning

- reasons for terminating the company;
- final account;
- involvement of the executive officers of the company;
- involvement of a liquidator;
- role of the Court of Registration in case of bankruptcy.

The claims against the economic association or its members arising from the liabilities imposed on the company shall expire within five years from the termination of the association or the membership, respectively. In the statute a shorter deadline can be defined.

Personnel and Labour

Hungarian laws are applicable as far as employment is concerned, conditions of labour, social insurance of employees and the functions of trade unions. Besides, the deed of association and the contract of employment will also be relevant.

Foreigners can be employed as managers, members of the supervisory board or in any other function.

Social insurance for foreigners

Should the foreign employee wish to use the Hungarian social insurance the company is obliged to pay the relevant contributions for him.

Salaries

The generally binding provisions on wages and salaries are only relevant, if the foreign share is less than 20% or 5 million forint.

Foreign managers and employees may transfer 50% of their salary abroad in the currency of their home country.

Number of employees

An economic association which has exclusively natural persons as members is not allowed to employ more than 500 people. This provision does not apply, however, to economic associations which are fully or mainly owned by foreigners.

Management

Workers' representatives

In every joint enterprise, LLC and Co. Ltd., where the number of full-time employees exceeds an annual average of 200 persons, the employees should participate in the monitoring of the association's operation through the Supervisory Board. In this case, 1/3 of the members of the Supervisory Board should consist of employees which have been elected by their colleagues.

Management

Executive officers are:

- in case of a union and a joint enterprise (see Act VI/1988) the director;
- in case of a LLC the managing director(s);
- in case of a Co. Ltd. the members of the Board of Directors.

The executive officers, the members of the Supervisory Board and the auditors should be appointed for a definite period of not more than five years, but may be re-elected*****.

2.4 POLAND

The regulations on joint ventures in Poland have initially been issued in 1986 in a special law that allows and stimulates foreign investments in state owned sectors of the Polish economy.

*****For detailed information on the regulations for bodies of legal entities refer to Act VI/1988.

Fully foreign-owned companies have been legalized in 1982, but only for small scale business activities (700 Polonia enterprises). The main goal of the latest legislation dated December 23, 1988 is "to create better conditions for further development of mutually advantageous economic cooperation between Polish persons and foreigners (both legal and natural persons) in capital ventures"***** and to put more emphasis on the principle of freedom of contract compared to the previous law. The areas of production, trade, services and construction are affected by the recent law.

The main features of the latest Polish law on Economic Activity with Foreign Participation are the following:

Legal Forms of Companies with Foreign Participation

Types of companies

limited liability company, company limited by shares

Entitled to participate are

1. Polish persons: The Treasury and other legal entities domiciled in Poland; natural persons living in Poland;
2. Foreigners: Legal entities domiciled abroad; natural persons resident abroad;

Application and Establishment

An application must be submitted to the Agency for Foreign Investments in order to obtain permission to start up a new business. It has to contain

- specification of partners
- scope and type of business activities, including export and import
- planned duration of business activities
- initial capitalization and credit needs
- proportion of equity shares with regard to partners, forms of capital invested
- location of the new enterprise's headquarters and production centers
- contract of establishment (according to Polish Commercial Code)
- documents on the financial standing and legal status of the partners (including authorized translation into Polish, if applicable)
- financial and economic assessment of the envisaged project; information on the financial standing of foreign partners obtained through the offices of the Polish Commercial Attache abroad might be helpful.

A decision on the application has to be taken within 2 months from the day of submission.

*****see the Polish Foreign Investment Law, December 23, 1989

Preferred business activities (for easier permission)

a) in general:

- application of modern technologies or management techniques
- provision of goods or services for export;
- improvement of national market supply with modern high-quality goods or services;
- protection of environment;

b) branches:

agriculture, foodstuff industry, pharmaceutical industry, medical equipment, chemical and paper industry, equipment and material for domestic architecture, electronics and telecommunication, modern office equipment, consumer goods, packing industry, transport, tourism.

To establish a company a permission is required from the President of the Agency for Foreign Investments. This Agency is directly responsible to the Prime Minister.

The permission will list

- partners, name of company, location of headquarters and production centers, subject and duration of business activities;
- proportion of equity shares with regard to partners, forms of invested capital;
- duration of permission;
- other requirements the company has to meet.

A permission will not be granted, if the intended economic activity

- endangers the economic interests of Poland;
- does not meet the requirements of environmental protection;
- is incompatible with security and defense of the nation or with protection of state secrets.

If a permission is not granted, it is possible to appeal to the President of the Agency for Foreign Investments within two weeks.

A company submits its application for registration according to the regulations pertaining to the Commercial Register.

Capitalization and Ownership

Foreign share

The share of foreign participation can be 20% - 100% of capital stock.

Forms of capital invested

Cash (zloty or foreign currency) or non-monetary capital investment is permitted; foreign investment of zloties is subject to documented exchange of equivalent foreign currency. Value and kind of non-monetary investments should be specified in the contract of establishment.

Minimum value of foreign investment

Total value of foreign investment in a company must not be less than 25 million zloties (worth 50 000 US\$ at the time the law was adopted). This amount will be adjusted to foreign exchange rate changes.

