[Vanderbilt Journal of Transnational Law](https://scholarship.law.vanderbilt.edu/vjtl)

Volume 24
Issue 2 *Issue 2 - 1991*

Article 3

5-1991

# Considering Business Opportunities in the Soviet Union in the 1990s

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## I. INTRODUCTION

In evaluating a commercial opportunity in the USSR, one must consider three fundamental areas. First, how do the overall economic, political, social, and cultural conditions in the USSR form the background and influence the type of commercial transaction that can be accomplished? Second, how does one "balance" the benefits and risks, the positive and negative factors in evaluating specific transactions, against the backdrop of the foreign trade and investment "record" to date? Third, how do companies actually complete and implement transactions?

## II. The Economic, Political, Social, Cultural, and Legal Contexts

### A. *Lack of Direction in the Soviet Economy Amidst Continued Deterioration*

The direction of economic reform has been unclear and the pace of reform uncertain. All agree that the old system of centralized planning has failed and that reforms are necessary. However, the debate over how to reform the economy has raged for months with no clear resolution in sight and reforms to date have been poorly developed and inconsistent. Republic and local initiatives continue to clash with central directives, resulting in paralysis.

#### 1. Failure of Early Efforts

From March 1985, when Mikhail Gorbachev became the Soviet leader, until the end of 1989, the Soviet approach to economic reform focused on attempts to impose greater discipline, to exhort workers to greater productivity and efficiency, to reorganize and eliminate large inefficient Ministries, to replace and relocate personnel, and to experiment with decentralization of decisionmaking. By the end of 1989, it was clear that these efforts had failed and that the Soviet economy was deteriorating at an alarming pace.

#### 2. The Economic Compromise of 1989

In late 1989, Prime Minister Ryzhkov announced a new six-year plan, which represented a political compromise between the more aggressive economic reformers who favored acceleration towards a more market-oriented economy and those who were worried about the dislocations that would be created by price reform and decentralized economic decisionmaking.

The Ryzhkov Plan (the Plan) contemplated a continued role for centralized economic planning through 1992, with a gradual transition to a more market-oriented economy over the next three years. The Plan also called for a substantial reallocation of resources from the defense sector to the consumer products sector.

The Plan sent mixed signals to foreign companies. The Soviets continued to promote investment opportunities through joint ventures, but the Plan created certain disincentives for foreign companies. Foreign exchange allocations from the state budget for the purchase of imported goods were to be reduced, and the emphasis of Soviet foreign trade policy was to be on the export of finished goods, a sector of the Soviet economy that has performed poorly on world markets. Soviet financial policy would emphasize reduction in foreign indebtedness rather than the use of foreign credits to purchase additional Western goods and technology. In direct conflict with the trend toward economic decentralization between 1987 and 1989, the Ryzhkov Plan also imposed new restrictions on the use of foreign exchange earned by Soviet organizations.

### 3. Another "Push" Toward Dramatic Reform

In the spring of 1990, the Soviets announced their intention to implement drastic market-oriented reforms, including price reforms, the abolition of the industrial Ministries, and the introduction of new laws on land use, banking, antitrust, and entrepreneurship. The new reform package, in Mr. Gorbachev's words, would lead the USSR toward a "full-blooded market economy." These new measures were scheduled to be implemented by July 1, 1990 and, had they been implemented, would have marked a dramatic departure from the Ryzhkov Plan. However, within 60 days after the announcement of these reforms, the leadership hesitated, largely because of public outcry over the proposal to raise the prices of basic foodstuffs, such as bread, which have always been heavily subsidized. Mr. Gorbachev declared that such dramatic reforms could not be implemented without having in place an appropriate system of welfare to counter the adverse consequences of the reforms, *e.g.*, unemployment and price increases. Notwithstanding his pledge to move the USSR rapidly toward a market economy, Mr. Gorbachev promised the Soviet people that "shock therapy" would not be applied.

Since virtually all Soviet and Western economic analysts believe that genuine economic reform is impossible without "shock therapy," Mr. Gorbachev's unwillingness to suffer the political consequences of such dramatic and decisive economic policies has been particularly disappointing. It is precisely this indecisiveness, which continues to date, that has formed the basis for the harshest criticism of Mr. Gorbachev in the USSR.

