A U.S. Lawyer's Opinion of the Economic Impact of Technology and Corporate Law Developments in the USSR/Russia and China from the mid-1970s to Today

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Abstract: When the author began practicing law relating to the USSR/Russia in 1975, the Soviet Union was significantly more advanced economically than China. This was still the situation when he began practicing law relating to China in 1983. When he retired from legal practice in 2006, however, this situation was reversed. This article contains his views, based on his extensive experience in both countries, on what may have contributed to this remarkable reversal in these countries' relative economic positions during this short time period.

Keywords: China, comparative economic development, law, technology, USSR/Russia

I was a lawyer for two large American companies—first for Allis-Chalmers and then for Corning—devoting a great deal of my time to the Soviet Union and Russia beginning in 1975 (including being a resident for Allis-Chalmers in Moscow for 1977 and 1978), and to China beginning in 1983. I worked with both countries until my retirement from Corning in mid-2006. As such, I was in a position to observe significant, indeed historic, changes in both countries' relative economic developments, which I believe were based in significant part on their respective corporate and related technology-law developments during that time. This paper is based on my own observations, including my interactions over this period with many Western, Soviet/Russian and Chinese lawyers, businesspeople and government officials.[1]

In brief, this entire period saw China, beginning from a developmental base far inferior to that of the USSR, leapfrog the USSR/Russian Federation in economic development; today, any neutral observer could only conclude that China vastly outpaces the Russian Federation economically, using virtually any relevant indicia or means of comparison.

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The clearest support for my personal observations contained in this paper is whether legislative changes in areas supporting foreign trade and investment were adopted more quickly and in greater depth, continuity and clarity in China than in the USSR/Russian Federation. This indeed was the case.

A very important reason for China being so comparatively successful in developing its economy, beginning with the administration of Deng Xaioping, has been its ability—indeed, its desire—to incorporate Western industrial design and manufacturing technology, and increasingly to build on this technology to develop its own sources of technology in an ever-growing number of industrial sectors. Greatly assisting China in this regard has been the country's extremely open regulatory environment in relation to foreign investment and its cultural receptivity to Western business practices, as well its extensive adoption of Western commercial law concepts, including those relating to technology. Though it is outside the scope of this paper, it must be noted that certainly important for China was the desire (if not the necessity) to be open to Western investment in order to create a rapidly growing domestic industry, making export-quality products, in order to absorb what turned out to be a rural-to-urban internal migration of a size unmatched in history. Russia did not face this problem, and hence had no corresponding need to attract foreign investment to solve it.

Given China's ongoing policies and attitudes encouraging foreign investment and other forms of foreign company participation in the Chinese economy, I do not see anything in the current commercial law developments within the Russian Federation relating to foreign companies that would, in the foreseeable future, help to narrow this development gap between the two countries.

Historical Background—Prior to 1972

In February 1972, the United States and China signed the Shanghai Communique. In May and October of that same year, the U.S. signed a series of trade accords with the USSR. The Shanghai Communique would (though beginning only in the late 1970s under Deng Xaioping) serve as the basis for what became expansive business cooperation between the two countries. This was in contrast to the relatively immediate implementation of the U.S.-USSR trade accords.

There was not extensive Soviet or Chinese trade or commercial cooperation prior to the 1970s with the U.S., Western Europe or Japan—one reason for this was that after World War II, Western companies were severely restricted in what they could trade with both countries because of the multilateral COCOM export control structure. This structure constituted the agreement by Western governments on which products and technologies could be supplied freely to Communist-controlled countries, and which could only be supplied on the basis of an export license issued by the government of the proposed exporter. Licenses were not granted for products or technologies with military applications or that otherwise raised national security concerns.

Prior to 1972, both countries' recent economic-development histories were chaotic, and, as such (together with their overriding Communist dogma), not conducive to any form of meaningful cooperation with foreign companies. During my commercial negotiations in both countries, there were invariably discussions, during breaks or over dinners, about why each country lagged behind the West (typically focusing on the U.S.), and it would have been difficult for me fully to represent Corning or Allis-Chalmers without being aware of this historical “baggage,” since it was so important to the people across the table and in fact had a profound influence on how issues were brought up during negotiations and how they were resolved. It was important at that time to keep in mind that both countries were emerging from a traumatic 20th century history, that Soviet/Russian and Chinese negotiators were new to having to interact with U.S. companies, and that they had enormous pride in their own countries (most certainly when interacting with an American lawyer). Hence, some brief historical comments—based largely on my negotiation notes about what their negotiators would emphasize about both countries’ recent histories—are needed as background.