Utilization of real estate

Polish persons are entitled to contribute rights of use for state-owned real estate according to the relevant provisions.

Issuing of shares

Issuing of shares to the public can be permitted by the President of the Agency for Foreign Investments when it is economically justified. Shares must be registered.

Finance

Profit

Profit is estimated to be sales minus expenses, including depreciation ('amortisation'); net profit means profit minus profit tax.

8% of net profit have to be put into the reserve-fund to cover losses until this fund amounts to 4% of total annual expenses.

Accounting

General accounting principles are provided by the Minister of Finance in accordance with the Commercial Code.

Auditing

Balance sheets have to be audited within 3 months after being submitted at the company expense. Auditing can be done by the responsible body of the Ministry of Finance or by a person chosen by the company and authorized by the Minister of Finance.

Foreign currency authorization

A general authorization to deal with foreign currency is required for several foreign currency operations. However, Law does not mention this precondition explicitly: Various paragraphs contain the statement that "no separate authorization is needed". From our point of view that means that the authorization will be granted together with the permission to establish the company.

Foreign currency earnings

15% of foreign currency earnings from exports have to be sold to a Polish foreign exchange bank. The President of the Agency for Foreign Investment can reduce this rate in cases where it is economically reasonable. Such a reduction will be stated in the permission to start the business.

All other foreign currency revenues can be spent for purchases of goods and services abroad, which are necessary to run the business. No separate authorization is required for these foreign exchange operations.

Goods and services can be bought with foreign currency from authorized Polish sources. After having received the general foreign currency authorization, the company can sell goods and services in Poland for convertible currency.

Profit repatriation

Dividends in foreign currency can be paid to the extent by which export revenues exceed import expenses. These dividends can be transferred abroad without special authorization. The foreign partner can transfer a higher share of foreign exchange abroad, but only with the approval of the Ministry of Finance. Polish partners are entitled to transfer their foreign currency profit shares to their own foreign exchange account.

Profits in zloty

A separate permission from the Minister of Finance is required if zloty profit shares are to be spent by foreigners for purchasing real estate in Poland. Apart from this, the foreign partner can freely dispose of his zloty profit on the Polish market.

Repatriation of invested capital (zloty and/or foreign currency?)

Without separate authorization the foreign partner is entitled to transfer those amounts of money abroad which he obtained

- by selling his shares
- through the liquidation of the company.

Financial resources

The financial resources of the company are kept on accounts opened with a Polish exchange bank of the company's choice. Credits can be raised from that bank or from foreign sources. Accounts with foreign banks can be opened after receipt of the foreign exchange authorization.

Guarantee of foreign partner's investment share

The foreign partner can obtain a guarantee from the Minister of Finance saying that losses occurring from expropriation or nationalization will be compensated by the state.

Operation

Supply

As regards supplies of Polish goods, the principles and procedures which are relevant to Polish nationalized enterprises apply.

State enterprises are entitled to transfer fixed assets to companies and to grant limited legal rights to them as far as these assets are concerned.

Land

State-owned land can be transferred to companies for utilization according to the principles defined in the Provisions on the Utilization of State-Owned Land. State-owned land can also be rented.

Provided that existing provisions are observed, companies can buy and rent land and other real estates which are not property of the state.

Taxation

Joint ventures are subject to the following kind of taxes: Turnover tax, profit tax, wage related tax, real estate tax, etc.

The basic profit tax is 40% minus 0.4% for each percentage point of sales exported (the minimum value of tax is 10%).

No profit tax will be charged for the first three years after establishment (i. e. date of first invoice). This exemption can be extended for up to 3 further years by the President of the Agency of Foreign Investment, if the company is active in a business area that is defined as a preferred one by the Council of Ministers.

In addition, the profit share of the foreign partner is subject to 30% taxation (if transferred abroad).

If the company is liquidated within 6 years from the date of its establishment, profit tax has to be paid subsequently for the entire activity-period.

Customs exemptions

Exempt from import duty are

- machines, equipment and other means which are part of the non-monetary investment share of the foreign partner
- machines, equipment and other means which are needed for the business activities of the company and are bought within 3 years from the establishment of the company.

Exempt from export duty are those items assigned to the foreign partner in case of a liquidation of the company.

Personnel and Labour

Polish laws are applicable to employment, conditions of labour, social insurance of employees and the functions of trade unions.

Foreigners can be employed on permission of regional authorities.

Salaries

The principles of salary payment are to be defined in the contract of establishment or by the management body. Salary should generally be paid in zloties. Foreigners can partly be paid in foreign currency (salary tax is 30%, if there are no other bilateral agreements).

Management

Law contains no regulations. It can be concluded that the decision on this issue is left with the partners and should be mentioned in the contract of establishment.

2.5 SOVIET UNION

The practice of foreign capital investment into USSR started in 1987 after the adoption of the Decree of the Presidium of the USSR Supreme Soviet on "Questions concerning the Establishment and Operation of Joint Ventures on the territory of the USSR". Several additional governmental decisions have been following the first Decree in order to clarify some main issues concerning the establishment and operation of the enterprises with Western companies' participation. In more than two years of experience about 400 joint ventures have been registered in the USSR.***** Based on the extending tendency of foreign trade relations' democratization some new regulations in the Decree of the USSR Council of Ministers (2 December 1988) on "Further development of foreign economic activities of states cooperative and other social enterprises amalgamations, and organizations", were adopted to stimulate further development of the foreign economic activities in Soviet enterprise.

