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East-West Joint Ventures: Lessons from Past Soviet-Western Joint Ventures and Projections for Future Deals with the CIS

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I. INTRODUCTION

In the past five to six years, former President Mikhail Gorbachev and a new group of young thinkers have revolutionized the philosophy and practice of foreign relations in the Soviet Union.[1] They have rejected the traditional idea of autarchy, or economic nationalism, and replaced it with an understanding that they should become part of the world financial and trading system.[2]

The Joint Venture Decree of 1987 opened the Soviet Union to Western business for the first time in seventy years.[3] Western business entrepreneurs have eagerly embraced the idea of accessing both resources and markets formerly forbidden to them. However, the practical realities of developing and conducting business in a society with no basic law of contracts, no knowledge of market economics, and no understanding of work performance tied to rewards has proved daunting.

Joint venture successes, when they have occurred, have involved extensive negotiations between Western partners and their Soviet business counterparts plus approvals by principals in the Soviet central ministries, the republic governments and, sometimes, local administrations. However, as the republics emerge as sovereign states and central Soviet control disappears, questions emerge about how best to pursue business with the new Commonwealth of Independent States.

This essay will review the changes in Soviet law that have led to current hospitable business relationships. Next, it will discuss the recent Soviet societal changes that make continuing steps to establish a joint venture questionable. Finally, the essay will attempt to marshal insights from the Soviet experience and project the most likely scenarios for future East-West business.

II. ISOLATIONIST HISTORY

The introduction of Communism during the Russian Revolution of 1917 effectively ended all foreign investment that had been allowed under

1. Richard N. Gardner, *The Triple Crisis of the Soviet Union Today*, 11 N.Y.L. SCH. J. INT'L & COMP. L. 435, 437 (1990).
2. *Id.*
3. Nicole M. Houri, *Joint Venture Law in the Soviet Union*, 11 N.Y.L. SCH. J. INT'L & COMP. L. 499, 504 (1990).

the czarist regime.[4] The small beginnings of open trade had ended; the West was shut out. In March of 1921, Lenin sought to revitalize the Soviet economy with his New Economic Policy (NEP) by partially restoring Western business interests. Lenin's 1923 "Law on Concessions" allowed more foreign participation in Soviet businesses.[5] This open market policy was short lived, however, and in 1930 Josef Stalin outlawed joint ventures with all foreign firms, stating that it was ideologically improper for any part of the Soviet Union to be under foreign control.[6]

Thus, from the late 1920s until the end of 1986, the Soviet Union exercised absolute state control over foreign trade.[7] Two characteristics typified this state monopoly: first, private persons were barred from engaging in business transactions with non-socialist partners or from holding currencies that had value elsewhere; and second, state firms engaged in production were prohibited from dealing directly with capitalist businesses.[8] Foreign trade organizations (FTO's), subordinate to the Ministry of Foreign Trade, acted as intermediaries and handled all contracts with foreigners for items available only from the West.[9]

The FTO's might have been viable had they been able to work directly with the foreign firms that they served. Instead, national plans issued by "Gosplan," the State Planning Commission, directed the FTO's negotiations with the West.[10] State central planning restrictions also gave the FTO's a special operational agenda that minimized hard currency expenditures, which normally led to buying the cheapest goods, and that maximized hard currency return on Soviet produced goods, while compensating Soviet firms only in rubles. This currency return policy decreased the incentive for Soviet firms to produce quality goods for export.[11] In addition, the FTO's acted as information barriers. Since Soviet firms had little contact with foreign customers or suppliers, they had no way to learn about new technology that could enhance their production or about changes in overseas demand.[12]

III. THE WINDS OF CHANGE

By the early 1980s, central planning and isolationism had placed the Soviet economy in decline, triggering the need to re-evaluate Soviet restrictions on foreign investment. In 1983, the Soviets approved joint ven-

4. *Id.* at 500.
5. *Id.*
6. *Id.*
7. Paul B. Stephan III, *The Restructuring of Soviet Commercial Law and Its Impact on International Business Transactions*, 24 GEO. WASH. J. INT'L L. & ECON. 89, 90 (1990).
8. *Id.*
9. *Id.*
10. John P. Feldman, *Soviet Joint Ventures: Providing for Appropriate Dispute Resolution*, 23 CORNELL INT'L L.J. 107, 111 (1990).
11. Stephan, *supra* note 7.
12. *Id.* at 91.

tures with other socialist countries, and by 1986 they had officially started to discuss partnerships involving Western investors.[13] The Soviet Joint Venture Decree of January 1987 opened the first avenue for direct investment in the USSR in over sixty years.[14]

The government believed that the traditional centrally planned economy had not provided a level of development equivalent with industrialized capitalist nations.[15] For this reason the government introduced *perestroika*, the policy to allow controlled entry of Western investment and technology. Joint ventures were seen as the crucial vehicle for stimulating newly permitted private cooperatives which provided an important source of Western management skills and technology.[16] From a Western view point, joint ventures remain attractive because they offer access to what is potentially the world's largest untapped market for Western goods and services.[17] The Soviet Union also represents a store of abundant natural resources.[18] General benefits may accrue to the Western world, including decreased defense spending and greater social and cultural interactions with Soviet citizens.[19]

The disadvantages of conducting business with the Soviet Union continue: a shortage of materials, unreliability of transportation systems,[20] and the non-convertability of the ruble.[21] While it is positive that Western companies can now directly deal with their relevant Soviet counterparts, Soviet domestic enterprises simply have very little or no understanding of business practices in the West and still less experience with negotiating and implementing foreign trade contracts.[22]

IV. FUNDAMENTALS OF SOVIET JOINT VENTURES

A proposed joint venture with the Soviet Union should meet "Joint Venture Decree" objectives, as well as the criteria from subsequent proclamations, to gain approval.[23] The Decree states that joint ventures should be approved for several purposes: to satisfy domestic requirements for certain types of industrial products, raw materials and food stuffs; to

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13. Houri, *supra* note 3, at 501.

14. Decree of the USSR Council of Ministers on the Establishment in the Territory of the USSR and Operation of Joint Ventures with the Participation of Soviet Organizations and Firms from Capitalist and Developing Countries, No. 49 (Jan. 13, 1987) [hereinafter Joint Venture Decree]; *see also* Daniel J. Arbess, *A Few Things U.S. Businesspeople Should Know About Joint Ventures in the Soviet Union: A Lawyer's View*, 22 INT'L L. & POL. 411 (1990).

15. Houri, *supra* note 3, at 502.

16. Arbess, *supra* note 14.

17. *Id.* at 412.

18. Houri, *supra* note 3, at 502.

19. *Id.* at 503.

20. Stephan, *supra* note 7, at 92.

21. Arbess, *supra* note 14, at 412.

22. *Id.* at 414.

23. Joint Venture Decree, *supra* note 14, at art. 1.

attract advanced foreign technologies, management expertise, additional material and financial resources to the USSR national economy; to expand exports; and to reduce superfluous imports.[24] The Decree also lists other areas for expansion: research and design, engineering, sales and marketing, finance, and service industries such as tourism.[25]

The three phases of development involved in creating joint ventures are discussion, contract negotiations, and official registration.[26] Successful discussions with a legally recognized prospective Soviet partner and the relevant government officials will lead to the signing of a protocol letter or letter of intent.[27] Though not binding, this letter captures each venturer's understanding of its respective responsibilities and the general goals of the joint venture.[28]

A feasibility study will then follow to more fully examine the venture's possible difficulties and to clarify each partner's role.[29] This study includes a cost analysis, projected earnings, and technical assumptions.[30] Finally, the necessary joint venture documents are prepared, including the joint venture agreement, the joint venture statute and all ancillary contracts, and submitted for approval to the USSR Ministry of Finance for registration, and to the administrative organ that exercises control over the Soviet partner.[31]

The joint venture is also required to specify the objectives of its operation.[32] The concept of "ultra vires" is treated very seriously by Soviet authorities, and there is evidence that joint ventures with overly broad objectives may not be approved.[33] More importantly, Western companies must recognize that the Soviets place great emphasis on the written word.[34] They negotiate contract terms carefully and will rely on a contract as an accurate and exclusive reflection of the matters contained therein. Their position tends to be that what is not explicitly permitted by the written terms of any agreement or contract is not permitted at all.[35]

Soviet tax law, labor law and property law are all binding on the joint venture partners, unless they are exempt under international treaties to

24. *Id.* at art. 1 § 3.

25. Decisions of the CPSU Central Committee and the USSR Council of Ministers on Additional Measures to Improve the Country's External Economic Activity in the New Conditions of Economic Managment, No. 1074 (Sept. 17, 1987).