Russia and the USSR

Russia’s first complete corporation law was adopted in 1836, which served as the basis for the section of the Russian Commercial Code that dealt with corporations until 1917. Thus, historically, Russia did not fall behind the U.S. in early corporate law development. In addition, Tsarist Russia had a relatively high level of foreign investment, which had increased through the last few decades of the 19th century until the beginning of World War I. The November 1914 edition of *National Geographic* was devoted to Russia (ironically, given that it was being written on the threshold of Russia’s August 1914 entry into World War I), praising it as one of the two (along with the U.S.) predicted growth powers during the upcoming 20th century.[2] However, for the more than 70 years of the Soviet Union’s existence, not only did corporate life not exist, but prior to 1972 the Communist Party rejected any form of substantive cooperation with foreign businesses. The New Economic Policy (NEP), adopted in 1921 and continued until terminated by Stalin in 1928, included concessions to foreign companies, but it did not constitute such cooperation in this regard (nor did the extensive World War II U.S. aid to the USSR).

China

Paradoxically, prior to Deng Xaioping’s reforms in the late 1970s and early 1980s, China had been more hostile to Western economic development—or any type of economic development—than had the USSR. China’s initial foreign investment, by the British American Tobacco Company (BAT) beginning in the late 19th century,[3] was accomplished at a difficult time for the country—i.e., the Western powers’ treaty port concessions approach to China under the late Qing Dynasty[4] and the eventual Chinese reaction to these concessions, such as the Boxer Rebellion between 1898 and 1901. The 1911 revolution against the Qing Dynasty, which led to the 1912 formation of the Chinese Republic, hardly produced an atmosphere conducive to foreign investment. For example, the market share of BAT’s domestic rival increased dramatically following 1912. Further hurting Western businesses in China (and, of course, China’s own development) were the successive periods of warlords’ fractional rule, the Japanese invasion, World War II, nationalizations following 1949, Mao Zedong’s Great Leap Forward in the late 1950s, and the ten-year Cultural Revolution. As this period in China’s recent history continued to unfold, any type of Western involvement in the country’s development ceased to exist.

The relatively higher degree of Soviet technological development after World War II, compared to that of China, was illustrated by the large amount of Soviet technical advisors sent to China (to help develop China’s heavy industry according to the Soviet model) in the mid-1950s, and the harmful impact to the Chinese economy (even given the economy’s overriding mismanagement under Mao) which resulted when these advisors were withdrawn after the late-1950s split between Mao and Nikita Khrushchev. China's subsequent Cultural Revolution not only put a coda on the lack of any business and technology development in China, but produced a devastating amount of violence throughout its reign.

Unfortunately, the 1972 trade agreements with the U.S. did not help alter the substance of the Soviets' very limited cooperation in international business, up through the late-1991 collapse of the Soviet Union. These agreements did, however, help alter China's economic cooperation with the West, beginning with Deng Xaioping. In general, following World War II, international business cooperation was extensive. Specifically, and to an extent in Western Europe and the U.S. prior to the War, there was an increasingly complex network of foreign investment and foreign technology licensing/joint development agreements by companies of developed countries—the latter either as part of foreign equity investments or standing alone. This network, certainly by the 1960s, had been broadened to include Japan and soon thereafter certain "developing" countries, notably South Korea and Taiwan—even given the latter's unclear political status vis-à-vis China—and the city-states of Hong Kong and Singapore. This burst of international corporate cooperation developed in a very transparent manner between private corporations, based on clearly understood and well-developed corporate laws in the participating countries and thoroughly negotiated contracts between companies. All of these agreements were facilitated by the international trade and monetary-system structures put in place by the 1944 Bretton Woods Agreement and the 1947 General Agreement on Tariffs and Trade (GATT). China and the USSR were outside this network of cooperation, and this isolation was particularly damaging to the USSR's subsequent economic development. In contrast, China relatively quickly overcame most damage caused by its isolation. The main reason for this marked difference was the comparative receptivity of the two countries to Western corporate development in their economies.

