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Eastern Europe: Observations and Investment Strategies

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It is my impression that right now an American lawyer has no problem getting acquainted with East European laws concerning foreign investment. There are so many translations now in this country that almost every new law is immediately translated into English. The American lawyer can get to this text at almost the same time as the East European lawyer can get to it.

So it is very easy to get acquainted with legal texts of the most important laws from the point of view of foreign investors, but there are some traps. And it is my impression that when lawyers get in trouble with investment, or foreign investors get in trouble in Eastern Europe, it is because of the lack of knowledge. They lack knowledge of the entire legal environment, the general legal system, and how to do business, how to negotiate, with whom to deal, and how to deal in Eastern Europe.

This is for two reasons. First, laws in Eastern Europe are generally based on the civil law system. So quite often there is simply no possibility of taking direct translations into English. It is much easier to translate the East European text into German or French and to understand it with a lawyer who is acquainted with the German or the French legal system than to seek an American lawyer. Another problem is that all these countries are at a moment of deep transition. Transition always means changes. Quite often, something old has been destroyed, but nothing new has been put in its place.

It is necessary to keep in mind a sharp distinction between the three countries mentioned earlier: Hungary, Czechoslovakia, and Poland. They have quite clear objectives: to forget the entire communist past, to make their system a market economy like Western Europe, and to join, at the turn of century, if possible, the EC. The question is not what is the object, the object is clear. The question is how to achieve it.

On the other side, we have the Soviet Union, Rumania, and Bulgaria, and those three countries are trying to do what was done in other coun-

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tries in the seventies. They seek to attract some foreign investment, to change the system, to keep the system somewhere between a free market and a communist system, and to find some kind of solution.

The changes go deeper, because, for example, there were free elections everywhere. In Hungary, Czechoslovakia, and Poland, the former communist party did not manage to get more than ten percent of the votes. On the other hand, in the Soviet Union, Bulgaria, and Rumania, former communists, after free elections, still maintained a majority. So the distinction is not only the attitude towards the economy and foreign investment, it is the general attitude. What I observe here quite often, is the treatment of Eastern Europe like just one unit. In fact, you can treat it as at least two separate units.

There are plenty of American lawyers moving to Eastern Europe. There are several very respected firms opening offices, but there are also people coming to Eastern Europe for three days and then lecturing around the United States about what is going on there. And you should be aware of the experience of people, because I know American lawyers who are better acquainted with Russian law than the Russian lawyers. But I also know people who went to Eastern Europe for three days and then started lecturing about what is going on.

There are plenty of people moving in expecting to do some business, for example, immediately after the changes. I have personal knowledge and experience with American lawyers who wanted very much to draft the Polish Constitution. That was really not exactly what we needed at the moment. We need tax lawyers; we need corporate lawyers and securities lawyers. The constitution is something that we can manage. There is a lot of movement around, and of course, it is very difficult for you to evaluate what is going on.

There were very ambitious plans to transform the East European economies. You have heard about the five hundred day Shatalin Plan in the Soviet Union. You have heard probably from Professor Zachs of the Harvard Business School who advises the Polish Government that all the transformation can be done in three months.

It goes much slower because there are certain contradictions. Like, for example, introduction of democracy means freedom for the people to do what they want. And immediately Eastern Europe faces *uptum status integraet.* Of course, this is most visible in multinational countries where every nation wants to get away from the union, without regard to what economic results this may produce. But we may observe in unitary states that local government is very eager to take some powers away from the central government. What does it mean for general politics? Governments try to shift from autocracy to democracy, to more autocracy, because they are unable to handle the whole country together.

Also, for just practicing lawyers, it means that sometimes it is difficult to locate who is really the partner, who is in charge of this particular enterprise. Is it local government, or is it central government with whom you should deal?

Another big contradiction that very much hinders all of the changes is the contradiction between traces of the communist past in the human mentality and the requirements of modern business. Employees of many government enterprises have a tendency to treat the enterprises as kind of community property. And in fact, many enterprises, government enterprises, became community property of the employees. How did it happen? Employees became quite influential through trade unions, and they were granted some rights by statutes. For example, Soviet law provides that employees select people who are at the medium level of the structure of enterprise; Polish law provides that employees, in fact, may fire management.

Some people called it some kind of Bermuda Triangle for East European economies. A triangle between management of government enterprises, trade unions, and employees. Employees would welcome very much foreign investment, provided that everything would stay as it is—so that you have foreign investors coming with money and the enterprise going on as it has been. They are very much afraid that new owners, or foreign investors, may immediately reduce employment to thirty percent because this would make the enterprise efficient. In fact, quite often employees try to hinder the transformation.

This can be done in many different ways. For example, there always has been mentioned this huge problem of how to valuate government property that should be sold because if you start to count in accordance with the principles of East European accounting, the price would be enormous. To invite foreign accounting firms to do a valuation would cost a lot. This has been done in Poland, and the cost of the whole valuation of the enterprise sold to foreign investors amounted to fourteen percent of the whole transaction.

In Hungary, there was a huge political scandal connected to the sale of government enterprises because people started to claim that those enterprises were sold to foreign investors almost for nothing. Nobody took under consideration that the foreign investor, if he has to come, he is bringing money, he is investing, he is going to buy something if it is cheap, he is not going to pay the full market price.

There are big problems concerning privatization of government enterprises because the majority of the economy in Eastern Europe is still formed by government enterprises. Everybody assumes that it is necessary to turn those enterprises into private hands, but it is a big problem how to do that job. And what should be the role of foreign investors? There are people who are afraid foreign investors may not come, that Eastern Europe will remain constant without money brought by foreign investors. There are also people who are very much afraid that foreign investors will take the entire economy, and this would become some kind of modern colonialism. You can see some kind of conflict.

As far as the governments of the three European countries I mentioned earlier, Hungary, Czechoslovakia, and Poland, are concerned, they have a clear idea that it is necessary to have foreign investment. Without foreign investment, it is not possible to revive the economy. So there is some kind of competition for attracting foreign investment. Currently, probably the most liberal law for the foreign investors is Hungarian law. In a couple of days, there will be a Polish law which is clearly a kind of competitive development towards Hungary's in that it offers more incentives and is more liberal for investors.

For the Polish Solidarity Government, it was absolutely clear that without foreign investment we could not change our economy. So our current President, when he went to the United States and spoke in the American Congress, he spoke about ten billion dollars in investment that is simply necessary to avoid disaster in East Europe.

What can we expect in Eastern Europe as a place for foreign investment? For sure, it is a place with a labor market of cheap labor that is relatively well-qualified. We have a hungry market for products and a cheap market. So the amount of money that is necessary to invest is much smaller. There were figures given here that someone could invest a couple of thousand dollars and make profit. That is true. People bring amounts of money that are very small, which would not be totally considered as investment here, but nevertheless, they bring this money, they invest, and they turn a profit.

It is my impression that in fact small companies, very small investments, some kinds of family investments of just fifty thousand dollars or so, bring more profits sometimes than huge investments. Small companies perform relatively better than huge companies. It is my impression that frequently huge companies, if they move to Eastern Europe, they simply want to be there, and their performance is not that good. The majority of small companies bring real profits in a relatively very short time.