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The Recent Transformation of Hungarian Investment Regulation: the Legal Framework, the New Regulation of Direct and Financial Investment, and the Dynamics of Reform

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THE RECENT TRANSFORMATION OF HUNGARIAN INVESTMENT REGULATION: THE LEGAL FRAMEWORK, THE NEW REGULATION OF DIRECT AND FINANCIAL INVESTMENT, AND THE DYNAMICS OF REFORM

I. INTRODUCTION

Over the past several years a change in the environment for investment in Hungary has taken place in which regulations concerning foreign investment and the capacity to engage in foreign trade have been substantially modified.[1] These changes have followed Hungary's modest success in stabilizing financial accounts during the late 1970's and the first half of the 1980's.[2] The changes have also followed as resources

1. *See* Telegram from the American Embassy in Budapest, Hungary to the Secretary of State, Washington, D.C. 053177 (Jan. 1987) (discussing joint ventures in Hungary) [hereinafter Review of Joint Ventures in Hungary]; U.S. DEPARTMENT OF COMMERCE, INTERNATIONAL TRADE ADMINISTRATION: FOREIGN ECONOMIC TRENDS IN HUNGARY 7-8 (1987) [hereinafter FOREIGN ECONOMIC TRENDS]. *See also* Madl, *Principle Elements of the New Regulation of Foreign Trade in Hungary*, in 3 QUESTIONS OF INTERNATIONAL LAW: HUNGARIAN PERSPECTIVES 133 (H. Boker-Szejo, ed. 1986). Concerning development of reform measures in Hungary over a longer period of time, see HUNGARIAN CHAMBER OF COMMERCE, HOW TO TRADE WITH HUNGARY (1983) [hereinafter HOW TO TRADE WITH HUNGARY]; THE WORLD BANK (A COUNTRY STUDY), HUNGARY: ECONOMIC DEVELOPMENTS AND REFORMS 30-66 (1984) [hereinafter HUNGARY: ECONOMIC DEVELOPMENTS AND REFORMS]; P. MARER, EAST WEST RELATIONS AND TECHNOLOGY TRANSFER: A STUDY OF HUNGARY, 1968-1984, AT 55 (1986). Concerning the nature of Hungarian Enterprises, see Naray, *Hungarian Foreign Trade Reform*, 20 JOURNAL OF WORLD TRADE LAW 275 (1986); Bassanyi, *The Newly Independent Enterprises in Hungary*, 32 ACTA OECONOMICA 266 (1984).

2. FOREIGN ECONOMIC TRENDS, *supra* note 1. *See also* Comisso & Marer, *The Economics and Politics of Reform in Hungary*, 40 INTERNATIONAL ORGANIZATION

for investment have become more scarce in Hungary.

In the early 1980's Hungary, which is a member of the Council of Mutual Economic Assistance ("CMEA"), the economic association of Eastern European trading partners of the Soviet Union, expanded trade with CMEA partners while trade with Western nations declined.[3] Hungary responded to these changes by liberalizing joint venture laws in 1986. The Hungarian banking system was restructured in 1987, partly to support joint ventures. Included in the banking reform was the development of commercial banking and the extension of onshore banking privileges to Western institutions.[4]

A new international posture is highlighted by membership in the World Bank and affiliated institutions.[5] New bankruptcy laws have been developed, and the government has committed itself to a broader application of such laws.[6] In 1988 a new program of economic austerity focusing on price increases is to take effect.[7] A progressive income tax is also to be introduced.[8] Moreover, the Hungarian leadership is considering further economic reform measures and, even more conspicuously, political reform.[9]

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430 (1986); Antal, *Zur Lage der Ungarischen Wirtschaft in Fruhjahr 1984*, 33 SUDOST-EUROPA 279 (1985). Hungary's success in stabilizing financial accounts was assisted by a stabilization program developed under the auspices of the International Monetary Fund. *See infra* note 75 and accompanying text.

3. *See* FOREIGN ECONOMIC TRENDS, *supra* note 1, at 5-7; *East-West Financial Relations: Developments in 1985 and Future Prospects*, FINANCIAL INVESTMENT TIMES, Mar. 1986, at 21 [hereinafter *East-West Financial Relations*]. *See also* Antal, *supra* note 2, at 271-276.

4. Citibank established such a venture in late 1985. *See* Review of Joint Ventures in Hungary, *supra* note 1. "Hungary's upcoming bank decentralization may lead to serious confusion, at least initially for Western companies. Outstanding policy issues as well as logistical shortcomings mean that it will take some time for [Foreign Trade Organizations] and the new 'commercial' banks to sort themselves out." *Bank Decentralization: Confusion in Hungary*, Business Eastern Europe, Nov. 24, 1986, at 371.

5. Hungary acceded to the General Agreement on Tariffs and Trade ("GATT") in 1973. Concerning the reconstruction and reform of foreign trade practices in Hungary, see Madl, *supra* note 1, at 134.

6. *See Hungary, a Lesson in Reform*, THE ECONOMIST, July 11-17, 1987, at 67; *See also* FOREIGN ECONOMIC TRENDS, *supra* note 1, at 5; Kamm, *In Hungary, the Spirit of Change Reappears*, N.Y. Times, Aug. 10, 1987, at A10 col. 1 [hereinafter *In Hungary*].

7. *See* Kamm, *Budapest Leaders*, *infra* note 9, at A11, col. 1. The general process of restructuring of pricing mechanisms with specific reference to foreign trade is discussed in Madl, *supra* note 1, at 141.

8. *Id.*

9. The discussion of political reform concerns, among other approaches, giving more independent authority to parliament; Hungary has been distinguishable among

Hungarian economic reform can be traced back to 1968 with the creation of the New Economic Mechanism ("NEM") which extended personal economic rights and began a process of structural reform.[10] Similar measures, which sought to implement elements of market economics and provide greater autonomy to enterprise decisions, are now reflected in the economic programs of many Soviet-bloc countries.[11] Indeed, Soviet foreign relations increasingly focuses on the need for economic reform in these countries, and Secretary-General Gorbachev has indicated a Soviet willingness to tolerate greater economic diversity in Eastern Europe.[12]

Despite the changes in Hungary, many believe that the stagnation that has developed in Hungary's economy since the late seventies nevertheless will persist without more thorough reform.[13] In the midst of this anxiety over the severity of the economic crisis, intellectual fer-

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such systems insofar as its elections are conducted with multiple lists, a practice also developing in other countries; *See* Kamm, *Budapest Leaders Look for Support: Seek to Enlist Intellectuals to Back a New Program of Economic Austerity*, N.Y. Times, Oct. 25, 1987, at A11 col. 1 [hereinafter *Budapest Leaders*]. Concerning options for economic reform, see Tardos, *A Development Program for Economic Control and Organization in Hungary*, EASTERN EUROPEAN ECONOMICS, Spring/Summer 1984, at 67-87; see the discussion of the views of R. Nyers, described as a "founding father of Hungary's drive for economic changes," in Kamm, *supra* note 6.

10. *See* THE ECONOMIST, *supra* note 6, at 48; HUNGARY: ECONOMIC DEVELOPMENTS AND REFORMS, *supra* note 1, at 30-66; *see also* Thompa, *Le point sur privitisation de l'economie Hongroise*, 281 LE COURIER DES PAYS DE L'EST 24 (1984).

11. It is apparent, however, that reform will not be forced upon Eastern European countries. *See* Kraus, *Soviet Policy Toward East Europe*, 86 CURRENT HISTORY 353 (1987); Taubman, *Soviets Won't Push Policy on Allies, Gorbachev Says*, N.Y. Times, Nov. 5, 1987, at A1, col. 1 (report of a speech by Gorbachev to foreign delegates attending the commemoration of the 70th anniversary of the Bolshevik Revolution). Concerning Soviet interest in reviving joint ventures, see Buxbaum, *Legal Issues Concerning the Financial Aspects of Joint Ventures with Non-Market Economy Firms*, 2 INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES 66, 67 (1987). Concerning Soviet economic reform, see Taubman, *Gorbachev Urges Radical Changes to Spur Economy*, N.Y. Times, June 26, 1987, at A1 col. 5; Keller, *Gorbachev Urges Expansion of Family Farms*, N.Y. Times, July 1, 1987, at A11, col. 1; Tucker, *Where is the Soviet Union Headed?*, 4 WORLD POLICY JOURNAL 179 (1987). An excellent discussion of the international politics of economic reform in Eastern Europe is Ruhfus, *Die Politische Dimension der Wirtschaftsbeziehungen zwischen Ost und West*, 42 EUROPA-ARCHIV 1 (1987). *See also*, *Steel Plant Attempts "Self-Financing*," The Washington Post, Aug. 17, 1987, at A17 col. 2 (concerning the Magnitogorsk steel factory in the USSR).