26. Houri, *supra* note 3, at 503.

27. *Id.*

28. Feldman, *supra* note 10, at 115.

29. Houri, *supra* note 3, at 503-504.

30. Feldman, *supra* note 10, at 115.

31. Houri, *supra* note 3.

32. Joint Venture Decree, *supra* note 14, at art. 7.

33. *Id.* at art. 51.

34. *Arbess*, *supra* note 14, at 414.

35. *Id.*

which the USSR is party.[36] In addition, Article 1 of the Joint Venture Decree should be of particular concern to the Western partner, since it allows the Soviets to control joint ventures by enacting "other legislative acts of the USSR and Union Republics."[37]

All the above considerations have required Western partners to anticipate and address many potential contractual issues to maximize the success of the venture. Broad economic reforms, republic and central government laws, as well as the evolving structure of joint venture arrangements have had to be constantly monitored so that the negative impacts of any political or legal change could be minimized.

A. *Status of Joint Ventures in the Soviet Union*

As of January 1, 1990 there were 1,274 registered Soviet joint ventures with foreign partners.[38] However, only 184 of them had successfully maneuvered their way through the system and begun operations.[39] Matters of implementation have been complicated by the fact that Western companies cannot necessarily depend on their Soviet partners to guide them through the changing political and legal terrain.

B. *Legal and Operational Concerns*

The Soviet legal system is immature. Unlike a country possessing an established legal framework and body of precedent, the parties to a joint venture in the Soviet Union have had to negotiate and document many seemingly "standard" legal and business issues.[40] There is no Soviet equivalent of the Delaware Corporation Code — partners must establish a basic corporate framework for governance.[41]

The basic legal and business concerns of contribution valuation, profit repatriation, property rights, financing, taxes, and dispute resolution, plus special operational concerns about workers and supplies, have all had to be addressed. Any one area has the potential of derailing a business deal. The following sections outline how each of these business concerns has been dealt with in the past.

1. Contribution Valuation

Western partners need to determine early in the process how much to invest in a venture, and what share of equity capital this investment will represent. Soviet joint venture law permits many types of capital con-

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36. Houri, *supra* note 3, at 505.
37. *Id.*
38. FINANCIAL TIMES, Jan. 31, 1990, at 14.
39. *Id.*
40. Jeffery A. Burt, *Joint Venture Experience: Observations on the Business and Legal Challenges*, 22 INT'L L. & POL. 435, 445 (1990).
41. *Id.*

tributions.[42] Because the ruble is not a convertible currency, the Western partner is most likely to contribute hard currency and technology, while the Soviets will tend to provide mineral and property rights.[43] The 1987 Decree allows the parties to determine their respective equity shares by negotiation and to appraise their contributions in either rubles or hard currency.[44] Such negotiations ultimately focus on valuation: determining the value of the goods and services each partner proposes to contribute in exchange for their equity.[45]

Unfortunately, how to value each partner's contributions is one of the most difficult portions of the joint venture process. The Joint Venture Decree says contributions shall be valued by referring to world market prices, but it offers little direction on how to attach value to assets for which there is no market in the Soviet Union.[46] "Specifically, the value of Soviet real estate and natural resources will be difficult to assess because Soviets have consistently appraised them below market value by Western standards."[47] Likewise, there is no common standard by which the Western partner's "know-how" can be valuated.[48]

As a starting point, evidence of prior sales and valuations (particularly sales in the East Bloc), sales by comparable companies, current production costs, the value of licensing similar technology, and the cost of producing equivalent technology in the USSR can be submitted by the Western partner for examination.[49] The best approach so far appears to be to value the Soviet contribution in rubles and the Western contribution in hard currency.[50] This gives the Western partner a hedge against the risk of capital dissolution related to planned devaluations of the ruble.[51] By using this technique, a devaluation of the ruble would simply decrease the relative value of the Soviet partner's share resulting in a redistribution of equity ownership.[52] The mechanism for carrying out such a redistribution should be spelled out in a clause in the joint venture agreement specifically requiring the parties to revalue the ruble value of capital contributions.

2. Profit Repatriation

The ruble's non-convertability is a major obstacle to Western companies contemplating joint ventures in the USSR.[53] While both of the part-

42. Houri, *supra* note 3, at 509.
43. *Id.*
44. *Id.*
45. Arbess, *supra* note 14, at 416.
46. Joint Venture Decree, *supra* note 14, at art. 12.
47. Houri, *supra* note 3, at 509.
48. *Id.*
49. *Id.*
50. Arbess, *supra* note 14, at 419.
51. *Id.* at 418.
52. *Id.* at 419.
53. *Id.* at 430.

ners want the venture to earn money, the Western investor is mainly interested in repatriating profits while the Soviet investor's need is to increase the government's hard currency supply by keeping profits in the country.[54] Foreign partners have a guaranteed right under the Joint Venture Decree to transfer their share of profits abroad.[55] However, this right is worthless unless the joint venture has foreign currency available for this purpose. The average Soviet family does not have hard currency to spend so Western joint venture partners cannot expect to receive the type of money that they can repatriate from sales to the Soviet domestic market.[56]

To partially overcome this barrier to profit repatriation, the Soviets allowed the American Trade Consortium, a grouping of U.S. companies, to pool their respective joint venture generated foreign exchange cash flows.[57] This allows the consortium members who have joint ventures focused toward export markets to exchange excess amounts of hard currency at negotiated rates with other consortium members who sell products to the Soviet market for rubles. Another option that the Soviets have considered is using a special ruble backed by their gold reserves that would be convertible into Western currencies.[58]

Counter-trade deals have been the more usual way for joint ventures to earn hard currency. These deals allow Western goods to be exchanged for Soviet goods that are later sold for hard currency to the West.[59] Approximately half of all Eastern European contracts currently have some counter-trade provisions. In fact, it is estimated that one quarter of all world trade is actually counter-trade.[60] Combustion Engineering, for example, became the first U.S. partner in a Soviet joint venture,[61] using a counter-trade arrangement where it sells computer software and processing equipment to Soviet refineries and receives Soviet-produced petrochemicals as payment, which it then sells to other Western companies for hard currency.[62] Pepsico has counter-traded bottling factories and syrup for vodka.[63] Pepsico also agreed to train Soviet workers and to assist with bottling plant engineering, design, and construction. Twenty-six bottling plants now exist in the Soviet Union.[64]

One obstacle to counter-trade is the scarcity of Soviet commodities that meet quality standards necessary to make goods exportable to West-

54. Houri, *supra* note 3, at 509-510.
55. Joint Venture Decree, *supra* note 14, at art. 32.
56. Houri, *supra* note 3, at 510.
57. N.Y. TIMES, Mar. 31, 1989, at D4.
58. Houri, *supra* note 3, at 511.
59. *Id.* at 510.
60. Leo Welt, *Unconventional Forms of Financing: Buy-Back/ Compensation/Barter*, 22 INT'L L. & POL. 461, 467 (1990).
61. Burt, *supra* note 40, at 438.
62. Houri, *supra* note 3, at 511.
63. Burt, *supra* note 40, at 439.
64. Welt, *supra* note 60, at 466.

ern markets.[65] If the commoditites do meet Western market standards, the Soviet manufacturer may decide to market the products abroad itself, thereby avoiding the role of the joint venture "middleman."[66]

3. Property Rights

Property rights, based on the presumption that each party to a transaction understands what it receives for what it gives, are the foundation for commercial transactions in the West.[67] Western joint venture laws have historically given the joint venture itself all property rights, or allowed the individual parties to retain ownership of their separate contributions.[68]

The Soviet partner's main contribution to a joint venture typically is the right to use land areas and other resources.[69] However, a Soviet partner does not "own" the land that is contributed, since all land in the Soviet Union is "within the exclusive ownership of the State."[70] All natural resources, land and water are leasable to joint ventures under terms decided upon by the Council of Ministers.[71] Procedural rules and the type of resources involved guide decisions by the Council on what fees to charge for the right to use lands or resources.[72]

Before the 1990 amendment to the Soviet Constitution, private ownership of the means of production was historically forbidden by both Marxist-Leninist ideology and the Soviet Constitution.[73] The Supreme Soviet began reworking its private property laws beginning in 1988 with the Law on Cooperatives.[74] Cooperatives became the first private firms to legally hire employees and amass capital.[75]

More liberal measures were added in the winter of 1989 and 1990 with the enactment of the Fundamentals of Leasing Legislation, which established a legal basis for transferring possession and use of state property to private firms. The Fundamentals of Land Legislation, the Law on Property and associated constitutional amendments followed, and subsequently reworked the definition of property rights in the Soviet Union.[76] Currently, legislation recognizes state, collective and citizens' property,

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65. Houri, *supra* note 3, at 511.
66. *Id.*
67. Stephan, *supra* note 7, at 93.
68. Houri, *supra* note 3, at 508.
69. Arbess, *supra* note 14, at 417.
70. KONST. SSSR (1977), art. 11, *reprinted in* F. J.M. FELDBRUGGE, THE CONSITUTION OF THE USSR AND THE UNION REPUBLICS: ANALYSIS, TEXTS, REPORTS 111 (1979).
71. Procedure Assessing the Land, Natural Resources, Buildings and Structures Forming Part of the Soviet Parties' Contribution to the Authorized Capital of Joint Ventures for Temporary Use § 1.1 (Feb. 9, 1988).
72. *Id.* at § 2.1.
73. Stephan, *supra* note 7, at 93.
74. *Id.*
75. *Id.*
76. *Id.*

with the latter two categories including private productive assets.[77] Private ownership of land is still forbidden.