### 4. The Rise and Fall of the Shatalin (or the "500 Days") Plan

By the early fall of 1990, Stanislav Shatalin, who headed a special committee of economic advisors to President Gorbachev, had developed a radical plan to "push" the Soviet Union toward a market-oriented economy. The Shatalin Plan contemplated a dramatic decentralization of the Soviet economy and the abolition of central planning. Prices and wages would be set by market forces. Government enterprises and farms would be privatized. The republics would be given broad authority to manage their own economic affairs, although the Plan contemplated a common currency and unified tax and fiscal policies, which would be developed by the republics on a consensual basis rather than be imposed on them by the central authorities. Shatalin's Plan contemplated that the Soviet Union would have a market economy within five hundred days after commencing the Plan. From September through October 1990, the merits of the Shatalin Plan and Prime Minister Ryzhkov's more cautious approach, which was modeled after his former plan that was announced at the end of 1989, were debated in the Soviet press and among the Soviet leadership. Boris Yeltsin, who, in May 1990, had become the head of the Russian Republic, embraced the Shatalin Plan, and the Russian Republic Supreme Soviet overwhelmingly approved the Plan, ordering its implementation by November 1, 1990. President Gorbachev waffled, leaning first toward the more conservative Ryzhkov approach before finally announcing that he had decided to support the Shatalin Plan, but also intended to include some of the features of Ryzhkov's version.

### 5. The "Gorbachev Plan" for Reform

In November 1990, Mr. Gorbachev issued his version of the new economic plan. While representing a commitment to move the USSR toward a market economy, Mr. Gorbachev's effort to "combine" the Shatalin and Ryzhkov approach (an effort denounced by Boris Yeltsin as an attempt "to mate a hedgehog and a snake") resulted in a very general outline of principles. Entitled "Basic Guidelines for the Stabilization of the National Economy and Transition to a Market Economy," Gorbachev's approach contained few details and no deadlines. To date, its implementation has been limited to "stabilization" functions, with little progress being made on the "transition" aspects.

In early April 1991, many prices for basic foodstuffs and other items were raised dramatically, and halting steps have been taken to establish more realistic exchange rates through the establishment of a currency market that may, in time, lay the basis for limited rouble convertibility.

### 6. Confusion, Discouragement, and Anger

Mr. Gorbachev's program of *perestroika* (or "restructuring") of the Soviet economy has failed to bring about fundamental reform. His own hesitancy in selecting a direction for economic reform and his indecisiveness in implementing a program have embittered and angered Soviet citizens. As the Soviet economy (and with it the standard of living of Soviet citizens) has declined markedly in the last five years to the point where the Soviet authorities have openly solicited food and other forms of aid from the West, Mr. Gorbachev's standing and authority have also declined. The failure of the economy has become a rallying cry for conservative, anti-reformist forces, which are gaining influence.

### B. *Political and Social Instability*

It is difficult to overstate the impact of the continuing political and social turmoil in the USSR on short-term foreign investment and trade prospects.

#### 1. The End of the Empire

The Soviets have lost their dominance over Eastern Europe, and several republics (most notably the Baltic States, but also Georgia, Armenia, and Moldavia) have indicated their desire to secede from the USSR. All republics have declared that their laws take precedence over laws issued by the central (or All-Union) authorities, and Mr. Gorbachev has responded by declaring all such declarations illegal. What has been to date an intense political struggle appears to be evolving into more serious confrontation, as the central authorities have begun dispatching military and KGB forces to the republics to counter the forces of "separatism." Mr. Gorbachev seems determined to hold the USSR together and appears to be willing to use force to do so.

The most significant consequence of the tensions between the central authorities and the republics has been uncertainty over whether the "center" or the republic controls key Soviet assets, most notably natural resources, located in that republic. This problem is best illustrated by the now infamous "DeBeers case," in which the central authorities granted DeBeers an exclusive to distribute diamonds located in the Yakutia region of the Russian Republic. Russia declared the transaction illegal because republic level authorities had not approved it. Shortly thereafter, Yakutia, in an exercise of local "muscle-flexing," declared that only it—neither the "center" nor the Russian Republic—had the right to sell those diamonds.

