EAST-WEST TRADE: THE PHILOSOPHIES AND PRACTICALITIES OF STATE TRADING

DAVID E. ALLAN* AND MARY E. HISCOCK**

INTRODUCTION

East-West trade, in the sense of trade between free enterprise market economy countries and the centrally planned socialist economy countries, is no new phenomenon. What is new today on the part of traders and financiers in free enterprise countries is merely the pressure of the need for expanding markets and opportunities for investment of capital, technology, and services. This is matched in centrally planned economies by an appreciation of the need for commodities (capital and consumer), finance, and skills that only the West can supply; and a corresponding liberalization of policies which were designed to restrict capitalist penetration of socialist states.

What is the scope of "East-West trade"? And where do Asia, and Australia, fit into this expression? "East-West trade" was first coined within Europe to describe trade between the original countries of the Council for Mutual Economic Assistance and the countries of Western Europe. It is now generically used to describe all trade between countries with centrally planned economies which are ruled by a communist party, and countries with a capitalist or market economy. Within that definition, countries accord with the description to a greater or lesser extent.[1] Almost all countries attempt to regulate the economy; but the essence of the centrally planned economy is the state monopoly of foreign trade. The legal significance, rather than the economic reality, of that monopoly and of the Foreign Trade Plan, is the determinant factor in describing a country as "socialist" or "eastern" for the purposes of this article. The existence of state trading organizations carrying on foreign trade, even monopolising a particular commodity, is not enough. The State Trading Corporation as a vehicle for foreign (or even domestic) trade is neither novel nor confined to socialist

* The Sir Owen Dixon Professor of Law at Monash University, Australia.
** Reader in Law at the University of Melbourne, Australia.
This article is based on a paper presented by the authors at the Eighth Biennial Conference of the Law Association for Asia and the Western Pacific at Bangkok in August 1981. That paper was intended to review the area of state trading generally without discussing particular issues definitively. The authors wish to acknowledge that many of the ideas in this article stem from their joint work with Professor S. J. Picker Jr. of Case Western Reserve University.
1 How a country describes itself can, for the purpose of characterizing its trading system, be a most unsatisfactory guide.

countries. Where marketing or production conditions indicate it as the most effective vehicle for trade, it may be found in any country. Australia is no exception.[2]

This article is concerned with legal rather than commercial problems of trade between centrally planned and market economy countries, although often it is difficult to separate legal and commercial issues except in emphasis. Superficially, the transition to socialist law should not trouble the western lawyer, for most socialist countries with centrally planned economies belong to the family of the continental civil law. Hence, the civil lawyer should feel at home. For the common lawyer, the problems of appreciating the legal structures, concepts, and methods of reasoning in, for example, Poland are similar to those he would experience in, say, France. The use of penalties, the concepts of *force majeure* or changed circumstances, the absence of strict liability for defective performance, are all characteristics of the civil law, whether in non-socialist or socialist countries. To this extent there is little that is novel. What is different is the underlying ideology that affects in turn the role assigned to law and the legal system, the institutions for achieving it, and the understandings and expectations of the parties.

Given the above disclaimers and qualifications on the terms of reference of this subject, this article attempts to identify and describe those particular features of East-West trade which differ from the normal patterns of trade between market economy countries, and from the usual expectations of traders. The aims of the article are threefold: to describe the major features of a model socialist trading system, and indicate how that model has been modified in practice; to canvass some of the practical problems encountered by traders and investors from market countries in their dealings with socialist states; and to propound as a thesis that many of the difficulties stem from the limited extent to which the so-called socialist countries have been able to participate in the public international law regime which supports trade and investment between so-called free market countries.

CAPITALIST AND SOCIALIST THEORIES OF FOREIGN TRADE

Among free market nations, the purpose of international trade and investment is seen as being the increase of material wealth of participating nations. In economic terms, international trade is dominated by the theory of "specialization" according to "comparative advantage" whereby, subject to one basic condition, engagement in international trade increases the wealth of all participants beyond what any of them could achieve in commercial isolation merely through the exploitation of its own resources. This is said to apply equally to all nations, be they rich or poor, developed or developing, socialist or capitalist. The precondition, according to the theory

[2] See United Nations Economic Commission for Asia and the Far East, *State Trading in Countries of Asia and the Far East Region* (New York 1964) pp. 2-6.

of "comparative advantage", for international trade to produce this result is that there should be a realistic price mechanism which is the feature of a free market. The theory will work only if there is no price distortion. Among market economy nations it is the function of the General Agreement on Tariffs and Trade to preserve this free market and to avoid factors that produce distortion, such as embargoes and tariffs, dumping and subsidies.

This theory does not, however, obtain among socialist states where, according to classic socialist theory, the purpose of foreign trade is simply to export surpluses and to use the foreign currency obtained thereby to import deficiencies. Self-sufficiency is the ideal; and foreign trade is necessary only to the extent that the ideal can not be achieved at any particular time. Foreign investment should have no place within socialist planning. Domestically, the equitable distribution of wealth is more important than the quantum of wealth, and policies do not commend themselves simply on the ground that they increase wealth. No socialist state achieves the ideal of this theory of autarky, any more than capitalist states achieve the ideal of absolute free trade. However, the cornerstone of socialist theory is that the state has an absolute monopoly of foreign trade, which is conducted exclusively through state organs whose function it is to implement the "Plan". These are all planned economies, and foreign trade, like any other economic activity, is conducted according to the rubrics of the Economic Plan. Pricing, therefore, does not depend on market factors, but on a variety of social, economic, and political factors; and there is no necessary correlation between domestic pricing, inter-socialist pricing, and foreign non-socialist pricing. Prices are distorted, artificial, and arbitrary. The major exception to this socialist theory is Yugoslavia, where there is no dominant central economic plan and no absolute state monopoly of foreign trade, yet Yugoslavian enterprises and trade reflect a socialist philosophy.

THE MECHANISMS OF SOCIALIST FOREIGN TRADE

The key mechanism of trade in socialist states is state trading. All trade is conducted through the instrumentality of the state rather than individuals. This feature is present to some extent in all countries—socialist and non-socialist. But what distinguishes state trading in socialist countries is the total monopoly of all forms of trading, and the subservience of all other interests to the central economic plan. The foreign trade structure in socialist states, which may differ minimally from state to state, presents a hierarchy of both planning and executive organs, and a domination of trade by bureaucratic processes rather than commercial interests. The chief executive body is usually a Ministry of Foreign Trade which prepares a Foreign Trade Plan which in turn is intended to implement the national Plan by indicating the range and extent of exports needed to earn the foreign currency to pay for necessary imports.

The Ministry supervises the work of Foreign Trade Corporations. There may be separate Foreign Trade Corporations for different commodities, and they conduct the whole business of exporting and importing in the commodities within their jurisdiction. Exporting includes domestic procurement, pricing, and foreign marketing. Importing includes foreign purchasing, domestic pricing, and distribution. Usually these Foreign Trade Corporations have the status of independent legal entities, but considerable problems can arise in practice in ascribing this status to them, particularly if the law governing their status or incorporation is unclear. Given socialist theory, it is also difficult for western observers to concede them a status separate from the state itself. Yet their status is important to determine such matters as their contractual capacity and authority, their entitlement to sovereign immunity, and their responsibility in *force majeure* situations.[3]

Beneath the Foreign Trade Corporations in the hierarchy are various marketing and promotional organizations including commercial counsellors, permanent trade delegations, trade fairs, etc. In the development of the foreign trade of the People's Republic of China, the China Council for the Promotion of International Trade plays a major role and supplies important ancillary services such as arbitration facilities. There are also financing institutions, such as central and specialized banks, supporting the work of the Foreign Trade Corporations; and also usually arbitral institutions.

