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An Emerging Framework for Greater Foreign Participation in the Economies of Hungary and Poland

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Member of the Class of 1992

I. INTRODUCTION

Hungary and Poland are currently in the midst of a grand experiment: the transition of economies dominated by the hegemony of state control into free market economies with Western institutions.¹ This transition requires monumental changes. "To function efficiently, modern market economies rely heavily on institutions and rules established over a century or more: property and contract laws and the courts to enforce them; accounting and bankruptcy rules. . . . Governments in Eastern Europe have only begun to think about most of these issues."² The enormity of this transition requires massive and unprecedented recourse to the law.³

The creation of legislation regulating the entry and operation of foreign capital is a small but important aspect of the transition to a market economy. Both the Hungarian and Polish governments attach great hopes to the role the foreign investor will play in bringing important technology, expertise, and capital to the badly depressed markets. One commentator has described this desire as an obsession.⁴ Despite this, Western investors have found doing business in Eastern Europe bureaucratic and time consuming. Confusion over the new laws and the questions of ownership have hampered many negotiations.⁵

This Note will first examine the extent to which the legislation regu-

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5. Id. See also Stephen Engelberg, Eastern Europe Stymies All But The Hardiest of Western Capitalists, N.Y. TIMES, Mar. 5, 1992, at A1, C8.
lating foreign investment in Poland and Hungary establishes, controls, and encourages the entry of foreign capital. Second, it will analyze the extent to which this legislation has promulgated a rule of law. It is more likely that the concerns of the foreign investor will be satisfied to the extent that the legislation creates a system of rule by law.

Although theorists differ on the meaning of the term, commentators seem to agree on a number of major institutional characteristics that go to the heart of investor concerns. Some of the major institutional characteristics of the "rule of law" include government under the law, where the law precludes arbitrary actions, certainty, generality and equality, accessibility of the courts, and judicial review of executive action. The "rule of law" should not, however, be strictly construed to be a positive force in all instances. Strict rule of law must be weighed against the need for flexibility.

Finally, this Note will address the present status of foreign ownership rights and questions of ownership which remain unresolved. Ownership laws are only one of a number of strategically important areas of the host country's legal system, with which a foreign investor must become familiar. While this Note cannot address many of these important subjects in anything but a cursory way, the resolution of the ownership question is of prime importance to the entry and operation of foreign capital.

Ultimately, the conclusions drawn from this Note are intended to be used in developing constructive changes in the foreign investment laws of Hungary and Poland. They may also help create a model which can be applied to other Eastern European countries since the logic of change and the economic alternatives remain similar for all the countries of Eastern Europe.

II. HISTORY OF FOREIGN INVESTMENT IN THE SOCIALIST AND TRANSFORMING ECONOMIES

The idea that foreign investors did not participate in the socialist

6. See Geoffrey De Q. Walker, The Rule of Law, Foundation of Constitutional Democracy 24-41 (1988). It is important to note, however, that certainty must be weighed against the need for flexibility. Id. at 26.
7. Id.
9. See Kálmán Mizsei, Is the Hungarian Economic Mechanism a Model to be Emulated?, E. EUR. ECON. Summer 1988, at 58.
Foreign Participation in Hungary & Poland

economies of Hungary and Poland is mistaken. As early as the 1970s, foreign investment played a role in both economies.

Foreign participation in the socialist economies of Hungary and Poland, however, involved a great degree of ambiguity. In Hungary, the terms of foreign participation remained subject to ministerial decrees published by the Minister of Finance. In Poland, multiple and conflicting pieces of legislation regulated foreign participation.

Equally, foreign participation involved pervasive government control, characteristic of a strong state seeking to contain capitalist influences. In all cases of foreign participation, the Hungarian and Polish states required approval of the venture and the scope of the venture's activities, even though the foreign stake generally represented a minority position. Failure to abide by the terms of the permit had significant consequences. In Hungary, for example, the activity of the venture had to be explicitly laid out in the memorandum of association. If the Minis-

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11. As early as the 1970s, legislation accorded separate treatment for wholly owned ventures and joint ventures. Wholly foreign owned ventures were governed by a separate statute which allowed foreign operation in light industries such as crafts, domestic trade, food service, and hospitality. Christina L. Jadach, Ownership and Investment in Poland, 18 CORNELL INT'L L.J. 63, 75 (1985). Joint ventures with foreign participants could only operate in areas under regional supervision and foreign participation was limited to 49%. Id. at 76.


13. See Hungarian Decree No. 63/1982; 1986 Polish Law on Companies with Foreign Participation art. 7.
ter of Finance determined that the venture exceeded the scope of its activity, the Minister had the authority to terminate the venture.\textsuperscript{14}

Both Hungary and Poland limited foreign equity participation to a minority share (i.e. no more than forty-nine percent) in any venture with a state enterprise,\textsuperscript{15} subject to certain exceptions. In Poland, wholly foreign owned ventures could operate in certain light industries.\textsuperscript{16} In Hungary, a foreign investor could own a majority share in a service enterprise, such as banking, or in another type of business in the discretion of the Minister of Finance.\textsuperscript{17}

Where the state allowed wholly owned ventures, the state strictly limited the scope of the activity. Although one commentator on Poland wrote, "Western commentators have taken ideology far more seriously than have their Polish counterparts,"\textsuperscript{18} the existence of wholly foreign owned ventures in Poland did not reflect a substantial violation of Marxist ideology. Legislation limited foreign participation to a specified segment of the economy: small industry. The limited application in Hungary could be regulated by the discretion of the Ministry of Finance.\textsuperscript{19}

\textbf{III. FOREIGN INVESTMENT IN THE TRANSFORMING ECONOMIES}

In 1988 the first comprehensive statutes on foreign investment passed in the legislatures of Hungary and Poland. The Hungarian legislature passed Act XXIV of 1988 on Investments of Foreigners in Hungary, and the Polish Sejm passed the Law of 1988 on Economic Activity with the Participation of Foreign Parties.\textsuperscript{20} This legislation represented a comprehensive approach to foreign participation in the Hungarian and Polish economies and permitted freer entry of foreign capital. It governed wholly owned/unlimited equity share ventures, joint ventures, and foreign participation in the privatization of industry in the newly trans-

\begin{itemize}
  \item \textsuperscript{14} Hungarian Decree No. 63/1982, § 12(3).
  \item \textsuperscript{15} \textit{Id.} See also note 11 for examples of light industries in which the Polish government allowed foreign capital participation.
  \item \textsuperscript{16} Jadach, \textit{supra} note 11, at 75.
  \item \textsuperscript{17} Hungarian Decree No. 63/1982, § 4.
  \item \textsuperscript{18} Jadach, \textit{supra} note 11, at 69.
  \item \textsuperscript{19} Hungarian Decree No. 63/1982, § 4.
  \item \textsuperscript{20} The Law on Economic Activity with the Participation of Foreign Parties, 28 I.L.M. 1518 (1989) [hereinafter 1988 Polish Foreign Investment Law]. This statute repealed the 1986 Act on Companies With Foreign Capital Participation. \textit{Id.} art. 44, 28 I.L.M. at 1541, and provided that the "System of 1982" be phased out by providing that no more companies could be formed under this act after January 1, 1989. \textit{Id.} art. 49, 28 I.L.M. at 1541.
\end{itemize}
forming economies.\textsuperscript{21}

In the subsequent two years, the Hungarian and Polish governments began to privatize the majority of industry by passing a series of legislation. In Hungary, the principal pieces of legislation are Act XIII of 1989 on the Transformation of Business Organizations and Companies (Hungarian Privatization Law) and Laws No. VII and VIII of 1990 on the State Property Agency.\textsuperscript{22} In Poland, the principal pieces of legislation are the Law of 1990 on Privatization of State-Owned Enterprises (Polish Privatization Law), together with the Law on the Establishment of the Ministry of Ownership Changes (M.O.C.).