#### 2. Nationalities Problems

At the heart of many republic-level movements for independence are the traditional nationalities problems that the Soviet Union has faced. In a country of more than one hundred nationalities, many of which have faced brutal repression of their national cultures at the hands of their Soviet "masters," particularly during the reign of Stalin, Mr. Gorbachev's policies of *democratization* and *glasnost* have given vent to long-suppressed desires for independence, as is evident in the Baltic states and Moldavia. Another consequence of his policies has been the resurgence of historical ethnic strife, best illustrated by the Armenian-Azerbaijani conflict.

3. Mr. Gorbachev's Status

Mr. Gorbachev has accumulated vast power in his position as President of the Soviet Union. The Supreme Soviet has virtually ceded its legislative authority to him on matters relating to the economy. He has issued a variety of decrees, largely intended to "stabilize" rather than to reform the economy under his new "emergency" legislative power, giving rise to fears that the conservative forces in the USSR are exercising greater influence over his decisionmaking. He has imposed two major reorganizations of the Soviet Government in three years, and more structural uncertainty is likely until the fundamental questions of authority between the republics and the central authorities are resolved. As conservative forces have gained more prominence, they have been more boldly critical of Mr. Gorbachev. Since he has lost the support of the democratic reformers, he appears increasingly isolated; a man without a constituency.

4. Growth in Crime

Both violent crime and organized crime have increased significantly amidst the economic chaos and breakdown of authority. There is growing concern over the authorities' ability to impose law and order, and it appears likely that military force may be used against the rising wave of crime. While conservative forces oppose cooperatives because of their alleged economic crimes, *i.e.*, "speculation and profiteering," it is increasingly evident that a significant percentage of cooperative activity does involve criminal elements. Unfortunately, these elements have tainted the cooperative movement which, in its inception, represented one of the best opportunities for economic reform in the USSR.

5. The Role of the Communist Party

Among the most dramatic developments during Mr. Gorbachev's tenure was the Communist Party's decision in February 1990 to relinquish its monopoly over political power in the USSR. While this decision has laid the groundwork for the development of a multi-party system, the effective organization of new national political parties has developed slowly. Because the Communist Party has largely retained its infrastructure, which had enabled it to permeate every level of Soviet society, its influence continues and may even grow stronger as conservative forces reassert themselves.

6. The Limits of Democracy

Mr. Gorbachev's greatest contribution to the Soviet Union to date has been his policies of *democratization* and *glasnost*, which mark a dramatic departure from centuries of a Russia that was characterized by autocratic rule and was virtually closed-off from, and inaccessible to, foreigners. In 1989, the Soviet Union held free elections and the Congress of People's Deputies and its primary legislative arm, the Supreme Soviet, have been developing into democratic institutions. Progress is mixed, however, and much concern has been expressed over the inability of "radical reformers" to develop and obtain broader support for economic and political reforms. Mr. Gorbachev's vast power to legislate by personal decree has also undermined the influence of these new democratic institutions.

## C. *Cultural Constraints*

Certain Soviet, particularly Russian, cultural attributes limit the development of a more Western-oriented "business culture" in the USSR and inhibit commercial transactions.

1. The Impact of Fear

Fear both of the consequences of a bad decision and of taking actions not specifically authorized continues to make many Soviet negotiators (particularly more experienced negotiators in federal-level Ministries and foreign trade organizations) risk averse, which stifles creativity in problem-solving and often results in sound proposals being crushed under the weight of the multi-layered Soviet bureaucracy. Many times in negotiations, Soviet officials have reacted to business proposals made by our clients by acknowledging the soundness of a proposal, but refusing to agree because they "did not want to be the first to try it."

2. The Resentment of "Profit"

Russians often display a deep suspicion of what Westerners would regard as normal profit-making activity, particularly in the distribution of goods from producer to wholesaler, to retailer and, finally, to customer. Normal "mark-ups" are perceived as "speculating" and "profiteering." Such resentment explains more than any other factor the stunted growth of the Soviet "private" sector, best exemplified by the cooperatives. As soon as cooperatives began achieving success, harsh taxes and many restrictions were imposed. Soviet law even prohibits the importing by joint ventures and other organizations of finished goods for resale in the Soviet economy, unless special governmental approvals are obtained.