As foreign trade at any time implements the Foreign Trade Plan, which in turn implements the "Central Plan", foreign trade is comprehensible only by reference to those Plans. The Plans impose legal obligations in administrative law on all government bodies, officials, and enterprises. These obligations include production quotas for factories, and directions for the factories to purchase raw materials and dispose of their products, in all cases at predetermined prices. The Foreign Trade Corporations are directed to acquire goods for export from state producing enterprises at domestic wholesale prices and to sell in foreign markets at the best prices available. There are separate obligations concerning currency control and bilateral inter-governmental agreements. In the case of imports, the Foreign Trade Corporations are required to buy nominated goods in foreign markets at the best prices, and to sell domestically at nominated prices similar to the prices of domestically produced goods. All domestic prices are determined according to the national Plans, and the Foreign Trade Corporations have little or no discretion:

> "Planning, as one of the most important parts of the economico-organizational activities of the socialist state, represents a prerogative of the highest organs of state authority. The national economic plan, which has been approved by the highest organs of the state, acquires the authority of a law, in the legal sense."[4]

[3] These problems are discussed further infra.

[4] Usenko, (1966) 70 *Sozialistische Internationale Arbeitsteilung und ihre Rechtliche*

Two distinctive features appear from these procedures:

(a) the isolation of the producer or end-user from the foreign customer, with attendant commercial and technical problems; and

(b) the importance and artificiality of pricing; domestic prices are determined centrally without reference to costs of imports or export market conditions, with the corresponding total distortion of Western notions of "comparative advantage".[5]

RELAXATIONS OF THE SOCIALIST MODEL

Just as there is no country with a truly capitalist economy, so also no socialist state conforms entirely to the socialist model described above. The nearest is the U.S.S.R.; but other socialist states, whilst sharing the same ideological approach with the U.S.S.R., have totally different domestic economic situations to contend with. For most of them "self-sufficiency" is not a realistic aim, and there is consequently a greater dependence on foreign trade. There has also been in most socialist states a gradual pressure for diversification of local markets to place more emphasis on the needs of consumers and on neglected areas of the economy such as housing and light industry. This feature has presented western business interests not only with opportunities for expanding trade but also for industrial cooperation on projects within socialist states either on a joint venture basis or through the provision of western technology. There is no uniform pattern of this relaxation of the socialist model and it has proceeded to varying degrees from country to country. There are, however, certain common trends:

(a) The major feature has been a relaxation of central control, whereby the Ministries of Foreign Trade come to exercise less direct control over Foreign Trade Corporations, which in turn bring the producing or end-using enterprise into direct contact with the foreign customer during negotiations. This reflects an awareness of the problems of separating foreign trade, whether importing or exporting, from the production of goods.

(b) There has been an emergence of economic rather than administrative controls of foreign trade. Most significant has been the appearance of profit as a stimulus to trade and production in many countries; and this in turn has enhanced the focus on the importance of pricing.

(c) Wholesale prices have become more realistic and related to costs. This in turn has been conducive to the development of a relation between

Bedeutung, cited in C. Schmitthoff, "Commercial Treaties and International Trade Transactions in East-West Trade" (1967) 20 *Vanderbilt L. Rev.* 355, fn. 10, and translated by him.

[5] This artificiality of pricing enabled Eastern European countries to fend off inflation during most of the 1970s and to hold consumer prices at artificial levels. This has however broken down through the importation of western inflation through increased trade and particularly the need to import oil at world prices.

foreign and domestic pricing. It is recognized that foreign and domestic prices must influence one another.

(d) The need for technology has increased the use of joint venture contracts; and the presence of the foreigner within the gate has had effects on local attitudes. There has even been direct investment on a joint enterprise or even wholly owned subsidiary basis in some cases. Romania, Hungary, Bulgaria, China and Yugoslavia in particular have developed a legal framework for East-West joint ventures;[6] and Polish law now allows direct foreign investment either by way of joint venture or, in the case of service industries, a wholly foreign-owned business.[7] Nevertheless, socialist ideology still requires that one speak of "industrial cooperation" rather than "direct investment".

Events in Poland since 1980 raise the question whether liberalization of trade can proceed without general economic and political liberalization; and whether, if liberalization proceeds too far and too fast, there will be a reaction.

The most significant and dramatic relaxation in recent years has occurred in the People's Republic of China, where isolation and autarky have been abandoned as aims, and there has been a conscious adoption of the need for trade and foreign investment to secure Chinese development. This has been demonstrated in the following ways:

(a) The bureaucratic and administrative systems have been modernized along more functional lines. The number of state trading organizations has been increased and their terms of reference revised; the organizations now have branches in many areas; but factories have been given authority to deal with foreigners, negotiating directly.

(b) The necessity for a legal regime to support trade and investment has been recognized. Lawyers have been rehabilitated; legal education has been resumed. The legal system is being revised; old laws reformed and new laws promulgated. In particular there are new laws on joint ventures, on tax affecting foreign investment and on economic contracts. Procedures for dispute resolution have been reviewed. There is a growing interest and participation in international law-making bodies, such as the United Nations Commission on International Trade Law.

(c) The role of foreign finance in providing the foreign currency component of development projects has been recognized. The ideological

[6] See D. A. Loeber, "Foreign Participation in Soviet Enterprises?" in (1980) 6 *Int. Trade Law and Practice* 215.

[7] See 1978 Report of the Australian Trade Development Council Survey Mission to Poland, Czechoslovakia, and Romania, p. 18. The Mission nevertheless believed that the commercial prospects for joint ventures between Poland and Australia were better in Australia than in Poland, a view that may have been reinforced by recent events in Poland. See also J. G. Scriven, "Joint Ventures in Poland: A Socialist Approach to Foreign Investment Legislation" (1980) 14 *Jo. of World Trade Law* 424.

objection to foreign loans has been reconsidered, and lines of credit and finance have been extended by many capital exporting countries.[8]

(d) The promotional, advisory, and arbitral functions of the China Council for the Promotion of International Trade have been revised and new official bodies established such as the China International Economic Consultants to assist foreign investors.

(e) The importance of direct foreign investment and the skills and technology it brings with it have been recognized in the creation of the China International Trust and Investment Corporation, in the promulgation of the Joint Venture Law 1979 which permits investment in the form of a joint enterprise through a limited liability company, subject to safeguards for both parties and compliance with the overall Plan, and in the granting of tax incentives generally and in the Special Economic Zones.

It is suggested in this paper that, during the last decade, although the political and ideological differences between socialist and non-socialist states have remained, economically and commercially there has been a drawing together. The socialist states have not been able to secure the development for which they had planned through a dogmatic approach to trade and investment. They have come to realize that their development depends on trade, on technology, and on finance from other countries, socialist and non-socialist. Non-socialist nations continue to perceive the constant need for expanding markets, and the potential of socialist states in this regard can not be overlooked. For the West, the prizes are considered to be worth the risks.

This newly recognized interdependence of East and West is a product of economic and commercial necessity. The problems of implementing it, however, remain. These seem to have two major causes which are explored in the remainder of this article:

(a) The expectations of western traders, developed through dealings with one another, are often not fulfilled when they deal with the bureaucratic machinery, reflecting a different ideology and different expectations, in the socialist world; and

(b) Capitalist trade has been supported by a public international law regime, largely developed since 1945. The difficulties or inabilities of socialist states to participate in that regime confound many of the assumptions of normal western trade and investment.

THE EXPECTATIONS OF SOCIALIST TRADERS

To understand the problems of East-West trading contracts, it is first necessary to look at the expectations of the officials of the State Trading

[8] In 1979 Australia extended a A$50 million line of credit to the People's Republic of China.

Corporations based on their experience either in their own domestic legal system or in inter-socialist trade. This experience provides an established pattern from which the State Trading Corporation may move into trading arrangements with the West. The differences are dramatic. Whereas in the free market countries the normal assumption is that trade, whether domestic or international, is largely governed by private law and is conducted through the mechanisms of private law, the socialist sees it as an extension of the public law framework of his own system. This is because of the state monopoly of foreign trade, and also the structure of the socialist legal system. This dualism is an important characteristic of socialist law which is carried forward into international trade: trade is regulated on the one hand by inter-governmental or inter-ministerial agreements, and on the other by civil law contracts between state enterprises. The role of the former is concerned with the planning functions of the state; the role of the latter is to establish rights and duties between enterprises to implement the Plan. The interaction between the two dominates the socialist approach to contract.