12. Taubman, *supra* note 11.

13. *See* Kamm, *Budapest Leaders*, *supra* note 9; Kamm, *In Hungary*, *supra* note 6; Bognar, *Further Developments in Economic Reform*, 25 NEW HUNGARIAN QUARTERLY 53-54 (1984).

ment is occurring over strategies for modernization among Hungarian economists, and there is little shortage of plans for further market-oriented reform.[14] Current Hungarian policy is to develop new forms of economic organization and management expertise with the joint venture expected to play an important role.[15]

The two critical factors affecting Hungarian economic policy are (1) the relative stagnation of the domestic economy and (2) the reality of trade dependence under conditions where broader integration into the international economy has been an elusive goal.[16] Fifty-five percent of the gross national product is derived from foreign trade.[17] The resulting foreign debt, much of which has been restructured, encourages policies designed to maintain a constant supply of hard currency surplus.[18] As the terms of trade in a difficult international economic environment have worsened, and as the Soviet Union has demanded higher quality goods and demanded participation in joint intra-CMEA projects that has further drained Hungarian resources, domestic economic policy has placed a priority on implementing austerity measures.[19]

During the past two decades Western opportunities for investment in Eastern European countries generally have greatly expanded. Countries in the region have concluded numerous treaties concerning trade, taxation and investment with Western industrial nations.[20] As evident in these treaties and other agreements, the development of a legal framework to accommodate and reconcile differing conceptions of enterprise management and economic practices has been essential to the expansion of trade and investment.[21]

Nevertheless, reforms that have encouraged foreign investment

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14. Bognar, *supra* note 13.

15. *See* Review of Joint Ventures in Hungary, *supra* note 1; HUNGARIAN CHAMBER OF COMMERCE, JOINT VENTURES IN HUNGARY, 8-9 (1986).

16. *See* Volgyes, *Hungary: Before the Storm Breaks*, 86 CURRENT HISTORY 374 (1987).

17. *Id.*

18. *Id.*

19. *See* FOREIGN ECONOMIC TRENDS, *supra* note 1, at 8; Kamm, *In Hungary*, *supra* note 6; Volgyes, *supra* note 16.

20. Concerning tax treaties, see Doman, *East-West Trade Treaties*, 10 INT'L BUS. L. 193 (1982). Concerning investment agreements, see Burckhardt, *Promotion of East-West Joint Ventures by Governments of Western Countries*, 10 INT'L BUS. L. 112 (1982).

21. *See* T. Hoya, EAST-WEST TRADE, COMECON LAW, AMERICAN-SOVIET TRADE, 16-17 (1984); Schmidt, *Legal Aspects of Doing Business in Hungary* 15 VAND. J. TRANS. L. 253, 268-73 (1982).

have been criticized for lacking in implementation what they appear to strive for on paper.[22] These criticisms have been addressed in Hungary by designating the Hungarian Chamber of Commerce and other agencies as primary agents for overcoming impediments to the formation and development of joint ventures and for coordinating government action. The role of the Chamber of Commerce, in particular, is now quite prominent in this area.[23] Furthermore, while other East European countries have pursued strategies of economic reform and evolved policies designed to improve specific types of ties to Western nations, the Hungarian economic system has begun to resemble the economic structure of a Western European nation. Specifically, management has become less bureaucratized and significantly more decentralized, an effect that is changing the character of relations among enterprises and between enterprises and the state.[24]

Still, the Western investor will find that a division of responsibility persists among enterprises and state institutions that has debilitating effects. For example, because of exogenous structural constraints, joint-venture exports to other CMEA countries remain troublesome since much of the reform taken to date constitutes a diversification of roles — "a rearrangement of competencies" — rather than abandonment of state roles.[25] In the area of banking, the 1987 reforms created organizations with considerable autonomy, but the results may be inhibited by the structure of trade relations.[26]

Hungarian enterprise now is characterized by a three tier struc-

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22. *See* THE ECONOMIST, *supra* note 6, at 47-48. *See also* Scriven, *Cooperation in East-West Trade: The Equity Joint Venture*, 10 INT'L. BUS. L. 110 (1982). In some East European countries (e.g. Bulgaria) reform measures, are essentially "paper laws," being minimal in the degree of development. (Yugoslavia was the first eastern European country to actively develop a joint venture program in the late 1960's). *See* Scriven, *Joint Venture Legislation in Eastern Europe: A Practical Guide*, 21 HARV. L. J. 633 (1982).

23. *See* Review of Joint Ventures in Hungary, *supra* note 1. *See also*, *Hungary Sets up Club to Air Joint Venture Complaints*, BUSINESS EASTERN EUROPE, Nov. 10, 1986, at 355. For a discussion of government agency involvement see Sajo & Csillag, *Law-Making as Administrative Behavior: the Case of Investment Regulation in Hungary*, 15 INT'L. J. SOCIOLOGY L. 209 (1987).

24. Regarding decentralized management, see Sajo & Csillag, *supra* note 23. *See also* Naray, *supra* note 1, at 274, 277; *cf.* Havasi, *Further Development of a System of Economic Control and Management in Hungary*, 32 ACTA OECONOMICA 199 (1984); Bossanyi, *supra* note 1, at 269 (discussing the break-up of nation-wide holding companies); Kamm, *In Hungary*, *supra* note 6.

25. *See* Madl, *supra* note 1, at 134-38.

26. Concerning banking reform, see Review of Joint Ventures in Hungary, *supra* note 1; *Bank Decentralization: Confusion in Hungary*, *supra* note 4, at 371.

ture which includes two new forms: (1) traditional state enterprises; (2) enterprise council-directed associations; and (3) self governing enterprises.[27] Self-governing enterprises are under the direction of a meeting of delegates, or an employee's general meeting, and enterprise activities are discretionary, i.e., under the control of the enterprise rather than the state.[28] More and more enterprises are being reorganized into this third category.[29]

The development of formal relationships with the International Monetary Fund and the World Bank, i.e., the International Bank for Reconstruction and Development has established a basis for increased international integration and has furthered the process of reorganization of the Hungarian economy.[30] Privately held hard currency Hungarian debt was substantial at the time of Hungary's application for membership in the World Bank in 1982.[31] This debt remains relatively large, motivating, as is the case in other Eastern European countries, policies designed to balance the flow of currencies and stabilize the availability of convertible currencies.[32]

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27. *See* Naray, *supra* note 1, at 274-75.

28. The state's role has been reduced to that of founder. *Id.*

29. *Id.*

30. The impact of Western legal concepts on economic relations within Hungary and other CMEA countries should not be overlooked. International law agreements and joint venture contracts have been borrowed in Hungary particularly as municipal law. *See* Schmidt, *supra* note 21, at 253, 268-273. *See also* Roman, *Conflicts of Laws Solutions in the Hungarian New Private International Law*, 10 INT'L. J. LEGAL INFO. 169 (1979). Concerning legal process and the legal profession in Hungary, see Simon, *The Hungarian Legal System, with Special Regard to the Practice of Law*, 9 INTERNATIONAL BUS. L. 189 (1981).

31. Sajosi-Kovats, *Hungary and the World Bank Group*, 2 HUNGARIAN BUSINESS HERALD 14 (1986)

32. Writes one author:

> Hungary has been unsuccessful in integrating itself with the Western economy; today its debt service ratio is one of the highest in the world and in 1987 it faces the necessity of rescheduling, the resulting loss of future loans, and financial chaos. Because of the unwise use of loans, the enormous changes in oil prices—both in the East and in the West—and the complete stoppage of investments, however, the expected technical and technological restructuring has not occurred. Today Hungary is at the mercy of Western bankers demanding repayment, and it is also at the mercy of both eastern and Western economies.

Volgyes, *supra* note 16, at 374. It should be noted that what must be put up with by Hungarian financial officials is no less than what is experienced in other regions. *Compare* Sajosi-Kovats, supra note 31. *See also* FOREIGN ECONOMIC TRENDS, *supra* note 1, at 5-7.

Concerning the recent trade imbalance and its impact on reform considerations, see Kamm, *In Hungary*, *supra* note 6, quoting R. Nyers: "The present circumstances

II. United States Policy

Reform of the banking system, the development of onshore Western financial institutions, and the liberalization of joint venture law must be understood in terms of the overall financial setting and East-West relations generally. Numerous considerations enter into an assessment of the recent changes affecting the choice among options for the United States. Some of the options are whether to pursue negotiations of investment agreements, the choice of roles to play in multilateral associations, whether to encourage U.S. corporations to do business in the region, and whether to condition expanded trade with the Soviet Union on the restructuring of intra-CMEA trade practices.[33]

The International Monetary Fund and the World Bank have provided leadership in addressing the financial difficulties of the region and have helped these countries regain access to Western financial markets.[34] In the context of this leadership, the United States economic policy has centered on human rights and, to a lesser extent, U.S. export opportunities.[35] The United States government also has given special priority to augmenting vigilance and co-ordination in the area of tech-

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remind us of the 1970's, external and internal imbalances, overregulated state machinery, financial survival of lame duck companies and an aversion by efficient enterprises to taking new risks." Hard currency surpluses exist between Hungary and other CMEA countries. *See* Foreign Economic Trends, *supra* note 1, at 9.