Individuals can invest only in firms with which they maintain some labor relationship. Property and non-property personal rights can be acquired by a joint venture in its own name.[78] Joint ventures are protected, under Article 17 of the 1987 decree, in a manner quite similar to Soviet state organizations, including protection allowances for copyrights and patents.[79] Ownership of technology is not covered by Soviet law.[80]

A startling development was the October 26, 1990 Presidential Decree which authorized direct investment by foreigners in the Soviet economy.[81] The decree may well place foreigners on an equal basis with Soviet citizens in terms of rights recently created and protected by property legislation.[82]

4. Financing

Article 27 of the Joint Venture Decree allows joint ventures to use both rubles and convertible currencies to raise debt capital.[83] *Vnesheconombank* (the USSR Bank for Foreign Trade) has made initial financing directly available to joint ventures in foreign currency from non-Soviet sources.[84]

The dominant issue for a Western bank is how a loan is collateralized. Increasingly, the borrowers involved will be self-financing, privately-owned businesses formed in the image of Soviet cooperatives or other forms of associations.[85] In the past, banks have been willing to finance joint ventures when the Western partner backs the venture with guarantees, or when the partners pledge equity interests in the joint venture.[86] However, joint venture partners will continue to prefer to pledge joint venture assets.[87]

As as result, Western banks are considering increased "limited recourse" financing based on traditional project finance credit evaluation criteria. An example is the recent cooperation between Moscow Narodny Bank (a Soviet-owned U.K. bank based in London), and the Finnish Postipankki Bank that provided $10.7 million in financing for a joint venture hotel renovation in Tallinn, Estonia.[88] The Finnish partners have par-

77. *Id.* at 94.
78. Joint Venture Decree, *supra* note 14, at art. 6.
79. Houri, *supra* note 3, at 508.
80. *Id.*
81. Stephan, *supra* note 7, at 91.
82. *Id.*
83. Joint Venture Decree, *supra* note 14, at art. 27.
84. *Id.*
85. *Id.*
86. *Id.*
87. *Id.*
88. *MNB in USSR Joint Ventures*, TRADE FINANCE, Apr. 1989, at 5.

tially guaranteed the loan, but a major portion of the loan is secured by a collateral assignment of a construction contract, as well as by the partners' promise to ensure sufficient occupancy rates and to guarantee high management standards.[89]

5. Taxes

In the recent three and one half year period when joint ventures have been allowed, nine separate legislative or regulatory acts related to joint venture taxation have been issued by five separate governmental groups.[90] In January of 1987, the Council of Ministers first allowed establishment of joint ventures, provided that they would be taxed at thirty percent of their profits, with an exemption from payment for the first two years of operation.[91] A September 1987 joint decree from the USSR Central Committee and the Council of Ministers modified the original tax holiday so that it would run from the time when declared profits were first received.[92] This is an important benefit for Western partners because a joint venture might not produce profits for up to ten years.[93] Payment of the thirty percent profits tax can be indefinitely delayed if the joint venture's earnings are used for expansion, or to increase its various reserve and development funds.[94]

In December 1988, a Decree was adopted by the Council of Ministers extending the tax holiday for joint ventures in the Far Eastern economic region to three years after profits are first declared.[95] In 1989, the USSR's Supreme Soviet Presidium gave the Council of Ministers more flexibility in granting reductions and exemptions from taxation to joint ventures.[96] The most recent enactment was the June 1990 "Law on the Taxes on Enterprises, Associations and Organizations," which limited tax concessions to joint ventures in two ways: first, profits are to be taxed at thirty percent only if the foreign partner's investment in the capital fund exceeds thirty percent, otherwise the tax rate is the same as for other Soviet enterprises (maybe as high as forty-five percent); second, service and other non-production oriented joint ventures, plus fishing or mineral extraction joint ventures are no longer eligible for the tax holiday.[97]

In addition to the profits tax, a twenty percent withholding tax is

89. *Id.*

90. Michael Newcity, *Tax Issues in Soviet Joint Ventures*, 25 TEX. INT'L L.J. 163, 168 (1990).

91. *Id.* at 169.

92. *Id.* at 170.

93. Houri, *supra* note 3, at 513.

94. Joint Venture Decree, *supra* note 14, at art. 30.

95. Decree of the USSR Council of Ministers on the Further Development of Foreign Economic Activities of State, Cooperative, and other Public Enterprises, Entities, and Organizations, No. 1405, arts. 28, 31 (Dec. 2, 1988).

96. Newcity, *supra* note 90, at 171.

97. *Id.* at 172.

also levied on all profits repatriated by Western partners.[98] However, since the USSR has entered into double taxation agreements including provisions relating to the taxation of royalty, interest and dividend income with most of its Western trading partners, it is likely that the joint venture will be relieved from paying part, or all of this withholding tax if the transaction is structured so that a portion of the profits are characterized as royalty payments, interest or dividends.[99]

Finally, foreign employees of a joint venture must pay income tax in the USSR if they are located there for more than 183 days during a calendar year.[100] New legislation, in effect as of July 1, 1990, imposes a sixty percent tax rate on monthly incomes in excess of 3,000 rubles.[101] Since many of the non-Soviet employees of a Western-Soviet joint venture will earn more than this amount, which is equivalent to a $60,000 annual income, the resulting tax liability imposed on foreign employees is substantial.[102]

Change has been the predominant characteristic of Soviet tax policy toward joint ventures since the 1987 Joint Venture Decree.[103] It is fair to say the current laws are only temporary. Another area of considerable potential change lies with the republics and local authorities. Several of them are drafting their own tax laws and all are likely to play a much greater role in future taxation of joint ventures.[104]

6. Dispute Resolution

Article 20 of the 1987 Joint Venture Decree provides that disputes shall be settled "according to legislation of the USSR either by the USSR courts or, by common consent of both sides, by an arbitration tribunal."[105] The term "courts" in the Soviet context actually refers to their economic regulation and enforcement system called *arbitrazh*.[106] *Arbitrazh* is an administrative agency that implements and then monitors national economic plans through union and republic level branches.[107] It functions much like a court of law in that it hears cases after there has been a private resolution attempt.[108] Whether *arbitrazh* should ever be used for dispute resolution for joint ventures is questionable given its administrative nature and its adherence to the Soviet economic plan.[109]

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98. Joint Venture Decree, *supra* note 14, at art. 41.
99. Newcity, *supra* note 90, at 189 n.133.
100. *Id.* at 202.
101. *Id.* at 203.
102. *Id.*
103. *Id.* at 206.
104. *Id.* at 207.
105. Feldman, *supra* note 10, at 116.
106. *Id.*
107. *Id.*
108. *Id.* at 117.
109. *Id.* at 118.

U.S. federal courts could be used for a Soviet-U.S. joint venture dispute if the hurdle of potential sovereign immunity under the Federal Foreign Sovereign Immunity Act could be overcome.[110] However, it is not clear whether federal or state law would be applied, and, if the Soviet partner does not have assets in the U.S., the U.S. partner cannot enforce the judgment.[111] The application of foreign law is not unknown, however. For example, Swedish courts were utilized in 1988 when the American Trade Consortium persuaded its Soviet partner to arbitrate disputes.[112]

Arbitration may be the best way to adapt an agreement to unforeseen changes.[113] The joint venture agreement should contain a section covering arbitration in three parts. First, a general clause covering all disputes is necessary, and should specify the language to be used as well as acceptance of the UNCITRAL rules, which permit the selection of an institution capable of assisting with the administration and organization of the dispute resolution. The drafting of the arbitration clause should be supervised by the Stockholm Chamber of Commerce, a recognized international arbitration institution. Second, a clause distinguishing technical disputes to be arbitrated by "on site" experts and reviewable by the tribunal is necessary in the general arbitration clause. Finally, it is important to include a clause recognizing areas where increased contact with the state would be beneficial to the enterprise and where certain actions would warrant submission to *arbitrazh*.[114]

7. Labor

Supervising and motivating a local work force that has traditionally not been rewarded for productivity is a difficulty that has always affected foreign investments in Eastern Bloc countries.[115] In fact, the preamble to the USSR Constitution contains the Soviet ideology of eliminating capitalist exploitation of the people.[116]