The new provisions with respect to joint ventures, additionally created to help the practice in some directions are the following:

Foreign partner's share

The respective shares of the partners in the capitalization fund of a joint venture have to be determined by the parties. This means that a foreign majority ownership is possible.

Management

In a Board Meeting all Board Members have to agree unanimously upon the major questions concerning the activities of a joint venture.

Labour and Personnel

Procedures of hiring and firing employees for the joint venture will be determined by the joint venture itself. The same is true concerning the forms and amounts of payment, and material incentives in Soviet roubles for the joint venture's personnel.

Foreigners can also be chairmen of the management board or managing directors.

Accommodation and other services to foreign employees of the joint venture will be paid in Soviet roubles, except in the cases defined in decisions of the USSR Council of Ministers.

*****Note: The last officially registered number of East-West joint ventures located in the USSR comes up to 164 (1 January 1989, Governmental Bulletin No.1).

Customs duties

Goods imported by the joint venture to the Soviet Union for development of production may be subject to a very low rate of customs duties, or may be totally exempt from duties.

Taxation

Joint ventures located in economic regions of the Far East are exempt from the profit taxation during the initial three years. They also enjoy a 10% reduction on the profit tax.

Profit repatriation

The USSR Ministry of Finance has the right to suspend taxation or to reduce the rate for a certain period of time on the foreign partner's repatriated profit. This is even more true for those joint ventures being involved in economic activities of branches in industry with high priority for the USSR or regions of the Far East.

* * *

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2. Maciejko, R.R. Joint Ventures in Poland, 1989 (draft).