In 1990 and 1991, the Polish and Hungarian governments changed the substantive provisions of its foreign investment legislation. Poland repealed the 1988 Act,\textsuperscript{23} after having amended it in 1989, under the Law of June 14, 1991 on Companies with Foreign Participation.\textsuperscript{24} In 1990 Hungary amended its 1988 legislation pursuant to Act XCVIII of 1990.\textsuperscript{25} The present forms of foreign investment legislation have substantially changed the previous regulatory structure, by relaxing restrictions on foreign capital’s entry and operation.

A. Scope of the Foreign Investment Laws

The foreign investment laws are the principal form of regulation of foreign capital in Hungary and Poland. Polish and Hungarian foreign investment laws apply to most areas of foreign investment. The Hungarian statute applies to companies with foreign participation, companies set up by a foreigner, and the acquisition by a foreigner of equity in a company.\textsuperscript{26} The present Polish foreign investment statute applies generally to any participation of foreign parties in operating businesses in Poland.\textsuperscript{27}


\textsuperscript{22} The full names of these pieces of legislation are Law No. VII 1990 on the State Property Agency and on Management of Property of the State Operating in Enterprises [hereinafter Hungarian Law No. VII of 1990] and Law No. VIII 1990 on Protection of State Property Entrusted to Enterprises [hereinafter Hungarian Law No. VIII of 1990].


\textsuperscript{24} \textit{Id.} art. 43, 30 I.L.M. at 889.


\textsuperscript{26} Amended Hungarian Foreign Investment Law § 2(b), 2 H.R.L.F. at 305.

\textsuperscript{27} 1991 Polish Foreign Investment Law art. 1(1), 30 I.L.M. at 875. There is an interest-
The foreign investment statutes, however, are not the exclusive instruments for regulation. Article 2 of the Polish Foreign Investment Law states that the provisions of the law "do not affect other laws establishing conditions for the admission of foreign parties . . . ." Other laws include legislation relating to foreign exchange, the admission of foreign parties into certain specialized industries such as the financial industry and telecommunications, and the purchase of real property by foreigners.

The privatization laws also impose important conditions on the entry of foreign capital and overlap with the provisions of the foreign investment legislation. In Hungary, the privatization statutes impose conditions on foreign entry even though the foreign investment legislation would appear to govern. Law No. VIII on the State Property Agency regulates foreign participation in companies formed with or utilizing state assets and the acquisition of shares in a newly privatized company. These regulations impose conditions which differ from the corresponding provisions in the foreign investment law.

In Poland, there is less overlap between the privatization laws and the foreign investment law. First, the present version of the Polish foreign investment law governs transactions between state enterprises and foreign individuals. Second, it repealed those provisions of the Privatization Law which call for a partner of any foreign person who is a company. Under article 3 of the Polish statute, a foreign person is any natural person domiciled abroad, a legal person with their registered office abroad or a company which lacks legal personality but is created according to foreign law. 1991 Polish Foreign Investment Law art. 3, 30 I.L.M. at 875. The Hungarian statute, under section 2(a), only defines foreigner to include an individual or corporation under the rules of Exchange Control. Amended Hungarian Foreign Investment Law § 2(a), 2 H.R.L.F. at 305-06. It is uncertain, therefore, what impact the laws have upon a partnership which invests in Hungary.


33. Id.
34. 1991 Polish Foreign Investment Law art. 6, 30 I.L.M. at 876-77.
tization Law which separately regulated foreign investment.\textsuperscript{35} Any provisions specifically dealing with foreign investment have been put in the Law of June 14, 1991. The Polish Privatization Law previously established separate approval requirements as well as separate provisions regarding profit repatriation and tax.\textsuperscript{36} The government, however, retains its powers under the privatization statutes, to control the transfer of shares to foreign parties.\textsuperscript{37}

Finally, neither the Hungarian nor the Polish statute specifically governs franchising arrangements with foreign parties,\textsuperscript{38} placing the foreign franchisor in an uncertain legal position. Although franchising arrangements typically involve many of the same concerns affecting other forms of investment covered by foreign investment legislation,\textsuperscript{39} the franchisor’s concerns are not protected by the statute. Such concerns include currency convertibility and profit repatriation, the possibility of expropriation, and questions of ownership of real property. Where the concerns are more particular to the franchisor, including intellectual property rights and the enforceability of contracts which restrict the franchisee’s rights,\textsuperscript{40} the franchisor may not be adequately protected by existing legislation or bilateral or multilateral trade agreements.

B. The Government Role in the Admission and Participation of Foreign Investment

1. Regulation in the Private Sector

The present legislation in Hungary and Poland has the principal effect of creating a rough equality between foreign and domestic investors with respect to transactions in the private sector. The preamble to the amended Hungarian Foreign Investment Law statute explicitly reflects this objective. The preamble in its amended form states,

The parliament has enacted this statute in support of the following objectives that is to say: to develop international cooperation and specifically in the interest of promoting technological advance in the Hungarian economy inter alia through promoting a direct involvement of foreign capital in our economy; assuring foreign investors equaled treat-

\textsuperscript{35} See id. art. 33, 30 I.L.M. at 885-86.


\textsuperscript{37} Id. art. 19 (1), 29 I.L.M. 1226.


\textsuperscript{39} Id. at 5.

\textsuperscript{40} Id. at 6-7.
The preamble to the 1991 Polish Foreign Investment Law does not state this objective, but the statute in fact achieves this objective by eliminating state approval of foreign participation in most areas.

Prior to the passage of the present foreign investment laws, foreign investment in Hungary and Poland had to be approved by the state. In Hungary, the 1988 legislation required government permission for foreign participation where the foreign entity had a controlling interest. In Poland, the state exercised a degree of control over the investment which was disproportionate to any fear of foreign exploitation. Any limited liability company or joint stock company with foreign participation required a permit issued by the Foreign Investment Agency before the company could commence activity. The creation of a company with as little as twenty percent foreign participation, the minimum investment allowed by law, required an approval permit. Other acts were also subject to approval, including a transfer of shares or an ownership interest in the company; amendment of the company’s founding act; a change in the ratio of equity holdings, the voting rights of shareholders or the nature and value of contributions; or any change in the object of the company’s activity as specified in the permit.