Chinese Business Cooperation with the West from 1972 to the Collapse of the Soviet Union Exceeded Soviet Cooperation with the West

When China began to work toward developing a "normal" quasi-market economy in the late 1970s, it was significantly behind the level of development in the USSR. To put this into context, at this time the commonly held view among the small number of Western businessmen and bankers based in Moscow was that the Soviet economy not only was very backward, but, more importantly, was not structured in a way conducive to adopting the technology that Western companies were attempting to install. Western businessmen were also struck by the weakness in the Soviet economy—which they experienced on a daily basis in their work—in contrast to the portrayal of Soviet economic strength often emphasized in the U.S. press. At this time, China was in the midst of a very contentious transfer from Mao to Deng Xaioping, and was simply not on the radar screen for Western company involvement of any substantial nature. China was then an unwelcoming place even to consider visiting, much less doing business in—except, on a relatively superficial basis, for the annual Canton Trade Fair.

However, beginning in the early 1980s, the relative positions for economic development in China and the USSR began to change.[5] The extent of the change did not begin to become noticeable until the early 1990s, and my perception of China surpassing the Russian Federation in economic development did not become clear until the mid-to-late

1990s. The early 1980s saw the USSR courting Western business involvement—albeit in a very suboptimal way—for approximately seven years. China under Deng, in contrast, changed much more dramatically and more substantively.

China adopted the Chinese-Foreign Equity Joint Venture Law in 1979, which was followed by significant implementation regulations and by two amendments to the Law itself. These two sets of amendments were each substantive, and each was spaced approximately ten years apart. The first one was adopted on April 4, 1990 and the second on March 15, 2001. This is noteworthy since (1) it shows China's interest in updating its basic foreign investment statute over a significant period of time to reflect changing circumstances within the country, and (2) it reflects a respect for the rule of corporate law, since this same 1979 law has continued to be valid for more than 30 years of dramatic change in China's economy. This business legal stability has served China well since it increased foreign investor confidence in the country. The relative legal clarity, even on the basis of the original joint venture law, was sufficient to permit Corning to establish two equity joint ventures in China by the mid-1980s. It is noteworthy, given the subsequent Chinese focus on its own technological development, that these were both engineering joint ventures.

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Tellingly, at this early point of its economic interface with the West, China adopted a Law on Technology Transfer in January 1985, which provided (for example) that after a ten-year period technology transferred by a foreign company to China—at that time primarily in the form of know-how since the Chinese patent system was nascent—belonged to the Chinese contracting party. Even though this statute is no longer valid, it is important that the Chinese had such a focus on controlling—to the benefit of China—technology being transferred into the country at this early period. For Corning and others, this was primarily a concern due to the manufacturing and process capabilities being transferred to China as part of turnkey plants. Unlike our Russian turnkey plant customers, the Chinese were quite insistent on pushing for technology updates, and took maximum advantage of face-to-face technology transfers, both in the U.S. and in China.

Another differentiating point with the USSR/Russian Federation was that China permitted wholly-foreign owned enterprises (WFOE) as early as April, 1986.[6] A WFOE then became a very popular form for foreign investment—including for Corning—since it permitted foreign companies to maintain better control over their technology, production processes and marketing, and allowed them to avoid the frequently cumbersome, time-consuming and expensive process of eventually buying out the Chinese joint venture partner. Having WFOEs markedly increased the quantity, and improved the quality, of foreign investment in China. There was no parallel Soviet process, and a Russian Federation process began only after the country's formation.