3. Pervasive Secrecy

Centuries of dictatorship have not fostered openness, and Soviet policy and administrative directives are often shrouded in secrecy. Even basic rules, such as export quotas, customs rates and key components of the taxation system, have not been published. Basic financial and commercial information about Soviet organizations is unavailable.

4. Sense of Responsibility

The totalitarian nature of the Soviet system and the pervasiveness of state control over individuals have severely repressed individual initiative and responsibility. Soviets must learn to be risktakers to succeed in a more market-oriented economy. A basic work ethic and rewards for performance have been severely lacking.

### D. *Improvement in United States-Soviet Relations*

1. End of the Cold War

United States-Soviet relations are better than at any time in the last forty-five years, which is best indicated by the widespread belief following the Malta summit in December 1989 that the Cold War is over. The close relationship forged between Secretary of State James Baker and former Foreign Minister Edvard Shevardnadze also served to personalize and enhance relations between the two countries.

2. Commercial Breakthroughs

A few months ago, it appeared likely that the Soviets would receive Most-Favored-Nation (MFN) status as part of a new overall United States-Soviet Trade Agreement, perhaps as early as the end of the first quarter of 1991. Despite President Bush's insistence on the codification of new, more liberal emigration laws before sending the new United States-Soviet Trade Agreement to the Senate for ratification, he granted a limited waiver of the Jackson-Vanik Amendment to permit the extension of credits to the USSR for the purchase of United States grain. The new Trade Agreement contains important new rights for United States companies operating in the USSR, including the right to hire Soviet employees directly and to pay them in freely convertible currency. However, the crackdown in the Baltics, the growing prominence of the Army, the Communist Party and the KGB (coupled with their anti-Western, xenophobic rhetoric) and alleged breaches by the Soviets of arms control understandings may significantly delay United States Senate ratification of the Trade Agreement.

3. Positive Perception of Americans

Soviet negotiators are no longer preoccupied with whether United States companies will be reliable partners. In fact, Soviets are often quite comfortable dealing with United States business partners and have begun to look to the West to learn more about business transactions.

## III. Evaluating the Commercial Environment

The decision whether to enter into a commercial transaction in the USSR, particularly a significant investment through a joint venture, involves a balancing of positive and negative factors and a thorough assessment of risks and benefits.

### A. *Some Joint Venture Success, but Problems from Poor Planning*

There are currently almost 3500 joint ventures registered in the USSR, which represents a significant accomplishment, since the joint venture law has only been in existence for four years. However, less than ten percent of those ventures are actually operating, and the amount of foreign investment in each venture has been decreasing and is now less than one million United States dollars. Actual cash investment averages less than 115,000 United States dollars per joint venture.

Too many joint ventures are entered into without careful consideration and planning; it is indeed possible—and to some extent encouraged by Soviet partners who see political and economic benefits for themselves in participating in joint ventures—to form a joint venture without clearly identifying the business to be conducted or how such business will be operated. Often only after a joint venture entity is formed do the parties begin to consider how to operate the business. It is not until this point that it is discovered that the Soviet partner may not be in a position to perform its obligations, whether such obligations consist of providing office space, arranging local supplies, obtaining certain approvals, or arranging to make available countertrade items to provide some form of usable return for the foreign investor. In an economy in which it is extremely difficult to obtain profits in freely convertible currency and to obtain basic supplies, forming a joint venture without care and thorough due diligence is a prescription for disaster.

Joint ventures have been predominantly in the services sector. Foreign investors have tended to be mostly small, more entrepreneurial; however, there are notable exceptions. Many large Western companies, such as Combustion Engineering, Honeywell, McDonalds, Pizza Hut, Dresser Industries, Tambrands, Baskin-Robbins, Lubrizol, Otis Elevators, and Young & Rubicam, have seen joint ventures as opportunities either to establish themselves as new entrants to the Soviet market or to build their existing Soviet businesses.