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5. APPENDIX

Fig. 1
SHARE OF JVs IN EAST - WEST COOPERATION

Source ECE - Reports 1979 - 1988

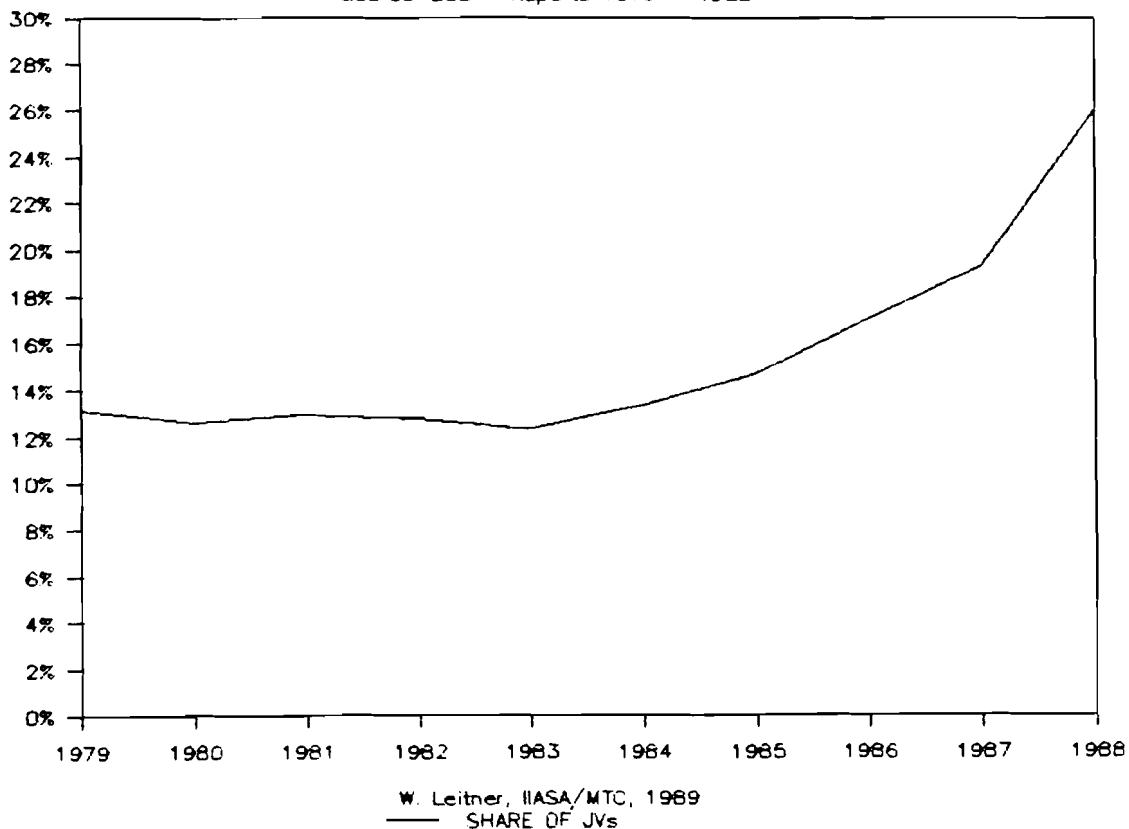


Fig. 2

GROWTH RATE OF SHARES
OF SOME COOP. CONTRACTS

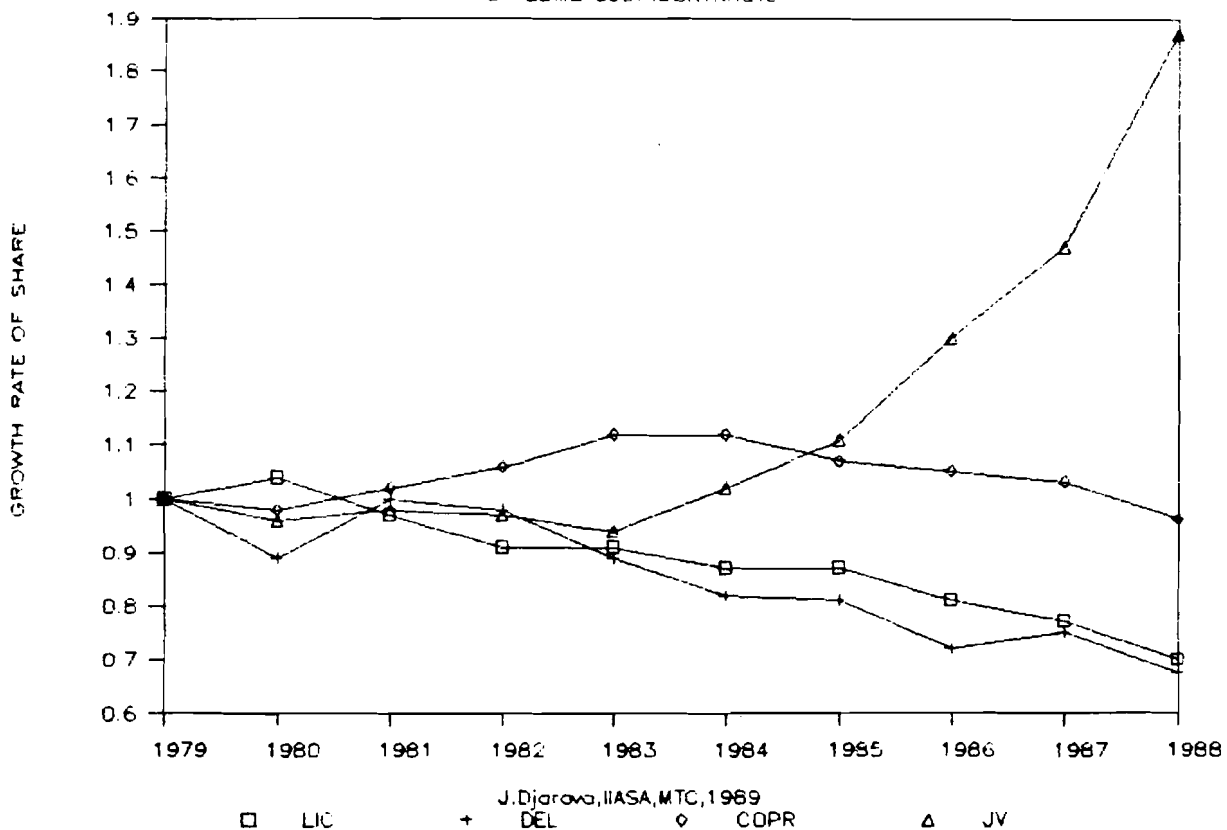