In socialist law, at one stage contract played little part as it was seen as pre-eminently a capitalist institution. Today it is the means by which State planning is carried into effect. First the Plans, at varying levels, are formulated and approved; then production and delivery orders are made pursuant to the Plan, addressed to particular enterprises. These give rise to rights and duties in administrative law, which are implemented when the enterprises enter into contracts with one another which create civil law obligations.[9] The major types of contract are delivery contracts (sales without a transfer of property), contracts for purchase of farm products, contracts for capital construction, shipment contracts and credit contracts.

One of the major problems of domestic socialist systems concerns the effect on contracts of a change in the Plan. Where this occurs, the change must be incorporated into the agreement either by an additional contract or a variation by exchange of letters. If each enterprise is subject to a separate Plan and only one Plan is changed, this does not affect the contract rights of the other party unless agreement is reached between the planning agencies. But new planning acts take precedence over existing contracts.[10]

[9] See, for example, *Principles of Civil Legislation* 1961 (USSR):
Art. 33: Once concluded, the obligation must be carried out according to law, the planning Act or the contract.
Art. 34: Contents of contracts concluded must conform with the planning Act; differences in the pre-contract stage must be resolved by *Arbitrazh*.
Art. 36: Agreements permitting exemptions from liability are not permitted; fines, penalties and forfeitures fixed by law for late or improper delivery can not be waived.

[10] The rigidity of this principle is mitigated in international intersocialist transactions where the accompanying inter-governmental agreement or contract terms settle the consequences of any change in plan.

In most socialist countries there is no separate law regulating foreign trade.[11] All apply their own civil law, including their conflict of laws rules, to contracts relating to foreign trade. If *renvoi* arises, it is accepted into the domestic civil law. Within the Council for Mutual Economic Assistance there are supranational provisions, particularly the "General Conditions of Delivery" governing contracts between enterprises in member states. There are also standard contracts of particular types.

PROBLEMS ENCOUNTERED BY FREE MARKET TRADERS DEALING WITH SOCIALIST ENTERPRISES

In contrast to the officials of the Foreign Trade Corporation, the western trader enters the transaction with all the assumptions of the capitalist system concerning contract. The underlying philosophy is still freedom of contract: freedom to enter or not to enter into the particular contract; freedom of choice of trading partner; and, subject to a small but increasing area of mandatory and regulatory law, freedom as to the terms of the contract. Contract serves to establish and to define his relation with his trading partners, as well as to effect particular transactions. How can this be reconciled with the attitude of his socialist counterpart? What should the western trader expect to encounter in the negotiating process?

1. Status of the Foreign Trade Corporation

The socialist party to the contract will always be the relevant Foreign Trade Corporation. Foreign Trade Corporations are usually governed by formal Charters and Constitutions. The status of the Foreign Trade Corporation as a trading partner needs to be carefully checked. It is important, first, in relation to the contractual capacity and authority of the Corporation and its officers; and, second, to determine whether the Corporation is so closely associated with the state that it may enjoy sovereign immunity from legal process in some jurisdictions.

Usually Foreign Trade Corporations are independent legal entities, separate from the state, with power to enter into contracts, to hold and dispose of property, and to sue and be sued. The problem for the western trader, if he is not dealing in a country with a readily accessible and comprehensible legal system, is how to verify the status of the Corporation. In the U.S.S.R. one looks to the Constitution and to the Charter of the particular Foreign Trade Corporation; but in the People's Republic of China, while the Foreign Trade Corporations consider themselves separate legal entities, it is difficult to verify this assertion or the extent of their

[11] Yugoslavia, Czechoslovakia, and the G.D.R. are exceptions. D. A. Loeber, "Plan and Contract Performance in Soviet Law" (1964) *U. of Ill. Law Forum* 128; P. Katona, "The International Sale of Goods among Member States of COMECON" (1970) 9 *Col. Jo. of Trans. Law* 226; J. Rajski, "Basic Principles of International Trade Law of Certain European Socialist States" (1978) 4 *Int. Trade Law & Practice* 9.

powers in the absence of a Charter or a Commercial Code. The absence of clear cut criteria for determining the status of the Corporation as a separate legal entity is at the base of the problem.[12]

The fact that the Corporation is a separate legal entity with power to enter into the particular contract does not conclude the question of whether it will partake of its government's sovereign immunity from legal process, for it may nevertheless be so closely identified with the government as one of its economic enterprises as to justify its sharing in that immunity.[13] Two problems of characterization have to be faced: first, whether the Corporation is sufficiently identified as an economic enterprise of government; and second, whether the particular activity called into question is administrative and political, or commercial. In most jurisdictions today a restrictive approach to the doctrine of sovereign immunity denies immunity to the commercial activities of governments, but this is not so in some of the unreformed common law jurisdictions, such as Australia. It is necessary therefore to speculate in which countries legal process might need to be sought against the Foreign Trade Corporation, and to examine the nature of the doctrine in those jurisdictions.[14]

2. Negotiating with the Foreign Trade Corporation

The charter of the Foreign Trade Corporation should prescribe the powers and scope of authority of both the Corporation and its officers, and will include such matters as the formalities for contracting, the need for writing, and the number and identity of authorized signatures.[15] There is, therefore, an emphasis in the negotiations on formalities and formalism that is not usual between private traders. All agreements, decisions, understandings, waivers or variations must be recorded in writing in the contract with the Corporation. This particularly applies to after-sales obligations which may have been negotiated with the end-user and which may be performed directly

[12] So also is the question of the appropriate law by which this is to be determined. This aspect is discussed infra. For an example of the difficulties western courts experience in determining whether the Corporation is a separate legal entity, see *C. Czarnikow Ltd* v. *Centrala Handlu Zagranicznego Rolimpex* [1979] A.C. 351. See also K. Gryzbowski, "The Foreign Trade Regime in COMECON Countries Today" (1971) 4 *N.Y.U. Jo. of Int. Law and Politics* 180.

[13] See *Krajina* v. *Tass Agency* [1949] 2 All E.R. 274; *Baccus S.R.L.* v. *Servicio Nacional del Trigo* [1957] 1 Q.B. 438; *Mellenger* v. *New Brunswick Development Corporation* [1971] 1 W.L.R. 604. See generally on this topic C. Schmitthoff and F. Wooldridge, "The Nineteenth Century Doctrine of Sovereign Immunity and the Importance of the Growth of State Trading" (1972) 2 *Denver Jo. of Int. Law and Policy* 199; V. Knapp, "The Function, Organisation and Activities of Foreign Trade Corporations in the European Socialised Countries", in C. Schmitthoff (ed.), *The Sources of the Law of International Trade* (London, Stevens, 1964) pp. 52, 62-3; and G. Triggs, "Restrictive Sovereign Immunity: the State as International Trader" in (1979) 53 A.L.J. 244, 296.

[14] It is the practice of the U.S.S.R. not to claim immunity for the commercial transactions of its Foreign Trade Corporations. However, the same would not apply to lesser organizations such as permanent trade delegations.

[15] This will be in addition to any formalities prescribed by the civil and commercial codes.

with him, for he is not a party to the contract. The writing must be properly executed and the signatories properly authorized. Wherever the negotiators of the Foreign Trade Corporation lack authority on any aspect of the contract, the negotiations must be with the Ministry. The extent of freedom of the Ministry and the Corporation to negotiate on vital terms of the contract will be governed more by the need to comply with the Plan than by usual market considerations.

Most Foreign Trade Corporations are very large concerns, and they are likely to employ teams of negotiators who have considerable but narrow expertise. It is important, therefore, for the western trader to ensure he discusses particular matters with the appropriate expert. The socialist negotiators, through exchanges of information within the COMECON organisation, are likely to have a wide knowledge of competitors, products, and contracts.