The above-mentioned factors, plus a growing feeling in the USSR that current foreign investment policy has yielded little direct benefit for the Soviet people, resulted in a reassessment of joint ventures and foreign investment laws and policy during 1990. The immediate result was a dramatic slowdown in the number of joint ventures registered by the USSR Ministry of Finance. At the height of joint venture registrations in mid-1989, approximately ten joint ventures per day were being registered; by the end of April 1990, that number had fallen to between three and four per week. Registrations accelerated at the end of 1990 as the USSR Ministry of Finance cleared its backlog before turning over the registration function to the Republic-level Ministries of Finance, effective January 1, 1991. The USSR Supreme Soviet is considering a new foreign investment code, which may be adopted during 1991.

## B. *Promising Market Opportunities, but the Problems of a Lack of Convertible Currency and Poor Infrastructure Make Access Difficult*

The Soviet Union is one of the last large, untapped markets in the world and is characterized by an insatiable demand for Western goods. Obtaining convertible currency, however, continues to be the greatest hurdle to doing business in the USSR. Countertrade has not proved thus far to be very successful. Commodities (not the very "liquid" and valuable commodities such as furs, gold, diamonds, or oil and gas) are limited, and there is intense competition for what is available. Furthermore, restrictions on exports and licensing requirements have made such transactions even more difficult.

Other means of earning foreign exchange, such as selling under currency clearing arrangements through India, Turkey, Egypt, and other Third World countries or in "compensation trade" transactions (earning foreign exchange by assisting the Soviets in an activity that generates foreign exchange, the proceeds of which are then shared with the foreign partner to purchase its products for distribution in the Soviet economy) have been difficult to arrange and involve a significant commitment of time and money.

Soviet authorities have refused to use foreign exchange reserves or to provide any assurance of foreign exchange repatriation (beyond the joint venture's own earnings) even to meet critical domestic priorities. Even in "import substitution" projects (where foreign investment in production would reduce or eliminate Soviet foreign exchange expenditures to import the product), Soviet authorities have refused to "set aside" a portion of the foreign exchange savings to provide a fund that would permit the foreign partner to convert rouble profits into foreign exchange.

### C. *New Participants in Foreign Trade Offer Opportunities, but also Much Chaos and Uncertainty*

Soviet economic reform has created new opportunities to do business and to deal directly with Soviet Republics, Soviet enterprises, and privately owned cooperatives. The availability, however, of new partners has created great confusion. Many "new partners" have almost no foreign trade experience, and it is almost impossible to acquire any information about such entities. Basic information about assets, financial performance, commercial experience, and other similar types of information remain state secrets or are otherwise unavailable because of poor record-keeping practices.

After decades of central control over foreign trade, Soviet authorities have "stepped back" too dramatically. There is little coherence in Soviet foreign trade policy, no clear identification of priorities and little support for Soviet organizations, which are only beginning to understand foreign commercial transactions.

The general failure of Soviet foreign investment policy since 1987 is directly attributable to the failure of the central authorities to identify priorities for investment in key sectors of the Soviet economy, such as natural resources, agricultural and food supply, medical services, and support projects falling within those priorities. Despite expectations and pronouncements from the Soviet authorities regarding their desire to use foreign trade to upgrade Soviet manufacturing capabilities, improve Soviet technological performance and earn foreign exchange, Soviet foreign trade policy has, in fact, lacked coordination and direction. This failure to set priorities and work toward achieving them is linked to the historic failure of the Soviet system to develop coherent and effective policies to integrate foreign trade and, more recently, foreign investment into the Soviet economy.

This lack of coordination has been particularly damaging to major foreign investment opportunities. The central authorities have failed to coordinate legal, financial, and tax policies to create an environment supportive of foreign investment. Soviet lawmakers have not enacted adequate legislation to develop a legal infrastructure to support commercial financing, such as a mortgage law or even clear laws on ownership and use of assets. Indeed, Soviet authorities have not effectively used the centrally controlled banking system to promote foreign investment. For example, the USSR Bank for Foreign Economic Affairs (or "*Vneshekonombank*") has been unwilling to participate significantly in joint venture financing. This has been a key reason for the slowdown of major investment in the large natural resource projects, because Western banks and financial institutions have resisted providing capital in high-risk ventures without Soviet state (or "sovereign") guarantees.

Along the same lines, the USSR Ministry of Finance has developed its own tax and joint venture registration policies, which conflict with published joint venture decrees and regulations in many cases. This practice raises the prospect that, since joint venture registration is now being handled at the republic level, each Republic's Ministry of Finance may develop its own registration procedures. Moreover, new legislation in 1988 required the USSR Customs authorities to develop and publish rules to facilitate the importation of goods for use in connection with joint ventures. Not until April 1991 was a Customs law published.