33. The region has experienced varying degrees of economic hardship for many years. In Rumania, six years of food shortages are leading to widespread malnutrition, and U.S. trade preferences are in danger because of restrictions on emigration, particularly of members of the Hungarian minority. *See* Lee, *Romanian Austerity Grips Citizens*, The Washington Post, Aug. 17, 1987, at A15, col. 1. Poland's financial problems are severe, resulting in a recent plan to hold a referendum on whether to raise prices generally by as much as forty percent. *See* J. Tagliabue, *Poland, Planning Many Changes Calls Referendum on Economy*, The N.Y. Times, Oct. 9, 1987, at A1, Col. 1. In Hungary itself, the legality of moonlighting in independent enterprise, a routine lifestyle for individuals and teams of workers has given rise to overwork, leading to what Janos Kis, a Hungarian philosopher has called "the biological limits of self-exploitation." Kamm, *Lean Times in Hungary, The Land of Good Living is Looking a Bit Wan*, N.Y. Times, August 5, 1987, at A3, col. 1 [hereinafter *Lean Times in Hungary*].

34. Hungary had never lost access to Western markets. Note also that the United States has a continued interest in maintaining and expanding agricultural and related industrial product trade to Hungary. *See* Foreign Economic Trends, *supra* note 1, at 9. *But see* Leurs, *The U.S. and Eastern Europe*, 65 Foreign Affairs 980, 989 (1987).

35. Dept. of State, Country Reports on Human Rights Practices for 1986, at 940-950 (1986) [hereinafter Country Reports]; Foreign Economic Trends, *supra* note 1, at 9-11.

nology transfer.[36]

U.S. export opportunities were affected by the NATO coordinating committee ("Cocom") which produced a list of embargoed items which directly affected U.S. trade practices.[37] Unilateral trade action on the part of the United States could be circumvented by other Western countries. In response Congress passed the Export Administration Act, legislation that circumscribed the authority of the President to order trade restrictions.[38]

A development that might impact on joint ventures and trade would be an Hungarian arrangement utilizing a strategic resource which, for some reason, became an immediate strategic issue; e.g., a Soviet pipeline to the West over Hungarian soil. In an emergency, or for critical national security reasons, the President of the United States has authority to restrict movement of goods.[39] The United States Embassy in Hungary, however, currently views investment in Hungary as involving minimal political risk.[40]

Similarly, there seem to be limited political risks associated with Hungary's human rights policy. Over the past two decades Hungary's human rights record has been among the more exemplary of the Eastern European States. During years of difficult relations between Washington and Moscow, this factor, along with the more favorable climate for international investment, allowed for warmer relations between

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36. *See* DEPT. OF STATE, EAST-WEST RELATIONS AND TECHNOLOGY TRANSFER, CURRENT POLICY NO. 568, MAR. 29, 1984, AT 2-5 [hereinafter TECHNOLOGY TRANSFER]. For a discussion of the issues in detail, see Blair, *Export Control on Western Made Goods and Technology: Are We Penalizing the Soviets or Ourselves?* 21 TEX. INT'L. L. J. 363 (1986); Levine, *Technology Transfer, Export Controls v. Free Trade*, 21 TEX. INT'L. L. J. 373. *See also* Osakwe, *Navigating the Unchartered Waters of East-West Economic Relations: A Legal Compass*, 21 TEX. INT'L. L. J. 211.

37. Three lists exist under the auspices of Cocom: (1) a munitions list; (2) an atomic energy list, and (3) an international list covering so-called "dual use" items. The latter area is clearly the most difficult one. Ability to effect enforcement against companies violating Cocom rules, or independent U.S. restrictions is the determinant of U.S. leverage, and significant efforts have been made in the area of enforcement of existing or newly agreed-upon rules. TECHNOLOGY TRANSFER, *supra* note 36.

38. 50 U.S.C. § 2401 (1982). A good exploration of the labyrinth of U.S. export controls is Davis & Bialos, *The Predictability Problem: Issues Under U.S. Export Policy*, in PRIVATE INVESTORS ABROAD—PROBLEMS AND SOLUTIONS IN INTERNATIONAL BUSINESS IN 1986 (1986).

39. Once a good is classified as an export, differing types of licensing requirements will be required: *see* 15 C.F.R. § 376.14. The Jackson/Vanik amendment to the Trade Act of 1974 placed human rights conditions on Most Favored Nation treatment, including Export/Import Bank credits; *see* COUNTRY REPORTS, *supra* note 35.

40. *See* FOREIGN ECONOMIC TRENDS, *supra* note 1, at 9-11.

Washington and Budapest than existed between Washington and other Eastern European capitols. Certainly, a reversal of Hungary's human rights conduct could impact upon joint ventures and trade relations generally. In this regard it is also noteworthy that the Trade Act of 1974 requires the President of the United States to find that emigration policies are sufficiently liberal to allow for continued favorable economic treatment.[41] Nevertheless, Hungary has maintained its favorable economic treatment.[42] Hungary, Romania, and recently Poland have obtained Most Favored Nation Status in economic relations with the United States, and human rights policies have been invoked to justify such differentiation.[43]

Hungary currently enjoys very good relations with Washington. The increasing personal economic freedom is being received warmly. In its 1986 *Report to Congress* concerning human rights the State Department stated:

> Economic reform, launched in 1968, is still the key to Hungary's relatively tolerant domestic policies. After years of belt-tightening, the Government is trying to cope with growing popular unhappiness about rising prices and a stationary, if not declining, standard of living by allowing modest wage increases and moving ahead with economic reforms. Hungarians as a whole are significantly freer of the type of economic restrictions and state interference in private life which characterize other Warsaw Pact members.[44]

There are few formal economic ties between the United States and Hungary. The treaties governing United States-Hungarian economic relations were for the most part concluded during the late 1970's. These agreements are: (1) the Agreement on Trade Relations which entered into force on July 7, 1978;[45] (2) the Convention for the Avoidance of Double Taxation which entered into force in September of

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41. Export Administration Act, *supra* note 38.

42. *See Presidential Message to Congress on Trade with Hungary, the People's Republic of China, and Romania*, 19 WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS NO. 22 (JUNE 6, 1983), AT 825-27.

43. *See* Marer, *U.S. East-West Trade Policy*, in East-West Economic Relations in the Changing Global Environment, p. 10 (1986) (A review of report to the Congress and the Trade Policy Committee on trade between the U.S. and the non-market economy countries, Wash., D.C.: U.S. International Trade Commission Quarterly).

44. *See* COUNTRY REPORTS, *supra* note 35, at 940-41.

45. Agreement on Trade Relations, Mar. 17, 1978, United States - Hungary, 29 U.S.T. 2711, T.I.A.S. No. 8967.

1979;[46] and (3) the Agreement on Tariff Matters within the Multilateral Trade Negotiations at Geneva, which entered into force in January, 1980, with Related and Amending Agreements, entering into force in May and September of 1980.[47] No distinct investment agreement has been concluded between Hungary and the United States.

The Agreement on Trade Relations recognizes in its preamble "that the development of economic and commercial relations can contribute to general strengthening of their relations."[48] Article 1 provides that the parties shall abide by the provisions of the General Agreement on Tariffs and Trade that are not inconsistent with the Trade Agreement. Reciprocity in reductions of trade barriers and a satisfactory level of concessions are the principles established in Article 1. Article 2 commits the parties to the expansion of trade and cooperation in economic matters, including relationships between "firms, enterprises and companies of the two countries." Article 2(3) defines broadly the practices and law to be applied in commercial transactions. Article 3 goes into greater detail on providing increased business facilities, recognizes mutual rights of access to courts and administrative agencies, provides in detail for representation of businesses within each country, and establishes the principles of (1) advertising access, (2) exchanges of information among businesses, (3) access of personnel, (4) assistance with business problems by governments, and (5) the barring of unreasonable government interference with contracts.[49] Article IV establishes U.S. dollars as the commercial currency between the countries, and commits the parties to "grant any authorization necessary" to facilitate financing of commercial transactions. Free movement of convertible currencies out of each country is established in Article IV(5). Article V incorporates provisions of the Paris Convention for the Protection of Industrial Property and the Universal Copyright Convention, and national treatments are established as required and where they are more favorable. Article VI commits the parties to encourage the establishment of commercial offices. Article VII is an escape clause for situ-

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46. Convention on the Avoidance of Double Taxation and Income Tax, Feb. 12, 1979, United States - Hungary, 30 U.S.T. 6347, T.I.A.S. No. 9560.