Fig. 3

SHARE OF THE JOINT VENTURES IN THE TOTAL NUMBER OF CONTRACTS

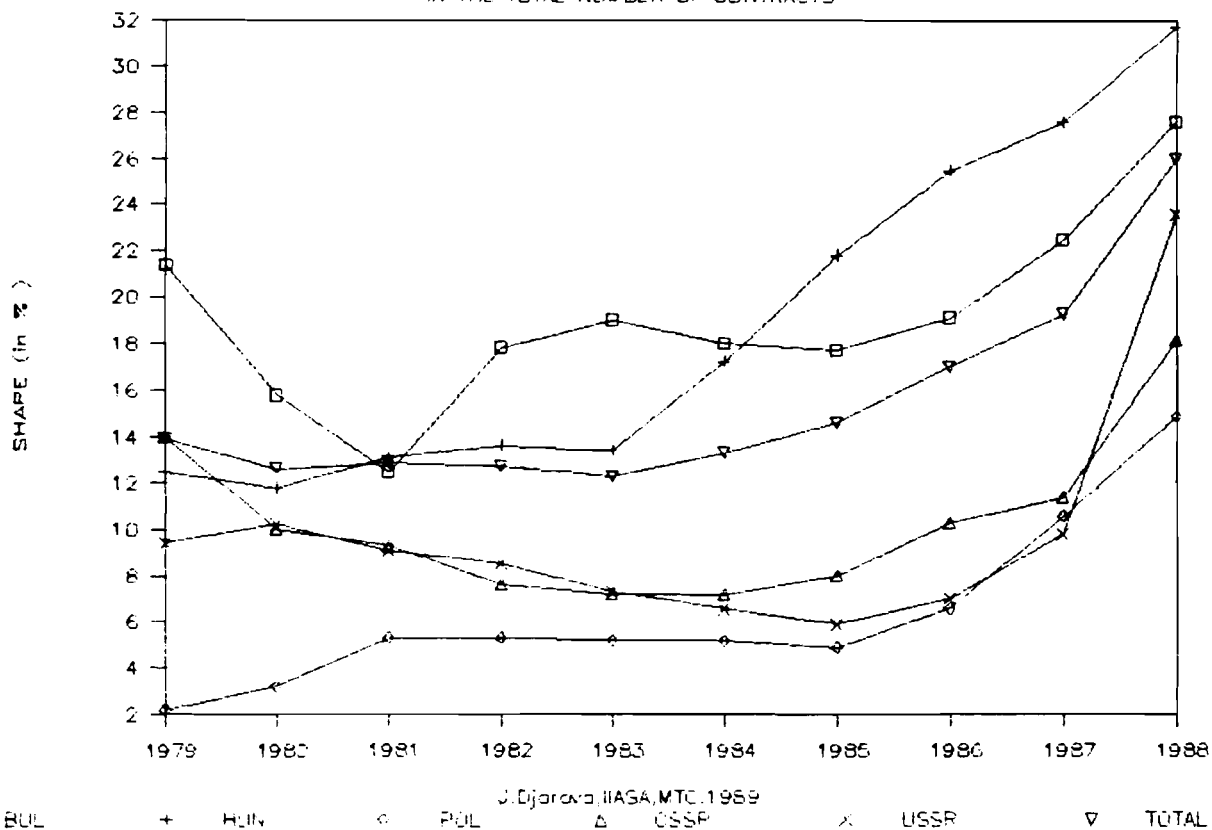


Fig. 4

NUMBER OF EAST - WEST JOINT VENTURES

Source: ECE - Reports 1979 - 1986

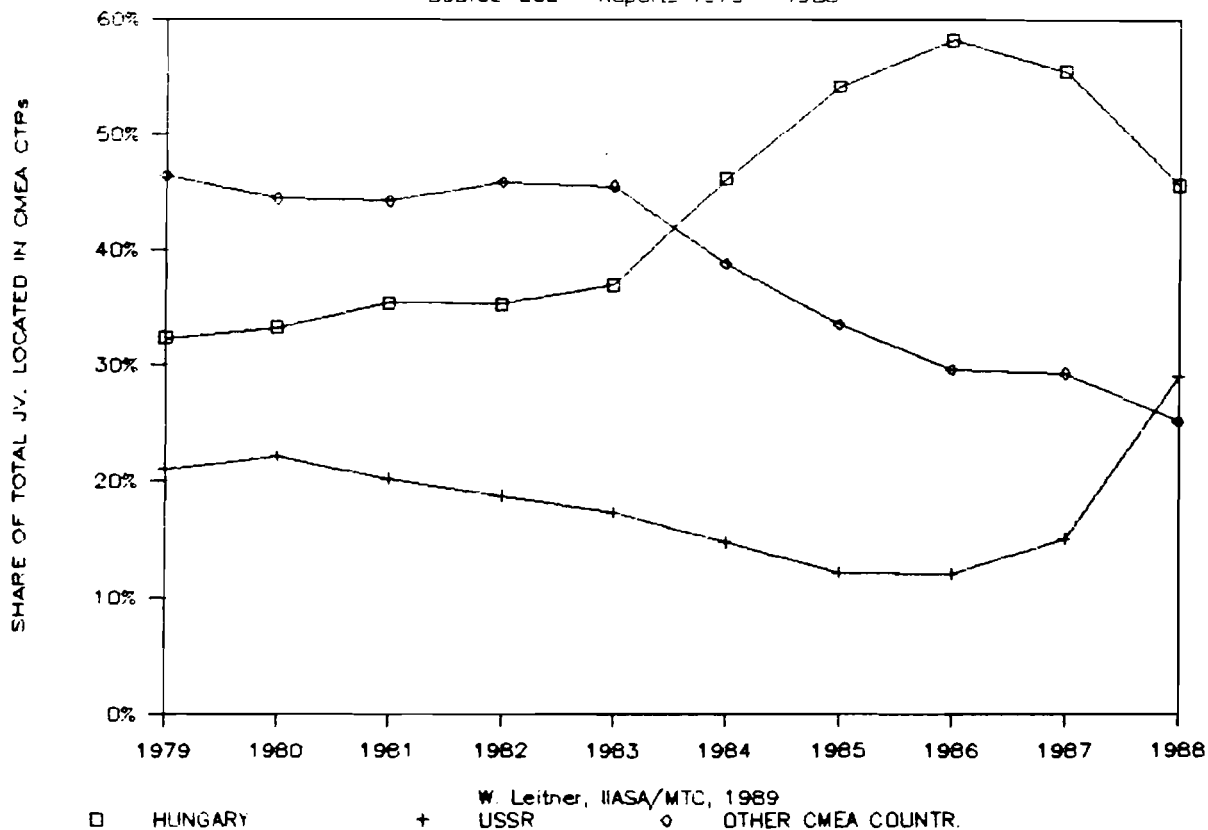


Fig. 5

EAST-WEST JOINT VENTURES 1987 (sum=161)