Soviet labor law is "voluminous and complex," consisting of labor codes and uncodified statutes promulgated by both federal and republic lawmakers.[117] In addition, there are countless regulatory decrees designed to implement statutes. The decrees are so numerous and detailed that they are often more important than the underlying statutes.[118] Local norms also play an important role in labor concerns. Finally, USSR and

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110. *Id.*
111. *Id.* at 119.
112. Houri, *supra* note 3, at 505.
113. Feldman, *supra* note 10, at 119.
114. *Id.* at 129.
115. Houri, *supra* note 3, at 514.
116. F.J.M. Feldbrugge, *The Constitution of the USSR*, 16 REV. SOCIALIST L. 163, 167 (1990) (citing the USSR CONSTITUTION, preamble).
117. Kevin P. Block, *The Disciplining and Dismissal of Employees by Joint Ventures in the USSR*, 23 GEO. WASH. J. INT'L L. & ECON. 619, 621 (1990).
118. *Id.* at 622.

republic courts periodically issue "guiding explanations" to lower courts.[119]

On the whole, there are four notable characteristics of Soviet labor law. First, there is an extraordinarily powerful role assigned to trade unions; second, the central government regulates many issues that are left to bargaining in Western cultures; third, the system is very protective of workers; and fourth, there is a quick and inexpensive, if not always equitable, means to resolve employee disputes.[120] Two fundamental concepts underlie all of Soviet labor law: "all Soviet citizens have a right to a job and all able-bodied citizens have a corresponding duty to work."[121]

Under the 1987 Decree, over half of a joint venture's employees had to be Soviets, which required that joint ventures abide by the very stringent requirements of Soviet labor law.[122] From the perspective of the Western partner, the December 1988 Decree appeared to simplify employment matters by permitting questions of hiring and dismissal, the form and scale of labor pay, and material incentives to be determined in negotiations between the parties.[123] Read literally, this language would return the USSR to the employment-at-will doctrine.[124]

The validity of this provision is highly questionable, however, since it violates Soviet labor laws, the Soviet Constitution,[125] and is in opposition to powerful ideological, historical and political precedents.[126] A concrete example concerns dismissals. Soviet labor law requires an exclusive list of grounds for termination and prior union consent for most dismissals.[127] Courts will not only reverse a dismissal that was put into effect without union consent, but will charge the responsible managers with personal fines.[128]

The May 1989 Decree now says that decisions by a joint venture on these matters must be consistent with all the USSR "legislative acts" that govern the rights of its citizens.[129] But "legislative acts" is a general phrase. It is not clear whether "legislative acts" are intended to include general norms applicable to Soviet citizens, or only the specific legislative acts applicable to state enterprise employees.[130]

Without being able to offer meaningful material incentives to encourage increased quality and production, Soviet enterprises have re-

119. *Id.*
120. *Id.* at 622-632.
121. *Id.* at 623.
122. Houri, *supra* note 3, at 514.
123. Arbess, *supra* note 14, at 424.
124. Block, *supra* note 117, at 626.
125. Houri, *supra* note 3, at 515.
126. Block, *supra* note 117, at 626.
127. *Id.* at 625.
128. *Id.*
129. Arbess, *supra* note 14, at 424.
130. *Id.*

sorted to a complex system of punishment for those who do not follow the rules.[131] Articles 127 through 138 of the RSFSR Labor Code cover discipline and speak in very general terms of employee obligations while imposing a long list of duties on management.[132] Only a few people are allowed to impose discipline, and failure to follow the proper steps (including requesting a written explanation of the event from the employee, receiving permission from the trade union to administer discipline, issuing a directive enunciating the basis for the discipline and giving it to the employee no later than three days after its issuance for the employee's signature) may render the disciplinary measures void.[133]

The grounds for actual dismissal of an employee are limited by Articles 33 and 254 of the labor code.[134] Among those most likely to be imposed by a joint venture are:

a. *Violation of Labor Discipline.* A frequently litigated action, which allows an employer to terminate an employment contract for "inadequate work performance, insubordination, or other numerous forms of unsatisfactory behavior."[135]

b. *Abenteeism.* Many of these cases arise in connection with transfers. Since employees must consent to a transfer to another job, employees who feel they have been improperly transferred sometimes do not report to their new positions.[136] Dismissals in these cases will stand only if the transfer was legal.

c. *Layoffs.* The labor code recognizes this as a permissible ground for dismissal, but it has been largely unused in the USSR.[137] Certain employees are classified as having preferential rights to remain at work, but performance results are not listed as a criteria for that right.[138] Two months notice must be provided and, if possible, the employee must be provided with alternative work.[139]

d. *Flagrant Breach of Duty.* Nothing in the statute indicates what actions or inactions constitute a flagrant breach, and it is unclear whether a court or the joint venture's board of directors would review such a dismissal since a joint venture isn't under a ministry's jurisdiction.[140]

e. *Loss of Confidence.* Intentional wrongdoing is not required,

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131. Block, *supra* note 117, at 627.
132. *Id.* at 628.
133. *Id.* at 631-632.
134. *Id.* at 639.
135. *Id.* at 640.
136. *Id.* at 641-642.
137. *Id.*
138. *Id.* at 643.
139. *Id.* at 644.
140. *Id.* at 645.

just an improper act indicating extreme carelessness.[141] There must be individualized proof of wrongdoing.[142]

f. *Miscellaneous.* This includes inability to work for more than four months unless it is due to a job related accident; a person who previously held the job reclaims the position; the employee is not qualified; the employee is committed by a court to a drug or alcohol rehabilitation program; and immoral acts committed by people in the educational system.[143]

Trade unions also have the authority to dismiss management employees under Soviet law.[144] Potential targets of a trade union demand for dismissal include all individuals in the management staff.[145] With this authority, unions instituted more than 6,000 administrative actions in 1979 against management officials, which resulted in 146 dismissals. By 1985, the number of actions had almost doubled.[146]

8. Procurement and Product Quality

Product quality in the USSR is strongly dependant on access to supplies.[147] Unlike state enterprises, joint ventures are not guaranteed access to sources of natural resources and production materials, nor are they guaranteed a market for their resulting products and services.[148] A November 1988 amendment to the 1987 Joint Venture decree allowed joint ventures to use either hard currency or rubles to purchase supplies directly from Soviet producers.[149] But purchasing supplies has been troublesome since joint ventures have no priority and manufacturers few goods left after filling state plan orders.[150]

Importation of equipment, materials and other property is an alternative supply source.[151] Only convertible currency, however, can be used to make payments.[152] Soviet customs has also remained unclear about how it will treat components that are sent regularly from overseas as contributions that are not part of equity.[153]

Chronic supply shortages and no industry competition have resulted in inferior product quality and low Soviet consumer expectations. Yet quality must be high to meet Western standards, or the Western partner

141. *Id.*
142. *Id.* at 646.
143. *Id.* at 647.
144. *Id.* at 649.
145. *Id.* at 650.
146. *Id.* at 649-650.
147. Houri, *supra* note 3, at 516.
148. Arbess, *supra* note 14, at 428.
149. Houri, *supra* note 3, at 516.
150. *Id.*
151. Arbess, *supra* note 14, at 429.
152. Houri, *supra* note 3, at 516.
153. Arbess, *supra* note 14, at 429.

will not want to lend its trade name.[154] The McDonald's joint venture required over twelve years to negotiate, partly because McDonald's quality standards could only be met by establishing a large farm outside Moscow to grow potatoes and other food products.[155] But very few Western companies can afford to invest as heavily as McDonald's, which brought in its own supply chain and production equipment for the staggering sum of $50 million.[156]

V. THE NEW PLAYING FIELD

Joint ventures may not have thrived in the environment described above, but they had made headway in the new liberalized world of *perestroika*. Before the disintegration of the USSR, the Soviet central government was beginning to have some market-based business experience to rely on, and further market expansion was planned.