47. Agreement on Tariff Matters, Nov. 18, 1978 - Sept. 18, 1980, United States - Hungary, 32 U.S.T. 5371, T.I.A.S. No. 9992. Non-Tariff Matters, Tokyo Round of Multi-Lateral Trade Negotiations, Aug. 3, 1978 - May 30, 1980, 32 U.S.T. 5357, T.I.A.S. No. 5357. Concerning CMEA countries participation in the General Agreement on Tariffs and Trade, see Patterson, *Improving GATT Rules for Non-Market Economies*, 20 JOURNAL OF WORLD TRADE LAW 185 (1986).

48. *Supra* note 45, at 2712.

49. Concerning advertising law in Hungary, see HOW TO TRADE WITH HUNGARY, *supra* note 1, at 15-19.

ations where there is significant disruption of a domestic industry, and provides for consultations detailed in the Agreement Annex.[50] Article VIII concerns encouragement of arbitration among commercial contractors. Article IX establishes the right of either party "to take any action for the protection of its security interests." Article X provides some definitional specificity.

The Agreement's duration is for three years, automatically extended for successive three year periods unless there is termination thirty days prior to expiration. The United States has retained the right to abrogate should domestic legislative authority to carry out provisions be lacking.

The Convention for the Avoidance of Double Taxation and the prevention of Fiscal Evasion with Respect to Taxes on Income is quite detailed.[51] It categorizes certain individuals for taxation purposes and provides the rates of taxation to which they will be subjected and the resulting payments to each country. The principle of non-discrimination in the application of taxes to citizens of each country is also provided.

These agreements raise questions as to the degree to which the United States ought to do more to "encourage, promote and facilitate" cooperation among firms,[52] "facilitate the exchange of goods and services"[53] and generally develop stronger trading ties with Hungary. The basic principle of reciprocity is clearly within the contemplation of such provisions, even if that principle is expressly established mainly with respect to reducing tariffs and non-tariff trade barriers.[54] These policy questions must now be considered in terms of the expectations underlying the Agreement and with particular reference to the rapid, significant changes in Hungary and in the Soviet attitudes.

III. The Council of Mutual Economic Assistance and the Developing Structure of Foreign Trade

The potential for change in the structure of trade among Eastern European countries and the Soviet Union, which is now being actively promoted by reformers in the region, is perhaps the most crucial issue that could influence foreign participation in production of goods in

50. The Article is worded to expressly meet provisions of the United States Trade Act of 1974 requiring safeguards regarding market disruption due to imports of goods from communist countries.

51. *Supra* note 46.

52. *Supra* note 45, art. 2.

53. *Id.*

54. *Supra* note 45, art. 1.

Eastern European countries.[55] International economic relationships between Eastern European countries and others are governed by agreements within the CMEA, an organization developed following the Second World War as a counterpart to the Warsaw Pact military alliance.[56] In effect, CMEA is a set of bilateral relationships that seek, among other things, to develop the economic integration of its members.[57] It generally has been ineffective. Currencies are not convertible and trade is conducted in rubles and Western currencies. The existence of national monopolies is intended to achieve a certain degree of uniformity between CMEA members in order to promote integration, but there is little of what is recognized in the West as specialization of industries.[58] Special programs for further economic integration are launched periodically, but they are devoid of practical consequences, although the Soviet Union has continued to insist on joint venture projects.[59]

In CMEA countries generally, Foreign Trade Organizations ("FTO's") have exclusive responsibility for conducting foreign trade.[60] Each FTO normally has a monopoly in trade in particular areas of goods.[61] Hungary, however, is now distinguished among CMEA countries in that large domestic enterprises are eligible to be independently

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55. Concerning economic development and East-West relations see M.I. GOLDMAN, USSR IN CRISIS: THE FAILURE OF AN ECONOMIC SYSTEM, (1983); MARER & MONTIAS, EAST EUROPEAN INTEGRATION AND EAST WEST TRADE, (1980); EAST-WEST TRADE AND FINANCE IN THE WORLD ECONOMY, (C. Saunders ed. 1985); FOREIGN AND DOMESTIC POLICY IN EASTERN EUROPE IN THE 1980'S, (Sodaro & Wolchik eds. 1983); SOBELL, THE RED MARKET: INDUSTRIAL COOPERATION AND SPECIALIZATION IN COMECON, (1984); Kitchen, *A Bibliography on Transnational Litigation in Socialist Countries: Discovery Evidence and Enforcement of Foreign Judgments*, 21 TEX. INT'L. L. J. 383 (1986); concerning Hungarian relations with the Soviet block countries see C. Gati, HUNGARY AND THE SOVIET BLOCK (1986); Roosa, Matsukawa & Gutowski, *East-West Trade at a Crossroads: Economic Relations with the Soviet Union and Eastern Europe*, 24 THE TRIANGLE PAPERS, REPORT TO THE TRILATERAL COMMISSION (1982). Concerning Soviet interest in trade with the Far East see Perkovich, *The Soviet Union Turns East*, THE ATLANTIC, Dec. 1987, at 30. For a discussion of CMEA firms operating outside the CMEA countries see C. MCMILLAN, MULTINATIONALS FROM THE SECOND WORLD (1987).

56. *See* T. HOYA, *supra* note 21, at 9; *East-West Financial Relations*, *supra* note 3, at 19-21.

57. Kamm, *Lean Times in Hungary*, *supra* note 33. *See also* Kamm, *In Hungary*, *supra* note 6.

58. *See* Kamm, *Lean Times in Hungary*, *supra* note 33.

59. *See* Volgyes, *supra* note 16.

60. *Id.*

61. *Id.*

authorized and to engage in foreign trade along with the FTO's.[62]

Despite such changes, CMEA decision-making structure remains elaborate and deeply rooted, and it has constrained systematic, planned, coordinated trade among member nations. Prior to the Gorbachev era, differing views developed regarding the problems of CMEA trade, i.e., the "Hungarian" and the "Soviet" view, and actual trade practices were fractious.[63] The Soviets favored the economic integration of the activities of state enterprises, whereas Hungary and others would have liked to westernize trade relationships by establishing convertible currencies and through further decentralization.[64]

With respect to FTO's specifically, disagreements still arise in intra-CMEA trade concerning the degree to which FTO's are bound by intergovernmental agreements. In fact, FTO's are increasingly less bound by planned specifications and more inclined to seek an FTO contract before international agreements. Annual protocol provide for such contracts under the expectation that such contracts will be permitted by future CMEA agreements.[65] Nevertheless, even in the traditional sequence allowing for foreign trade — international agreement, annual protocol, and FTO contract — matters not included in a general intergovernmental agreement or in annual protocols are within the discretion of contracting FTO's.[66] It is noteworthy that pricing is not undertaken in international agreements and thus is governed under the discretionary authority of the FTO's.[67] Where two FTO's contract in a way that diverges from the long term agreement or the annual protocol, increasingly their judgment has been sustained.[68] Where FTO's fail to agree on trade that is mandated in an intergovernmental agreement or protocol, the matter must be addressed by foreign ministries.[69]

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62. Joint ventures also have this authority. Note also that the 1972 Hungarian constitution did not indicate that FTO's must hold a monopoly, but FTO's traditionally have been limited in number and serve as a state monopoly on foreign trade. *See* Madl, *supra* note 1, at 136.

63. *See* WALLACE & CLARKE, COMECON, TRADE AND THE WEST, 155-157 (1986).

64. *Id.*

65. *Id.* Among Hungary, Poland, the German Democratic Republic and Czechoslovakia in particular, FTO contracts are increasingly concluded before corresponding inter-governmental long term agreements and annual protocols.

66. *Id.*

67. *Id.* at 157.