The provisions of Hungarian Act XCVIII of 1990 eliminate any need for government authorization for foreign participation. The statute reads, “[n]o specific exchange control permission is required for the creation of or acquiring an interest in a company with foreign participa-

41. Amended Hungarian Foreign Investment Law, pmbl., 2 H.R.L.F. at 305 (emphasis added).
42. See 1991 Polish Foreign Investment Law arts. 1-6, 30 I.L.M. at 875-77. Other provisions within the statutes also promote this objective. In Hungary, a state enterprise or financial institution has no special status where over-subscription requires rejection of some investors. Amended Hungarian Foreign Investment Law § 13(1), 2 H.R.L.F. at 308. A company with foreign participation is entitled to tax concessions due other companies, id. § 15(1), 2 H.R.L.F. at 308; may acquire real property, id. § 19, 2 H.R.L.F. at 311; may pursue any wholesale or retail trade or engage in foreign trade under the laws applicable to other business organizations, id. § 21, 2 H.R.L.F. at 311. A non-resident may also be appointed as an executive, manager, member of the supervisory board, or other employee. Id. § 27, 2 H.R.L.F. at 312.
43. Former Hungarian Foreign Investment Law § 9(2).
44. The statute referred to these companies as those “established jointly by Polish parties and foreign parties, or solely by foreign parties.” 1988 Polish Foreign Investment Law art. 2(1), 28 I.L.M. at 1520.
45. Id. art. 5(1), 28 I.L.M. at 1522.
46. Id. arts. 2(1), 5(1), 28 I.L.M. at 1520, 1522.
47. Id. art. 5(3), 28 I.L.M. at 1522.
A company need only register with the court of registry, pursuant to Act VI on Business Organizations which governs the creation of a company with foreign participation, to become a valid company under Hungarian law. Significantly, Act XCVIII repealed the prohibition against acquisition of a controlling interest in a domestic company by a foreign controlled company.

Similarly, the Polish Foreign Investment Law substantially reduces, while not entirely eliminating, the role of government approval in the private sector. The statute requires state approval in a specific and limited number of areas of the economy which involve state interests. Under Article 4(1) of the statute, a company with foreign participation cannot be created without permit approval when the company's business would involve the operation of harbors or airports, real estate brokerage activities, the defense industry not requiring a concession, wholesale trade of imported consumer goods and performance of legal services (collectively hereinafter 4(1) areas). These proscriptions in the Polish Foreign Investment Law also apply to activities of an existing company which wants to expand into the 4(1) areas. The law also limits the acquisition of shares in an existing company which carries on activity in the 4(1) areas or activities requiring a concession by virtue of other regulations.

49. Amended Hungarian Foreign Investment Law § 3, 2 H.R.L.F. at 306. See also id. § 35, 2 H.R.L.F. at 314, which reads, "Unless otherwise specifically enacted thereby the company in its trading activities is not subject to the regulations which are not part of the civil law and which only apply to economic organisations of the state and to co-operatives in such capacity."
51. Act XCVIII § 13(2); Former Hungarian Foreign Investment Law § 4(3).
52. 1991 Polish Foreign Investment Law art. 4(1), 30 I.L.M. at 875. See also id. art. 39, 30 I.L.M. at 887, explaining that provisions applicable to state enterprises do not apply to companies with foreign participation.
53. Id. art. 4(1)(a), 30 I.L.M. at 876.
54. Id. art. 4(1)(b), 30 I.L.M. at 876.
55. Id. art. 4(1)(c), 30 I.L.M. at 876.
56. This language may be subject to a great deal of ambiguity.
57. Id. art. 4(1)(d), 30 I.L.M. at 876.
58. Id. art. 4(1)(e), 30 I.L.M. at 876.
59. Id. art. 6(1)(1), 30 I.L.M. at 876.
60. Id. art. 6(1)(1)(a), 30 I.L.M. at 876.
61. Id. art. 6(1)(1)(b), 30 I.L.M. at 876. In the case of activities requiring concessions pursuant to other regulations, the appropriate licensing authority and not the Ministry of Ownership Transformations issues the approval or denial. Id. art. 8, 30 I.L.M. at 877.
2. Regulation of Transactions Between Foreign Investors and State Enterprises

The governments of Hungary and Poland continue to substantially regulate transactions between foreign individuals and state enterprises. The continuing use of the joint venture in Poland and Hungary underscores the importance of these provisions. In 1989, 867 joint ventures had been established in Poland and 180 in Hungary. In 1990 the numbers markedly increased to 2,799 in Poland and 4,400 in Hungary. In the first quarter of 1991, 4,000 joint ventures had been established in Poland and 2,420 in Hungary. Though many of these joint ventures are small or only exist on paper, the form of joint venture has been applied on a much larger scale. For example, on February 28, 1992, General Motors agreed to a seventy-five million dollar joint venture with the Polish state enterprise, FSO.

In Hungary, the approval requirements under the present regulations are stricter than under the previous legislation. In the Former Hungarian Foreign Investment Law, the statute only required government approval of a company formed with state and foreign participation if the foreign interest exceeded fifty percent. Now, any transaction between a state enterprise and a foreign investor involving significant state assets requires government approval.

Under the privatization laws, the Hungarian government has the power to review any transaction between a state enterprise and a foreign investor, including joint ventures, pursuant to Law No. VIII of 1990. The statute provides that any in-kind distribution or transfer of state assets to an economic association is subject to the approval of the State Property Agency.

63. Id.
64. Id.
65. Id.

67. Former Hungarian Foreign Investment Law § 9.
68. See generally Hungarian Law No. VIII of 1990, art. I.
69. Id. Before the passage of the statute, foreign consortia gave sizable golden parachutes to departing Communist managers in return for undervaluing the purchased facility. The Apisz stationery chain sold for one-seventh its value and the departing manager left with one-third of the shares of the new company. The Hungarian government strengthened the position of the State Property Agency in response to these abuses. Paul Knight, Strong domestic interest and controversy provoked by Hungary's privatization policy, FIN. TIMES, Sept. 20, 1990, § 1, at 30.

The absence of any provisions regulating transactions between foreign investors and state enterprises in the Amended Hungarian Foreign Investment Law may mislead the foreign investor, but this is not intentional. The statute which regulates transactions with state enterprises makes no distinction between foreign and domestic investors.

The statute, however, regulates only those transactions which involve the transfer, contribution, or use of significant state assets. If a non-financial contribution is greater than ten percent of the assets of the enterprise and the value of the contribution exceeds HUF twenty million, it is subject to approval. Property transfers of an intangible asset only require approval if the value exceeds HUF thirty million; the transfer of land as an asset is subject to approval if its value exceeds HUF one million; and the transfer of other fixed assets requires approval if the value of the asset exceeds HUF fifty million. Any contract such as a rental or lease agreement which causes the transfer of rights of usage, utilization, or collection of proceeds of more than fifty percent of the enterprise's assets also requires approval. For the purposes of calculation, the value of all contracts concluded within two calendar years are totaled.

In Poland, the 1991 Polish Foreign Investment Law regulates transactions between a foreign investor and a state enterprise. It requires approval of all such transactions. Any in kind distribution of a state enterprise in order to create a company or purchase a share in such a company requires the approval of M.O.C. In addition, a state enterprise may not conclude an agreement which provides the use or ownership of state property for a period greater than six months without permit approval.

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71. Id. art. 1(1)(b)-(d). The State Property Agency supervises the process of privatization and has broad authority under Hungarian Law No. VII of 1990.
72. Id. art. 1(1)(a).
73. Id. art. 1(1)(b).
74. Id. art. 1(1)(c).
76. Id. art. 1(1)(e).
77. Id. art. 1(2).
78. It is important to note that the Hungarian statute makes no distinction between foreign and domestic investors in transactions with state enterprises.
80. Id. art. 6(1)(3), 30 I.L.M. at 876.
3. Discretionary Authority of the Government Agencies Over the Approval Process

The legislative limits on the authority of the State Property Agency and M.O.C. over the approval process vary greatly. In Hungary, Law No. VIII of 1990 specifically defines and circumscribes the authority of the State Property Agency in reviewing contracts between state enterprises and foreign individuals. In Poland, however, the 1991 Foreign Investment Law delegates potentially greater discretionary authority to M.O.C.