It is no longer advisable to sell "on open account" (unsecured basis) to Soviet organizations. Significant payment problems have emerged. Soviet foreign trade organizations are past due on between two and three billion dollars. The use of letters of credit or bank guarantees has become important to protect foreign sellers.

The infrastructure problems in the USSR are tremendous. Housing and office space for foreigners are in short supply and subject to long waiting lists. Communications systems are very poor in quality and extremely expensive. The charge for merely installing a direct-dial long distance telephone line can be as high as twenty thousand United States dollars.

### D. *The Joint Venture Law Offers Flexibility, but Lack of Business Culture Limits its Scope*

The Soviet joint venture legislation permits the parties much flexibility in "working out" the best means (i) to operate their joint enterprise, including management appointments and decision-making, valuing and structuring capital contributions and seeking financing and (ii) to structure the legal documents embodying their business arrangements. Despite the current chaos in the Soviet system, the joint venture law itself, which now comprises more than twenty-five separate decrees, regulations and instructions, has provided a relatively stable legal basis for foreign investment in the Soviet Union.

The fundamental problems of investment in the Soviet Union are political and economic, not legal. The joint venture law has afforded parties a reasonable degree of flexibility in arranging their commercial affairs and has basically offered adequate legal protection to foreign investors. These laws have not been without their problems, but compared with the early joint venture laws of China and Eastern Europe, the initial Soviet joint venture legislation has been far more effective.

In the USSR, there is no business culture, as we in the West understand that concept. Soviets do not understand how to negotiate, document, or manage a transaction in accordance with Western standards, making it extremely difficult to finalize and properly document a transaction. Ironically, the lack of a business culture makes the legal documentation even more important, because the lack of commercial understanding between the parties means that the documents will be the key (and perhaps only) source of that understanding and, therefore, should be even more detailed and explicit than would be the case in Western transactions.

### E. *Soviet Concessions Are More Difficult to Obtain than is Commonly Believed*

There is a widespread belief that it is possible to receive special benefits from the Soviets if the Western company is particularly favored by Soviet authorities. Pepsi-Cola, with its "cola concentrate for vodka" deal, and Occidental Petroleum, with the late Armand Hammer's long history of Soviet transactions, are often named as examples of this favoritism. In today's joint venture environment, it is widely rumored that the USSR Ministry of Finance will readily grant extensions of the two-year income tax holiday for joint ventures or that, even more aggressively, whatever the Soviet and foreign partners agree in their joint venture documents will somehow be "binding" on Soviet authorities, especially tax authorities.

There is, however, much misinformation on this issue. In fact, the Ministry of Finance through its tax department has strongly resisted the granting of extensions to the tax holiday provisions of the joint venture law and that same Ministry, through its joint venture registration department, has applied greater and greater scrutiny to joint venture documents. In registering joint ventures, the Ministry often has applied its own "unpublished" standards and will often require deletions of items to which the parties have agreed in their joint venture documents.

### F. *Deal Structures and Problems*

Despite the difficulties identified above, transactions are being accomplished. On the joint venture side, companies such as McDonalds, Combustion Engineering, Honeywell, Dresser Industries, Young & Rubicam, Baskin-Robbins, and Tambrands have begun operating joint ventures in the Soviet Union. Others such as Fiat have announced their intention to form joint ventures, and many other major Western companies are seriously considering possibilities. The consortium structure, best exemplified by the American Trade Consortium consisting of Johnson & Johnson, Chevron, RJR Nabisco, Archer Daniels Midland, and Eastman Kodak; and the American Medical Consortium, consisting of Hospital Corporation International, Abbott Laboratories, Hewlett Packard, Colgate Palmolive, Medical Service Partners, and Pfizer International, is becoming more popular. The consortium structure offers a means to focus and coordinate efforts, to defray high costs of arranging transactions and, perhaps, to provide a coordinated solution to the problem of rouble convertibility.

