

Soviet Law and Foreign Investment: *Perestroyka's* Gordian Knot

Since the promulgation of the first decrees on joint ventures in late 1986, the Soviet Union has produced many new laws affecting the status of foreign investment. In less than four years the legal regime has gone from an absolute ban on any foreign ownership of the means of production to an embrace of foreign enterprises operating in the Soviet Union. The opportunities created by the opening of the Soviet market have excited businesses throughout the capitalist world.

Yet both technical and conceptual problems have accompanied this radical transformation. Although the Soviet Union seems eager to use foreign investment as a development tool, the Soviet leadership has not succeeded in creating a legal infrastructure that will encourage outsiders. Rather, the legal enactments send conflicting signals that generate more anxiety than reassurance. None of the countries in Eastern Europe has produced more laws intended to encourage capitalist investment than has the Soviet Union, yet the contemporary Soviet legal environment presents greater uncertainty and risk for foreign investors than any of the other formerly socialist countries. The famous knot that confronted Alexander the Great provides an apt metaphor for the welter of laws that foreign businesses now face.

At the heart of the Soviet effort to restructure its economic system lies a deep paradox. The country needs a fundamental overhaul of its economic, organizational, and managerial institutions. By any measure the Soviet capacity to make use of its labor and material resources is inadequate: labor productivity is low and declining; the level of technology commonly employed in production compares unfavorably with much of the developing world, and much less favorably with the developed countries; environmental despoliation and workplace health hazards are rampant; and the population's deplorably low standard of living con-

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tradicts the nation's assumed status as a superpower.¹ Yet the severity and extent of these problems has hindered the formation of a consensus about how best to attack them.

With the passing of the old political structures, particularly the Communist Party of the Soviet Union, new governmental institutions connected with republic and local legislatures have emerged to contest the right to grapple with the nation's fundamental problems. Some have tried to compete with the center as a host for foreign investment. These bodies have both enacted laws that would be more attractive to potential investors, and obstructed implementation of the center's decisions. The resulting "war of laws" has not produced any victors, but rather has increased the insecurity of foreign businesses.

I. Business Forms

Until 1986 business ties between foreigners and the Soviet economy were limited to direct sales and had to go through designated government agencies. These restraints engendered all of the problems associated with the Soviet system: The inability of buyers and sellers to deal directly with each other discouraged information flows and capital investment, and the absence of competition produced monopoly rents for certain elements of the bureaucracy (reflected in access to privilege and the operation of the *nomenklatura* patronage system) while reducing productivity.² Yet socialist ideology, which insisted that private ownership of property used for profit constituted exploitation, seemed to preclude any broader involvement of foreign investors in the Soviet economy.

The promulgation of the first joint venture decree at the end of 1986 signaled a willingness to experiment with new forms of business organization. The decree permitted foreign entrepreneurs to take part in an enterprise's management and to share in asset appreciation generated by a firm's activities.³ It limited for-

1. See A. ÅSLUND, *GORBACHEV'S STRUGGLE FOR ECONOMIC REFORM* (1989); J. BERLINER, *THE INNOVATION DECISION IN SOVIET INDUSTRY* (1976); *Planning and Management*, in *THE SOVIET ECONOMY: TOWARD THE YEAR 2000* 350 (A. Bergson & H. Levine eds. 1983); E. HEWETT, *REFORMING THE SOVIET ECONOMY: EQUALITY VERSUS EFFICIENCY* (1988); Armstrong, *Legal Restraints on Innovation in the USSR*, 9 REV. SOCIALIST L. 243 (1983); Goldman, *The Soviet Economy and the Need for Reform* 507 ANNALS AM. ACAD. POL. & SOC. SCI. 26 (1990); Moore, *Agency Costs, Technological Change, and Soviet Central Planning*, 24 J.L. & ECON. 189 (1981); Noren, *The Soviet Economic Crisis: Another Perspective*, 6 SOV. ECON. 3 (1990); Schroeder, "Crisis" in the Consumer Sector: A Comment, 6 SOV. ECON. 56 (1990); Winiacki, *Are Soviet-Type Economies Entering an Era of Long-Term Decline?* 38 SOV. STUD. 325 (1986).

2. See generally Simons, *Soviet Foreign Trade: Economic, Legal and Political Aspects*, in *SOVIET LAW AND ECONOMY* 243 (O. Ioffe & M. Janis eds. 1986); Pozdniakov, *The Legal Status of All-Union Foreign Trade Organizations and Other Soviet Organizations Authorized to Conduct Foreign Trade Transactions*, 8 REV. SOCIALIST L. 169 (1982).