Experience tends to show that negotiating a contract with the Foreign Trade Corporation of a socialist state may be a slow, patience-trying, and costly process. It will almost certainly take place over a protracted period in the socialist country where the western negotiator may not, however good the intentions of his hosts, feel completely at ease. His consolation is that, whilst socialist negotiators regard hard and detailed bargaining as essential to the transaction, their record of performance once the contract is concluded is meticulous and exact. But likewise their expectations of counter-performance are that it should be strictly in accordance with the contract. There is therefore a need at this stage for each party to understand perfectly the terms vital to the other party and the nature of the other party's expectations.

3. Standardization of Contract

The scale of transactions entered into by the Foreign Trade Corporations, together with the limited scope for free negotiation of terms, has led to standardization of both procedures and terms of contracting of the Corporations. Whether the Corporation is contracting as buyer or seller, negotiations will normally be on its standard terms rather than those of the western trader.[16] However, there is a willingness in many cases to use internationally approved terms, whether they be those of commodity associations or of other institutions concerned with international trade. For example, the Economic Commission for Europe produced, not only General Conditions for the Supply of Plant and Machinery for Export in western trade,[17] but

[16] The Foreign Trade Corporations of the People's Republic of China tend to have separate standard terms depending on whether the Corporation is buying or selling. When it is buying, the terms are usually more detailed and demanding than those it proffers as seller. This, however, is not a phenomenon confined to the P.R.C. or even to socialist states. See Stephan Jaschek, "Chinese Standard Form Contracts: Their Legal Significance" in *China Trader* (December 1981) pp. 23-31.

[17] The 188 Series.

also similar conditions for use in East-West trade.[18] The Council for Mutual Economic Assistance itself has sophisticated General Conditions of Delivery for trade amongst its members, and Finland in 1978 produced General Conditions for the Delivery of Goods between Finland and member countries of the Council. As the volume of trade develops between socialist countries and market economy countries, the development of general conditions of this nature to be used as approved models in particular transactions can only have a valuable effect.

Standard terms need to be detailed and comprehensive. They need to incorporate all undertakings because they are the Corporation's authority to pay. But additionally, depending on the governing law, it may be difficult to fill gaps in the written contract. The range of matters which need to be covered in standard contracts, whether those of one of the parties or the result of bilateral or multilateral international agreement, are description of the goods or services; guarantees (warranties); testing and inspection; pricing and finance; licensing requirements; *force majeure*; cancellations, dispute resolution, and penalties; choice of law and choice of forum. The remainder of this part of the article considers in more detail some of these matters.

4. Choice of Law and Choice of Forum

There is usually an expectation that the forum for the settlement of any dispute will be in the socialist country, and that it will be by arbitration rather than before the courts. This has two immediate consequences: first, there is unlikely to be any body of case law to fill the gaps in contracts,[19] so that again detailed negotiation of the contract is desirable; and second, the conflict of laws rules of the socialist country as the laws of the forum are likely to determine the proper law of the transaction.

All foreign trade contracts must be subject to some national law, and although many of the constituent elements of socialist and non-socialist commercial law are the same, the role and function may differ, particularly to the extent that contract is seen as implementing the Plan.[20] Inter-governmental agreements have a role here, but it is often limited to recommending the use of particular general conditions.[21] There are sometimes, however, mandatory provisions which will bind the parties. In

[18] The 574 Series.

[19] In some countries, however, there is systematic reporting of arbitral decisions.

[20] For an interesting example of how this can affect East-West trade see *C. Czarnickow Ltd* v. *Centrala Handlu Zagranicznego Rolimpex* [1979] A.C. 351 which concerned a contract for the sale of the surplus of the Polish sugar beet crop to the plaintiff. The crop failed, and the Polish Plan was amended to divert the crop into the domestic market. The contract was a standard form commodity contract of the Refined Sugar Association containing an arbitration clause. The change in the Plan was treated as a species of *force majeure* within the contract, leaving as the main issue the question whether the State Trading Corpororation was a separate entity from the Polish Government so as to enable it to rely on this *force majeure* clause.

[21] For example, the U.S.S.R.-Swedish Inter-Governmental Agreement 1947.

particular they are capable of having a significant effect in defining such concepts as *force majeure*[22] and illegality, and their consequences. The work of the United Nations Commission on International Trade Law, culminating in the Vienna Convention of 1980 on the International Sale of Goods, may go a long way towards providing an international law. The Commission has also produced model rules for *ad hoc* arbitrations, the Hamburg Rules on Carriage of Goods by Sea (as a revision of the Hague Rules), and a new Convention is being prepared on international negotiable instruments. Meanwhile the Geneva Convention of 1980 established a legal regime governing multi-modal transport. All these Conventions will assist to overcome the problems of choice of law if all the trading nations, socialist and non-socialist, ratify them.

In the absence of an applicable international law, three problems arise:

(a) what system of national law governs the contract?

(b) to what extent does that system permit provisions of law to be overridden or avoided by contract? That is, to what extent is the law mandatory and to what extent dispositive?

(c) is only one system of law relevant, or do different systems govern different aspects of the contract?

In socialist countries, as in most non-socialist countries, the conflict of laws rules recognize party autonomy, so that the parties have power to choose their own applicable law. However, in non-socialist countries, in the absence of an express or implied choice, no one fact or presumption is dominant. One has regard to all places with which the contract is connected: the place where it is made, the places where it is to be performed, etc. But in most socialist systems, if no express choice is made, then the *lex loci contractus* can not be overridden; and in most cases this will be the law of the socialist state. In two cases the *lex loci contractus* as such will be held not to apply by a socialist tribunal. The first is that the formal validity of the contract, in such matters as compliance with the civil code and any special requirements of the charter of the Foreign Trade Corporation, will always be determined by socialist law. The second is that the capacity of each party is governed by its own national law. There is therefore a danger, wherever the contract is made, that, if the formalities and procedures required by the socialist state are not followed, the contract may be held to be *ultra vires* the Foreign Trade Corporation.[23]

[22] Two major difficulties arise with *force majeure* clauses: first, the refusal of most socialist states to acknowledge industrial strikes as *force majeure* events; and second, the failure of most clauses to come to grips with the problem of non-performance through changes in the Plan. See supra.

[23] See generally S. Szászy, "The Proper Law of Contract in Trade between Eastern Europe and the West; the Position of East European Socialist States" (1969) 18 I.C.L.Q. 103; and G. Roman, "Socialist Conflict of Laws Rules and Practice in East-West Trade Contracts" (1975) 7 *Law and Policy in International Business* 1113.

Although most socialist states contend for dispute settlement by their own arbitral tribunals, there is an increasing willingness to agree to arbitration before permanent international arbitral bodies or before the arbitration tribunals of some third country.[24] Arbitration tribunals in socialist countries may have general commercial or specialized jurisdiction.[25] They are usually established by the state, supervized by the Minister of Foreign Trade, administered perhaps by a Chamber of Commerce or similar quasi-governmental organization, and carry out their functions according to national policy. Although there have been some *causes célèbres*, most of the tribunals have a good record for efficiency and impartiality, and see their role as doing justice between the parties more than securing compliance with the Plan. Whatever arbitral tribunal is chosen, the law governing the arbitration will be the arbitral law appropriate to that tribunal.

5. Pricing and Finance

Reference has already been made to the problems of pricing in contracts in East-West trade. Socialist domestic prices are Plan prices, determined centrally without reference to costs of imports or export market conditions. In its classic form "comparative advantage" plays no part in exporting, where the aim is primarily to dispose of surpluses and earn foreign currency to pay for essential imports. However, outside the U.S.S.R., market conditions have softened the rigours of this socialist model. Wholesale prices have been more realistic and related to costs; and a relation has developed between foreign and domestic prices.

To some extent, however, the sophistication of pricing depends on the sophistication of accounting techniques. For example, the pricing of major engineering contracts in China used to be on the basis of fixed price with percentage payments at fixed periods. Newer methods employed a cost-reimbursable basis plus a percentage. The difficulty, however, is to define what is a reimbursable cost, and there appears to be no alternative to including a glossary in the contract.