68. *Id.*

69. Agreements between Western corporations and FTO's generally fit the standards of FTO's. *See* T. HOYA, *supra* note 21, at 19-22. In joint venture agreements (recent Hungarian law has liberalized joint venture access to foreign trade rights) the contracts are certainly more influenced by Western standards. HUNGARIAN CHAMBER OF COMMERCE, *supra* note 15, at 9, 13, 53. Strict trade agreements between Western

One of the key complaints of Western corporations involved in joint ventures is the inability or unwillingness of Hungarian authorities to assist in the development of export relationships with other CMEA countries. In principle, the development of foreign trade rights for the joint venture itself should help ease problems in developing trading relationships; but the more significant change would be the creation of joint venture enterprises across borders or in different countries. If such a structural change becomes a reality in the future, not only might considerable trade develop among organizations removed from the reach of detailed planning specifications, but greater managerial control over the marketing of goods, services, and equipment also could develop. This development is thought to be the key to expanded involvement of large Western firms in the region.[70]

Exchange rates in Hungary currently are set to encourage imports from the Soviet Union and exports to hard currency areas, factors that discourage joint ventures. The Hungarian government is aware the problem needs to be addressed. Another hurdle to making joint ventures operational and profitable is that exporting to CMEA countries, being on a government to government basis, involves little opportunity for promoting products. Even if such opportunities presented themselves, it may not be in Hungary's national interest to engage in promotion. In effect, where the Hungarian government engages too strenuously in promotion, it places itself at a disadvantage by encouraging other CMEA governments to establish direct links to Western firms.[71] Thus, the Western firm faces major obstacles to gaining access to other CMEA markets through Hungary while the Western partner must also grapple with a loss of control over marketing, pricing, sourcing, and

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companies and FTO's continue to employ the CMEA standards, a product of bargaining of companies with FTO's and not a product of agreements at the intergovernmental levels. In this regard there are several areas that have been singled out, on the basis of prior experience, as areas where Western governments should aid in the development of trade contracts: substantive law third country designation, force majeure clauses (particularly regarding labor disputes) and price escalation clauses. *See* T. HOYA, *supra* note 21, at 363-364; Naray, *supra* note 1, at 280-85; Burckhardt, *supra* note 20, at 11. *See also*, *Resolution of International Trade Disputes: An Analysis of the Soviet Foreign Trade Arbitration Commission's Decisions Concerning the Doctrine of Force Majeure as an Excuse to the Performance of Private International Trade Agreements*, 10 MD. J. INT. L. AND TRADE, 135 (1986).

70. Review of Joint Ventures in Hungary, *supra* note 1, at 053179. The Hungarian Chamber of Commerce is careful to limit expectations about major expansion of markets for Western companies in its joint venture policy statements, emphasizing rather, the ability of Western corporations to realize more profit in Hungary and existing markets. *See* HUNGARIAN CHAMBER OF COMMERCE, *supra* note 15, at 10.

71. *See* Review of Joint Ventures, *supra* note 1, at 053179.

distribution.[72]

The key aspect of the new Hungarian law on joint ventures is precisely that regulatory change in the domestic and foreign trading system represents a gamble which could yield large returns perhaps only on the condition that other CMEA countries follow suit.[73] The Secretary-General of the Institute of Economics at the Hungarian Academy of Sciences has urged that CMEA "open [its] markets to each other; and cooperative links should exist not through interstate but intercompany specialization, so that a more up-to-date and cheaper product would take the place of the more costly. . . . This would involve competition in efficiency, to be encouraged by long term reforms.[74]

IV. The Development of International Regulation of Financial Investment and the Restructuring of the Hungarian Banking System

Since the debt problems of the late 1970's and early 1980's, Hungary has sought and accomplished debt restructuring under a plan fashioned in cooperation with the International Monetary Fund.[75] Eighty percent of combined foreign debt is now structured in medium and long term debt with an average maturity of seven years.[76] Since Hungary joined the international lending institutions during the first half of the 1980's,[77] its internal credit system and its financial practices have been restructured to conform with those employed by the World Bank group.[78] Relationships such as these are crucial to the reorganiza-

72. *Id.* One solution proposed for dealing with the exchange rate problem is to develop "trading houses" to serve as "umbrella organizations" for joint ventures. "Their main mission would be the in-house conversion to dollars of the trade ruble imports Hungary received in exchange for the joint venture's trade ruble export." *Id.*

73. *Id.* Concerning changes in the way in which Hungarian foreign trade is to be conducted see Madl, *supra*, note 1, at 136.

74. *See* Kamm, *In Hungary*, *supra* note 6. Open criticism of Soviet CMEA policy is a relatively new development in the region. *See* Lipsius, *Capitalism in the Soviet's Front Yard*, 46 Business and Society Review, 57, 59 (1983).

75. Sajosi-Kovats, *supra* note 31.

76. *Id.*

77. Hungary has been a member of the World Bank since June, 1982, and joined the two affiliated institutions of the World Bank, the International Finance Corporation and the International Development Association in April, 1985.

78. Sajosi-Kovats, *supra* note 31, at 14-15. Hungary has participated in major accounting adjustments in which standard measures of profitability, liquidity, and solvency are used. *Id.* Hungary's attitude toward the international financial system stands out among Eastern European countries. *Id.*

tion of the financial underpinnings of Hungarian affairs.[79]

Part of the process of reform and development of joint ventures, perhaps the most significant part, is the general reform of the domestic banking system. In 1982 several technical, specialized banks were established.[80] The banking system was revamped in 1987 into a two-tier structure with five commercial banks made responsible for taking deposits and providing credit throughout Hungary.[81] New banking entities in addition to the two that existed previously — the National Bank of Hungary and the Trade Bank — have been or will be established.[82]

Coupled with the process of banking reform has been the legalization of onshore foreign banking. Citibank has obtained onshore banking rights.[83] Unicbank, with the participation of the International Finance Corporation, began operations in 1987 specifically with an interest in developing joint ventures: fifty-five percent of its capital is shared with German (Deutsche Genossenshaftsbank) and Austrian (Genossenshaftsliche Zentral Bank) cooperative banks.[84] Another European bank, the Central European Investment Bank applied for an onshore banking licence in 1987.[85] With partners in West Germany, France, Italy and Japan, this bank represents significant potential for investments from a variety of sources.

Continued access to financial markets on favorable terms appears to be essential to Hungary's economic well-being.[86] The first principle of investment negotiation has therefore become that of maintaining flexibility and easing of obstacles for favored projects. Indeed, borrowing rose from half a billion dollars in 1983 to one and one half billion dollars in 1985.[87] Nevertheless, accumulated agricultural debt is an ongoing drain upon resources, and price increases and wider application

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79. For example, Hungary meets requirements for openness in financial information and thereby eases participation in the international financial system.

80. *See* Review of Joint Ventures in Hungary, *supra* note 1, at 053177.

81. *Id.*

82. *Id.*

83. Citibank Budapest has been in operation since late 1985. *Id.*

84. *Id.*

85. *Id.*

86. It is clear that the financial crisis of the late 1970's and early 1980's which significantly reduced income expectations has reshuffled relative economic priorities so that the maintenance of financial stability is always considered first. Targets for income growth, the investment strategies to be pursued, the role of Western capital, technology, and Western financial markets are all part of a comprehensive policy; reform of economic institutions is approached within this framework. *See* HUNGARY: ECONOMIC DEVELOPMENTS AND REFORMS, *supra* note 1, at 1-7.

87. FOREIGN ECONOMIC TRENDS, *supra* note 1, at 5.

of new bankruptcy laws are generally believed by Hungarian economists to be inadequate to address problems of insufficient resources and national income.[88] The development of a formal relationship with the World Bank, however, led to the almost immediate selection of Hungary in 1983 for pilot projects in partnership financing with private financial institutions for both agricultural and industrial projects.[89] These project loans were concluded in tandem with traditional development financing provided by the World Bank.[90]

Private financial institutions, particularly in Japan and Western Europe, have recently negotiated new credit issues on highly favorable terms. Despite the modest economic performance of the 1980's and political conditions which have not been amenable for reform,[91] Hungary has demonstrated an ability to gain financial support on favorable terms. In June, 1985, loans of approximately one-half billion dollars were arranged under the World Bank's B-Loan Co-financed Program, including a three hundred million Eurodollar loan that involved the participation of Chemical Bank International Ltd.[92] These projects are geared toward the expansion of exports, including projects involving livestock, chemicals, particularly pharmaceuticals, and a railroad.[93]

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88. *Id. See also* Bognar, *supra* note 13, at 53-54.

89. World Bank, World Bank News Release (June 11, 1985); Biro, *The Hungarian Economy 1984*, 25 NEW HUNGARIAN QUARTERLY 55-60 (1985).

90. World Bank, *supra* note 89.

91. This is to say that with a deepening crisis, the attraction of further extensive domestic reform is considerable, and it has been resisted until quite recently; see Volgyes, *Ungarn: Steht eine Krise Bevor?* 1987 OSTEUROPA 329 (1987). Yet the processes underway have a certain momentum of their own. *Compare* Lipsius, *supra* note 74, at 61. *See also* Volgyes, *supra* note 16, at 374-75.

92. World Bank, *supra* note 89.

93. The World Bank funded portion of any co-financed loan must be employed within the framework of World Bank contracting guidelines. The Bank component of the June 1985 arrangements was about 10%. The commercial portion of the Eurodollar loan was for eight years, at a rate of interest of ⅝ percent per year over the three or six month London Interbank Offered Rate ("LIBOR").