In Hungary, the language of Law No. VIII of 1990 defines the procedures for approval, limiting the authority of the State Property Agency to ensuring the proper valuation of state assets. A state enterprise seeking to enter into a transaction governed by the statute must report its intention to the State Property Agency and must submit a valuation by a registered auditor. The enterprise may conclude the transaction within thirty days unless the State Property Agency takes one of three steps allowed by the statute. The State Property Agency may require that a new valuation be undertaken by an auditor chosen by the agency, it may call for a public tender to obtain the best value for the property if it is an important transaction, or it may prohibit the contract if it is of obvious prejudice to the national economy.

Hungarian Law No. VIII of 1990 further circumscribes the authority of the State Property Agency by providing for an appeal to the court in case of a denial. Significantly, however, the foreign investor does not have this right of appeal. The statute provides that if the Agency prevents the transaction from occurring, the state enterprise may sue in court within thirty days of the announcement.

In Poland, regulation of transactions between state enterprises and foreigners serves the same purpose as the Hungarian statute, yet the

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81. Hungarian Law No. VIII of 1990, art. 3. If the company announces a public tender or publicizes the transaction in two daily national newspapers and then obligates itself to conclude the transaction with a third party if it gets a better offer, the enterprise does not need to report the transaction. Id. art. 6(b).
82. Id. art. 2.
83. Id. art. 4.
84. Id. art. 5(1)(a).
85. Id. art. 5(1)(b).
86. Id. art. 5(1)(c). Although the statute does not define what obvious prejudice means, it would seem to imply that the government only has authority to reject cases which are blatantly against state interests.
87. Id. art. 5(2).
88. The statute's regulation of in kind distributions operates to ensure that state-owned
language governing the Polish government’s authority to review transactions is markedly broader. One article regulates the entire approval process and the language is poorly drafted. There is no description of the application process, nor any description of the powers of the Ministry in anything other than general terms. The result is that the language of the statute injects a great deal of ambiguity and uncertainty into the approval process.

M.O.C., which has become the agency responsible for issuing permit approvals or rejections, exercises broad discretion in this area. The statute only requires that M.O.C. deny the permit when a company’s activities threaten state economic interests or state security. This discretion is broader than under the previous statute. Under the 1988 Polish Foreign Investor Law, an application would be approved whenever the business activity ensured the introduction of modern technologies and management methods, provision of goods and services for export, improvement in the supply of modern and high quality products and services to the domestic market, or the protection of the environment.

M.O.C. may formulate the conditions for investment in areas under its authority. The statute provides that M.O.C. may set certain operating conditions in the permit. The statute empowers M.O.C. to establish the ratio between the Polish and foreign parties’ contributions to the share (stock) capital of the company or the ratio between votes at the partners’ meeting, but it does not limit the authority of M.O.C. to impose further conditions on the permit. Further, M.O.C.’s regulation is ongoing, continuing after the transaction has been concluded. M.O.C.

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assets are properly valued. See Ania M. Frankowska & Radoslaw A. Gronet, Introductory Note to Poland: Law on Companies With Foreign Participation, 30 I.L.M. 871 (1991).

89. 1991 Polish Foreign Investment Law, art. 17, 30 I.L.M. at 880.

90. Id. art. 8, 30 I.L.M. at 877. This law eliminates the Foreign Investment Agency’s powers over the supervision of foreign investment (previously granted under articles 4 & 6 of the 1988 Polish Foreign Investment Law) and transfers them to the Ministry of Ownership Transformations in article 41. Id. art. 41, 30 I.L.M. at 888.

91. 1991 Polish Foreign Investment Law, art. 17, 30 I.L.M. at 880.


93. Id. art. 5(2)(2), 28 I.L.M. at 1522.

94. Id. art. 5(2)(3), 28 I.L.M. at 1522.

95. Id. art. 5(2)(4), 28 I.L.M. at 1522.

96. 1991 Polish Foreign Investment Law, art. 16(2), 30 I.L.M. at 880.

97. Id.

98. Id.

99. M.O.C. could, for example, require that the foreign investor purchase other less valuable assets of a state enterprise. In one case, Polish officials delayed the sale of a truck factory to Volvo until the company agreed to also acquire a bankrupt firm. See Engelberg, supra note 5, at C8.
may revoke its permit if the company engages in activity which is not in conformity with these conditions and refuses to cease the activity.\textsuperscript{100}

M.O.C. may be required to issue a factual justification of a denial when it refuses a permit for reasons other than state security. It is not clear from the language of the statute whether this is a mandatory procedure. The statute establishes that M.O.C. need not issue a factual justification when it bases its denial on state security reasons.\textsuperscript{101} By implication, it may be required to issue one in other circumstances. Even where M.O.C. issues a factual justification, however, there is no language requiring that the justification be anything but cursory, and there is no appeal. The statute does not include even a limited appeal to the head of the agency.\textsuperscript{102}

The state's limited purpose in regulating transactions with state enterprises does not justify the broad authority assigned to M.O.C. under the statute. Separate provisions should govern the regulation of 4(1) areas and those necessary to regulate the valuation of state enterprises. M.O.C. should be proscribed from establishing operating conditions other than the ratio of foreign and state investments. Similarly, M.O.C.'s continuing power to supervise the company after it has properly valued the state assets smacks more of paternalism than necessity.

It is important to note that the present statute limits the independent action of the Agency after the permit approval has been issued. Unlike the 1988 legislation, a company may be required to turn over its books and records to the Agency so that it can determine whether the company is within its proscribed activities.\textsuperscript{103} M.O.C. does not have an unqualified right to enter the premises and review a company's books and records.\textsuperscript{104} If M.O.C. determines that the company acts in violation of its permit, and the company refuses to change its conduct, M.O.C. must go to court to dissolve the company.\textsuperscript{105} Actions taken in violation of Articles 6 and 8 are null and void by law,\textsuperscript{106} but in order to void actions of the company taken in violation of Articles 4 and 6, M.O.C. must go before the court.\textsuperscript{107}

\textsuperscript{101} Id. art. 17, 30 I.L.M. at 880.
\textsuperscript{102} The absence of an appeal even by the state enterprise contrasts with the position taken by Hungary. It is also inconsistent with the treatment given when the state enterprise makes a formal application to privatize pursuant to article 5 of the Polish Privatization Law.
\textsuperscript{103} 1991 Polish Foreign Investment Law, art. 19(2), 30 I.L.M. at 1526.
\textsuperscript{104} See 1988 Polish Foreign Investment Law, art. 14, 28 I.L.M. at 1526.
\textsuperscript{105} 1991 Polish Foreign Investment Law, art. 19(4), 30 I.L.M. at 881.
\textsuperscript{106} Id. art. 9, 30 I.L.M. at 877.
\textsuperscript{107} Id. art. 20, 30 I.L.M. at 881.
C. Role of the Tax Provisions in Regulating Foreign Investment

The elimination of significant restrictions on foreign investment heightens the importance of the tax provisions as a method of regulating foreign investment. In Hungary, the statute creates a scale of tax benefits which are being used to promote participation in those sectors where technological innovation or capital is critical. The statute provides significant tax concessions when more than half of the gross profits of the company derive from the manufacture of goods, or a list of particularly important activities, and the registered capital exceeds fifty million Forints with at least thirty percent foreign participation. Previously, the capitalization requirement in the 1988 legislation was only twenty-five million Forints, and the statute imposed neither a capitalization requirement nor a minimum amount of foreign participation on particularly important activities. Act XCVIII of 1990 also extended the schedule of particularly important activities from fourteen to twenty-two.