#### 1. Natural Resource ("Compensation Trade") Projects

The best projects in theory should be those that combine a Soviet natural resource in abundance (oil, gas, timber, *etc.*) with Western technology to produce a product (petrochemicals, finished wood) that is readily saleable on international markets. Such projects upgrade Soviet production capabilities by adding Western technology which, in turn, produce products that enable the Soviets to earn more foreign exchange. The problem of how to obtain a return in foreign exchange for the foreign partner is solved because the foreign partner shares in the proceeds of the export sales.

Few projects have succeeded, and there have been many problems in getting these projects underway. First, there have disputes between central, republic, and local authorities over who controls the natural resources. Second, there has been uncertainty created by government reorganization and the inability or unwillingness of senior Soviet officials to decide to proceed with large projects. Third, there has been a lack of focus and priority from Soviet authorities. Fourth, Soviet authorities have been unwilling to provide appropriate financial and performance guarantees to support financing. Fifth, there have been growing, more vocal environmental concerns expressed by the Soviets, especially at local levels relating to resource development.

### 2. "Captive" Foreign Exchange Projects

Best known among these projects, which draw on the foreign exchange of tourists, business travellers, and foreign residents in Moscow, are hotels, office buildings, and related real estate projects, as well as service ventures focused on those groups. Despite the glaring need for housing, office space, and hotel accommodations in Moscow, only a few "office building" joint ventures and hotel joint ventures are operating. Other hotel projects have been announced, but are not yet operational.

Problems in launching these projects have included bureaucratic problems with Moscow authorities in obtaining approvals and sites; obtaining financing; obtaining control over operations for the foreign investor; and the difficulty of identifying credible and competent partners.

### 3. Rouble Earning and Countertrade Projects

Tambrands' joint ventures to produce feminine hygiene products are the best known of these projects, which are geared to the Soviet domestic market. Rouble profits are used to acquire Soviet commodities for export. In the Tambrands projects, the Ministry of Health has arranged an allocation of cotton for Tambrands, which has provided a source of foreign exchange. Tambrands' most successful joint venture to date is in the Ukraine, illustrating the positive side of working directly with Soviet republics.

There also have been several problems in launching these projects. First, there has been difficulty in arranging and securing appropriate countertrade. The status of the Soviet rouble, which is not readily "convertible" domestically into goods and services, causes difficulty because great shortages and planned allocations limit severely the availability of such goods and services. Second, the Soviets have failed to clarify their priorities for Western investors. Third, there is a new restrictive, rapidly expanding export licensing system, certain restrictions of which have not even been published.

The much publicized McDonalds restaurant project falls into this category. Despite opening a restaurant for roubles on Pushkin Square in Moscow, McDonalds must solve its own foreign exchange problem, perhaps by opening restaurants for foreign exchange, by selling extra food they produce to restaurants, or by constructing an office building to lease to foreign companies. McDonalds has also reportedly spent between fifty and sixty million dollars to construct its own food processing facilities and fourteen years of effort to open the Pushkin Square restaurant, illustrating vividly the time and expense necessary to gain a foothold.

#### 4. New Laws

The new USSR Supreme Soviet has adopted a number of new laws affecting foreign investors. For example, new real estate laws provide new legal bases for real estate and other leasing transactions, and new tax legislation has completely reoriented the Soviet personal and corporate tax systems. As one might expect, there remain many problems in interpreting and applying these new laws and reconciling differences and conflicts in such laws. The promulgation of new banking and currency, labor, antitrust, and environmental laws in recent months underscore the rapid developments of the Soviet legal system.

## IV. Problems in Completing and Implementing Commercial Transactions in the USSR

Companies that secure commercial opportunities in the USSR must face time-consuming and expensive problems in negotiating, documenting, and implementing these transactions. While Mr. Gorbachev speaks about the need for a society governed by the rule of law, the USSR is more like our understanding of the "ways things work" in less developed countries in the sense that the rules of power and relationships override the rule of law in commercial transactions.

### A. *Role of a Partner*

In a joint commercial undertaking, the quality of one's partner is an important factor in the success of the project. In the USSR, it is undoubtedly the key factor. Often, Western business people interpret this to mean that they must obtain high-level political support to make progress on their projects. While such support is important, and the most successful strategies involve pushing from the top and the bottom (in order to cut through the encrusted, petrified middle level of bureaucrats), "high-level political support" can only be used sparingly and, given the current social and economic crisis, Soviet leaders have very limited time for specific (even large and important) projects.