3. *Ukaz o voprosakh, svyazannykh s sozdaniyem na territorii SSSR i deyatel'nost'yu sovместnykh predpriyatiy, mezhdunarodnykh ob'yedineniy i organizatsiy s uchastiyem sovetskikh i inostrannykh organizatsiy, firm i organov upravleniya* (Decree on Questions Connected to the Formation

eigners to minority interests in a venture, and required that both the head of the firm's governing board and its chief executive officer be Soviet citizens. However, another decree issued at the end of 1988 loosened considerably the restrictions that applied to joint ventures, and in particular eliminated the cap on the percentage of foreign ownership.⁴ A presidential edict promulgated in October 1990 went even further by authorizing outright foreign ownership of firms established in the Soviet Union.⁵

Each of these measures rests on administrative rather than legislative authority—the U.S.S.R. Council of Ministers promulgated the joint venture

on the Territory of the USSR and the Operation of Joint Enterprises, International Associations and Organizations with the Participation of Soviet and Foreign Organizations, Firms and Organs of Management), Ved. Verkh. Sov. SSSR (1987), No. 2, Item 35; *Postanovleniye ob utverzhenii polozeniy o khozraschetnykh vneshnetorgovykh organizatsiyakh (ob'yedineniyakh) i Tipovogo polozeniya o khozraschetnoy vneshnetorgovoy firme nauchho-proizvodstvennogo, proizvodstvennogo ob'yedineniya, predpriyatiya, organizatsii* (Resolution on Confirming a Charter for Economically Self-sufficient Foreign Trade Organizations (Associations) and a Representative Charter for Economically Self-sufficient Foreign Trade Firms of Scientific-production and Production Associations, Enterprises, and Organizations), SP SSSR (1987), No. 6, Item 24; *Postanovleniye o poryadke sozdaniya na territorii SSSR i deyateli nosti sovmeystnykh predpriyatiy s uchastiyem sovetsskikh organizatsiy i firm kapitalisticheskikh i razvivayushchikhsya stran* (Resolution on Regulating the Formation on the Territory of the USSR and the Operation of Joint Enterprises with the Participation of Soviet Organizations and Firms from Capitalist and Developing Countries), *id.* No. 9, Item 40; see Block, *The Disciplining and Dismissal of Employees by Joint Ventures in the USSR*, 23 GEO. WASH. J. INT'L L. & ECON. 610 (1990); Carpenter & Smith, *U.S.-Soviet Joint Ventures: A New Opening in the East*, 43 BUS. LAW. 79 (1987); Dunn, *The New Soviet Joint Venture Regulations*, 12 N.C.J. INT'L L. & COM. REG. 171 (1987); Hazard, *Opportunities and Problems for Joint Ventures in Soviet Law*, 22 N.Y.U. J. INT'L L. & POL. 407 (1990); Hobér, *Joint Enterprises in the Soviet Union*, 1989 Y.B. ON SOCIALIST LEGAL SYS. 173; Rogers, Jr., *Glasnost and Perestroika: An Evaluation of the Gorbachev Revolution and Its Opportunities for the West*, 16 DEN. J. INT'L & L. POL'Y 209 (1988); Note, *Soviet Joint Ventures: Providing for Appropriate Dispute Resolution*, 23 CORNELL INT'L L.J. 107 (1990); Note, *The 1987 Soviet Joint Venture Law: New Possibilities for Cooperation and Growth in East-West Relations*, 17 DEN. J. INT'L L. & POL'Y 581 (1989); Note, *Glasnost: Joint Ventures Now Permitted in the Soviet Union*, 3 FLA. INT'L L.J. 125 (1987); Note, *The New Soviet Joint Venture Law: Analysis, Issues, and Approaches for the American Investor*, 19 L. & POL'Y INT'L BUS. 851 (1987); Note, *International Joint Enterprises in the Soviet Union*, 6 U.C.L.A. PAC. BASIN L.J. 121 (1989); Note, *Joint Ventures in the Soviet Union: Problems Emerge*, 13 U. PUGET SOUND L. REV. 165 (1989); Note, *The Soviet Joint Venture Decree and Soviet Labor Law*, 30 VA. J. INT'L L. 794 (1990); Comment, *Joint Venture Law in the Soviet Union: The 1920s and the 1980s*, 9 NW. J. INT'L L. & BUS. 633 (1989); *Recent Development, Foreign Investment: New Soviet Joint Venture Law*, 28 HARV. J. INT'L L. 473 (1987).

4. *Postanovleniye o dal'neyshem razvitii vneshneekonomicheskoy deyateli nosti gosudarstvennykh, kooperativnykh i innykh obshchestvennykh predpriyatiy, ob'yedineniy i organizatsiy* (Resolution on the Further Development of the Foreign Economic Activity of State, Cooperative, and Other Social Enterprises, Associations, and Organizations), SP SSSR (1989), No. 2, Item 7; cf. *Postanovleniye ob izmenenii i priznanii utrativshimi sily nekotorykh resheniy Pravitel'stva SSSR po voprosam vneshneekonomicheskoy deyateli nosti* (Resolution on Changes in and the Obsolescence of Certain Decisions of the Government of the USSR on Questions of Foreign Economic Activity), *id.*, No. 23, Item 75.