The tax treatment of foreign investors in Poland differs remarkably from Hungary in that the language of the tax provisions is ambiguous and vests in M.O.C. significant discretionary authority. The principal provision, Article 23, begins: "[t]he Minister of Finance may, upon an affirmative opinion of an appropriate minister, exempt a Company from corporate income tax... [under certain] circumstances." While theoretically such discretion may work to the foreign investor's benefit, the statute may also work to its detriment because of the uncertainty and generality of the provision.

The guidelines for granting an exemption are fairly general. A foreign investor may be entitled to an exemption whenever the foreign party's contribution to a company exceeds two million ECUs, and the

110. Id.
111. Id. § 15(2)(b), 2 H.R.L.F. at 308. These activities include electronics manufacturing, manufacture of vehicle component parts, machine-tool production, manufacture of agricultural, food processing, and forestry machines, packing technology, manufacturing of pharmaceutical products, and tourism. See 2 H.R.L.F. at 320-25.
114. Id. § 15(2)(c), 2 H.R.L.F. at 309.
116. 1991 Polish Foreign Investment Law, art. 23(1), 30 I.L.M. at 882 (emphasis added).
117. Id. art.23(1)(2), 30 I.L.M. at 882.
company participates in a region suffering high unemployment, its activity would ensure the introduction of new technology or its export sales comprise twenty percent or more of total sales. Foreign parties are also eligible for exemption when they purchase shares or stock from the State Treasury.

The statute does not make clear who has the authority to grant an exemption. It would appear that the Minister of Finance may only be able to issue an exemption where the "appropriate minister," in this case M.O.C., concurs. The statute states that only after the application has been reviewed and passed on by M.O.C., the Minister of Finance may decide whether a company qualifies. Further, only "upon an affirmative opinion" of M.O.C., does the Minister of Finance have authority to issue an exemption.

Similarly, the statute does not adequately limit the authority of the Minister of Finance and M.O.C. to disapprove an application when it appears to qualify under the statute. First, it entirely fails to address whether M.O.C. may disapprove the application before passing it on to the Minister of Finance. Second, the statute only provides that the Minister of Finance may set forth conditions in the permit, "or, due to important economic reasons, deny the exemption." While the language implies that the Minister of Finance may only deny the permit when important economic reasons exist, there is no requirement that there be a factual justification which could expose the arbitrariness of a decision.

D. Ownership Rights and Protection of Foreign Investment

1. Right to Own Property

The laws of ownership are principally governed by legislation other than the foreign investment laws. The right to property is guaranteed under the Hungarian and Polish Constitutions. Pursuant to this

118. Id. art. 23(1)(2)(a), 30 I.L.M. at 882.
119. Id. art. 23(1)(2)(b), 30 I.L.M. at 882.
120. Id. art. 23(1)(2)(c), 30 I.L.M. at 882.
121. Id. art. 23(5), 30 I.L.M. at 882.
122. See id. art. 23(4), 30 I.L.M. at 882.
123. Id.
124. Id. art. 23(1), 30 I.L.M. at 882.
125. Id. art. 23(2), 30 I.L.M. at 882.
right, property may only be expropriated in exceptional circumstances when it is a matter of public interest, and compensation must be paid. In Hungary, Act I of 1987 governs ownership of land by foreigners. In Poland, foreign ownership of land is governed by the 1920 Law on Real Estate Acquisition by Foreigners with recent amendments.

The rights of foreigners to own property under the existing statutes, however, may be varied by the provisions of the foreign investment laws. In practice, this principle has only been illustrated in Hungary where the provisions of section 19 of the Hungarian Foreign Investment Law conflicted with a corresponding interpretation of the provisions in Hungarian Act I of 1987. Under the Hungarian Act I of 1987, any purchase of real property by a foreigner requires a permit by the Ministry of Finance. The Council of Ministers classified domestic companies with foreign participation as foreign entities under the Land Law and required them to apply for a permit, pursuant to Decree 145/1989 of the Council of Ministers.

In 1990, the Hungarian Constitutional Court annulled the decree of the Council of Ministers. Under the Amended Hungarian Foreign Investment Law, a company with foreign participation could acquire real property so long as it relates to carrying out the business of the company. The Constitutional Court stated that to require a permit for those domestic companies with foreign participation would conflict with the provisions of the Amended Foreign Investment Law.

Since the decision of the Hungarian Constitutional Court, nullifying

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133. Decree of 145/1989 (XII.27.); MT of the Council of Ministers on Acquisition of Real Estate by Foreigners arts. 1, 2, under authority given by article 70 of modified law 1 of 1977 on land.


135. Amended Hungarian Foreign Investment Law, § 19(a), 2 H.R.L.F. at 311. The statute further provides that the company is at liberty to deal with its assets freely. Id. § 19(b), 2 H.R.L.F. at 311.

Decree No. 145/1989 of the Council of Ministers, the Hungarian government has issued new regulations pertaining to the acquisition of real property by foreigners under Hungarian Act 1 of 1987 on Land. The regulations govern the process and the standards by which a foreigner may receive a permit to purchase Hungarian real property. More specifically, they only regulate acquisition of real property by foreign legal entities and foreign private individuals, not including non-Hungarian permanent residents.

As in other cases, the Finance Ministry has broad discretion to grant the permit. It appears, though it is not entirely clear from the language of the statute, that the Finance Ministry may approve a permit so long as it does not violate state, local, or general societal interests, and there is no right of appeal against the decision of the Finance Ministry. Unless otherwise stipulated by statute, a foreigner may not acquire arable land or protected nature conservation areas.

In contrast to the Hungarian law, the Polish Law on Real Estate Acquisition by Foreigners requires that any foreign person, including a foreign controlled domestic corporation, must obtain a permit to purchase real property. There are some indications, however, that obtaining this permit may not be particularly difficult. From August 1988 to the end of 1989, 325 foreigners obtained permits. In 1990, the government received 589 applications, 565 of which were granted.

2. Foreign Investment Guarantees

The foreign investment laws of both Hungary and Poland guarantee the value of a foreigner's investment in the event of a expropriation. In Hungary, an event of nationalization, expropriation or similar measures effecting the foreign ownership entitles the investor to automatic

139. Id.
140. Id. at Art. 4(2).
141. Id. at Art. 1(1)(a).
142. Id. at Art. 2(4).
143. Id. at Art. 1(5).
144. Bialik, supra note 130, at 4.
146. 1991 Polish Foreign Investment Law, art. 22, 30 I.L.M. at 881-82; Amended Hungarian Foreign Investment Law § 1, 2 H.R.L.F. at 305.
147. This language currently exists in the present version of section 1(2) of the Amended Hungarian Foreign Investment Law and may serve to protect the foreign investor in circum-
indemnification. In Poland, the statute provides for indemnification for losses caused by expropriation or any other acts with equivalent results.