However, changes catalyzed by the "controlled" release of information, *glasnost*, were not complete. After seventy years of threatening the whole world, the Soviet Union split apart in six short years. What happened? In changing the nature of power relations the Soviet Union had to change its ideology, which had guaranteed "an absence of serious national conflicts, a quiescent working class and the solidarity of the ruling elite."[157] Gorbachev chose to implement the change by limiting the Communist party and exposing its vices. However, control of the relevant information was quickly lost, resulting in discredit to the legitimacy of Soviet rule as a whole.[158]

Wall Street Journal headlines on Monday, December 23, 1991, officially announced the end: "Eleven Republics Lay USSR to Rest."[159] On December 11, 1991, Russia, Byelorussia and the Ukraine created the Commonwealth of Independent States (CIS). They accepted the popular demands for independence by the republics, framed a confederation, and intended to allow non-communist private enterprise and private markets to flourish.[160] Eight of the remaining nine Republics, Azerbaijan, Armenia, Kazakhstan, Kirgizia, Moldavia, Tajikistan, Turkmenia and Uzbekistan, signed on as co-founders on December 21 and 22, 1991.[161] Georgia joined the CIS early in 1992 following the resolution of its internal fighting over republic leadership.[162]

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154. Houri, *supra* note 3, at 515.
155. Burt, *supra* note 40, at 439.
156. Houri, *supra* note 3, at 515.
157. David Satter, *The Seeds of Soviet Instability*, WALL ST. J., Sept. 20, 1991, at A10.
158. *Id.*
159. Elisabeth Rubinfien, *Eleven Republics Lay U.S.S.R. to Rest*, WALL ST. J., Dec. 23, 1991, at A6.
160. *Goodby USSR, Hello CIS*, WALL ST. J., Dec. 13, 1991, at A14.
161. Rubinfien, *supra* note 159.
162. *Slavic Shakeout*, WALL ST. J., Feb. 14, 1992, at A12.

The republics had reacted to the new information filtering out of the Kremlin with a surge of nationalism.[163] The people were informed that the Baltics did not join the Soviet Union voluntarily, but were part of a secret Molotov-Ribbentrop Pact between Hitler and Stalin; that the placement of Nagorno-Karabakh in the territory of Azerbaijan was part of a strategy of divide and rule; and that the Ukrainian famine of 1932-33 which claimed the lives of millions was artificially induced.[164]

The breakup of the world's last great empire is actually an enormous process of decolonization.[165] The Soviet empire was not the Russian empire; the Russians were colonized just as much as the people in the Ukraine, Georgia and Kazakhstan.[166]

When the fictional world of Soviet ideology was removed, the republics rediscovered their own history and recovered in spirit, if not in name, separate statehood.[167] The August coup attempt, with its threat to plunge the republics back into the repressive conditions of old, catalyzed the Russian spirit and moved an outraged citizenry into the streets in defense of their new-found freedoms. Afterward, it may well have been Gorbachev's continued insistence on maintaining a powerful central government which finally solidified the resolve of the republics' leaders to reject the Soviet system.[168]

What does this mean for existing Western-Soviet joint ventures? Do we start again? Will all the rules be new? How should a new joint venture begin? The answers to all these questions lie in following the lead of the republics. The foundation for the Commonwealth is state independence.[169] The only agreements reached in the early days of the CIS were that pricing policies would be coordinated, the ruble would remain the common currency (though sources differed on whether the Ukraine intended to issue its own), each republic would pursue its own economic policy, each republic would have equal status in the CIS, central military leadership would transition to military groups in each republic, and Russia would occupy the Soviet Union's General Assembly and Security Council seats in the United Nations.[170]

In truth, the world has twelve new nations to learn about, plus the three Baltic Republics already granted independence earlier in 1991. If the revolution had been pre-planned, the various republics would have negotiated a pact long ago with provisions for an association of free na-

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163. Satter, *supra* note 157.

164. *Id.*

165. Jack F. Matlock Jr., *The Politics of Russian Economic Reform*, WALL ST. J., Nov. 5, 1991, at A6.

166. *Id.*

167. Satter, *supra* note 157, at A10.

168. Peter Gumbel, *As Soviet Events Seem to Bypass Gorbachev, Talk is of His Legacy*, WALL ST. J., Dec. 13, 1991, at A1.

169. Rubinfein, *supra* note 159 (quoting Boris Yeltsin).

170. *Id.*

tions with a common currency, a common economic space and centralized control over weapons of mass destruction.[171] Lacking such forethought, what is clear now is that the nations that made up the Soviet Union must move apart before they can find their way back to a limited union.[172] From a Western perspective, our first step is to learn as much as possible about our new business partners (See Appendix).

A. *The Republics: Tension between Interdependence and Separation*

From the start, the union was actually a confederation formed from national or multinational entities that were often artificially defined.[173] When it was formed in 1922, the Soviet Union consisted of Russia, two republics (the Ukraine and Belorussia), two confederations (the Peoples Republics of Central Asia and Turkestan), plus an ersatz confederation of Georgia, Armenia and Azerbaijan.[174] The reorganization of Central Asia resulted in five republics roughly divided along ethnic lines, and which were officially added to the Soviet Union in the 1920s and 1930s: Uzbekistan (1925), Turkmenistan (1925), Tadzhikistan (1929), Kazakhstan (1936), and Kirgizia (1936).[175] Next, Bessarabia was annexed from Romania to form Moldavia and finally, in 1940, the Baltics (Latvia, Lithuania and Estonia) were incorporated as a result of the now notorious Hitler-Stalin agreement.[176]

Today, the 286 million people who live in the CIS and the Baltic states are from the same geographic regions where their ancestors have lived for centuries;[177] but in creating its new world order, the Socialists tried to level any cultural differences by depriving people of their homelands through deportation, radical changes in living conditions, and forced changes in ethnic composition via in-migration and resettlement.[178] Much of the discontent in the republics today is directly tied to the depletion of natural resources, and the cultural and environmental degradation of cities and farms by central planning authorities.[179]

1. Interdependence

The republics must first face the realization that most of them cannot exist on their own.[180] The majority of Soviet products are made from

171. Matlock Jr., *supra* note 165, at col. 4.
172. *Id.*
173. Thomas J. Samuelian, *Cultural Ecology and Gorbachev's Restructured Union*, 32 HARV. INT'L L.J. 159, 168, (1991).
174. *Id.*
175. *Id.* at 169.
176. *Id.*
177. *Id.* at 164.
178. *Id.*
179. *Id.*
180. Paul Hofheinz, *Let's Do Business*, FORTUNE, Sept. 23, 1991, at 64.

raw materials or parts from more than one republic.[181] The central planners gave the republics bits and pieces of industry and agriculture, but ensured that no republic was self sufficient in goods or services.[182] A few notable facts include:

> a. Russia produces ninety per cent of the oil and most of the natural gas output of the Soviet Union,[183] but still must import grain from the Ukraine and the West, cotton from the Central Asian Republics, and meat and dairy products from the Baltics.[184]
>
> b. The Baltics depend on other republics for two-thirds of their goods and services.[185]
>
> c. Armenia has the only factory that makes a filter used in all power stations. Without it, there is no electricity and lights go out everywhere.[186]
>
> d. Uzbekistan was largely self-sufficient in food until central planning decided in the 1950s that the Soviet Union needed more cotton. So, five million farmers there were forced to switch. Now, Uzbekistan produces seventy per cent of the Soviet Union's cotton while it imports food.[187]
>
> e. Mongolia lacks a dependable telephone system, facsimile machines are almost unknown and its people, primarily from rural areas, are ignorant about a market driven system.[188]
>
> f. Moldavia and Georgia are in critical need of enormous investments in infrastructure — from road construction to phone systems.[189]

An economy like this is particularly susceptible to disruption if inter-republic trade breaks down. The pursuit of independence and separate currencies risks just such a breakdown.[190] Only Russia, the Ukraine, and possibly Uzbekistan may have the resources and hard currency earning potential to survive a collapse in intra-republic trade,[191] but even that is doubtful considering their commitment to service their share of the old

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181. Craig Forman, *Soviet Economy Holds Potential Disaster As the Union Weakens*, WALL ST. J., Sept. 4, 1991, at A1.

182. *Id.* at A6.

183. Elisabeth Rubinfien, *Yeltsin Seizes Control of Soviet Resources*, WALL ST. J., Nov. 18, 1991, at A13.

184. Forman, *supra* note 181, at A6.

185. *Id.*

186. *Id.*

187. *Id.*

188. Susan Carey, *Free From Moscow, Mongolia Makes Up for Lost Time by Embracing Markets*, WALL ST. J., Oct. 3, 1991, at A14.

189. Hofheinz, *supra* note 180, at 65.

190. *Saving Soviet Trade*, FIN. TIMES, Nov. 21, 1991, at 22.

191. *Id.*.