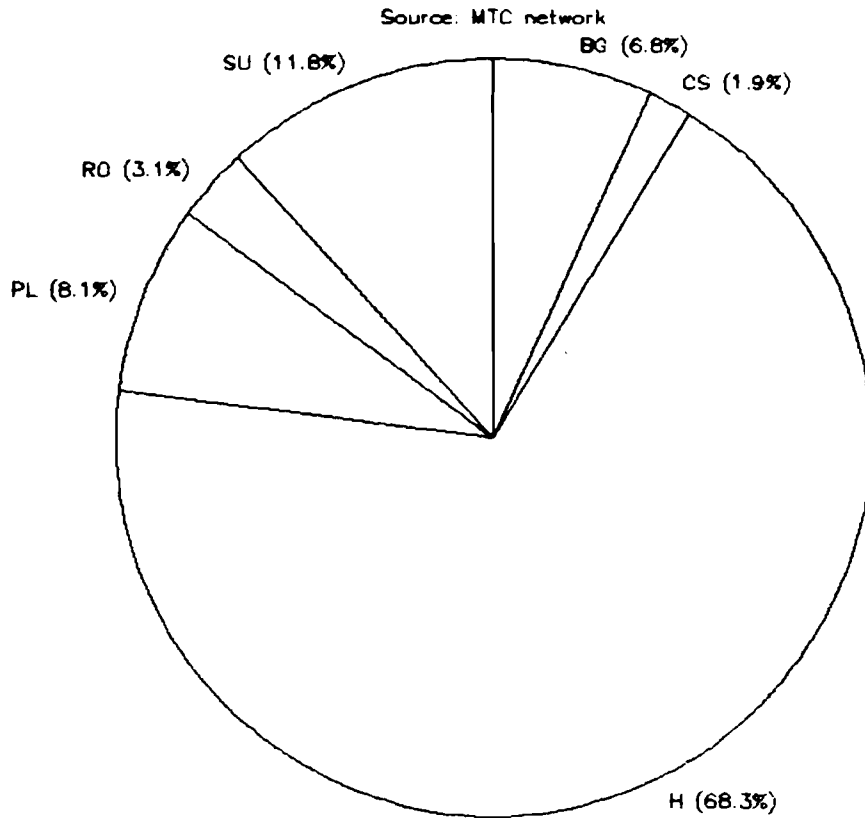


Fig. 6

EAST-WEST JOINT VENTURES 1988 (sum=506)

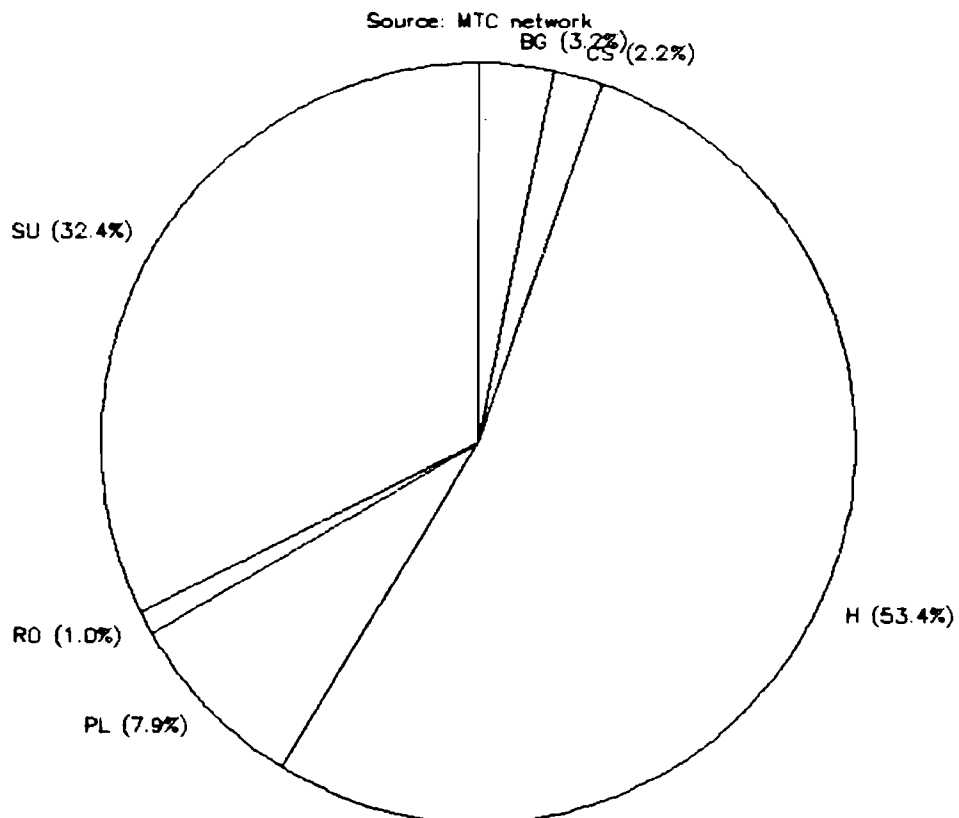


Fig. 7

JV CAPITALIZATION 1987 (sum=580mn US\$)

Source: MTC network
CS (1.2%)