On a continuing basis after the introduction of the WFOE, China also enacted a series of other statutes expanding and clarifying the different types of entities for permissible foreign investment. The first of these was the Chinese-Foreign Contractual Joint Venture Law, enacted on April 13, 1988 and amended on October 31, 2000. Even though this statute had limited impact, since it permitted a joint venture structure based only on the contract between the parties to the venture, it nonetheless revealed Chinese flexibility in its early desire to attract foreign investment. This was followed by the Corporation Law on December 29, 1993 (then amended twice), which by its terms applied only to the extent an issue was not regulated by other laws regarding foreign investment. The Corporation Law dealt in large part with protections for minority shareholders and with management and board fiduciary duties—issues of real interest to foreign investors. Finally, on February 23, 1997 a Partnership Law was enacted (and then amended in 2006). This breadth of forms of possible business formations greatly enhanced the extent of Chinese foreign investment, in particular when compared to the USSR/Russian Federation. These various forms also provided foreign companies with what became an increasing sense of legal security regarding the viability and strength of Chinese corporate law. Unfortunately, there was a much lower sense of foreign investor security in Russian Federation corporate law, due in no small part to the relatively chaotic privatization program for Russian businesses in the early 1990s.

On January 13, 1987, the USSR Council of Ministers adopted a decision permitting equity joint ventures with foreign companies, which was promptly followed on February 12, 1987 by the USSR Ministry of Finance's instructions on establishing and operating joint ventures. On January 19, 1991, the USSR Council of Ministers adopted clarifying regulations on foreign firms' presence in the country. However, there was too much uncertainty at that time about the stability of the USSR for these decisions to have any real impact on Soviet economic development prior to the country's dissolution.

Another important advantage that China developed in comparison to the USSR—and, then, to the Russian Federation—was in regard to both corporate and personal taxation. Shortly after China passed its 1979 Joint Venture Law, it adopted the Income Tax Law for Chinese-Foreign Equity Joint Venture Enterprises (September 10, 1980), which was then amended on September 2, 1983. Also in 1980, a Personal Income Tax Law was enacted. On December 13, 1981, China adopted a complimentary Income Tax Law for Foreign Enterprises. Both of these corporate tax laws for foreign-invested companies were superseded on April 9, 1991 by a single Income Tax Law for Enterprises with Foreign Investment and Foreign Enterprise, which in turn was superseded by the Corporate Income Tax Law on March 16, 2007. In addition, as early as 1992, a Law on the Administration of Tax Collection was passed. These tax laws were rather clearly drafted, since questions were not being raised during various negotiations as to their meaning or intent. Also, they were administered in a transparent manner throughout the terms of the contracts in which I was involved. I do not believe that these iterations of China's corporate tax law regime served as a detriment to Western investment in China. They were viewed more as refinements of an ongoing tax framework. Unfortunately, I do not believe the same can be said about the Soviet (and in particular the Russian Federation's) corporate tax law regimes as they have related to foreign investment, which on occasion had been used for arbitrary enforcement.

On top of and strengthening these Chinese corporate and tax law developments were new laws, beginning as early as the mid-1980s, on a variety of key subjects, all of which helped foreign investors gain increasing confidence that at least in corporate law China's legal system was strengthening the rule of law. This statutory listing is impressive in its scope—the 1985 Law on Economic Contracts Involving Foreign Interest (expired in 1999 when a new Corporate Law was passed), the 1986 Foreign Capital Enterprise Law, the 1986 Land Administration Law (plus a separate 2007 Real Estate Right Law), the 1987 Customs Law, the 1989 Import and Export Commodity Inspection Law, the 1994 Foreign Trade Law, the 1995 Commercial Bank Law, and the 2007 Anti-Monopoly Law (which is only now beginning to be administered).

The breadth of all of these Chinese laws was not matched by the USSR/Russian Federation—due in no small part to the collapse of the USSR, the difficulties experienced with the Russian privatization program, and the 1998 financial crisis in the country. However, as explained in the following part of this article, there were also deeper (and probably more significant) issues impacting Russia's failure to match China's resurgence.

USSR/Russian Federation Relative Stagnation Compared to China After 1972

Soviet Policy

In the 1980s, the Soviets were faced with a dilemma. The oil-price surge of the 1970s was over. Unfortunately, unlike China, the Soviet government's approach to economic development was to make slight changes (exemplified in Mikhail Gorbachev's Perestroika reforms of the late 1980s) to the existing Soviet system rather than more wholeheartedly welcoming foreign investment, which would have required substantial structural and attitude changes. This choice has had an ongoing negative impact on the Russian Federation's economic development.