Union's foreign debt.[192] A leading Soviet scientist, Yevgeny Velikhov, warned that failure to preserve at least some current economic links would "turn the Soviet Union into little more than a Third World producer of raw materials."[193]

There is no indication of what will happen to the long-term agreement that allows U.S. grain exports to go to the Soviet Union.[194] The central government agency *Exportkhleb* bought for all republics; some are now considering importing on their own, others can't afford individual importing.[195] Conditions for a successful new federation include rapid agreements on a monetary system, a customs union so that republics won't set up tariff barriers against each other, and an agreement on uniform commercial and civil laws.[196]

2. Separation Activity

"The hypernationalism dominating life in many republics interferes with rational economic decision-making," says Andrei Kortunov, a political analyst at the Soviet Academy of Sciences.[197] Squabbles over natural resources and economic assets pit the republics against each other.[198] Escalation can be expected when they confront, for example, who controls genuinely Soviet assets such as Aeroflot, the national airline, and who will pay what portion of the Soviet Union's existing sixty four billion hard currency debt.[199]

"Its working by seizure," says Abraham Becker, director of the Rand Corporation's UCLA Center for Soviet Studies in California. "If it's in my back yard, it's mine."[200] Examples include the Baltic Republics and Russia who are claiming control over federal assets in their territory.[201] Azerbaijan, Uzbekistan and Kazakhstan say oil located on their land belongs to them.[202]

The republics also have different foreign policy interests. For example, Tadjikistan is a predominantly Muslim republic that sees itself tied to Europe, but has interests that are different from Russia.[203] Most republics want consular, cultural and economic affairs to be directed by

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192. *Id.*
193. Forman, *supra* note 181.
194. *Id.* at A6.
195. *Id.*
196. *Id.*
197. Gerald F. Seib, *U.S. Loses Hope that Coherent Economy Will Link Nationalistic Soviet Republics*, WALL ST. J., Oct. 28, 1991, at A10.
198. Forman, *supra* note 181.
199. *Id.*
200. *Id.* at A6.
201. *Id.*
202. *Id.*
203. Peter Gumbel, *Russia's Foreign Minister Seeks to Unite Republics on Key Issues*, WALL ST. J., Nov. 8, 1991, at A12.

their own people.[204]

The need to exhibit true independence is also evidenced by the following:

a. Russian President Boris Yeltsin freed price controls for many products on January 2, 1992.[205] He also reduced foreign aid and credits to all countries, began charging market prices for Russia's natural resources, sold or gave away government-owned housing and unprofitable state farms, and ended the uncontrolled printing of currency.[206] In April of 1992, state controlled energy prices were also freed.[207] The Russian economic-reform team has maintained a strict credit policy since the first of the year to stabilize the economy.

b. Russia is also taking control of Soviet gold reserves, diamonds, precious metals, and oil exports, which are the main collateral for the nation in its efforts to secure more international credit.[208] Russia produces sixty seven per cent of Soviet gold and has claimed control of the entire resource, notwithstanding the theory that republics in a new union should mutually work out a plan to divide debt obligations and resources.[209]

c. The Ukraine plans to introduce its own currency and has banned exports of scarce consumer goods to other republics.[210] However, soaring prices in Russia have forced the issuance of a temporary coupon currency.[211] A capital fund has been created for the republic's new National Bank of Ukraine and special multiple-use coupons are now used in Ukrainian stores to prevent the out-flow of goods to other republics.[212]

d. Both Russia and Ukraine have laid claim to the 300-ship Black Sea fleet which sales out of Sevastopol, a Ukrainian port.[213]

e. Mongolia plans to privatize most state enterprises and cooperatives, sell land to private investors, wipe out debts of companies to be sold, provide credit to new small businesses, and train brokers, bankers, and managers in the ways of the market.[214]

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204. *Id.*

205. Adi Ignatius, *Backlash to Russian Price Rises Stops Short of Violence So Far*, WALL ST. J., Jan. 20, 1992, at A6.

206. *Yeltsin Goal: Free Market*, DENV. POST, Oct. 29, 1991, at A2.

207. Laurie Hays, *Russia Yielding on its Policy of Tight Money*, WALL ST. J., Mar. 20, 1992, at A6.

208. Rubinfien, *supra* note 183.

209. *Id.*

210. Forman, *supra* note 181.

211. Tim Carrington, *Ukraine Falters Over Creating Currency*, WALL ST. J., Jan. 31, 1992, at A10.

212. Natalia Feduschak, *Ukraine Keeps a Firm Stance as Moscow Raises Pressure on Republic to Cooperate*, WALL ST. J., Oct. 23, 1991, at A12.

213. Adi Ignatius, *Black Sea Fleet Stranded in Tug-of-War*, WALL ST. J., Jan. 17, 1992, at A8.

214. Carey, *supra* note 188.

f. Georgia is allowing foreign companies to bid for mineral water concessions.[215]

g. Kazakhstan and Azerbaijan are negotiating with foreign petroleum firms, including Chevron and Amoco, for oil exploration rights.[216] Elf Aquitaine, a French owned oil giant, signed a pact with Kazakhstan in February of 1992 to allow oil exploration and production sharing.[217]

h. Almost half of Afganistan's total revenue is made from natural gas sales.[218] It is offering to sell its huge reserves to European markets for cash to rebuild its economy.[219]

3. Economic, Ethnic and Leadership Difficulties

As if the independence/separation tug-of-war wasn't enough, economic, ethnic and leadership problems are ripping at the core of the CIS's existence. The country is lurching through a draconian depression: GNP fell by ten per cent in the first half of 1991, while the budget deficit ballooned to over thirty three and one half billion dollars.[220] Since prices were liberalized in January of 1992, the Russian inflation rate has rocketed upward by 300%, while production has dropped by half in some sectors.[221] Yeltsin's program did not allow for industry privatizations along with price increases, so factories remain state owned and no real competition has begun.[222] Instead, true to their bureaucratic training, factories jointly have raised all their prices to a higher fixed level to insure their mutual survival.[223] Central planning has simply been replaced by self-imposed industry controls at a high cost to the common people.

Winter hit the republics in midstride between the old system and the new.[224] The cost of staple foods in Russia bounced up tenfold and many people survived on reserves of food that they had stockpiled before the price increases.[225] Enough food and fuel exist for everyone in the republics, but the transportation system simply cannot deliver all the goods.[226] More than a quarter of available grain is wasted, and over half the pota-

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215. Hofheinz, *supra* note 180, at 65.

216. *Id.*

217. Robert Johnson, *Kazakhstan, Elf Aquitaine Set Oil Pact*, WALL ST. J., Feb. 19, 1992, at A8.

218. *Afghanistan Offers Natural Gas*, WALL ST. J., Dec. 12, 1991, at A10.

219. *Id.*

220. Hofheinz, *supra* note 180, at 62.

221. Hays, *supra* note 207.

222. Laurie Hays and Adi Ignatius, *Moscow's Capitalists' Decide the Best Price is a Firmly Fixed One*, WALL ST. J., Jan. 21, 1992, at A1.

223. *Id.*

224. Russel Watson, *et al.*, *And What Now?*, NEWSWEEK, Sept. 16, 1991, at 33.

225. Adi Ignatius, *Russians Endure a Winter of High Prices But Face More Economic Shocks in Spring*, WALL ST. J., Mar. 10, at A15.

226. Watson, *supra* note 224.

toes and fruit rot before getting to consumers.[227]

To preserve themselves, trade unions are positioned in the front of a growing popular movement of dissatisfaction.[228] The unions appeal to people angry over shortages, and seek to link wages to prices, as well as to have industry spend more of its revenue on pay.[229] However, if the republics try to buy stability by buying off workers, catastrophic hyperinflation could result and may jeopardize the whole reform movement.

Over sixty years of ethnic repression by the manipulative central planners is erupting in violence.

> a. Ethnic factions in Afghanistan are warring.[230]
>
> b. Muslim-dominated Azerbaijan intensified an embargo against mostly Christian Armenia during the week of Nov. 4, 1991, by cutting off all natural gas shipments.[231] As a result, Armenia closed all but essential factories and limited TV broadcasts to one hour per day to conserve energy.[232] The economic situation in Armenia is worsening, and as of March, 1992, no cease-fire had been negotiated.[233]
>
> c. The Chechen-Ingush Autonomous Republic declared independence from Russia and armed a 3,000 man militia with weapons purchased from Hungary.[234]
>
> d. The Uzbeks have ongoing feuds with people in their bordering republics of Kazakhstan and Turkmenia.[235]

There is no consensus about what to do next. Instead, the leaders of this struggling group of newly born sovereignties continue to scrap among themselves. Fighting erupted in Georgia in October of 1991 between opposition forces and supporters of President Gamsakhurdia, who was being accused of dictator-like actions since his election the previous May.[236] Thousands of Communist protestors clashed with Moscow riot police in late February of 1992, denouncing President Yeltsin.[237] The Russian Vice President, Alexander Rutskoi, has lead the opposition to Boris Yeltsin's economic policies by openly criticizing the Russian plan to liberalize

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227. *Id.*

228. Neela Banerjee, *Unions Give Voice to Struggling Russians Tired of Yeltsin's Economic Promises*, WALL ST. J., Oct. 31, 1991, at A13.

229. *Id.*

230. Gerald F. Seib, *Baker Forging New Soviet Economic Ties as Issues such as Afghanistan Melt Away*, WALL ST. J., Sept. 16, 1991, at A5.

231. *Energy Crunch Slows America*, WALL ST. J., Nov. 11, 1991, at A10.

232. *Id.*

233. WALL ST. J., Mar. 19, 1992, at A1.

234. John Fialka, *Former Soviet Republics of South-Central Asia Have Nuclear Arms, Links with Volatile Lands*, WALL ST. J., Dec. 17, 1991, at A16.