5. *Ukaz ob inostrannykh investitsiyakh v SSSR* (Decree on Foreign Investments in the Soviet Union), Izvestiya, Oct. 26, 1990, at 1.

decrees, and Gorbachev issued his edict on foreign investment under the extraordinary powers granted him by the Supreme Soviet in September 1990.⁶ While such nonlegislative pronouncements clearly reflect the policy of the central administrative apparatus, they lack the stature of enactments of the Supreme Soviet. These pronouncements therefore inspire somewhat less confidence on the part of investors who might rely on them. But in June 1990 the Supreme Soviet passed the Law of Enterprises, which provides some additional guidance on the rights of Soviet firms owned in whole or in part by foreign investors.⁷

The Law permits foreign corporate bodies and citizens to form joint enterprises "in accordance with legislation of the U.S.S.R."⁸ Like all firms covered by the Law, foreign-owned businesses must set up a governing board consisting of representatives of its owners and employees. The Law presumes that owners and employees will have an equal number of seats, but allows enterprises to give its investors greater control. The workers, however, retain at least a voice (and perhaps a veto) with respect to an undefined range of the enterprise's business decisions.⁹

A critical issue left unsettled by the new legislation is specification of the governmental bodies that must approve the creation of an enterprise owned wholly or in part by foreigners. A U.S.S.R. statute enacted in early 1990 seems to give the republics authority to charter joint ventures, but the prior Council of Ministers decrees require the permission of the U.S.S.R. Ministries of Foreign

6. *Zakon o dopolnitel'nykh merakh po stabilizatsii ekonomicheskoy i obshchestvenno-politicheskoy zhizni strany* (Law on Additional Measures for Stabilizing the Economy and the Social-political Life of the Nation), Ved. S'yezda narodnykh deputatov SSSR i Verkh. Sov. SSSR (1990), No. 40, Item 802.

7. *Zakon o predpriyatiyakh v SSSR* (Law on Enterprises in the USSR), Ved. S'yezda narodnykh deputatov SSSR i Verkh. Sov. SSSR (1990), No. 25, Item 460; see Stephan, *Perestroika and Property: The Law of Ownership in the Post-Socialist Soviet Union*, 39 AM. J. COMP. L. (1991) (forthcoming) [hereinafter *Perestroika*]; Hanson, *Property Rights in the New Phase of Reforms*, 6 Sov. ECON. 95, 104-06 (1990). A decree of the Council of Ministers issued shortly after enactment of the Law elaborated on the rules applicable to joint stock companies. *Postanovleniye ob uverzhenii polozheniya ob aktsionnykh obshchestvakh i obshchestvakh s ogranichennoy otvetstvenosti'yu i polozheniya o tsennykh bumagakh* (Resolution on Confirming the Regulation on Joint Stock Companies and Companies with Limited Liability and the Regulation on Financial Instruments), SP SSSR (1990), No. 15, Item 82. An earlier law also was meant to promote market relations within the state owned economy, but it did not purport to authorize private firms. See *Zakon o gosudarstvennom predpriyatii (ob'yedinenii)* (Law on the State Enterprise (Association)), Ved. Verkh. Sov. SSSR (1987), No. 26, Item 385, as amended by *Zakon o vnesenii izmeneniy i dopolnennykh Zakon SSSR "O gosudarstvennom predpriyatii (ob'yedinenii)"* (Law on Introducing Changes in and Additions to the USSR Law "On State Enterprises (Associations)"), Ved. S'yezda narodnykh deputatov SSSR i Verkh. Sov. SSSR (1989), No. 9, Item 214; P. STEPHAN, *SOVIET ECONOMIC LAW: THE PARADOX OF PERESTROYKA* [hereinafter *PARADOX*]; C. BECK, *PAPERS IN RUSSIAN AND EAST EUROPEAN STUDIES*, No. 805, at 36-38 (Jun. 1990).

8. *Zakon o predpriyatiyakh v SSSR*, *supra* note 7, art. 2.2; see also *id.* art. 4.3:

The particularities of the creation and operation of joint enterprises with the participation of Soviet corporate bodies and foreign corporate bodies and citizens are established by legislative acts of the USSR and the union and autonomous republics.

9. *Zakon o predpriyatiyakh*, *supra* note 7, arts. 15.1, 18.1.

Economic Activity and of Finance.¹⁰ The rules governing wholly owned business are even more uncertain. The Law on Enterprises presumes that local authorities can decide whether to register a firm, but it recognizes exceptions based on other legislation.¹¹ The presidential edict authorizing direct foreign investment does not address the question. A draft U.S.S.R. Law on Foreign Investment, which Soviet officials contemplate submitting to the Supreme Soviet in the spring of 1991, might resolve the matter, but at present no governmental body possesses clear authority to grant the necessary permissions.

The problem of which level of government can regulate foreign investment goes beyond the question of enterprise formation. The right to decide where private firms, including those with foreign ownership, can compete with the state sector remains hotly contested. The Law on Enterprises follows the earlier Law on Cooperatives in allowing the U.S.S.R. Council of Ministers to carve out areas where private firms cannot go. The Council has used this authority to protect a range of state monopolies.¹²

Some of the republics have attacked these limitations as a manifestation of the old administrative command system's continued hold on the economy. A Russian Republic (R.S.F.S.R.) law on entrepreneurial activity, enacted in December 1990, purports to abrogate the U.S.S.R. Law on Enterprises.¹³ If effective, it would authorize the establishment of private firms in industries such as publishing, medicine, and telecommunications, where the central authorities have insisted on preserving a state monopoly. This law, however, elides the fundamental issue—whether a republic has the power to negate a law of the Union.