When it comes to financing the contracts,[26] the legal forms are familiar to the western businessman but the attitudes and terms differ. Also, there are different institutions. The state monopoly of socialist states applies also to banking and so do bureaucratic processes. The differences are conse-

[24] For example the Chinese Joint Venture Law, article 14, provides for arbitration by a Chinese arbitral body or such other body as the parties agree on. This agreement can be expressed in the articles of the joint venture. See generally H. Holtzmann, "Arbitration in East-West Trade" (1975) 9 *Int. Lawyer* 77.

[25] Examples of specialized tribunals in the People's Republic of China are the Foreign Maritime Arbitration Commission and the Foreign Economic and Trade Arbitration Commission, both within the China Council for the Promotion of International Trade. See K. Gryzbowski, "Arbitral Tribunals for Foreign Trade in Socialist Countries", in *East-West Trade* (Dobbs Ferry, Oceana, 1974) p. 202.

[26] See generally on this topic Lebahn, "The Questions of Financing between the U.S.S.R. and the Federal Republic of Germany" in *East-West No. 256* (24 October 1980) and *No. 275* (7 November 1980).

quences of the economic system, and in particular the balance of payments problems of most socialist countries including the shortage of convertible foreign currencies, and the system of currency and foreign exchange control.

Contracts are concluded on cash, credit or barter terms. Although credit arrangements have developed dramatically in the last few years, the traditional form in East-West transactions has been cash or barter. Credit was unpopular because of balance of payments problems, foreign currency shortages, and the absence of acceptable forms of security. Accordingly, the extension of credit came to depend on credit assessments, the availability of guarantees and insurance, and also on possibilities for risk spreading. Through this impetus, old forms have been adapted, and new forms developed.

The application of normal techniques of credit assessment to the socialist Trading Corporation has not always been easy. To normal economic and commercial risks, there have to be added political risks. The willingness to pay is as important as the ability, though the socialist record is generally good. However, financial information to support the assessment is not always readily available, and as a financial criterion the willingness of the government to assign funds to the contract is more important than its profitability. State control over all foreign debt obligations means that the Foreign Trade Bank must approve the foreign exchange transactions of the Foreign Trade Corporations.

A number of financing institutions have evolved specifically for East-West trade. The Foreign Trade Bank of a socialist country is normally a subordinate of the Central or National Bank which exercises the banking monopoly. The Foreign Trade Banks, except in Albania, Romania, and China, adhere to the International Chamber of Commerce Uniform Customs and Practices on Documentary Credits. The Council for Mutual Economic Assistance has developed two specialist banks primarily for inter-socialist trade, but which also play some role in East-West trade. These are the International Bank for Economic Cooperation and the International Investment Bank. A number of western banks now have branches in socialist countries, and the Moscow Narodny Bank currently has branches in London, Beirut, and Canada. There have been some experiments in banking joint ventures between East and West. A number of West European trading houses have developed specialist functions in East-West trade, including financial services.

As mechanisms of payment, letters of credit are recognized and are used. There does however appear to be some antipathy to them in some countries, and also to the use of bills of exchange or promissory notes. It is said that socialist states object to the discounting of their paper in western markets, though whether this is on ideological grounds or to protect their economic standing is not clear. Some socialist states press for cash against documents, either as a method of payment under a letter of credit arrangement or alone,

or open account terms with 30-60 days for settlement. If longer terms of credit are required, then use must be made either of supplier credit techniques, whereby the Foreign Trade Corporation supplies the western trader or his bank with negotiable instruments guaranteed by the Foreign Trade Bank, or of buyer credit arrangements whereby western financing institutions extend lines of credit to the Foreign Trade Corporation or Foreign Trade Bank. Bank-to-bank lines of credit between western commercial banks and Foreign Trade Banks are not uncommon. Credit insurance extended by western institutions such as Export Credit Guarantees Department of the United Kingdom, U.S. Eximbank, Japan Eximbank, Export Finance and Insurance Corporation (Australia), and Hermes (West Germany) is playing an increasing role. Although the classic role for these insurers is that of insuring foreign accounts receivable against risk of non-payment, they are now playing a more significant role in the direct financing of the socialist Corporation.

The shortage of foreign convertible currency in socialist states has led to the development of many barter techniques under the name of "compensation trading".[27] Barter arrangements in the form of direct exchanges between the parties of specified quantities of different commodities may well be proposed, and it may be suggested that some arrangement of this nature is essential if the Foreign Trade Corporation is to conclude the contract. The proposal places the onus on the western trader to find a market for the socialist product.[28] Where a western supplier is required to buy eastern manufactures to a certain value within a stated period, it is important that he stipulate in his contract either the exact description of the exchange goods or a free choice from a specified list. The pricing of the bartered goods, or rather the determination of a value to be placed on them, also presents difficulties. If the transaction is covered by an export credit guarantee, it is necessary to separate the contract for the bartered goods from the export contract. Credit insurers will not guarantee the western obligation to remarket eastern goods!

"Counter-purchase" is a more sophisticated form of barter, often tied to the purchase of the products of technology or equipment sold. It involves a series of contracts: the first, between the western seller and the eastern buyer, provides for a cash settlement of the transaction; the second, between the same parties, ties the western trader to buy eastern goods for a price equal to that in the first contract or to some lesser limit; the third, between a western bank and the socialist Foreign Trade Bank, is the financial agreement and is often accompanied by the provision of a credit guarantee

[27] Many horror stories are told about compensation trading which may not present a reliable picture of the general situation. It is true that the shortage of foreign currency induces the socialist state to take every opportunity to push counter-trading: occasionally some instances may be a little bizarre.

[28] Trading houses often assist by finding markets for bartered commodities.

or insurance. Those transactions are frequently of large amounts and often involve governments.

Similarly "counter-production" agreements often accompany industrial cooperation agreements and the provision of technology. The western trader supplies plant, equipment, technology, etc. and obtains finance and insurance from western sources for this purpose. The Foreign Trade Corporation then contracts to pay wholly or partially in goods produced by this technology and equipment. The western trader in effect is buying a specified quantity of the output. He must be sure of the quantity, quality, and price; and he must possess the necessary marketing expertise.[29]

"Co-production agreements" are really industrial cooperation agreements. Each party makes reciprocal deliveries of various components to be used in the manufacture of a joint product. The measure of the contribution of each is determined in the contract. Each then pays the other in kind by exchanging the necessary components for the finished product. There may well be separate marketing and profit sharing agreements.

Two special facilities, developed specifically for East-West trade, are "switch trading" and "non-recourse (*á forfeit*) financing". Switch trading is a means by which the socialist country can overcome difficulties of payment caused by lack of the relevant foreign currency, and which enables the western supplier to be paid in the currency he requires, although at a discount. Accordingly, if switch trading is to be employed, the western trader needs to be aware of this when settling his price.[30] In its most simple form, the device arranges for payment in a convertible currency by means of an intermediate "switch trader". The convertible currency results from a clearing settlement between the socialist country and a third country which has a negative balance with the socialist country.

Non-recourse or *á forfeit* financing is a special facility developed in trade between East and West Europe for the financing of accounts receivable that are not fully covered by insurance. Ordinarily, sales of accounts receivable to commercial banks are "with recourse" so that in the event of non-payment the bank may simply recoup its loss by debiting its customer's account. But the special non-recourse facility frees the western supplier from contingent liabilities, and the purchasing bank (*forfeiter*)[31] accepts the risk of collecting payment from the Foreign Trade Corporation without recourse against the western supplier. The purchasing bank holds the paper until maturity, or rediscounts. Normally the purchasing bank may seek a guarantee of the accounts from the relevant Foreign Trade Bank or an international bank. The facility is often expensive to the western supplier.

[29] This system has been much used in the People's Republic of China where it is regarded as a form of repayment of credits by instalments. It can be financed by direct loans by the Bank of China or its finance subsidiary, and Bank of China guarantees are possible.

[30] If a switch payment is proposed after the contract has been concluded, it may be too late to adjust the price.

[31] Usually a western bank or a specialist East-West bank.