235. *Id.*

236. *Violence in Georgia spawns emergency legislative session*, DENV. POST, Oct. 6, 1991, at A7.

237. *Thousands of Communists Clashed*, WALL ST. J., Feb. 24, 1992, at A1.

prices before privatizing industry.[238] Citing the same issues as Rutskoi, Moscow mayor and long-time Yeltsin ally Gavril Popov resigned in late December. A number of the elected Presidents of the smaller republics are the same Communists that lead them before, but the new freedoms have them keenly interested in developing their backward economies.[239] Indications are that they will no longer wait for leadership from the larger republics if they can establish diplomatic relations directly with the West to secure economic help.

B. *Revisiting East-West Joint Ventures Today*

The first issue that Western businesses have to consider is who to deal with. Though the emergence of fifteen new possibilities is daunting, complications may actually be lessened since the central Ministry maze will soon be nonexistent. The current joint venture deal making steps of discussion, negotiation and registration remain logical ones to continue, though registration will now likely be with a republic government. Without guidance from the Soviet central core and no precedent for many of the republics to follow, it is even more critical than before that Western partners remember and use to the benefit of the joint venture, the CIS people's love of the written word. Specificity of all conceivable venture terms in writing is a must.

Potential new developments in the eight areas of law and operations usually negotiated in a joint venture are discussed below.

1. Contribution Valuation

While the CIS Republics are struggling with how to establish a monetary system, problems with contribution valuation will not improve. The emergence of a market economy will be the main long term remedy. In the short term, Western partners should plan to continue assisting their CIS partners with valuation procedures, while using evidence of previous sales and valuations in the Eastern Bloc for foundation.

2. Profit Repatriation

The ruble is still the root of the trouble in this area, and the move to a market economy is the ultimate key to the solution. Western interests will continue to press for ways to make profits for the CIS citizenry, and this may become more likely without the central government standing guard. In the short term, counter-trade deals still appear to be the best way to convert joint venture profits into hard currency for Western repatriation. It may even continue as a long term solution if the quality of CIS produced goods improve.

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238. Elisabeth Rubinfien, *Yeltsin Deputy Opposes Plans for Economy*, WALL ST. J., Dec. 19, 1991, at A10.

239. Robert S. Greenburger, *Baker is Wooing Central Asian Republics*, WALL ST. J., Feb. 14, 1992, at A8.

3. Property Rights

Three generations of citizens have accepted the idea that the state owns virtually everything. Even as Moscow and some republics move toward private ownership of property, it is questionable how quickly such a shift can be made or if it will be made in all parts of the CIS. Ownership of things like mineral rights may be hard to sever from republic governments in cases like Afganistan, where over half of the republic's income is from natural gas sales. Western partners should watch these laws closely but be prepared to continue operations as before.

4. Financing

Continued movement on project financing can be expected since there is even less assurance that CIS partners can be held financially responsible for their part of any deal. Financiers can be expected to continue to rely heavily on the Western partner and look to the joint venture itself for their return on investment.

5. Taxes

There will likely be major shifts in tax laws as the republics rush to raise hard currency from the only existing enterprises linked to a market economy. Westerners should expect new tax laws in republics that have never had them before. Tax laws may also be issued coincidentally with laws that allow more privatization of industry. Employees may get a break, however, if the republics move to ease some of the burden their citizens are carrying due to the move toward a market economy.

6. Dispute Resolution

Arbitrazh is likely to cease to exist in its current form as a forum for dispute resolution, and use of U.S. courts hold no better promise than before. Arbitration carefully outlined in the joint venture agreement still appears to be the best alternative. Western partners should be more cautious than ever about negotiating these terms with CIS partners.

7. Labor

Labor law may have less impact than the expectations of the work force. The concept of having a right to work has long been seen as an entitlement to a present job. The power of the trade unions to control discipline and challenge management won't soon be forgotten.

Potentially, Western business partners should take cues from the General Electric Co. Tungstran factory established in Budapest, Hungary, twenty months ago. General Electric found that schools haven't prepared workers for a demand economy.[240] One Western manager gathers

240. Roger Thurow, *Seeing the Light*, WALL ST. J., Sept. 20, 1991, at R2.

his Hungarian managers every morning to see what can be learned from problems in the previous twenty-four hours. "What I often get is an eloquent detailed description of what went wrong and what the current situation is, but absolute silence about a plan to go forward to solve it," he says.[241]

General Electric has established "business made easy" courses where everyone, including janitors through executives, learns that profit is not a bad word.[242] There are sensitivity classes which teach that criticism of processes and work patterns is necessary. A weekly newsletter has replaced the sayings of Lenin with those of Lombardi; "We want to win, not just exist."[243] The going will not be easy, especially since economic pressures are likely to cost some workers their jobs. In the words of a female factory worker, "Everything belonged to the workers: the factory and the machinery. Now they just tell us to get out."[244]

8. Procurement and Quality

Transportation problems simply must be solved. This will be tricky, even if the republics negotiate open trade among themselves. How do you teach the value of good quality to people who are accustomed to standing in line to buy whatever is available? It will not be easy, but McDonald's and Pepsico's experiences show that it can be done. Pressures from meeting market demands, and the emerging awareness that people have a right to good quality, will help address these problems in the long term.

C. *Three More Barriers: The Ruble, Banking and the Law*

The worthless ruble, the nonexistent banking system, and a legal system designed to promote Communist Party goals rather than objectivity are three immense difficulties that must be attacked soon.

1. The Ruble

The ruble never served the traditional role of money. It was neither a medium of exchange, nor an item of value.[245] In September of 1991, the Soviet Union printed rubles as fast as possible for masses of transactions.[246] However, the uncontrolled printing fuelled by rising wages was not matched by increased production, and hyperinflation resulted.[247] The official exchange rate for rubles in early November of 1991 was devalued

241. *Id.*
242. *Id.*
243. *Id.*
244. Barry Newman, *Troubling Omen: Poland's Shaky Transformation to a Free Market Carries Warning for Soviets*, WALL ST. J., Sept. 13, 1991, at A10.
245. George Soros, *U.S.S.R.: See the Future, Make it Work*, WALL ST. J., Sept. 13, 1991, at A12.
246. John Lloyd, *Rubles Printed Round the Clock*, FIN. TIMES, Sept. 18, 1991, at 1.
247. *Id.*

from thirty-two rubles to the dollar to forty-seven rubles to the dollar.[248] The black market rate then was around seventy rubles to the dollar and banks got seventy seven rubles to the dollar at Moscow auctions.[249] The slide in value became a frightening plunge. But Russian central bank officials tightened credit at the beginning of the year, reduced the supply of rubles in circulation, and began a delicate support intervention. As a result, the ruble has seen some stabilization, trading at 170 per dollar in late February, 1992, up from 230 rubles per dollar at the end of January.[250]

A possible long term solution would be to enact a Russian version of the Bretton Woods system used for twenty-five years following World War II.[251] Under the system, the U.S. kept its currency convertible to gold at a fixed rate and other countries wanting to engage in the system agreed to keep the value of their own currencies in terms of the dollar at fixed rates.[252] This system provided monetary stability and promoted trade among the members.[253] Gold may be the most acceptable foundation for sound money.[254] Most important, the ex-Soviets have substantial gold holdings. CIA estimates have put the amount at about twenty-five billion dollars, which is enough to start minting coins in troy ounces.[255]

2. Banking

The problem of ruble non-convertability is heavily complicated by the lack of an efficient banking system that enables money to move easily from one section of the economy to another, for example from farming to food stores.[256] The CIS lacks savings bonds, mutual funds, checking accounts and credit cards.[257] Factories dole out payrolls in paper rubles; there is no such thing as a paycheck.[258] Since CIS citizens can't put their money to work for them, the economy lacks what is called a multiplier effect. If a U.S. consumer spends a dollar to buy milk, that money ultimately goes to pay the store clerk who uses it to buy a shirt.[259] The buck does not stop anywhere in a healthy economy.[260] What citizens do instead

248. *Soviet State Bank Plans To Further Devalue Ruble*, WALL ST. J., Nov. 4, 1991, at A16.
249. *Id.*
250. Elisabeth Rubinfien and Laurie Hays, *Suddenly Scarce Rubles Regain Value, But Not Without Moscow's Intervention*, WALL ST. J., Feb. 20, 1992, at A10.
251. Judy Shelton, *A Bretton Woods System for Ex-Soviets*, WALL ST. J., Sept. 4, 1991, at A10.
252. *Id.*
253. *Id.*
254. *Id.*
255. *Id.*
256. Penelope Purdy, *If Money Talks, Why's the Ruble so Quiet?*, DENV. POST, Sept. 15, 1991, at H1.
257. *Id.*
258. *Id.*
259. *Id.*
260. *Id.*

is stuff their pockets with rubles so, if they are walking near a shop and see something on sale, they can buy an item before the rubles devalue.[261]