The taxation of private firms and foreign investors also has generated a conflict between Union and republic laws. Decisions about an enterprise's form will

10. See also *Zakon o razgranichenii polnomochiy mezhdu Soyuzom SSR i sub'yektami federatsii* (Law on the Demarcation of the Powers of the USSR and the Members of the Federation), art. 8(9), *Ved. S'yezda narodnykh deputatov i Verkh. Sov. SSSR* (1990), No. 19, Item 329 (reserving for the central government "overall management of foreign economic activity"). Compare *Zakon ob osnovakh ekonomicheskikh otnošeniy Soyuz SSSR, soyuznykh i avtonomnykh respublikh* (Law on the Fundamentals of Economic Relations Between the USSR and the Union and Autonomous Republics), art. 2.2, *Ved. S'yezda narodnykh deputatov i Verkh. Sov. SSSR* (1990), No. 16, Item 270 with *Postanovleniye o myerakh gosudarstvennogo regulirovaniya vnyeshneekonomicheskoy deyatel'nosti* (Resolution on Measures for State Regulation of Foreign Trade Activity), *SP SSSR* (1989), No. 16, Item 50 and *Postanovleniye o dal'neyshem razvitií vnyeshneekonomicheskoy deyatel'nosti*, *supra* note 4.

11. *Zakon o predpriyatiyakh*, *supra* note 7, art. 6.1.

12. See *id.* arts. 1.3, 8; *Zakon o kooperatsii v SSSR* (Law on Cooperatives in the USSR), *Ved. Verkh. Sov. SSSR* (1988), No. 22, Item 355, amended by *Zakon o vnesenii izmeneniy i dopolneniy v Zakon SSSR "O kooperatsii v SSSR"* (Law on the Introduction of Changes in and Additions to the USSR Law "On Cooperatives in the USSR"), *Ved. S'yezda narodnykh deputatov SSSR i Verkh. Sov. SSSR* (1989), No. 19, Item 350, and *id.* (1990), No. 26, Item 489; *Postanovleniye o regulirovanií ot del'nykh vidov deyatel'nosti kooperativov v sootvetstvií s Zakonom SSSR "O kooperatsii v SSSR"* (Resolution on the Regulation of Various Aspects of the Activity of Cooperatives in Correspondence with the USSR Law "On Cooperatives in the USSR"), *SP SSSR* (1989), No. 4, Item 12; *Perestroyka*, *supra* note 7, at nn. 65–67.

13. *Sovetskaya Rossiya*, Dec. 26, 1990, at 1.

affect its taxation, but the choice has different consequences at the national and republic levels. The U.S.S.R. joint venture decrees allowed tax holidays and permitted the Ministry of Finance to negotiate preferential rates with ventures engaged in desirable activities such as manufacturing for export; where these preferences did not apply, a 30 percent income tax was collected, with a 20 percent withholding tax also applicable to repatriated profits.¹⁴

By contrast, a law on enterprise taxation enacted in June 1990 imposes a 22 percent federal tax on business profits and authorizes the republics to levy an additional tax, with the combined total not to exceed 45 percent. The law maintains the 30 percent rate for joint ventures where foreign ownership constitutes more than 30 percent, but it has limited the earlier decrees' tax holidays to enterprises with greater than 30 percent foreign investment, but only if they engage in manufacturing (the statutory term is "material production") and do not engage in fishing or mineral extraction.¹⁵ Because Soviet law did not permit wholly foreign-owned businesses at the time of the June 1990 enactment, the enterprise tax statute does not extend the 30 percent cap to firms other than joint ventures. The law also levies a supertax of 80 percent (increasing at specified levels to 90 percent) on profits in excess of twice the industry norm. The enterprise tax law, like the joint venture decrees, imposes a 20 percent withholding tax on profits repatriated to foreign owners, whether in the form of dividends, interest, lease payments, or royalties.¹⁶ In addition, individuals who either work for or have an interest in a Soviet firm and who reside in that country must pay a personal income tax of up to 60 percent on payments received from the enterprise.¹⁷

The comparable R.S.F.S.R. law on enterprise taxation, enacted in December 1990, uses the full 45 percent rate authorized by the U.S.S.R. law, but applies the preferential 30 percent cap only to firms wholly owned by foreign investors. It both redefines the supertax base (principally by allowing firms to expense the

14. See authorities cited in note 3 *supra*; Newcity, *Tax Issues in Soviet Joint Ventures*, 25 *TEX. INT'L L.J.* 163 (1990); Note, *Soviet Taxation of United States Businesses: State of the Law and Recommendations*, 42 *TAX LAW.* 801 (1989). The program for transition to a market economy enacted by the Supreme Soviet in October 1990 contemplates the creation of free enterprise zones in which all foreign investors will enjoy favorable tax treatment, but details remain sparse. *Postanovleniye ob Osnovnykh napravleniyakh stabilizatsii narodnogo khozyaystva i perekhoda k rynochnoy ekonomike* (Resolution on the Fundamental Directions of the Stabilization of the National Economy and the Transition to a Market Economy), *Ved. S'yezda narodnykh deputatov i Verkh. Sov. SSSR* (1990), No. 43, Item 889; *Osnovnyye napravleniya stabilizatsii narodnogo khozyaystva i perekhoda k rynochnoy ekonomike* (Fundamental Directions of the Stabilization of the National Economy and the Transition to a Market Economy) *id.*, No. 44, Item 906.