These guarantees may represent psychological reassurance to the investor, but substantively are not necessary in light of the similar guarantees under the Polish and Hungarian constitutions. The process for compensating investors, however, may be of some importance. Neither statute fully establishes a set of procedures for compensation, but both provide certain protections. The Hungarian statute guarantees immediate compensation in the currency of the investment, and establishes that the right to indemnification in Hungary is actionable under the law. The provision states that "application shall lie before the Court of Justice in case of any contravention of the law." In Poland, the process has yet to be defined under a separate set of regulations, however the Polish statute provides that a foreign investor may repatriate the full amount of compensation.

3. Reprivatization

The status of foreign investment cannot be entirely certain until adequate laws are developed regarding reprivatization. Compensation for the claims of previous owners of nationalized property or the return of the seized property (collectively "reprivatization") has become an issue of great concern to the legislatures of Hungary and Poland.

By the end of February [1991] the Ministry of Ownership Transformation alone had received 550 applications concerning the return of flour mills, chemists' shops, breweries and food processing plants. Twenty-nine former hotel owners, 338 former farmland owners and 121 own-

149. In Poland, pursuant to Amendments to the Law on Land Management and Real Estate Expropriation, Dziennik Ustaw, 1990, no. 79, item 464, the state may only expropriate real estate necessary for the construction and maintenance of public roads, communications devices, utilities, elementary schools, hospitals, cemeteries, sanitary utilities, national defense installations, public housing, and "other obvious public purposes." See Bialik, supra note 130, at 4.
150. 1991 Polish Foreign Investment Law, art. 22(1), 30 I.L.M. at 881.
151. See supra notes 131-32 and accompanying text.
152. Amended Hungarian Foreign Investment Law § 1(2), 2 H.R.L.F. at 305.
153. Id. § 1(3), 2 H.R.L.F. at 305.
154. Id.
155. 1991 Polish Foreign Investment Law, art. 22(2), 30 I.L.M. at 882.
156. Id. art. 26(3), 30 I.L.M. at 883-84.
ers of plots and buildings are also demanding that their property be returned. Eighty-two applications concern factories and large industrial plants, 5 concern mines and 6 are for river barges. More than 50,000 applications for the return of various objects and real estate have been filed with local authorities throughout the country.\textsuperscript{157} However, the resolution of this issue has become tied up in the legislatures because of the persistence of certain factions and the intervention of the courts.\textsuperscript{158}

Hungary has passed legislation in response to the problem, Law XXV of 1991 on Partial Compensation for Damages Unlawfully Caused by the State to Properties Owned by Citizens in the Interest of Settling Ownership Relations.\textsuperscript{159} In large part, the statute would resolve many of the concerns of investors. The statute provides for compensation to former owners.\textsuperscript{160} Where practicable the former owner may obtain an option to reacquire the property.\textsuperscript{161} An option is practicable only provided the property has not been acquired by a resident or is not currently owned by a newly private company whose shares have been sold to investors or a company formed by an in-kind contribution with property in dispute.\textsuperscript{162} The statute does not seem, however, to protect property which is purchased by a wholly foreign owned company.

The constitutionality of this statute, however, is in some doubt based on prior opinions of the Hungarian Constitutional Court. On October 4, 1990, the Constitutional Court issued a unanimous opinion in response to inquiries of the legislature on the issue of reprivatization.\textsuperscript{163} In its opinion, the Court indicated that the compensation of former owners unconstitutionally discriminated against those citizens who lost no property during the nationalization.\textsuperscript{164} The Court concluded that the former owners lacked any valid right to former properties. (The Hungarian Constitution provides that the state has exclusive right to nationalized property.) The Court indicated that such a statute would only pass constitutional muster if the state could show that the statute "would

\textsuperscript{158} See, e.g., Ethan Klingsberg, \textit{Hungary: The Constitutional Politics of Compensation}, 2 P.S.S.E.E.L. 1, 8 (June 1991); Telephone Conversation with Prof. Andrzej Szlezak, Professor of Law, Poznan University (Feb. 17, 1992).
\textsuperscript{160} \textit{Id.} \S\ 1.
\textsuperscript{161} \textit{Id.} \S\ 9.
\textsuperscript{162} \textit{Id.}
\textsuperscript{163} Decision 21/1990 (X.4) AB. See Klingsberg, \textit{supra} note 158, at 1.
\textsuperscript{164} Klingsberg, \textit{supra} note 158, at 2.
cause a more favorable total social result.\textsuperscript{165}

A subsequent opinion of the Court, however, indicates that some form of compensation might be acceptable. In 1991 the Court unanimously struck down a proposed draft of the statute,\textsuperscript{166} but appeared to change its position from October 1990.\textsuperscript{167} Rather than focusing on the inherent unconstitutionality of reprivatization, the Court struck down the draft because it failed to compensate victims of pre-1949 nationalizations.\textsuperscript{168} Consequently, the existing statute which has been passed compensates both the victims of pre-1949 and post-1949 nationalizations.\textsuperscript{169}

In Poland, the legislature has not yet passed a statute resolving the questions raised by reprivatization. It had been prepared to implement a plan denying any claims of nationalization where the state had seized the property pursuant to legislation enacted by the Communist government.\textsuperscript{170} The legislature, however, did not adopt this approach. Instead, it has agreed that proposals for a plan will be submitted to the legislature in March 1992.\textsuperscript{171} It is not likely, however, that this deadline will be met, as no proposals currently exist which are reasonably likely to garner sufficient support.\textsuperscript{172}

In the absence of laws addressing reprivatization claims, the foreign investor may still be protected. It is possible that the indemnity guarantees respecting expropriation may have some application to this problem. A statute or judgment which would allow pre-Communist owners to re-take property would be action by the state which would effectively result in expropriation. Although the principal intent of the provisions may have been to assuage fears of renewed nationalizations,\textsuperscript{173} the language "similar measures effecting the foreign ownership" and "any other acts with equivalent results" may very well apply.\textsuperscript{174}

The provisions of bilateral trade agreements may also provide protection. The Hungarian statute provides that if an international agreement contradicts the substantive terms of the Hungarian Foreign

\textsuperscript{165} Id.
\textsuperscript{166} Decision 28/1991 (VI.3) AB.
\textsuperscript{167} Id. at 1.
\textsuperscript{168} Id.
\textsuperscript{170} Bartyzel, supra note 157. Only those claims arising from nationalizations, which were not pursuant to statutory authorization, would be satisfied.
\textsuperscript{171} Telephone Conversation with Prof. Andrzej Szlezak (Feb. 17, 1992).
\textsuperscript{172} Id.
\textsuperscript{174} See supra notes 146-50 and accompanying text of this article for further discussion of the current state of this matter.
Investment Law, the international trade agreement controls. There is no express provision in the Polish Foreign Investment Law which states a similar proposition. However, it is understood that a treaty between two nations controls over domestic law.

Finally, it appears that the state may be willing to assume responsibility for third party reprivatization claims in individual cases. The Polish treasury took this step when it sold shares in the newly privatized furniture maker, Swarzedskie. Under the terms of the prospectus, M.O.C. promised to assume responsibility for all claims against property which had been duly registered in the name of the state or the company, and for which there were no administrative decisions depriving the original owners of their titles. Any property held by the company which was not duly registered in the name of the state or company, however, was classified as "at risk" and not protected against any claims which might arise.