In 1985, a 7%, 15 year Dm 150,000 bond issue was offered. More recently, Hungary has been able to take advantage of surplus Japanese liquidity in a March, 1987, syndication on Tokyo and European markets of a $150 million loan at ¼ percent above LIBOR. However, a May, 1987, $400 million Eurosyndicated loan was arranged at ⅜% over LIBOR with large fees attached. *See* Sajosi-Kovats, *supra* note 31, at 15. *See also* FOREIGN ECONOMIC TRENDS, *supra* note 1, at 7-8. The partnership financing program is called a "B loan" and may involve, though it has not involved in the Hungarian loans, guarantee of the loans provided by private investors where there is some "additionality," provided by the private investor for the guarantee. World Bank, *supra* note 89. Concerning co-financing in general, see THE WORLD BANK, CO-FINANCING (1983); THE WORLD BANK, PROCUREMENT AND CO-FINANCING: METHODS AND PRO-

The success of Hungarian financial officials in stabilizing debt and obtaining new credit on highly favorable terms stands out among developing countries. In fact, Eastern Europe is the only region among developing countries that has been able to regain access to the international financial markets following the 1981 crisis.[94] Within Eastern Europe, Hungary is the only country not to have lost access to syndicated loans throughout the period.[95] Nevertheless, Hungary remains the most vulnerable in terms of relative debt burden.[96] The Hungarian National Bank has presented the Hungarian circumstances as unique, seeking to distinguish Hungary from the region. These efforts have resulted in the easing of rates for export-related credits for the last four years.[97]

V. JOINT VENTURES

The first joint venture law in a Soviet-type economy was developed in the Soviet Union in the 1920's under the New Economic Program ("NEP").[98] When the NEP was discontinued, so was the development of joint ventures,[99] although the Soviet Union has indicated an intention to re-establish them.[100] Yugoslavia developed a joint venture law in the late 1960's and Hungary in 1972.[101] Wholly owned or majority owned subsidiaries in such countries are highly unusual, and the conditions which may attach to such enterprises are an open question.[102]

Though a large part of joint venture activity in Hungary is regulated by statutory law,[103] the hard currency input of Western firms and the policy of promoting joint ventures for the development of the Hungarian economy generates a degree of negotiating flexibility despite the statutory context. Factors of particular importance that motivate Hungarian flexibility are the development of managerial skills, the possibil-

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CEDURES, THE WORLD BANK (1986).

94. *See East-West Financial Relations*, *supra* note 3, at 44.

95. *Id.*

96. *Id.*

97. *Id. See also* Sajosi-Kovats, *supra* note 31, at 15-16.

98. *See* Lebkowski & Monkiewicz, *Western Direct Investment in Centrally Planned Economies*, 20 J. WORLD TRADE L. 624 (1986).

99. *Id.*

100. *See* Buxbaum, *supra* note 11, at 67.

101. *Id.*

102. *Id.*

103. The more regulated these relationships become, the more flexibility appears to be institutionalized. *See generally* Review of Joint Ventures in Hungary, *supra* note 1; Naray, *supra* note 1, at 283.

ity of technology transfer, and opportunities for countertrade.[104] Many practical difficulties have been eased by such an approach while others, including problems of the most basic sort such as telephone links, are being addressed. Problems are accordingly influenced by an active governmental effort to promote and assist joint ventures, including the area of capitalization.[105]

Joint ventures, which have been on a small scale in the past, have enjoyed an impressive success rate.[106] The Hungarian Chamber of Commerce describes government support for the new joint venture policy as follows:

> The Hungarian Government supports the formation of joint ventures as being in accordance with its long term economic strategies. The activities of such associations — whether producing, commercial or servicing — are considered useful if they aim at the development of the technical or economic level, if they promote the introduction of advanced techniques, technologies and organizational methods; if they enlarge the market system, increase exports or contribute to obtaining some other advantage in the foreign exchange balance.[107]

Joint ventures can occur in five forms: (1) unlimited partnerships; (2) public limited companies; (3) limited liability companies; (4) joint enterprises; and (5) limited partnerships.[108] The Hungarian partner may be an Hungarian state enterprise, a trust, other state-owned economic associations, a cooperative, a cooperative enterprise, an economic association of a cooperative enterprise, an affiliate company, and certain other enterprises maintained by legal entities as well as water management societies.[109] Except for the National Bank of Hungary and banking institutes active with foreign participation, Hungarian banks may enter into joint ventures arrangements.[110]

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104. HUNGARIAN CHAMBER OF COMMERCE, *supra* note 15, at 7-11.

105. The availability of state funds for joint ventures eases the problem of the Hungarian partner's lack of assets; *see id.* at 9.

106. *See generally* Review of Joint Ventures in Hungary, *supra* note 1. Note also, however, that only about a dozen of the ventures operating in Hungary in 1985 involved manufacturing, and many believe that without the development of the capacity to penetrate the Soviet market and use Hungary as a base for such operations, large scale investment may not develop.

107. *Id.* at 8-9.

108. HUNGARIAN CHAMBER OF COMMERCE, *supra* note 15, at 19-21.

109. *Id.* at 13.

110. *Id.* at 14.

Among the key questions regarding the regulation of investment and economic reform involving joint ventures are the following: (1) the potential effect of subsequent legislation on contractual joint ventures undertaken within the scope of the joint venture law;[111] (2) the legal powers of joint ventures, especially regarding foreign trade;[112] (3) the division of responsibility and the issue of control; and (4) the equity relationships involved in them.[113]

Two particularly thorny issues involved with the practicality of joint venture are the issues of valuation[114] and taxation.[115] Certainly one of the most difficult problems faced by joint ventures is the valuation question. Calculation of the value of land, buildings, and labor[116] must address the question of whether it should be priced using the local or international measures, but it is perhaps the most important factor in the assessment of potential returns facing the foreign partner.[117] Valuing the inputs of the foreign partner presents the same problem as does the pricing of such overhead costs.

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111. *Id.* at 9-10. Note that the security of investment is addressed in current law.

112. Concerning the development of the law of joint ventures, see Scriven, *Joint Venture Legislation in Eastern Europe: A Practical Guide*, 21 HARVARD INTERNATIONAL LAW JOURNAL 633 (1980); Lebkowski & Monkiewicz, *supra* note 98; Buxbaum, *supra* note 11; Buzescu, *Joint Ventures in Eastern Europe*, 32 AM.J. COMP. LAW 407 (1984); Schmidt, *supra* note 21. Concerning the development of joint ventures in the People's Republic of China, see Saney, Fisburne & Chandri, *Joint Ventures in China, the First Water Stop*, 21 TEX. J. INT. L. 221 (1986).

113. Concerning negotiation of the joint venture contract, see Buzescu, *supra* note 112, at 407-413 and 421-429. Note that five corporate forms for joint ventures have been put into practice, whether under the rubric of revived pre-World War Two statutes or through the creation of new corporate forms, i.e., the limited partnership. HUNGARIAN CHAMBER OF COMMERCE, *supra* note 15, at 15-22.

114. Buzescu, *supra* note 112, at 421-425, and Buxbaum, *supra* note 11, at 69-77.

115. Concerning taxation see Nagy, *Introduction to Tax Systems in Comecon Countries*, 10 INT. BUS. LAW. 56 (1982); Doman, *supra* note 20; P. JONAS, TAXATION OF MULTINATIONALS IN COMMUNIST COUNTRIES (1978). Special rules, including exceptions from many Hungarian laws, including fixed wages, have been established for ventures in customs free zones, established beginning in 1982. HUNGARIAN CHAMBER OF COMMERCE, *supra* note 15, at 21-22.

116. Hungary advertises the higher training of its workers in comparison to workers of the same relative wage level in other countries. In effect, Hungary advertises the opportunity for higher productivity by using Hungarian workers. The wages of skilled workers in Hungary are estimated to be at about the same level as wages of workers in Taiwan and Brazil and countries of similar levels of development. *See* Review of Joint Ventures in Hungary, *supra* note 1, at 053179; HUNGARY: ECONOMIC DEVELOPMENTS AND REFORMS, *supra* note 1, 8-12. Social insurance contributions to the state are mandatory. *See* Buxbaum, *supra* note 11, at 70-72.

117. *See* Buxbaum, *supra* note 11, at 70-72. Note that equity ownership is generally limited to 49% of the venture.