15. *Zakon o nalogakh s predpriyatiy, ob'yedineniy i organizatsiy* (Law on the Taxation of Enterprises, Associations, and Organizations) art. 6.6, *Ved. S'yezda narodnykh deputatov i Verkh. Sov.* (1990), No. 27, Item 522.

16. *Id.* art. 5.

17. *Zakon o podokhodnom naloge s grazhdan SSSR, inostrannykh grazhdan i lits bez grazhdanstva* (Law on Income Taxation of Soviet Citizens, Foreign Citizens, and Persons Without Citizenship), *id.*, No. 19, Item 320.

cost of intellectual property investments) and lowers its rate to 70 percent.¹⁸ The R.S.F.S.R. personal income tax law distinguishes between employees and entrepreneurs, taxing profits received from a business at a maximum rate of 35 percent, as compared to the 50 percent tax levied on salaries.¹⁹ Both laws purport to supersede the Union legislation.

Execution and ratification of the contemplated United States-Soviet Union Tax Treaty will reduce some of the tax burdens born by United States investors. The present treaty does not limit dividend withholding, but bars any host country taxation of royalties.²⁰ This treatment encourages the western investor to structure its return in the form of licensing fees rather than as dividends or interest. The new treaty probably will reduce the discrimination against dividends by capping host country withholding taxation at a relatively low level.

A final consideration for investors is the distinction in U.S. tax law between subsidiary corporations and passthrough entities. A U.S. corporate parent usually can avoid immediate taxation on its investment if the Soviet-based enterprise qualifies as a corporation under the Internal Revenue Code.²¹ But if the type of business activities involved threaten to bring the firm under the subpart F rules, the investor might prefer to structure the business so that it qualifies as a partnership or trust.²² Both U.S.S.R. and republic laws appear to offer sufficient flexibility to do either. In the case of joint ventures, for example, the decrees provide for centralization of management and limited liability, but permit the parties to a joint venture agreement to decide whether the enterprise will have continuity of life and freely transferable interests. The choice as to these last factors will determine whether the firm constitutes a corporation for U.S. income tax purposes.²³

II. Laws of Ownership

Until 1990 the Soviet Constitution cast a shadow over all foreign investment. Reflecting Marxist theory, it recognized only two types of property: "socialist," which either the state or specified collective organizations could hold; and "personal," which private persons could use for consumption but not to generate

18. *O nalogakh s predpriyatii, ob' yedinenii i organizatsii* (On Taxation of Enterprises, Associations, and Organizations), *Ekonomika i zhizn'*, Jan. 1991 at 2.

19. *Sovetskaya Rossiya*, Dec. 23, 1990, at 2.

20. Convention on Matters of Taxation, June 20, 1973, United States-Union of Soviet Socialist Republics, 27 U.S.T. 1, T.I.A.S. No. 8225. The Treaty applies only to Union-level taxes, which means that the Republics remain free to tax Soviet-sourced royalties received by United States' licensors.

21. See I.R.C. § § 881, 882, 7701 (a) (4), (5) (1982).

22. See I.R.C. § § 951-64 (1982). An investor faced with potential Subpart F problems would prefer to structure the business in noncorporate firm if a foreign corporation, itself the subsidiary of a United States parent, made the actual investment. The character of the income received by foreign subsidiary would determine whether it too came under Subpart F. See *id.* § 954(c).

23. *Morrissey v. Commissioner*, 296 U.S. 344 (1936); *Treas. Reg.* § 301.7701-2(b) (1960).

income.²⁴ Together these provisions seemed to indicate that Soviet law would not tolerate any private ownership of the means of production.

Early in 1990, however, the Congress of Deputies and the Supreme Soviet passed constitutional amendments and the Law on Property, which restructured the fundamental terminology and provided a stronger legal foundation for private ownership.²⁵ The category of "citizen's property" replaces "personal property" and admits accumulation based on "lawful grounds." "Collective property" substitutes for "socialist property" (except for the newly separated category of "state property") and comprises, inter alia, the assets of privately owned firms. The Law on Property provides specifically that "ownership by foreign states, international organizations, and foreign juristic persons and citizens may exist in the USSR."²⁶

Nevertheless, the 1990 changes have not eliminated all of Soviet property law's impediments to foreign investment. The constitutional amendments left intact article 17, which permits economic activity within the Soviet Union only if it is "based exclusively on the individual labor of citizens and members of their families."²⁷ The Law on Property states that "the use of any form of property must preclude the alienation of the employee from the means of production and the exploitation of man by man."²⁸ These provisions might represent nothing more than empty sops to a dead ideology, but they also can legitimate any subsequent move against private economic activity.