E. Expatriation of Profits and Other Provisions Which Facilitate Investment

The provisions for repatriation of profits in Hungary and Poland are almost identical, with minor exceptions. In both countries, a foreign investor may repatriate its share of profits. In Poland, the investor may repatriate those profits only after paying applicable taxes and obtaining an audit certificate. The foreign investor may also transfer abroad proceeds from the sale or liquidation of an investor's stock, its share of the proceeds from a company's liquidation or indemnification

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175. Amended Hungarian Foreign Investment Law § 6, 2 H.R.L.F. at 306.
178. Id. P.III, § 7.2.
179. In Poland, a foreign investor may change its zlotys profit for foreign currency. 1991 Polish Foreign Investment Law, arts. 25, 26, 30 I.L.M. at 871, 883 (1991). The Hungarian statute provides that the profit be transferred abroad in the currency of the investment. Amended Hungarian Foreign Investment Law § 32(1), 2 H.R.L.F. at 313. Where the investment arises from a contribution of property or the reinvestment of profits, the currency of investment is deemed to be the legal tender where the foreigner is domiciled. Id.
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proceeds from expropriation.\(^{184}\)

The only substantial difference between the repatriation provisions is the amount of compensation which may be repatriated by foreign employees. Employees of a Polish company may transfer abroad any compensation they receive provided the company issues a certificate reflecting that amount of compensation.\(^{185}\) In Hungary, fifty percent of the salaries of foreign employees, officers and partners may be freely transferred abroad.\(^{186}\)

Both countries have also relaxed the restrictions on the form of investment. In Hungary, under the 1988 legislation, cash contributions to a Hungarian venture had to be in convertible currency.\(^{187}\) Poland placed a similar requirement on foreign investment.\(^{188}\) Presently, a foreign investor in Hungary can use its forint profits in a Hungarian company to invest in an existing company, create a new company or increase capital.\(^{189}\) Similarly, in Poland, an investor can invest its share of profits and proceeds from a sale or liquidation of stock, or proceeds from the distribution assets of a company.\(^{190}\) Additionally, Poland no longer requires a minimum foreign capital contribution under its foreign investment law.\(^{191}\)

F. Transformation of State Enterprises: Alienation of Shares

The opportunities for investment in newly privatizing companies are impressive because of the vast numbers of enterprises which will be transferred to private owners. Although some estimates establish that the private sector accounts for twenty-five to thirty percent of Hungary’s economy and up to forty percent of Poland’s economy,\(^{192}\) a significant portion of industry remains under state ownership. It is estimated that between seventy-five and ninety percent of industries in Hungary and Poland are owned by the state.\(^{193}\) As of September 1991, Hungary had about 2,300 state owned firms, and Poland about 7,500.\(^{194}\)

\(^{184}\) 1991 Polish Foreign Investment Law, art. 26(3)(3), 30 I.L.M. at 883-84; Amended Hungarian Foreign Investment Law § 32(1), 2 H.R.L.F. at 313.
\(^{185}\) 1991 Polish Foreign Investment Law, art. 28(1), 30 I.L.M. at 884.
\(^{186}\) Id. art. 33, 30 I.L.M. at 885-86.
\(^{187}\) Former Hungarian Foreign Investment Law § 12(1).
\(^{188}\) 1988 Polish Foreign Investment Law, art. 16(2)(1), 28 I.L.M. at 1526.
\(^{189}\) The forint is the national currency of Hungary.
\(^{190}\) Amended Hungarian Foreign Investment Law § 12(1), 2 H.R.L.F. at 307.
\(^{191}\) 1991 Polish Foreign Investment Law, art. 10, 30 I.L.M. at 877-78.
\(^{192}\) See 1988 Polish Foreign Investment Law, art. 2, 28 I.L.M. at 1520.
\(^{193}\) Too Many Firms, Too Few Buyers, supra note 62, at survey 14.
\(^{194}\) Id. at survey 17.
Pursuant to the privatization laws, the supervision of privatization is vested in a single "super-agency." In Hungary, the State Property Agency (S.P.A.) is the responsible supervisory body. Its tasks include bringing state enterprises under state administrative supervision, preparing for sale of the companies under its supervision, and, in exceptional circumstances, management. In Poland, the authority of the agency is vested in the M.O.C. At their discretion, S.P.A. and M.O.C. affect the speed of change and the extent to which foreign investors may participate on beneficial terms through their discretionary power.

1. The Process of Transformation of State Enterprises

The process of privatizing state enterprises in Hungary and Poland involves two stages. In the first stage, the state enterprise is transformed into a private company. This can occur in three ways. First, M.O.C. or S.P.A. may order the state enterprise to privatize. S.P.A. may agree to transform an enterprise even if the enterprise objects. Similarly, in Poland, the Prime Minister, upon the request of M.O.C. may order the transformation. Secondly, the enterprise itself can initiate the process by application to S.P.A. or M.O.C. Either the founding body of the state enterprise requests the transformation, or the majority of the managing enterprise council or of a general meeting of the employees makes the request.

The process of transformation is not automatic where the state enterprise itself initiates the process. Both S.P.A. and M.O.C. must approve the transformation. In Hungary, S.P.A. has broad powers to approve the transformation, but any disapproval is subject to the review of the court. Under its powers of approval, the S.P.A. gives an opinion about the transformation plan, makes recommendations if necessary, and establishes any conditions it finds necessary. "Within thirty days from registering the reported intentions of transformation,"

197. Id. art. 10(e).
198. Id. art. 10(f).
199. Id. art. 10(h).
201. Id. § 1.3.
206. Id. art. 13(1).
the S.P.A., along with the company, will determine the conditions of transformation... the conditions of sale..."208 The enterprise only has the discretion to decide whether or not to go forward with the transaction.209 If the transformation "interferes with the interests of the society or it can be detrimental to the national economy," the S.P.A. can prohibit the transaction within sixty days of submission of the plan.210

The Polish Privatization Law also provides similar authority to M.O.C. The Ministry may determine the statute or charter of a newly formed corporation;211 it may also issue conditions pursuant to a denial which, if satisfied, would entitle the application to be reconsidered;212 it may order the preparation of a financial analysis of the enterprise to ensure that proper value is obtained for the shares;213 it may condition sales upon the introduction of certain changes to the successor corporation;214 and it may determine the method of sale necessary to achieve the greatest value for the company.215 It may also deny the application for transformation "due to economic and financial conditions of the enterprise or an important state interest."216 The denial must be issued within three months from the date of the request.217 It must be "rational" and "reasoned" and the state enterprise may challenge the law pursuant to article 61 of the Law on State-Owned Enterprises.218

In the second stage of privatization, shares in the newly created companies are sold. The S.P.A. and M.O.C. exercise the authority to alienate shares of newly privatized companies. In Hungary, Law No. VII of 1990 authorizes the S.P.A. to sell state property to either foreign or domestic investors.219 Similarly, the Polish Privatization Law provides that the Ministry of Ownership Changes makes all the decisions regarding alienation of shares owned by the State Treasury.220 For example, it may call for a sale through a public auction, a public offering,