Recent law establishes preferential treatment for joint ventures in matters of taxation, foreign trade rights, and access to capital.[118] It should be noted that both Hungarian and foreign participants are treated preferentially in the context of the joint venture.[119] In particular, a larger share of revenues is available to the Hungarian partner than would be the case in a purely Hungarian endeavor.[120] The Hungarian founder may obtain state funds for joint ventures and receive credits on favorable terms.[121] Further, the Hungarian partner is taxed at the same overall, preferential rate as is the foreign participant. Thus, the impact of foreign participation is to expand control over revenues by the Hungarian partner. Despite foreign ownership, the enterprise is treated as a single entity legally and practically.

The new Hungarian law also creates more certainty and ease in the process by which joint ventures can be established.[122] Licensing is now carried out in one step.[123] A permit for preliminary negotiations is no longer required, merely a notification of intention.[124] The general provisions for granting foreign trade rights have been simplified and liberalized, and the joint venture is in a better position now to obtain a license to export its products.[125] The liberalization applies to both exports and imports in non-rouble currencies.[126]

The minister of finance supervises the legality of the operation of joint ventures.[127] Questions of repatriation and investment security are described by the Hungarian Chamber of Commerce as following:

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118. HUNGARIAN CHAMBER OF COMMERCE, *supra* note 15, at 9.

119. *Id.* On recent liberalization of foreign trade rights see Naray, *supra* note 1, at 283.

120. HUNGARIAN CHAMBER OF COMMERCE, *supra* note 15, at 9.

121. *Id.*

122. One of the most significant factors in the change of environment in Hungary is clearly the delegation of responsibility to the Hungarian Chamber of Commerce to assist in the development of joint ventures. Other agencies have been created as well, but the Chamber of Commerce is the most active in the development, promotion, and coordination of joint ventures. The Chamber of Commerce represents the management of industrial (state) companies. *See* Review of Joint Ventures in Hungary, *supra* note 1, at 053177. *Compare* HOW TO TRADE WITH HUNGARY, *supra* note 1, at 60-63

123. *Id.*

124. *Id.*

125. *Id. See also* Naray, *supra* note 1, at 283. This appears to be a critical development not only for joint ventures, but the liberalization of general laws has also allowed even purely Hungarian ventures to circumvent the Foreign Trade Organizations. The liberalization applies, moreover, to both exports and imports in non-ruble currencies.

126. Review of Joint Ventures in Hungary, *supra* note 1.

127. *Id.*

The foreign partners' profit and other remunerations can be transferred abroad in the currency defined in the articles of the Deed of Association. On request, the National Bank of Hungary will issue a guaranty to that effect. Similarly, the Bank will guarantee the compensation of any loss of the foreign partner's material contribution caused by a state (government) measure. If the foreign party leaves the association, the relevant share of assets will be transferred abroad in the currency defined in the articles of the Deed of Association, as when the association is wound up the property share remaining after the acquittal of debts will be transferred abroad free of tax.[128]

For ventures operating in a preferred area, the tax system is now simplified and restructured by statute.[129] After deduction of social insurance contributions, the general tax rate is forty percent. It is unusual, however, for a joint venture to pay this tax, and if the joint venture is taxed at that rate, other benefits can still be negotiated.[130] The Minister of Finance has the power to grant tax benefits more favorable than the legislative prescriptions for certain categories and levels of investment.[131] For example, if the total capital of the venture amounts to at least twenty-five million forints and the foreign share is at least thirty percent, producing companies are taxed at a rate of twenty percent in the first five years, and subsequently at a rate of thirty percent.[132] Reinvestment of fifty percent of the profit, if greater than five million forints, yields a fifty percent reimbursement of paid taxes, and a 100 percent reinvestment, if greater than ten million forints, yields a seventy-five percent reduction.[133]

Since 1982 economic associations have been permitted to be established in customs free zones.[134] The Ministries of Foreign and Domestic Trade and the Ministry of Transport share consultative authority re-

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128. *Id.* at 10. *See also* Review of Joint Ventures in Hungary, *supra* note 1, at 053177.

129. *See* Review of Joint Ventures in Hungary, *supra* note 1, at 053177. Concerning U.S. tax treatment of various kinds of enterprises operating abroad, see Sitt, *Characterization of Foreign Business Entities for Tax Purposes: The Chaos Continues*, 8 HOUSTON J. INT. L. 201 (1986). Concerning the basic approach to taxation of foreigners, see Nagy, *The Hungarian Tax System as Applicable to Non-residents*, 10 INT. BUS. LAWYER 83 (1982).

130. Review of Joint Ventures in Hungary, *supra* note 1.

131. *Id.*

132. *Id.*

133. *Id.*

134. *See* HUNGARIAN CHAMBER OF COMMERCE, *supra* note 15, at 11-12.

garding zone designation with the formal designator, the National Command of the Customs and Excise guard.[135] In general, the rules for foreign trading in such zones are quite liberal, whereas the rules for trading within Hungary are much stricter. Purchases and sales of both imports and exports are regarded as free-currency transactions.[136] The associations are exempt from rules on enterprise-income, wages, state and internal control, the management of finances, and the purchase and use of automobiles.[137] Capital stock, however, must be kept in a Hungarian bank and a risk fund must be established.[138] All other Hungarian laws apply.

Despite these changes, there are only eighty joint ventures in Hungary today, twenty-five more than in 1985, but hundreds of cooperation and licensing agreements with Western firms.[139] Hungary's current five year plan (1986-1990), however, forecasts a $200 million flow in joint venture capital.[140] Recently concluded agreements include McDonald's and ITT, via ITT's West German subsidiary.[141] In addition, formal investment agreements have been completed with West European countries.[142] Still, it must be noted that the lack of natural resources, the rigid marketing structures among CMEA countries, and exchange rate problems among these countries all hamper the development of large joint ventures.[143]

Indeed, difficulties in undertaking any joint venture in Hungary, large or small, remain considerable even with the changes. Investment policies in the newly industrialized countries ("NIC's") are generally more favorable than in Hungary,[144] but the recent commitment of the Hungarian government has been effective. The recent presence of established multinational firms is evidence of increasing interest. The areas these firms are seeking to develop include advanced technologies such as biotechnology and telecommunications as well as the vehicle

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135. *Id.*

136. *Id.*

137. *Id.*

138. *Id.*

139. *Id.* at 053176. The lack of joint ventures and the proliferation of licensing agreements is obviously attributable to the government's past attitude toward such activities.

140. *Id.*

141. *Id. See also McDonald's in Hungary: Joint Venture Instead of Franchise*, BUS. E. EUR., Dec. 22, 1986, at 403.

142. *See generally* Review of Joint Ventures in Hungary, *supra* note 1.

143. *See East-West Financial Relations*, *supra* note 3, at 19-23, 43-46.

144. *Id.*

industry.[145] The Hungarian government's key priority is to develop the country's economic and technological infrastructure, particularly in management and consulting areas.[146] But the keys to successful development of a large base of foreign investment are considered to be (1) access to the CMEA market and (2) the development of component production and competitively priced products for international markets of multi-national firms.[147]

The joint venture represents, in part, a mechanism for achieving the benefits of trade relationships that cannot now be funded without engendering insurmountable hard currency costs. Furthermore, joint ventures allow for the introduction of financial capital without undertaking more radical measures of reform or risking the tensions that could result from independent foreign ventures, i.e., wholly owned subsidiaries within Hungary. In any event, joint ventures must be still viewed as an adventure for both parties. The U.S. Embassy in Hungary views the opportunity for Western business partners in this way:

> A joint venture in Hungary gives western partners valuable experience in the most flexible and favorable investment climate in eastern Europe. . . . Joint ventures are marriages of companies and like the personal kind may respond to certain stimuli that can defy reason and have a lot to do with the climate at a given moment. . . . Given this analogy the current climate for joint ventures in Hungary is relatively favorable, particularly when compared with other eastern European countries. The result is a growing number of joint western ventures and officially expressed hope that the trend will continue. . . . The growing interest in joint ventures elsewhere in eastern Europe, particularly in the Soviet Union, is also a stimulant that favors Hungary.[148]

VI. The Reform of Economic Organizations and Political Reform

One of the key concerns for Western companies seeking to invest in Hungary and other CMEA countries is the matter of political uncertainty. Presumably, significantly larger investments, combined with a

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145. *Id.*

146. *Id.*

147. *See* the review of a recent Paul Marer's Budapest lecture in Review of Joint Ventures in Hungary, *supra* note 1, at 053178.

148. *See id.* at 053176.