6. Licensing and Industrial Cooperation

The major need of socialist countries, in addition to foreign exchange, is western technology. Often the western entrepreneur will prefer to sell his technology rather than engage in direct capital investment with all the attendant risks, and particularly this is so where the host system is ideologically antipathetic to direct investment. Much trade, therefore, between socialist and non-socialist states takes the form of the licensing of technology. This is attractive to the host country as a means of saving development time and costs, of updating local technology, and of achieving planned targets. Payment is usually by lump-sum rather than royalties, which may be prudent if there are uncertainties about production schedules. Sometimes, particularly if the transaction is part of a wider scheme for cooperation, there may be payment in goods.

For the western owner of the technology, whether he is licensing patents, trademarks or know-how, the attraction of the scheme depends on the protection that is afforded to industrial property rights in the host country. If the laws of the host country do not recognize and uphold real rights created elsewhere, then the licensor's protection is limited to what he can obtain from contractual provisions requiring confidentiality or limiting the use of those rights.

Most socialist states are parties to the Paris Convention for the Protection of Industrial Property 1883,[32] and some are parties to the Patent Cooperation Treaty. But although there is considerable unity in principle on the concepts of industrial property, there is no distinctive socialist view of the nature or extent of legal protection they should be given. However, an initial attitude of socialist hostility to industrial property rights has undergone a total change.

Most socialist schemes of industrial property rights correspond to those in the West;[33] but the only possible users of patents and inventions are the state enterprises. The inventor or owner, therefore, although he has a right of recompense, has no bargaining power. As in the West, the fruit of an employee's work belongs to his employer, so that at least a private inventor's rights can be exercised only in a limited way for private and personal use. The patent system is centrally administered by a State Committee for Inventions and Discoveries that exercises broadly similar functions to Western patent offices. But most countries on the U.S.S.R. model require that all licensing agreements be recorded with the central authority for validity. The U.S.S.R. system also has two distinctive concepts: the certificate of authorship and the statutory protection of know-how.

[32] Which is currently undergoing its seventh revision.

[33] The People's Republic of China has a trade mark law and is expected soon to have a patent law. Albania, Bulgaria, and Hungary have patent laws based on the model of the U.S.S.R.; Poland, Czechoslovakia, and the G.D.R. retain their former patent laws but with some concessions to socialist doctrine. See F. K. Beier, "Traditional and Socialist Concepts of Protecting Inventions" (1970) 1 *Int. Rev. of Industrial Property and Copyright* 328.

As the ownership of patents and inventions vests in the State, a qualified inventor receives a certificate of authorship in lieu of a patent which entitles him to payment and other benefits and privileges if his discovery is accepted for use. In domestic use, it almost excludes patents, but is not available for foreigners. Similar protection is given to individuals who are responsible for advances in know-how.

Under normal socialist domestic law, western inventions are entitled to protection on the basis of reciprocity. Further, under the Paris Convention the right of priority of the inventor is recognized. The patent must be registered with the Central Patent Bureau, but some problems will affect the western entrepreneur. Registration is costly; the volume of use may be difficult to ascertain; prices may not be realistic; there may be a government pre-emption of the technology at a fixed rate of compensation; there will be no choice of licensee and the patent will be exploited by the enterprise designated by the State. However, the patent will be exploited and the licensor's rights will be protected. Copying is illegal, and export to third markets can be controlled.

Other forms of technology transfers are not protected in this way, and protection must be sought by contractual terms. The standard form terms tendered by the Foreign Trade Corporations may or may not be considered adequate by the western supplier.

Licensing of technology is usually found in conjunction with some chosen form of industrial cooperation, which implies some long term trading relation involving joint contributions through technology, raw materials, research, production, marketing, etc. Normal trading relations frequently develop in this way, and among western nations usually develop into direct investment. Whilst direct investment is not impossible in all socialist states, it will usually stop short of the location of a western owned enterprise in the socialist state or even a jointly owned enterprise. It may however be supported by inter-governmental industrial cooperation agreements.

The normal progression may be from merchandising through a whole range of cooperation and servicing: management services, turnkey projects, licensing technology, contract manufacturing or sub-contracting, co-production and specialization, co-marketing and after sales servicing, project cooperation, joint research and development, creation of joint marketing and servicing entities, participation in joint servicing ventures and joint production ventures. These joint cooperative ventures may take place in the country of either party or in some third country.

There is considerable experience of industrial cooperation among socialist states which is being adapted to ventures with non-socialist partners. Since 1973 most socialist states have followed the lead of the U.S.S.R. and linked themselves with many non-socialist nations through a series of bilateral inter-governmental industrial cooperation agreements. These provide most-favoured-nation treatment within the industrial cooperation context,

liberalization from quantitative import restrictions of commodities traded pursuant to the agreement, conditions for credits, joint commissions, and a wide range of joint projects and cooperative ventures. These agreements then need to be implemented by contracts between the relevant socialist instrumentalities and private western corporations.

Joint cooperative ventures[34] can be attractive to East and West as an institutionalized form of contract partnership which guarantees the socialist partner continued access to technology, usually, as payment is frequently a share of the product, without recourse to foreign currency reserves. The non-socialist partner gets access to markets, raw materials, labour,[35] and overcomes trade barriers caused by shortage of foreign currencies. It must, however, be self-financing and preferably export-oriented. There are, however, acute ideological problems in the establishment of joint enterprises. The concept of mixed ownership or of western financial participation in the means of production is incompatible with socialist ownership. Secondary problems arise concerning the nature of the western partner's proprietary interest in the joint venture, the extent of his participation in management and in relation to the plan, the measure and transfer of his profits, and the recovery of his investment. It is difficult to recognize and give effect to the interests of the western partner without repudiating an entire politico-economic system. Solutions therefore tend to be pragmatic.

However, except for Yugoslavia, Hungary, Romania, and China,[36] there are few joint enterprises in socialist states with western corporations. Bulgaria[37] and Poland[38] have recently established legal regimes for such cooperative ventures but there is, as yet, little experience in their operation. In other socialist states, notably U.S.S.R.,[39] there are no mixed companies as joint enterprises because of doubts as to the legal authority for their creation, and continuing ideological and financial objections. In the U.S.S.R., however, large-scale contract joint ventures do exist with the western partner being paid in production. Fifteen per cent of U.S.S.R. exports to western countries result from such arrangements.[40]

[34] In this paper "joint enterprise" refers to a "mixed company", jointly owned by socialist and non-socialist interests, through which the cooperative venture is carried out. "Joint venture" refers to a planned cooperation between a socialist and non-socialist entity, but without forming any new corporate entity. See generally on this topic D. A. Loeber, "Foreign Participation in Soviet Enterprises?" (1980) 6 *Int. Trade Law and Practice* 215.

[35] No strikes.

[36] Hungary, *Decree on Economic Associations with Foreign Participation* 1972, and Explanation, 1977: (1973) 12 *International Legal Materials* 989; (1978) 17 *International Legal Materials* 1451; Romania: *Decree on Joint Companies* 1972: in D. A. Loeber, *East-West Trade*, op. cit. vol. 3, p. 117; Yugoslavia: *Law on Investment of Resources of Foreign Persons in Domestic (Yugoslav) Associations of Associated Labour* 1978: (1979) 18 *International Legal Materials* 230; China: *Law on Joint Ventures* 1979: (1979) 18 *International Legal Materials* 1163.

[37] *Law on Joint Ventures* 1980; in (1980) 19 *International Legal Materials* 992.

[38] Decree of 1979: see J. G. Scriven, op. cit.

[39] Until 1930, there was substantial foreign equity participation in U.S.S.R. enterprises. The basic legislation for these still exists.

[40] *Counter Trade Practices in the E.C.E. Region* (1979) [ECE TRADE/R 385] 29.