The Soviet Union's rejection of international corporate cooperation through 1972, followed by a de facto lack of substantive involvement through 1991, put the Russian Federation and its nascent domestic companies at an enormous competitive disadvantage with developed (OECD) countries, and Russia's economic policies following 1991 have done little to mitigate this disadvantage.

This comment concerning post-1991 Russia continues to hold. As the *Economist* pointed ou in an early 2008 article:

1. Russia's recent growth rate is below that of either Ukraine or Georgia, neither of which has oil or gas, which of course are the bases for Russia's growth;

2. Russia's small- and medium-sized businesses (the sectors that often generate countries' sustainable growth) contributed less than 15% of Russia's GDP;

3. A World Bank Report states that only 5% of Russia's firms have been created over the past 5 years (serving as an indicator of the difficulty in starting up new businesses in Russia);

4. Oil and gas, as a percentage of Russia's GDP, rose from 12.7% in 1999 to 31.6% in 2007, and 80% of Russia's exports are natural resources;

5. Foreign direct investment (other than in energy) declined from 1.6% of GDP in 1999 to 0.65% in 2007; and

6. Total foreign investment is 2.2% of GDP (which is half the level of Ukraine's) and only

some of this is genuinely foreign, since investors in tax-haven jurisdictions are more often than not Russians returning money to Russia. [7]

There are some initial hopeful signs that the Russian government is slowly addressing the need for non-oil and gas development. For example, the Russian government, acknowledging the "technology gap," is creating "national champions" among state-owned companies, and is using project finance for transportation infrastructure with Western technology and equipment. However, to have a real impact, these initiatives would have to be done in a statutory environment truly conducive to long-term substantive involvement by Western companies.

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Soviet Technology Developments with Foreign Companies

From 1972 on, the USSR superficially sought out whatever benefits could be derived from foreign companies, but the artificial structure it put in place to do so—in order to fit in as a part of the Soviet centrally planned economic system—was extremely ineffective. First, due to ideological reasons, no equity investment was permitted until (and only to a very limited extent) Perestroika and the 1987 adoption of the Joint Venture Decree by the USSR Council of Ministers. Second, and probably more hurtful to the country's economic development, there were very few meaningful technology exchanges with Western companies. After 1972, the Soviet government, primarily through the Ministry of Foreign Trade, granted formal approval (accreditation) to select Western companies, and allowed them to open representative offices solely in Moscow. During the late 1970s, only about 25 American companies and banks were accredited. The ability of these offices to operate was very circumscribed by Soviet regulations.

The Soviet State Committee for Science and Technology would also enter into a cooperation agreement with such an accredited firm (and with certain other large Western firms). Such an agreement was, in essence, an umbrella letter of intent that was followed by specific protocols between the company and relevant Soviet industrial ministries. Although the Soviets expected that these protocols would have a marked impact on the development of Soviet technology in each protocol's area, this was not the case. For example, Allis-Chalmers (the company I represented in the USSR in 1977-78) made bona fide attempts over a 5-6 year period to energize the industry protocols it had signed, but it was difficult to generate interest within the ministries. This was similar to the experience of other U.S. and Western European companies at that time. By and large, the initiative in this regard came from the companies, not from the ministries. For example, in the early 1980s, when Allis-Chalmers showed an interest in licensing manufacturing rights in a Soviet rock-crushing machine, the only prototype of the machine was in a location in the Republic of Kazakhstan that was closed to foreigners, so visas were required even to see the machine. In addition, all licensing negotiations were conducted by a foreign trade organization (Licensintorg) under the Ministry of Foreign Trade, separate from the industrial ministries. Moreover, the relationship among Licensintorg, the industrial ministry, and the ministry's factory where the personnel with the needed technical expertise were located, was not well-coordinated.

The key point of relevance for the technical status of Russian companies today is that this initial Soviet effort to work with Western firms relating to technology was based on Soviet economic policy, which often placed political considerations ahead of economic ones. The entire effort was directed toward furthering a country and an economic system that no longer existed. In short, the USSR handed to its primary successor country, the Russian Federation, an unsubstantial technological foundation (and with minimal foreign input) to permit Russia's newly formed companies to compete worldwide in virtually any industrial sector. In contrast, by the early 1990s China had nearly a decade of open, virtually unrestricted, cooperation with Western companies based on a rapidly developing corporate legal regime. In addition, China had the benefit of continuity of government structure, which was not the case with the abrupt USSR-to-Russian Federation change.