"re-arrangement of competencies," could speed reform, or ultimately slow it, if retrenchment of established interests results. In either case, domestic unease is a certainty but its ultimate affect is not clear.[149]

The policy makers in Hungary have been divided between two viewpoints: (1) the inability of reforms initiated since the mid-seventies to spark stronger growth is thought by some observers to be due to the general stagnation in the international economy and, in particular, to protectionist forces; and (2) international slowdown and resource shortages are considered by others to be but one factor contributing to poor economic growth with the more significant factor being the insufficiency of reform.[150] Those subscribing to the latter view hold that the potential of existing reforms has been exhausted and relics of past practice act as a restraint upon economic initiative and institutional creativity.[151] They argue that the limits of the current mechanisms are becoming increasingly evident, particularly in terms of the morale of the population.[152]

One diplomat in Budapest has described the newest development of political and economic ideas as "pressing against the ideological bars of the cage."[153] Yet, whatever expressions of liberal attitudes by Hungarian leaders exist, these cannot be accepted either at face value or discounted as purely rhetorical. The one party ideology is a phenomenon of some solidity. But the "re-arrangement of competencies," the drain of the best intellectuals and scientists, and other factors have generated a considerable momentum for some form of political liberalization.[154] A policy of retrenchment, turning back the process of reform is not on the horizon, but could again emerge as it did in the early 1970's.

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149. Insofar as the expectations raised by the reforms that began have not been met, a marked increase in investment could help meet them to some extent, but in either case, given the experience of the 1980's, and the pending succession and generational changes, the political outcomes are uncertain, and made more uncertain by possible changes in Soviet attitudes that East Europeans may find value in probing. *See* Volgyes, *supra* note 16, at 375. *See also* Kamm, *Lean Times in Hungary*, *supra* note 33.

150. Volgyes, *supra* note 16.

151. *See* Kamm, *Lean Times in Hungary*, *supra* note 33.

152. *Id.* Note that workers have distributed handbills—following the destruction by fire of three factories—warning against the raising of prices. Volgyes, *supra* note 16, at 376.

153. *See* Kamm, *Lean Times in Hungary*, *supra* note 33.

154. The focus on the basic material problems of the Hungarian economy is a fixation, even where the disintegration of the state and party is recognized. Volgyes, *supra* note 16, at 375.

The reform of Hungarian investment law, strengthening the linkage of the Hungarian economy to the international economy, has itself developed considerable momentum. While this momentum is sustained and affirmed by rapid policy shifts in Moscow, the development of reliance on the institutions built within the new framework could strengthen that momentum even further. Within and without Hungarian society, reliance on the belief that there will be no reversal of the institutional changes and the new international financial relationships is crucial to furthering the legitimacy of the Hungarian regime. In effect, the furtherance and deepening of reform has been geared toward creating confidence in its permanence.[155]

Certainly economic reform can be viewed as a partial substitute for overt political change. If, however, the institutions upon which the regime relies for its claims to legitimacy and acceptance are dependant upon market mechanisms, then variance in economic performance could impact even more directly on the position of leadership than would be the case otherwise.[156] Reform in Hungary typically involves changes in party leadership, not with the basic features of the party-state system; but today both current economic and political models are widely viewed as being obsolete.[157] It is clear that the current government is insecure about retaining the status quo, but it is equally insecure about further reform.[158] Reformers in Hungary recognize that economic institutional developments are coming to dwarf the development of the polity itself, and at a certain point could overwhelm it.[159]

Political reform must be understood and viewed against the backdrop of prior domestic unrest in Hungary, including the 1956 revolu-

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155. Mr. Volgyes writes:

> At present, a restructuring program that goes beyond current policies does not appear to be politically feasible. The reformers seem to suffer from a double political handicap. . . . [T]hey are blamed by many of those whose standards of living have dropped significantly during the last decade. Many Hungarians view the reformers as haughty beneficiaries of the changes who have. . .become 'dizzy with their failures. . . . On the other hand the reformers are unable to find a respected and able leader. . . .

Id. at 376.

156. *Id.*

157. *See* Kamm, *Lean Times in Hungary*, *supra* note 33; Comisso & Marer, *supra* note 2, at 449-454.

158. Comisso & Marer, *supra* note 2, at 449-454.

159. *Id.* Said one Hungarian central banker: "The party is becoming a clearing house of interests and ideas." The head of the Chamber of Commerce reports that the new managerial class is not first initiated in the party, but rather is its darling. *See* Lipsius, *supra* note 74, at 61.

tion, and particularly with regard to the trade union movement which emerged in Poland at the end of the last decade.[160] Worker unease characterized the economic crisis of the late 1970's and early 1980's and the accompanying measures of austerity.[161] There appear to be no truly independent mechanisms for channeling worker disaffection.[162] The current worry is not about activism of workers for more radical democratic reform, however, but about opposition by workers to reforms which increase the cost of living and create unemployment.[163]

The new autonomous institutions could provide redress for such tensions arising from divergences in income and status. In particular, the exercise of autonomy, e.g., in the selection of managers, could channel the disaffection away from affecting political power. Thus, the new institutions may act to preserve the status quo. But such decentralization of decision-making also gives rise to new power bases, particularly local ones.[164] Such a development would represent a significant political shift. While such potential fragmentation in control could be offset by the development of broad independent national organizations such as trade unions and multiple political parties, neither of these institutional forms currently seem realizable.[165]

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160. The Solidarity experience in Poland has not been warmly received among Hungarians; however, when Lech Walesa was interviewed on Hungarian television he was closely interrogated concerning *economic* functions of the Solidarity organization. Lipsius, *supra* note 74, at 60.

161. Volgyes, *supra* note 16, at 376.

162. It is thought that as many as 200,000 Hungarians could be effected by an unflinching application of bankruptcy laws. Kamm, *Lean Times in Hungary*, *supra* note 33. Concerning the need or not for independent mechanisms, it should be noted that shop steward's organizations have the power in Hungary to call a strike against a particular company for reasons regarding working conditions. *See* Lipsius, *supra* note 74, at 61. Concerning labor law in Hungary, see Gayer, *Some Questions on Labor Law in Connection with Joint Ventures in Hungary*, 10 INT. BUS. LAWYER 133-137 (1982); Nagy, *Labor Rules in Connection with the Economic Activity Performed by a Foreigner*, 10 INT. BUS. LAWYER
129 (1982).

163. *See* Volgyes, *supra*, note 16, at 376.

164. Note also that institutions such as FTO's, the Chamber of Commerce, joint ventures, domestic enterprises and associations have been articulated juridically with relatively little reference to a formal institution of private property. It is interesting to speculate on the effect they might have in this regard.

165. Concerning the development of local power centers, see Comisso & Marer, *supra* note 2, at 449-454. One conclusion is that if the regime is perceived to be moving in steps toward effective political reforms, and follows suit, and if the nation is making economic progress, the risk of a sharp retrenchment over the next decade, sufficient to effect trade relationships or lead to a reversal of economic reform attitudes and practices, will remain exceedingly minimal. Another is that since the protracted economic

VII. Conclusion

Hungarian policy makers consider one of their most critical problems to be the protectionist trade measures imposed by Western countries.[166] Hungary's economy is trade dependent, and any rise of protectionism in the Western economies threatens to severely weaken the financial basis for reform and growth and enhance income dependency on CMEA trade. Moreover, protectionism could generate momentum in CMEA trade relationships which could act as a break upon international economic integration.

Resolution of the problems in the international economy — currency stability, distribution of surpluses, and expansion of trade — will certainly affect the pace and character of development and reform in Hungary. The other major development that must impact strongly upon Hungary is the scope and character of change in the Soviet Union and the development of more decentralized economic systems in CMEA countries. Efforts to achieve convertibility of the forint and increased export production financing also would have a significant impact.

A further factor for U.S. concern focuses on technology transfer. Western policy makers that wish to encourage Hungarian economic development and reform must allow for the export of more sophisticated technologies. Accordingly, a classification system that serves the needs of both countries should be developed.

A third factor is that Hungary has situated itself, perhaps more than any than other East European countries, to benefit from improvement in the economic strength of the major Western countries. If reform and increased trade are to be a priority, the U.S. and other Western countries must choose to take actions in areas such as currency convertibility and financing that make it easier for Hungary to benefit from successful Western efforts to redress problems in the international economy.

Finally, if personal economic rights are one element contributing to the development of democratic political systems, fostering their development in Hungary must certainly be a goal of Western policy mak-

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crisis is showing overt signs of leading to an escalating unravelling of the polity and that since the regime will be unlikely to be able to make the reforms necessary, the situation will lead, presumptively, to inevitable retrenchment. *But cf.* Volgyes, *supra* note 16, at 376. For an excellent discussion of political difficulties associated with international adjustments, see Ikenberry, *The State and Strategies of International Adjustment*, 39 World Politics, 53 (1986).

166. Volgyes, *supra* note 16.

ers. Hungary, however, appears to be seeking to develop Western interests that will be tied to its stability as a nation. Whether the U.S. should foster those interests by encouraging public and private support is a question that has to weighed against the uncertain consequences of deepening economic crisis.

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