Socialist states have confronted the need to overcome common problems: the ownership of real property or of the assets that constitute the share of the investment; planning the integration of the enterprise with foreign and national economic plans and the compatability of management decisions with the plan; and financial integration of the enterprise, particularly with respect to pricing, the currency of account, the transfer of profits, and liability to taxation.[41] In Yugoslavia, Hungary, China, and Romania, no difficulty has been found in providing a corporate form, whether it be a limited liability company as in China or a basic organization of associated labour as in Yugoslavia. Only in Romania does the question of the nature and extent of property rights in the assets of the enterprise remain open. There, "a right of operative administration" is given. In all other cases the enterprise owns its assets, and in Hungary and Yugoslavia, the western participant may reserve property rights. In all cases, the enterprise draws up its own plans, but in Romania and China, these must be approved. All have the right to engage directly in foreign trade. In all cases, participation in management is controlled by the appropriate charter documents, but each has overriding requirements which check the limits of foreign control. In China, the nationality of each level of management is prescribed by the law. In Hungary the joint venture contract must be approved. In Yugoslavia, the management is subject within the contract to the workers' council. All are taxed on "profits", within the range of 30%-40%. But the formula for establishing "profit" is prescribed by law. Generous incentives exist for reinvestment. The transfer of profits is permitted subject to withholding tax, and the availability of foreign exchange. On liquidation, repatriation of capital is contemplated, being permitted in some cases and guaranteed in others.

The principal difference between the systems lies in the regulation of currency and accounting problems. In the Romanian "enclave system" all transactions, including domestic transactions, are calculated in foreign currency. In Hungary, all transactions are calculated in both foreign and local currency, and converted from time to time. Local supplies are based on local prices, and foreign currency is used in export/import transactions. In Yugoslavia, all transactions are in local currency, and the enterprise is regarded as national, with foreign participation. This full integration is possible only because of the absence of planning, and it is significant that most joint production ventures are found in Yugoslavia. In China, transactions may be in local or foreign currency, but are ultimately convertible to local currency at prevailing rates of exchange. Funds may be held in either local currency or foreign exchange. All countries entertaining joint enterprises have pursued economic advantage pragmatically despite any ideological misgivings they might have.

[41] For an interesting tabular comparison, see Table I, D. A. Loeber, "Foreign Participation in Soviet Enterprises" op. cit. 246.

7. Breach, Remedies, and Enforcement

Breach of contract between socialist Foreign Trade Corporations and non-socialist corporations can occur in the same ways as in any trading relationship. Most, however, are thought to occur either through conflicting understandings or interpretations of the terms of the contract or through cancellations by the socialist partner.

The possibility of conflicting interpretations underlines the need that has been stressed through this paper for detailed negotiation of a contract. Whilst in ordinary non-socialist trading relationships businessmen may often prefer to leave a point unsettled rather than lose the deal, this is not good advice in East-West contracts. The danger also emphasizes the need for dispute settlement machinery to be built in to the contract—frequently by negotiation, mediation or conciliation, rather than arbitration or litigation which may endanger the whole relationship.

Cancellation is a more serious occurrence and is far from unknown. It can occur for purely political reasons or for economic ones. Shortage of a commodity, including foreign currency, which may or may not have produced a change in the Plan[42] is the usual basis. Ironically, whilst a change in the Plan is generally not a defence to a claim based on non-performance under the law regulating international intersocialist transactions, it would seem to be an event of *force majeure* or possibly even frustration under non-socialist systems.[43] Choice of the proper law of the contract and choice of the forum for the determination of any dispute are therefore fundamental. These matters have been considered earlier.

The consequences of breach and the remedies available should be detailed in the contract. All systems recognize this as primarily a matter for the parties' agreement, subject to any overriding policy considerations in the forum. If the contract is silent or not acceptable to the forum, then the remedies of the forum will be applied.

Under most systems of socialist law non-performance leads to a claim for performance, and the primary remedy is the elimination of defects, and price reduction. Rescission is available only rarely, and damages as such are never awarded. Instead there is extensive use of penalties, fines or forfeits. However under the conflict of laws rules of some socialist countries[44] a reference in the contract to the seller's law may make damages available. Conversely, if a prescribed fine or penalty were claimed in common law jurisdictions, nice questions would arise whether it was enforceable as liquidated damages or should be disallowed as a penalty. The policy problems encountered by all legal systems have recently been tackled by

[42] As in *C. Czarnikow Ltd* v. *Centrala Handlu Zagranicznego Rolimpex* [1979] A.C. 351. See also H. J. Berman, "Force Majeure and the Denial of an Export Licence" (1960) 73 *Harv. L. Rev.* 1128.
[43] C. Schmitthoff, *The Export Trade* (7th ed., London, Stevens, 1980) pp. 112-14.
[44] E.g. U.S.S.R.

UNCITRAL, which has propounded a set of draft rules for legislative adoption to regulate and to unify the law relating to penalties in international contracts.[45]

Most socialist states have ratified the New York Convention on the Recognition and Enforcement of Arbitral Awards, so that in theory wherever the award is given there should be little difficulty in enforcing it. However, the socialist party is the Foreign Trade Corporation which is likely to have few assets. Enforcement is not a question that arises. Satisfaction of awards is obtained through an allocation of funds in the socialist state to the Foreign Trade Corporation for that purpose. The socialist record in this regard is good.

SOCIALIST PARTICIPATION IN INTERNATIONAL LAW REGIMES RELATING TO TRADE AND INVESTMENT

Contract is the mechanism by which trade is able to take place. But contract can not operate in a vacuum: it is dependent on the existence of a legal regime to support it. International trade depends on a regime of public international law; and the free market nations have over a period of years, but particularly since 1946, built by bilateral treaty and multilateral convention an institutional regime to support their trade with one another. The weakness of contract as a tool of East-West trade stems from the limited extent to which socialist nations have felt able to participate in that international regime. Yet obstacles, where they exist, have proved to be more doctrinal and theoretical than practical.

1. Bilateral Intergovernmental Agreements

We have already seen the important role that is played in trade between socialist and non-socialist countries by bilateral inter-governmental agreements. Most socialist governments have linked themselves to the governments of their western trading partners by such agreements, which play a different role from Treaties of Friendship, Commerce and Navigation between free market countries. The latter are concerned to regulate rights of establishment of nationals of one country in the territory of the other; to regulate rights of navigation of vessels of one country in the territorial waters of another; and to regulate rights of nationals of one country to acquire property in the territory of another and to receive compensation if it is expropriated. None of these three limited functions is appropriate to trade with socialist countries; and in these cases bilateral inter-governmental agreements are concerned to establish the whole structure, qualitative and quantitative, by which trade and industrial cooperation between the two countries can take place.

[45] A CN./9/197 (1981).

2. Multilateral Law-Making Conventions

We have also seen in this article the extent to which uniform laws are now being developed by multilateral conventions, mainly but not exclusively[46] under the auspices of United Nations instrumentalities, covering fields of law vital to international trade. Some of the most important are the Vienna Convention on the International Sale of Goods, the Geneva Convention on Multi-Modal Transport, the Hague and Hamburg Rules on Carriage of Goods by Sea, the International Chamber of Commerce Uniform Customs and Practice for Documentary Credits, and the Paris Convention for the Protection of Industrial Property. There are many more, and the number increases significantly each year. Uniform laws such as these have a very important role in facilitating international cooperation and trade, and removing uncertainties and risks from transactions. Socialist states have played a prominent role in the development of these Conventions, and generally have ratified them.

3. Multilateral Commodity Agreements

Important sectors of international trade are regulated by multilateral commodity agreements. These are inter-governmental agreements dealing with the international movement of one or more related products or materials, usually basic, agricultural or raw. They seek by such agreement to alter the production, distribution or consumption of a commodity either quantitatively or by price regulation. They constitute an exception to the international obligations of the member countries of the General Agreement on Tariffs and Trade[47] (GATT) because of their effects in evening out the earnings of producers and assuring the constancy of supply at predictable prices to consumers. GATT therefore prefers such agreements to include both producers and consumers, but not all do. Most are producer-only agreements designed to raise or maintain prices, and GATT disapproves.[48]

Socialist states have no difficulty in joining appropriate commodity agreements. From the socialist point of view they work well because they plan and control prices and quantities, and socialist states have a ready-made administrative machinery to implement them without further measures.