In December 1990 the Supreme Soviet enacted another law intended to encourage entrepreneurs. The measure, designated the Fundamentals of Legislation on Investment Activity, creates a framework for republic laws directed at defining and protecting private capital.²⁹ Unlike the Law on Enterprises, this measure explicitly recognizes the existence of direct foreign investment as well as foreign participation in joint ventures.³⁰ It expresses a presumption in favor of unrestricted use of capital, although also carving out broad authority for governmental regulation in pursuit of "economic, scientific-technical, and social policy."³¹ One provision authorizes lawsuits to seek compensation for governmental actions

24. See *Perestroika*, *supra* note 7.

25. *Zakon ob uchrezhdenii posta Prezidenta SSSR i vnesenii izmeneniy i dopolneniy v Konstitutsiyu (Osnovnoy zakon) SSSR*, (Law on the Establishment of the Post of President of the USSR and the Introduction of Changes in and Additions to the Constitution (Fundamental Law) of the USSR), *Ved. S'yezda narodnykh deputatov SSSR i Verkh. Sov. SSSR* (1990), No. 12, Item 189; *Zakon o sobstvennosti* (Law on Property), *id.*, No. 11, Item 164. See generally Hanson, *supra* note 7; Maggs, *Constitutional Implications of Changes in Property Rights in the USSR*, 23 CORNELL INT'L L.J. 363 (1990); *Perestroika*, *supra* note 7.

26. *Zakon o sobstvennosti*, *supra* note 25, art. 4.1 ¶ 2.

27. *Konstitutsiya (Osnovnoy zakon)* (Constitution (Fundamental Law)) art. 17 (1977).

28. *Zakon o sobstvennosti*, *supra* note 25, art. 1.6.

29. *Osnovy zakonodatel'stva ob investitsionnoy deyatel'nosti v SSSR* (Fundamentals of Legislation on Investment Activity in the USSR), *Izvestiya*, Dec. 16, 1990, at 2.

30. *Id.* art. 2.2

31. Compare *id.* art. 6.1 ¶ 2, with *id.* art. 10.1.

that infringe on investors' rights; another guarantees compensation in the event of nationalization.³² The measure implies that the principal means of regulating investments will be taxation and fiscal restraints. But as long as state ownership continues in the industries on which investments will depend—transportation, communications, and most supplies—as a practical matter, the government will have enormous influence over the success and failure of particular investments.

Dissatisfied with the compromises embodied in the U.S.S.R. legislation, some republics have attempted to enact stronger guarantees for private economic activity. The R.S.F.S.R. Law on Property, for example, contains no ideological caveats about worker alienation.³³ It guarantees an individual's "right of ownership to property he has acquired on grounds that are not against the law, to things he has created or essentially reworked, [and] to products, yields, and other income he has obtained from use of property belonging to him."³⁴ The law forbids government regulations that discriminate against owners of private property and protects property owned by joint ventures and foreign nationals.³⁵ As compared to the Union law, the Russian law permits a broader scope for private interests in land, although neither law allows individuals to enjoy an unrestricted right of transferability.³⁶ Finally, Russia purports to abrogate the U.S.S.R. Law on Property.³⁷

Both the Union and the R.S.F.S.R. plan to enact laws directed specifically at foreign investment sometime in 1991. Negotiations with the United States over an investment protection treaty also are nearly completed. These measures might clarify some of the problems created by the present laws. Even if they were to resolve the differences manifested in the legislation discussed above, however, they probably will not address what has become the most important property issue affecting foreign businesses, namely the matter of title to natural resources.

Given the poor quality of Soviet industrial production and infrastructure, most large-scale projects of interest to foreigners involve some kind of natural resource exploitation. The Soviet Union possesses vast riches, but the decline in central authority has put into question what branch of the state can authorize their development. Firms stand ready to contribute capital and know-how to industries that currently either do not exist or operate with incredible waste, but the Union, the republics, and the various subunits (autonomous republics, autonomous regions, national territories, and the like) cannot agree among themselves as to who owns the resources to be exploited.

In the past year various legislatures have enacted laws purporting to resolve the title question, but taken together the legislation only sharpens the conflicting

32. *Id.* arts. 20.2, 23.2.

33. *Zakon o sobstvennosti v RSFSR*, Sovetskaya Rossiya, Jan. 10, 1991, at 1.

34. *Id.* art. 7.1.

35. *Id.* arts. 3 ¶ 2, 26–28.

36. Compare *id.* arts. 10.1, 12, with *Zakon sobstvennosti*, *supra* note 25, art. 20.

37. *Postanovleniye Verkhovnogo Soveta RSFSR* (Resolution of the RSFSR Supreme Soviet), art. 3, Sovetskaya Rossiya, Jan. 10, 1991, at 1.

claims. The Union has enacted the Fundamentals on Land Legislation,³⁸ the Law on Property,³⁹ the Law on Demarcation of the Powers of the U.S.S.R. and the Members of the Federation,⁴⁰ and the Law on the Fundamentals of Economic Relations Between the U.S.S.R. and the Union and Autonomous Republics,⁴¹ all of which stake the central government's claim to control the exploitation of the nation's natural resources. They allocate to republics and autonomous republics the right to "possess, use, and dispose" of the land, but reserve for the Union the power to establish general principles governing resource development and foreign trade. The republics, particularly the R.S.F.S.R., have rejected this formula and insist on their exclusive right to control their resources, subject only to such express concessions as they might make to the Union.⁴² For the most part foreign businesses have either tried to cooperate with both Union and republic authorities, or have shied away from any commitments pending resolution of the dispute.