The issue of banking operations will be particularly difficult since the republics have no history of managing their own spending.[262] The central bank collected all revenues and gave out what it chose in return.[263] The republics will have to learn the operation of balance sheets and a proper system of debits and credits.[264]

The International Monetary Fund (IMF), the World Bank and other similar institutions will have a special role to play by putting up both equity, as well as the knowledge and personnel resources to train and build local management.[265]

3. The Law

The Soviet legal system has been characterized by two features: inaccessibility of the laws, and dealing with the bureaucracy.[266] The legal system, because of central planning, was largely administrative with tens of thousands of internal regulations, many of which were not published.[267] Those regulations that were published were limited in number and not generally available.[268]

There is no judicial system that will enforce contracts, and the role of the lawyer has been that of an enforcer, not a deal maker.[269] A typical Soviet negotiation team prior to 1987 limited the role of lawyers to mere technicians, summoning them only when negotiations reached a technical question.[270] Lawyers had no authority to vary the text of a clause from a form book.[271]

Corporation law remains in its infancy. Under the 1987 Joint Venture Decree, the joint venture is considered a "judicial person subject to Soviet law;" there is no broader corporation law.[272] There are no publications that guide writing a valid contract, and no explanation of the legal consequences of signing a contract prior to registration with authorities.[273] It is uncertain at what point in the deal process the joint venture takes effect.

261. *Id.*
262. Laurie Hays, *Cracks Appear in Yeltsin's New Union*, WALL ST. J., Dec. 13, 1991, at A10.
263. *Id.*
264. *Id.*
265. *Let the Soviet Flowers Bloom*, FIN. TIMES, Oct. 1, 1991, at 20.
266. Richard Dean, *Practicing Law and Doing Business in the Soviet Union*, 11 N.Y.L. SCH. J. INT'L & COMP. L. 439, 441 (1990).
267. *Id.* at 442.
268. *Id.*
269. David Brooks, *The Capitalist Archipelago*, WALL ST. J., Dec. 10, 1991, at A5.
270. Dean, *supra* note 266, at 439.
271. *Id.*
272. Houri, *supra* note 3.
273. *Id.*

Workers have been consciously favored by the court in labor disputes.[274] Soviet jurists boast about this bias, saying it is a strength of their "socialist" court system.[275] In addition, courts have directions that they are to eliminate the improper labor practices they encounter and to instill in the citizenry a "communist attitude" toward work.[276] In short, they have not been a neutral forum for dispute resolution, but an important instrument of state policy.[277]

D. *Trade Continues*

Despite political upheavals, trade continues. In fact, increased trade may well be a life giving infusion to the new republics. Polariod has continued producing camera parts in a two-year joint venture despite the fact that its chief partner, the Soviet Ministry of Atomic Energy, no longer exists.[278] Coca-Cola says it will switch distribution rights for the Baltic states from Moscow to its Nordic division in Oslo.[279]

Russia's review of current oil export licenses shows that it is likely many Western agreements will remain intact.[280] By early December the licenses were to be reviewed so that fuel supplies for Russia during the winter of 1991 were assured, and that republic agreements, international agreements and treaties concluded in exchange for food, medicine or technical advice could be fulfilled.[281]

The biggest winner could be Chevron, who has been negotiating for four years to drill the huge Tenghiz field in Kazakhstan. Without Moscow's continued attempts to derail the deal, Chevron hopes to conclude it quickly with Kazakh officials.[282] Amoco negotiated a deal in June 1991 with the Soviets to allow off-shore oil explorations in the Caspian Sea in Azerbaijan.[283] The key is to now clarify which republic officials are responsible for what.[284]

Huntsman Chemical and Marriott Corp. have a joint venture with Aeroflot to produce plastic cups for the Soviet carrier's service and hope to operate a $40 million polystyrene plant in the Ukraine in partnership with a local cooperative.[285] Huntsman Chemical also opened a $2.5 million cement slab plant in Armenia in June of 1991, and hopes to open a

274. Block, *supra* note 117, at 658.
275. *Id.*
276. *Id.*
277. *Id.*
278. Thomas F. O'Boyle, *Soviet Breakup Stymies Foreign Firms*, WALL ST. J., Jan. 23, 1992, at B1.
279. Seib, *supra* note 230.
280. Rubinfien, *supra* note 183.
281. *Id.*
282. Hofheinz, *supra* note 180, at 68.
283. *Id.*
284. *Id.*
285. Tim Ferguson, *Container Giant Isn't Insulated from Soviet Spills and Chills*, WALL ST. J., Sept. 3, 1991, at A15.

building block operation there soon.[286]

The need for new communications systems is critical throughout the CIS. AT&T sold a sophisticated digital-switching system to the Armenian government in late 1991,[287] and in February of 1992 formed a joint venture with a Russian telephone equipment manufacturer to adopt AT&T's network equipment for use in Russia.[288] AT&T also recently signed a pact with the Ukraine to build and operate a new telephone network.[289]

A newly formed Russian trade group created a business center in New York in mid-December 1991 to link U.S. businesses with their privately owned Russian counterparts.[290] The intent is to ensure that Russian enterprises will have direct access to American markets.[291] A similar endeavor opened in Washington in October of that same year to link U.S. entrepreneurs with Moscow companies.[292]

VI. CONCERNS ABOUT THE COMMONWEALTH

James Madison came to Philadelphia in May of 1787 to expose the "vices" of confederations. They are inherently ineffectual since they are based on principles of local sovereignty and a weak central government.[293] Both a Constitution and a civil war were needed before the United States stabilized.

It seems the new CIS republics may be destined to repeat the American past. Fundamental power is in the hands of the republics. This creates a number of political anomalies; for example the six Muslim republics will be in a position to outvote Russia, despite Russia's possession of half the CIS's population. The likelihood of cohesive action on common interests, such as trade, is diminished.[294] Destruction of the union is a reality that the republics have created, and they must endure it just as Americans did. The question is whether they will eventually realize the interests they have in common despite the myriad ethnic, ideological and historical conflicts.[295]

VII. CONCLUSION

This essay has charted the recent developments in East-West business relations related to joint ventures, the emerging social reform of the

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286. *Id.*

287. John J. Keller, *AT&T Sets Accord to Adapt, Sell Gear in Russia*, WALL ST. J., Feb. 13, 1992, at A4.

288. *Id.*

289. *Id.*

290. Neil Barsky, *Business Center to Link Russian and U.S. Firms*, WALL ST. J., Dec. 16, 1991, at C13.

291. *Id.*

292. *Id.*

293. Peter McGrath, *Articles of Disunion*, NEWSWEEK, Sept. 16, 1991, at 45.

294. *Id.*

295. *Id.*

CIS republics, and attempted to project future developments that Western joint venture partners may encounter. The complexity and magnitude of the problems facing the CIS cannot be over estimated. Nations impoverished by the Soviet experiment need to focus on economic revitalization, and on channeling long suppressed energies into economic production. Joint ventures with Western partners will quite likely remain a major part of that effort.

S. Jan Vukovich

APPENDIX

Republic	Pop. (M.) % USSR	Size (Sq. mi.) % USSR	Resources
Russia	147 M 50.8%	6,590,950 76.0%	Iron, coal, oil, gold, platinum, copper, zinc, rare metals
Ukraine	51.4 M 17.9%	233,144 2.6%	Coal, iron, chemicals, rich farm land
Uzbekistan	19.8 M 6.6%	172,542 1.9%	Oil, gas, coal, copper
Kazakhstan	16.4 M 5.6%	1,048,762 12.0%	Coal, oil, zinc, tungsten, copper, manganese, lead
Belorussia	10.1 M 3.5%	80,288 .9%	Peat, timber
Azerbaijan	6.8 M 2.3%	33,582 .38%	Oil, gas, iron, bauxite, copper zinc, gold, silver
Georgia	5.4 M 1.8%	27,020 .31%	Coal, oil, timber, manganese
Tadzhikistan	4.8 M 1.7%	55,198 .63%	Coal, oil, lead, zinc, rare elements
Moldavia	4.2 M 1.5%	13,464 .15%	Lignite, gypsum
Kirgizia	4.1 M 1.4%	76,814 .88%	Oil, timber
Lithuania	3.6 M 1.3%	25,090 .29%	Timber, peat, amber
Armenia	3.4 M 1.2%	11,580 .13%	Copper, zinc, bauxite
Turkmenistan	3.5 M 1.2%	188,368 2.2%	Oil, coal, sulphur, magnesium
Latvia	2.6 M .9%	24,704 .28%	Peat, amber
Estonia	1.6 M .6%	17,370 .2%	Oil shale, timber