Soviet Commercial Developments with Foreign Companies

In addition to the Soviet mishandling of the country's technological development, efforts to facilitate Western technology-transfer into the country were far from optimal. No equity participation was permitted at all for foreign companies until the introduction of the fairly restrictive 1987 Joint Venture Decree. Compared to development in China, this was indeed late. For example, Corning's first equity venture in Russia was in 1997; in China, as noted above, it was in 1984.

Prior to 1987 and thereafter through 1991, instead of equity involvement in the USSR, Western companies would typically install equipment or construct a facility on a turnkey basis in a part of the Soviet Union selected solely by the relevant industrial ministry. The contract for such a plant would typically preclude not only any export of the technology outside the USSR, but would also preclude the technology's replication in whole or in part inside the country. If export rights to the licensed technology were granted, this would have been on the basis of the Western company waiving patent rights in certain countries to permit the import into those countries of the turnkey plant Soviet product. For all practical purposes, due to the plant's domestic requirements for its products (based on the relevant ministry's own plan, which was a part of the overall rigid state plan) and to endemic poor Soviet product quality, exports outside Eastern European Council of Mutual Economic Assistance (CMEA) countries would have been difficult for the plant's ministry—via the Ministry of Foreign Trade—to accomplish. Also, I am not aware of any turnkey plant contracts that obligated a Western company to provide the Soviet factory with updates to the initially licensed technology, so that by the time the factory had been built and put on stream, the imbedded technology was normally already a number of years old.

Turnkey plant locations were not based on a Western company's typical plant location criteria, and the construction and technology-transfer difficulties faced by a Western company building a plant in a remote location normally closed to foreigners made the process all the more inefficient. Not surprisingly, with the demise of the Soviet Union the number of Western-built factories in the country, which were either non-operational or partially built was substantial. In fact, ultimately unsuccessful attempts were made at that time by some Western investors to obtain sufficient information about such plants to see if there was a way to make at least some of them attractive—one example (noted below) was a Corning televsion-glass plant, contracted by the Soviets shortly before the collapse of the USSR, and the sporadic attempts made by various foreign investors thereafter to purchase the equipment out of a Russian warehouse and construct the factory. Those factories that were completed and subsequently privatized after the fall of the USSR, if still operational, clearly have not served much if at all as an engine for industrial growth in Russia. This is particularly noteworthy since the scarce foreign exchange expenditures committed were for the key industrial sectors identified by the Soviet leaders at the time for development.

Russian Federation Development

Commercial/Legal

I cannot overemphasize the industrial disorganization facing Russia with the fall of the USSR. The overall structure of the country's economic system, in place for decades, became suddenly irrelevant. Russian factories that Allis-Chalmers and Corning worked with, which were typical, found former key Soviet suppliers and customers now located in newly independent countries with extremely weak commercial law regimes. The term "heroic" has become so often used that it risks becoming trivialized; but those Russian plant managers who—even with all the faults of the country's privatization program—were able to hold their companies together, produce and sell product, and pay their employees can truly be called heroic.

An example of this industrial chaos is illustrated by Corning's systematic search, after the fall of the Berlin Wall, for companies in the former CMEA countries as potential acquisitions. At that time, candidates in Russia—or indeed in any of the new countries of the former USSR—were not even considered. Corning restricted its efforts to Eastern Europe, where there was some legitimate legislative effort being made to encourage foreign investment. By contrast, Russia was not making a similar push. Another example of this post-Soviet chaos was Corning's sale of a TV-glass turnkey plant to a Soviet ministry just before the collapse of the USSR, destined for one of this ministry's factories in Lithuania. Shipments were scheduled after Lithuania had declared its independence, so Corning was told by the Russian Federation government to ship to a Russian location instead, where the equipment then sat in storage for years.