III. The U.S.-U.S.S.R. Trade Agreement

In June 1990 Presidents Bush and Gorbachev signed a bilateral trade agreement that, if implemented, would overcome several barriers to foreign business operations in the Soviet Union.⁴³ The focus of the agreement is the grant of most-favored-nation status to the Soviet Union, but it contains other significant provisions. The agreement requires the Soviet Government to "make available publicly on a timely basis all laws and regulations related to commercial activity," and to enact comprehensive measures to protect intellectual property.⁴⁴ Of more immediate importance are articles permitting U.S. firms to pay Soviet employees in hard currency and to maintain ruble accounts in Soviet banks.⁴⁵

Whether this agreement takes effect depends on both the Supreme Soviet and the United States Congress. The 1988 Trade Act requires the submission of trade agreements to Congress for approval.⁴⁶ The Jackson-Vanik Amendment to the 1974 Trade Act predicates any submission that would give the Soviet Union most-favored-nation status on a presidential finding of substantial improvement

38. *Osnovy zakonodatel'stva Soyuzo SSR i soyuznykh Respublik o zemle*, Ved. S'yezda narodnykh deputatov i Verkh. Sov. SSSR (1990), No. 10, Item 129.

39. *Zakon o sobstvennosti*, *supra* note 25.

40. *Zakon o razgranichenii polnomochiy*, *supra* note 10.

41. *Zakon ob osnovakh ekonomicheskikh otnosheniy*, *supra* note 10.

42. See *Zakon o sobstvennosti v RSFSR*, *supra* note 33, arts. 6, 20-21; *Postanovleniye ob obespecheniya ekonomicheskoy osnovy suvereniteta RSFSR* (Resolution on Ensuring the Economic Foundation of RSFSR Sovereignty), *Sovetskaya Rossiya*, Nov. 2, 1990, at 1.

43. *Agreement on Trade Relations Between the United States of America and the Union of Soviet Socialist Republics* (1990).

44. *Id.* arts. 6.1, 8.

45. See Stephan, *The Restructuring of Soviet Commercial Law and Its Impact on International Business Transactions*, 24 *GEO. WASH. J. INT'L L. & ECON.* 89, 95-97 (1990).

46. 19 U.S.C. § 2901-2903 (1988).

in emigration practices.⁴⁷ President Bush in turn has conditioned any action on his part on the Supreme Soviet's enactment of a law formalizing the right to emigrate, a step President Gorbachev has promised to undertake but so far been unable to accomplish.

The Jackson-Vanik Amendment also requires a presidential finding of improved emigration as a condition of government financing of trade with the Soviet Union. In December 1990 President Bush made the requisite finding to permit Export-Import Bank guarantees of up to \$300 million in sales to the Soviet Union, in addition to \$1 billion of Commodity Credit Corporation financing for grain sales.⁴⁸ Logically, conditions that justify a Jackson-Vanik waiver for one purpose should apply to all, but the President may find it difficult to back down from his insistence on emigration legislation.

The underlying irony in the debate over the trade agreement is that a grant of most-favored-nation status, whatever its symbolic value, will have almost no immediate impact on United States-Soviet trade. The Soviet Union has insufficient hard currency reserves to buy much from the United States, and the poor quality of Soviet marketing and production precludes it from enjoying any quick success in penetrating the U.S. market.⁴⁹ Whatever the merits of the human rights concerns that prompted the amendment, one can question whether the lower tariffs that flow from most-favored status should remain the focus of the ongoing debate over the bilateral economic relationship.

IV. The War of Laws

The larger problem in Soviet law today is the contest over the legitimacy of the various branches of the Soviet state. The "war of laws," as the central Soviet authorities have dubbed it, reflects deeply felt hostility between the Union and many of the republics based on ideological and cultural conflicts as well as powerful historical grievances. A vicious cycle has begun. The hostility grows as the economy deteriorates, and the contest over legitimacy further aggravates the economic situation.

The Union Supreme Soviet has attempted to state the rules of conflict. Under the Law on Ensuring the Effectiveness of U.S.S.R. Legislation, Union laws will

47. 19 U.S.C. § 2432 (1982). Technically, the Jackson-Vanik Amendment would not apply if the Soviet Union were to attain the status of a market economy country. Compare *id.* with 19 U.S.C. § 1677(18) (1982). Whatever the extent of Soviet economic reform, it seems unlikely this goal will be achieved any time soon.

48. 7 Int'l Trade Rep. (BNA) 1910 (Dec. 19, 1990). The Stevenson Amendment, 19 U.S.C. § 2487 (1982), forbids any federal agency other than the Commodity Credit Corporation from extending trade financing in excess of \$300 million. Unlike the Jackson-Vanik Amendment, this provision cannot be waived upon a finding of improved Soviet behavior.

49. See Special Comm'n on Soviet Affairs, Ass'n of the Bar of the City of New York, Report on Normalization of the U.S.-Soviet Trade Relationship, 46 RECORD OF ASS'N OF BAR OF CITY OF N.Y. 104, 118 (1991).

apply where their terms differ from republic legislation.⁵⁰ If a republic believes a Union law is unconstitutional, the republic may petition either the U.S.S.R. Supreme Soviet or the Committee for Constitutional Supervision to review the matter.⁵¹ The law further forbids republics from setting conditions for the applicability of Union legislation.⁵² The effectiveness of these rules can be judged by the actions of the R.S.F.S.R. Supreme Soviet, which has announced the abrogation of Union laws on property, enterprises, enterprise taxation, and personal taxation in the period since the Union law's enactment.