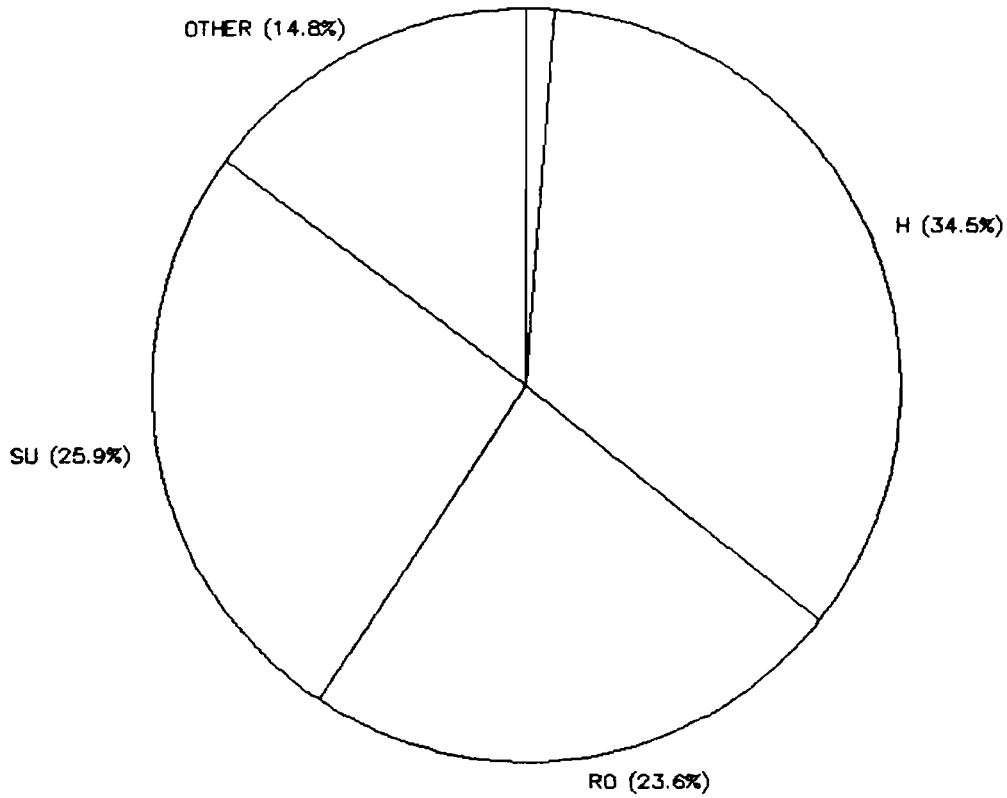


Fig. 8

JV CAPITALIZATION 1988 (sum=1.87bn US\$)

Source: MTC network
CS (1.2%)

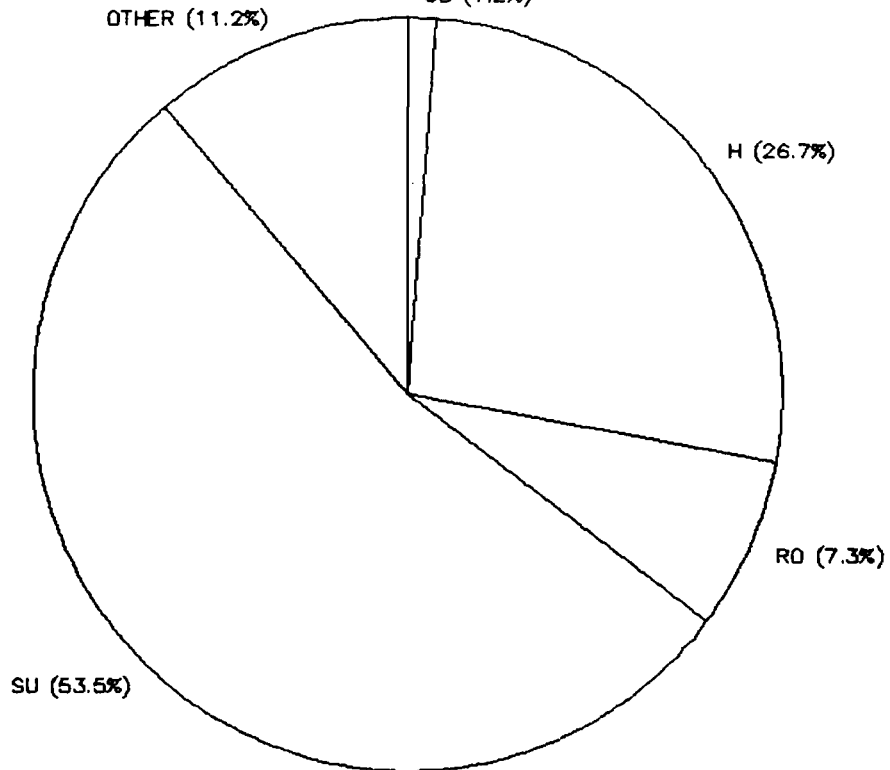


Fig. 9

JV FOREIGN CAPITAL '87 (sum=242mn US\$)