4. Multilateral International Institutions

The major difficulty concerning socialist participation in the international law regime relates to socialist acceptance of the three major institutions on which free market international trade depends: the International Monetary

[46] As well as the United Nations Commission on International Trade Law and United Nations Conference on Trade and Development one should mention the Institute for the Unification of Law, The Hague Conference, and the International Chamber of Commerce.

[47] See supra. The exception is under Article XX(h) of the Agreement.

[48] Many such agreements have only limited effect because of the ability to substitute commodities (e.g. tea for coffee). The big exception is OPEC. There is as yet no real substitute for oil.

Fund (IMF), the International Bank for Reconstruction and Development (IBRD), and the General Agreement on Tariffs and Trade (GATT). The Bretton Woods Agreement in 1944 planned three international institutions to regulate world trade. The IMF was to deal with exchange stability and balance of payments, the IBRD was to promote long-term international investment. And the International Trade Organization (ITO) was to reconstruct world trade and reduce world trade barriers. The ITO never came into existence because of the refusal of the U.S.A. to ratify it, and its functions have been performed by the GATT.

The U.S.S.R. failed to ratify the Bretton Woods Agreement for varying reasons; Poland withdrew from the IMF and IBRD in 1947, and Czechoslovakia in 1951. Yugoslavia remained a member of both; Romania joined in 1973, and the People's Republic of China in 1980. The major problems, however, centre on membership of the GATT.

5. The General Agreement on Tariffs and Trade

The GATT was founded on the twin bases of "most favoured nation" treatment and tariffs as the only acceptable legal protective device; and tariffs were subject to negotiated reductions. It sought to provide a forum for trade negotiations, a code of international trade rules, and an institution for dispute settlement. It was wholly capitalist free market in its concept of non-discrimination; its code, which sought to set fundamental rules for nations operating on a private enterprise market basis; and its notion of the tariff, whose effectiveness rests on the profit motive, as the only recognized form of protection. It provides for no actual trade, but as an agreement between governments, it provides a framework in which the private sector may operate free of discriminatory government practices. Most of its provisions are aimed at eliminating or controlling any state activity which might favour the promotion, sale or distribution of domestic over foreign goods—except the tariff. In particular, it opposes quantitative quotas. The tariff is acceptable as it is open, notorious, and subject to continuous reduction at GATT negotiations.

Originally GATT had 23 member countries, but now it has over 80. It has been remarkably successful for a poorly drafted interim agreement. There have been seven rounds of GATT negotiations as a result of which tariffs are of only small significance as a barrier to international trade. The problem today is still non-tariff barriers, such as safety and packaging regulations. In 1979 it produced an anti-dumping code (aimed at the selling of commodities at less than their fair value in order to dispose of surpluses or to destroy markets), and also a subsidies code (aimed at unfair pricing).[49] It, and its major principle of "most favoured nation" trading,

[49] The immediate response of GATT under Article VI is to authorize in the threatened country the imposition of anti-dumping and countervailing duties to offset the price distortion effect of these practices. The difficulty in applying this to state trading

have been jeopardised by the developing system of preferences,[50] the conclusion of a large number of special commodity agreements, and GATT's continuing inability to cope with trade between market and centrally planned economies. State trading and GATT sit uneasily together.

The problem is not one of state ownership of the means of production, so much as the fact that entrepreneurial decisions are taken by the state, which is responsive to political as well as economic considerations. This can occur in market type economies which engage in state trading of some commodities and also in centrally planned economies where the state has a monopoly of foreign trade. In both cases, state trading practices achieve the functional equivalent of taxes or subsidies by providing a resale price for imports different from that of domestic products and a lower price for exports. Depending how this is done, it may be difficult to ascertain or verify. They also provide functional equivalents of quantitative restrictions simply by stipulating planned quantities; and they engage in a functional discrimination through nominating sources of imports and destination of exports. The GATT, in Article XVII, responds to these threats by seeking to prescribe non-discrimination between contracting parties through state purchases and sales; by affirming the dominance of commercial considerations; and by requiring full disclosure of importing or exporting by state trading agencies or by private enterprises which have special or exclusive privileges. This requires "most favoured nation" objective conditions to apply in respect of, for example, price, quality, availability, marketability, rather than political factors. It also ensures that adequate opportunity will be given for all GATT member countries to compete in that particular market.

Article XVII, however, was designed to deal with state trading by market economies; it was not intended to deal with state trading by centrally planned economies, and it has not been able to do so because most are not members of GATT. It is not possible to supervise or police the Article XVII policies in relation to centrally planned economies, and therefore GATT has had to take a different approach.

The centrally planned economy countries that are members of GATT are Czechoslovakia (whose membership predates its becoming a centrally planned economy), Yugoslavia, Poland, Romania, and Hungary. The People's Republic of China is said to be contemplating seeking membership. The countries that provide the best examples of the problem of accommodating a socialist country within the GATT system are Poland, Romania, and Hungary.

nations, in the absence of any normal domestic price mechanism, is to identify the existence of dumping or subsidies.

[50] The role of UNCTAD has been to influence GATT on Preferences.

How can a centrally planned economy subscribe to the principles of the GATT and accept its obligations? How can one seek trade liberalization for state traded products? The reduction of tariffs is a meaningless concept because, whether tariff or price, it is all in the same pocket, and tariff reduction means no more than reduced price.[51] Similarly the removal of quantitative restrictions is an empty objective when the state controls the quantity it is purchasing anyhow. But how can the "most favoured nation" principles of the GATT be applied where it is impossible to determine if discrimination is being practised? What sort of mechanisms are appropriate to implement GATT policy in relation to centrally planned economies? Are the disclosure, supervision, and policing techniques acceptable or likely to be effective? How does a centrally planned economy achieve "balance" of its exports and imports in its trade with other nations? Should it do this bilaterally or multilaterally?

The factor on which socialist membership of GATT hinges is the commitment to lift trade by a stated amount, because this is the only way the effects of liberalization can be achieved. Poland in 1967 undertook to increase its value of GATT imports by a minimum annual stated percentage, to review this on an annual basis, and to set new targets for the ensuing year. Romania in 1971 agreed to increase imports at a minimum rate equal to the growth of total imports found in her five year plans. There is an obligation to consult and provision for biennial review. In approving the Polish and Romanian applications, there was a realization that the market countries would need to rely for protection on the safeguards of Article XIX rather than those of Article VI, namely the escape clause permitting them to withdraw concessions such as "most favoured nation" treatment if there was unforseen change or injury to domestic production, for example because Polish imports were less than promised. The weakness of this approach is that it does not identify individual products safeguarded nor prevent discrimination against individual countries. In contrast, on the accession of Hungary in 1973, the problem was made somewhat easier by the fact that Hungary did have a system of binding tariffs. GATT approved Hungary's maintaining its existing trade regulations with other socialist states provided the total level of East-West trade was not affected. Provisions for consultation, surveillance, and safeguards were inserted as in the earlier cases.

No one would pretend that these examples have yet solved the problems listed above. Nevertheless they show that centrally planned economies can be brought within the system of international trade even if they do not lie comfortably within a legal regime not designed for them. But it is a developing situation.

[51] GATT concentrates on trade effects, in its surveillance role, rather than on the factors that produce those effects. For example, tariffs in the market countries are published and visible. But they mean nothing in centrally planned countries where generally there is no tariff. See K. Gryzbowski," Socialist Countries in GATT" (1980) 28 *Am. Jo. of Comp. Law* 539.

CONCLUSIONS

Difficulties do arise in trade between state instrumentalities of centrally planned economies and private traders of market economies. Most of the legal problems, however, are either theoretical or insignificant. The exceptions appear to be:

(a) pricing and financing;

(b) the consequences of the interdependence of Plan and Contract; and

(c) forms of industrial cooperation.

These three difficulties all stem from an ideological base which in turn provides different economic theories and bureaucratic and institutional structures. This article has suggested that it is the role of GATT to overcome many of the problems, and has pointed to the difficulty of accommodating socialist states within the principles of GATT. This problem may be insignificant to individual traders, but its gravity is its potential for distorting or destroying markets. Nevertheless, the difficulties are being overcome; and if the desire is real, trade and industrial cooperation can flourish.