Beneath the surface of the war of laws lie many traps for the unwary foreign investor. Different levels of government may promise access and protection, but an unwise choice of allies can backfire. The Eko-Dove scandal offers a cautionary tale for those who would tie the fate of their investment to particular political careers.

The facts surrounding the affair remain exceptionally murky, but something like the following may be true: Dove Trading International, a Johannesburg-based firm controlled by a Briton wanted in his native country for smuggling defense-related technology to the Soviet Union, signed a sales contract with Eko, a Soviet cooperative connected with the association *Vozrozhdeniye Uralskoy Derevny* (Resurrection of the Urals Countryside). Dove would allow Eko-Vozrozhdeniye to pick from a list of consumer goods, which Dove would buy in the West for hard currency. Dove would sell the goods to Eko-Vozrozhdeniye for rubles, which Dove then would invest in various projects. The exact scope of the deal is a matter of dispute, but when unraveled its critics in the central government claimed that Dove had promised to provide \$7.8 billion in goods and expected roughly 140 billion rubles in return, a dollar to ruble equivalency of roughly one-to-eighteen.

Critical to the deal, or at least to its demise, was political support derived from the R.S.F.S.R. government, particularly a comfort letter signed by R.S.F.S.R. deputy prime minister Gennady Filshin. Soviet authorities seized documents relating to the contract from a Dove employee as he left the country and then leaked their contents to conservative elements in the press. A chorus of confused accusations followed, culminating in Filshin's resignation. The press portrayed the transaction as a black-market currency deal, with Western investors expecting to smuggle their profits out of the currency in the forms of diamonds, caviar, timber, gold, and art works. U.S.S.R. Prime Minister Valentin Pavlov provided a different, and even more sensational account: The arrangement represented a plot by Western banks to wreck the Soviet economy by flooding it with rubles smuggled in from abroad, with the intent of provoking a coup against Gorbachev

50. *Zakon ob obespechenii deystviya zakonov i inykh aktov zakonodatel'stva Soyuzo SSR*, Ved. S'yezda narodnykh deputatov i Verkh. Sov. SSSR (1990), No. 44, Item 918.

51. *Id.* art. 2.

52. *Id.* art. 3.

and (presumably) in favor of Yeltsin. Thus Pavlov linked the scandal to his widely unpopular decision to recall all fifty- and one-hundred ruble notes, a move justified as an attack on the underground economy but more likely directed at the savings of average citizens.

Many questions remain unanswered. If Dove's director had smuggled western military technology into the Soviet Union, would it not be reasonable to suspect that his continued presence in that country accorded with the wishes of the central authorities, and in particular the KGB? How was the purchase of western consumer goods to be financed, if all the rubles received for their resale were to remain in the Soviet Union? Why would western banks want to flood the Soviet Union with rubles, particularly in light of the energetic efforts of the central government during the previous two years, under the direction of then Minister of Finance Pavlov, to debase the ruble through reckless expansion of the money supply?

However implausible the Eko-Dove scandal, it offers a few lessons to western investors. The deal may have infuriated the central authorities precisely because it would have given R.S.F.S.R. leaders the power to distribute coveted consumer goods in derogation of Gorbachev's government. Under the current conditions of scarcity, those in the center would prefer prolonging consumer hardships to permitting other factions to harvest the political benefits that would flow from relieving popular discomforts. In other words, whatever the economic foundation of the transaction—and converting hidden ruble reserves into investment seems far more sensible than trashing the currency by withdrawing all large denomination notes—its political implications mattered more.

V. Conclusion

How or whether the Soviet leadership will manage to stabilize the present economic crisis remains far from clear. The recent signs are not reassuring. At the end of January 1991 Gorbachev issued a decree allowing the police and the KGB to enter all business premises, including those belonging to foreigners, unannounced to look for evidence of economic crimes.⁵³ Even if the implicit threat is directed primarily against those entrepreneurs who leave the center out of their transactions, the message remains disturbing: Economic as well as political pluralism has become a casualty of the leadership's failure to achieve structural reform.

One could not expect the undoing of such a gigantic, and ultimately disastrous, experiment as was Soviet socialism without more than a few rocky moments. The pace of change has been overwhelming over the last five years, and

53. *Ukaz o merakh po obespecheniyu bor'by s ekonomicheskimi sabotazhem i drugimi prestupleniyami v sfere ekonomiki* (Decree on Measures for Maintaining the Struggle with Economic Sabotage and Other Crimes in the Economic Sphere), *Izvestiya*, Jan. 28, 1991, at 1.

the current unpleasantness may reflect nothing more than temporary panic and anxiety. Perhaps the Union and republic authorities may yet come to an understanding that cooperative efforts to encourage foreign investment will produce greater benefits for everyone. But the last year, if it has done nothing else, has taught both the Soviet people and foreigners interested in doing business with them that the process of converting from a command economy to a system based on markets and property rights is extremely complex and difficult.