Therefore, there is no substitute in the current environment for an effective Soviet partner who understands how to get things done and is committed to the projects being undertaken.

### B. *A "No Can Do" Jurisprudential Attitude*

Another fundamental problem from a legal point of view is an approach by Soviets that is foreign to most Westerners. The Soviets approach legal questions with the deeply held belief that if an action is not specifically permitted, it is prohibited. This perspective sharply contrasts with the Western perspective that if an action is not specifically prohibited, it is permitted.

This Soviet perspective explains, in part, the Soviet desire to "push" joint ventures on foreign companies and Soviet resistance to simpler, more efficient and logical structures. The joint venture law is, from the Soviet perspective, an "authorized," politically acceptable means of conducting economic relations with foreigners. This perspective also underscores the conservative, risk-averse nature of Soviet negotiators; a vestige of their totalitarian history in which they believe a mistake might not simply close a career opportunity, it might cost you your life.

### C. *Secret, Unavailable Laws*

Another problem can generally be described as the difficulty of finding the laws or knowing what the rules are. Despite the reforms of *glasnost* and *perestroika*, published laws are scarce, many rules remain state secrets, and most Ministerial policies and rules consist only in the form of internal directives.

There are a wide variety of Soviet organizations participating in the legislative process to develop laws and regulations for foreign economic relations, but no central, authoritative, public source dispenses information about new legal developments. Much Soviet law is either not publicly available or is a state secret. The USSR Cabinet of Ministers frequently decides not to publish its decrees or to publish only portions of those decrees.

### D. *Lack of Commercial Legal Experience*

The Soviets are not experienced in drafting legislation with precision and clarity. Therefore, many rules are stated in very general, ambiguous language, and terms are used without clear meanings. A recent import-export decree prohibits "intermediary activity" in foreign economic relations without any attempt to define this term. The Soviet joint venture law itself requires that all "fundamental decisions" of the joint venture business be made by unanimous vote of the Board. There has been no attempt to provide guidance as to what constitutes "fundamental decisions."

### E. *Approval Process for Foreign Investment Transactions*

One of the most significant areas of problems for foreign investors has been the approval process for foreign investment transactions. Amidst the crisis of authority and decentralization of foreign trade, approvals in all forms have become more difficult to obtain.

### F. *Dramatic Changes in the Legal System*

It is clear that the Soviet legal system is in transition. As the system moves from rigid centralization, characterized by internal, administrative directives from Ministries, to more decentralization of authority for the enterprises and other business units, the importance of contractual relations will increase and pressure will build to develop clearer, more flexible and publicly available rules to govern commercial conduct.

The USSR Supreme Soviet and the Congress of People's Deputies over the next two to three years will be considering legislation that should completely transform the Soviet legal system, including laws on property, on ownership, on state enterprises, on corporations and partnerships, on freedom of speech and conscience and on political parties.

## V. CONCLUSION

The purpose of this Essay has been to provide, in somewhat summary fashion, basic background and guidelines to assist Western companies that are considering commercial transactions in the Soviet Union. It was not intended to be an exhaustive analysis of all factors that may affect the negotiation, completion and implementation of commercial transactions in the Soviet Union. Rather, we have drawn from our experience in assisting our clients over the last three years in the USSR and have attempted to provide an appropriate context for the consideration of potential business opportunities.

In our experience, the most effective perspective to adopt in evaluating commercial opportunities in the Soviet Union is to weigh the risks and the benefits and, in particular, to appreciate the difficulties in accomplishing a Western-style business transaction amidst extraordinary political, social, economic, and legal turmoil in a culture that is vastly different from our own.

No one knows yet whether recent events in the Soviet Union herald genuine reform and progress towards a more open, democratic system and a more market-oriented economy, or mark the destruction of an empire headed, at least in the short term, to chaos and breakdown. Therein lies the key risk in entering the Soviet market. Foreign companies that take up the challenge must be courageous, patient, and well-prepared. Few, if any, such companies will enjoy short-term rewards. Only those that develop and implement a long-term strategy will effectively secure themselves a place in the Soviet marketplace of the next generation.