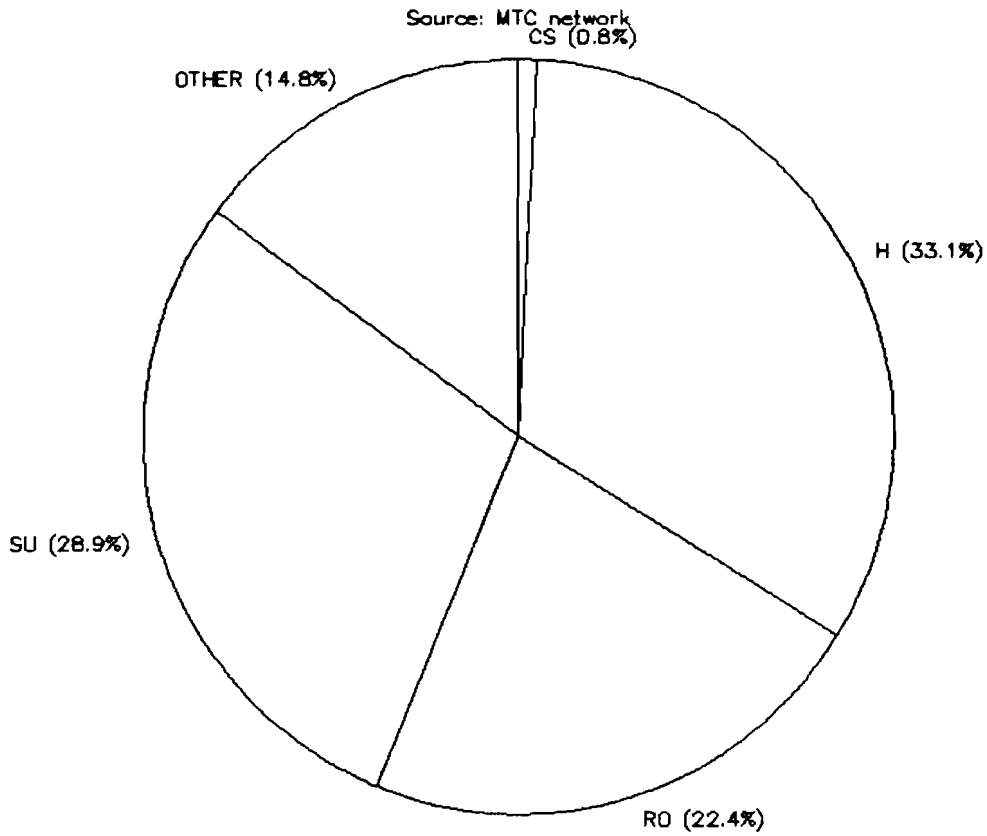


Fig. 10

JV FOREIGN CAPITAL '88 (sum=634mn US\$)

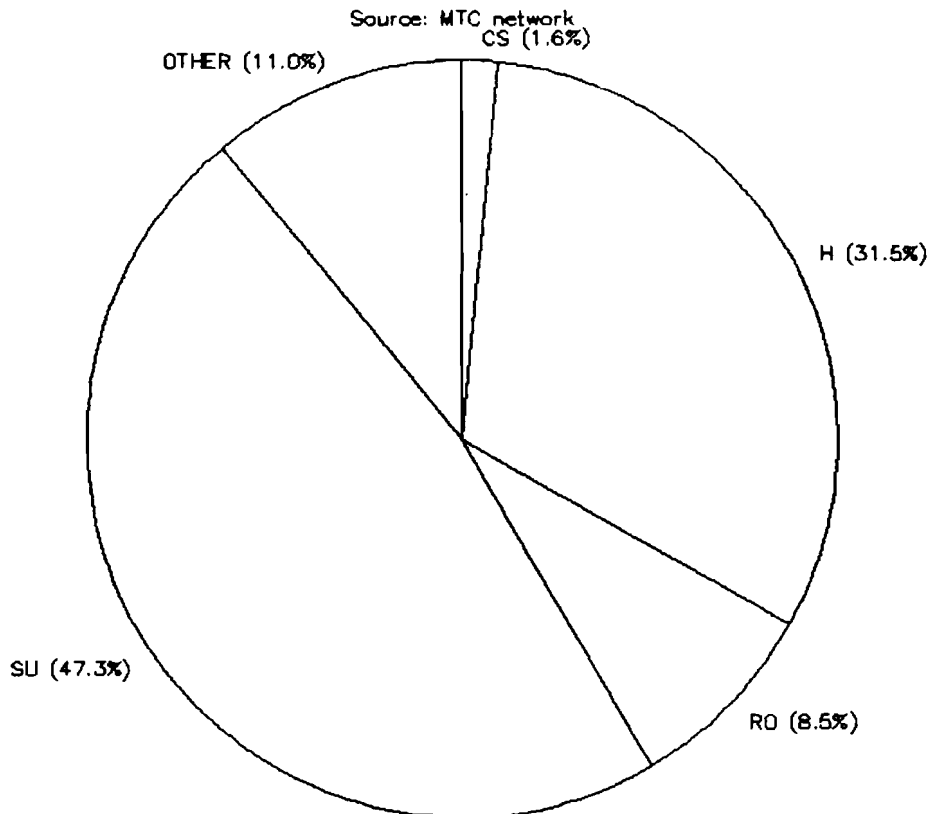


Fig. 11 - 32 -
 WESTERN COUNTRIES' E.-W. JV. ACTIVITIES

SOURCE: ECE, 1987