207. STATE PROPERTY AGENCY, INFORMATION ON THE PRIVATIZATION OF STATE OWNED ENTERPRISES 5-7 (1990).
208. Id. at 6 (emphasis added).
209. Id. at 7.
212. Id. art. 5(4).
213. Id. art. 20.
214. Id. art. 21.
215. Id. art. 25(4).
216. Id. art. 5(3).
217. Id. art. 5(4).
218. Id.
or a negotiated sale after public invitation. 221

2. Discretionary Authority of M.O.C. and S.P.A. in the Privatization of Industry: The Role of Foreign Investment

Directives issued by the Polish and Hungarian legislatures purport to circumscribe the authority of the S.P.A. and M.O.C. in the privatization of industry. The Polish Privatization Law provides that the Sejm, the lower house of parliament, "shall vote annual directives" to guide the M.O.C.. 222 "The Council of Ministers shall list in the form of a decree, state-owned enterprises especially important for the national economy; privatization of which requires a permit from the Council of Ministers." 223 Similarly, in Hungary, the State Property Agency must implement the privatization program according to the terms of the law and the Asset Policy Guidelines. 224

The extent to which these directives actually circumscribe authority over foreign participation is questionable. It is not clear that the directives issued by the Polish and Hungarian legislatures specifically define the role which foreign investors will play in the privatization process. Rather, the role continues to be defined in a piecemeal fashion, by specific legislative acts 225 or discretionary decisions by the supervisory agencies in individual circumstances, based on general notions of state interest, 226 or on general guidelines issued pursuant to legislative directives. In Hungary, the 1990 State Asset Policy Guidelines 227 only direct that the S.P.A. should sell property where the enterprise might expect significant technological development, foreign ownership would benefit external industries, or the state debts can be reasonably reduced. 228

Proposals indicate that more viable alternatives exist. In Hungary,

221. Id. art. 23(1).
222. Id. art. 2(1).
223. Id. art. 2(2).
225. For example, see Act LXXIV of 1990 on privatization, sale, utilization of assets of state enterprises dealing with retail sale catering trade and consumer services.
226. For example, pursuant to its powers, the S.P.A. may prevent the sale of shares to third parties if it determines that a better offer is possible, the sale would result in injuring competition, or it involves an industry which should remain in the control of the state. Decree No. 20/1990 of the Parliament on the Asset Policy Guidelines in 1990, § 1.4.
228. Decree No. 20/1990, § 2.3. For these purposes, the State Property Agency treats foreign controlled Hungarian corporations as foreign corporations. See id.
the Ownership and Privatization Committee, affiliated with the Government's Economic Cabinet, has proposed developing an annual list of companies in which state ownership will be maintained.\textsuperscript{229} Companies not on the exemptions list could be wholly sold off without any restrictions.\textsuperscript{230} A similar concept may be applied to the regulation of foreign participation.

IV. CONCLUSION

The Hungarian and Polish approaches to the regulation of foreign investment are remarkably similar. Both have achieved significant accomplishments in encouraging the participation of foreign capital. In the private sector, the foreign investor has great freedom in participating in domestic companies as well as forming new ventures. The restrictions on currency convertibility and forms of contribution have been virtually eliminated. Hungary retains a restriction only on the free expatriation of profits with respect to foreign employees.

The critical problem in the present legislation is the failure of the laws to adequately define the conduct of the state "super-agencies," or provide independent review of their decisions. The legal framework relies to a large extent on the discretion of the S.P.A. and M.O.C. The statutes fail to establish explicit standards for determining when a foreign investor may participate and fail to adequately determine the scope of authority of these agencies. This problem also occurs in the decisions of the other administrative agencies, affecting foreign investors, but the greatest impact is probably felt through the power of the super-agencies.

The situation is most acute in Poland. M.O.C. has significant authority to regulate transactions involving foreign investors. In transactions with state enterprises, the 1991 Polish Foreign Investment Law fails to tailor the authority of M.O.C. to ensuring the proper valuation of assets, as does the Hungarian legislation. Rather, it assigns broad discretion to M.O.C. in approving the venture, and continuing authority to regulate the transaction after its conclusion. As another example, tax incentives to foreign investors rest on the broad discretion of the Polish government. The 1991 Foreign Investment Law delegates the decision whether a company may qualify for a tax exemption to the discretion of the Minister of Finance and M.O.C. rather than creating a detailed

\textsuperscript{229} Proposal on Privatization Strategies in Hungary, MTI HUNGARIAN NEWS AGENCY, June 3, 1991.
\textsuperscript{230} Id.
schedule of those investments which shall be accorded preferential tax rates. In all of this, there is no independent review.

In the area of privatization, however, the problem is shared equally by both the Polish and Hungarian governments. While flexibility is important, *ad hoc* determinations, of whether foreign capital may participate and on what terms, are clearly inadequate. A more comprehensive approach must be taken. This can only occur through greater resort to the law.

Statistics and examples underscore the importance of implementing changes. As of September 1991, the number of firms in each country in which a controlling stake had been sold to foreign investors was less than ten. 231 In Hungary, the State Property Agency announced on September 14, 1990, the names of twenty relatively healthy state enterprises which were to be privatized. Only three of the twenty could have total foreign ownership. 232 The State Property Agency limited foreign ownership of all the others to between thirty and fifty percent. 233 Other actions by M.O.C. and the S.P.A. have also discouraged foreign investment. For example, in a somewhat controversial move, the S.P.A. intervened at the last minute to prevent the creation of a joint venture between Hungaroton and British E.M.I. company, which wanted to acquire a fifty percent stake. 234 In Poland, officials held up the sale of a truck factory to Volvo when they required Volvo to agree to acquire a notoriously bankrupt factory. 235

In the absence of change, the foreign investor remains a passive observer in the process of privatization. Such an investor may only take the lead in investing by directly negotiating with state enterprises over the contribution, sale or lease of its assets. In Hungary, an application to engage in a transaction with a state enterprise is deemed to be granted unless the S.P.A. responds within thirty days, 236 and if it does respond, its powers over denying the application are clearly defined. 237 Similarly, in Poland, M.O.C. must respond within two months. 238 This approach brings with it, however, the attendant difficulties of negotiating in earnest

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232. *Id.*
233. *Id.*
235. Engelberg, *supra* note 5. Renault, Volvo's partner, has continued the talks, but has not concluded an agreement.
236. Hungarian Law No. VIII of 1990, art. 4.
237. See *id.* art. 5.
238. 1991 Polish Foreign Investment Law, art. 18, 30 *I.L.M.* at 880.
with managers and employees whose interests vary with the interests of the enterprise itself.239

The questions of ownership, which have yet to be resolved, may eclipse these other concerns. A foreign investor must be aware of the attendant hazards. In the absence of laws resolving the question of reprivatization, the investor should attempt to more clearly establish the extent of rights and protections under the foreign investment laws and bilateral treaties, as well as specific guarantees and provisions which may exist within individual privatization offerings.

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239. The managers and employees of the state enterprise may very well have vested interests in maintaining the status quo. As one commentator noted,

Employee would welcome very much foreign investment, provided that everything would stay as it is—so that you have foreign investors coming with money and the enterprise going on as it has been. They are very much afraid that new owners, or foreign investors, may immediately reduce employment to thirty percent because this would make the enterprise efficient. In fact, quite often employees try to hinder the transformation.