Since the demise of the USSR—and certainly after the Russian Federation's August 1998 economic crisis—though foreign direct investment has not been strong (especially outside oil and gas), it has been possible for a Western company to enter into successful manufacturing investments. However, compared to China, the Russian pace has been glacial and the financial returns much less robust. Important reasons for this are that for investments in Russia, even today, possibly the three most important points to enhance the potential for success of a venture continue to be (1) to avoid industries the government considers strategic and hence more profitable (specifically natural resources, even given the ongoing low status of Russian technology), (2) to select a trustworthy partner (which is still prudently needed in Russia but not in China, as noted below) and (3) to be proactively on good terms with the responsible officials in the local and regional governments. In China, on the other hand, local governments in the 1990s did not have to be courted but were instead actively competing among themselves to attract and retain Western investment.

The basic rule for any company investing in Russia (moreso than in many other countries) is to establish a well-thought-out business plan prior to investment—i.e., properly factoring in the extent and ramifications of the various unique risks involved in operating in Russia. However, because Russia's legal regime for foreign investment continues to be opaque (much more so than in China, which itself is hardly a paradigm of transparency), Western understanding of Russian-specific requirements during this time continued to be relatively difficult for companies to achieve. In short, too many Western companies failed to put in the effort needed to understand the country well prior to investing (especially throughout the 1990s).

A major practical concern in this regard is to establish meaningful financial projections given the uncertainties of positions taken by Russia's federal and local tax inspectorates. This tax-administration uncertainty for investment financial results (including the administration of VAT) has been much more a concern for foreign investors in Russia than in China. In addition, the Western shareholder in a Russian company must have hands-on board membership, and that membership must be able to develop personal relationships with the board members representing the Russian shareholder. The importance of strong Western board membership and positive personal relationships is especially present in Russia, since the Western shareholders' local partner is its first and (depending on the strength and Western outlook of the city and regional government) possibly only line of defense against the frequent corruption issues facing Russian businesses. Any U.S. company has to operate its subsidiaries in Russia in compliance with Sarbanes-Oxley (depending on the percentage U.S. ownership), with the Foreign Corrupt Practices Act and with U.S. export control regulations; it would be extremely difficult to do so without having confidence in the Russian subsidiary's management and in the other board members.

This emphasis on board structure is also an important issue in China. The difference is that in China there is not an ongoing need for a strong local partner to "protect" Western investors from risks and political uncertainties, as has been the case in the Russian business environment. China, though far from transparent, does not generally pose the same degree of commercial and legal risk as does Russia, due in no small part to the relatively rich system of statutes enacted in China (described above) which provided a more stable "rule of corporate law" structure to a Western company's investment plan.

In China, as described above, the investment vehicle of choice became a WFOE. In Russia, a key choice for a U.S. company is what percentage level of foreign investment below 100% is preferred given the desire to control the subsidiary versus the accounting requirements of controlled foreign subsidiaries under Sarbanes-Oxley. It is of course generally optimal for a company to have wholly-owned subsidiaries in developing countries, unless there is an overriding, well-thought-out long-term need for a local partner. This WFOE preference in China has been a real competitive developmental advantage compared to Russia.

Technology/Legal

I have explained above how the USSR's demise left the Russian Federation with little benefit from the Soviets' interaction with Western companies during 1970s and 1980s. However, there was a great deal of Soviet domestic effort in trying to develop the Soviets' own technology. Unfortunately, the manner of this development was in large part centered on the military, and hence not appropriate for Western company involvement. The paradox of Soviet technological development is that having ignored its civilian market for years, there was little technology basis for the country's commercial enterprises to build on when the USSR collapsed and the Cold War ended. However, for a number of years during the early 1990s, Corning, like many other Western companies, tried to utilize the wealth of Soviet-developed research in a manner that did not need to take into consideration Russian companies' lack of technological prowess. Some of these approaches turned out to be quite successful for Corning—probably not unlike other foreign companies—but, unfortunately for Russia, not in a way that was beneficial to Russia's economic development:

1. Corning has historically invested comparatively large amounts annually into research and development; it was one of the first U.S. companies to have its own industrial R&D laboratory, which was launched early in the 20th century. Hence, beginning with the collapse of the USSR, it was not surprising that Corning hired a relatively large number of former Soviet scientists, who had already on their own moved to the U.S., to work in its U.S. laboratory—done in a manner consistent with U.S.-deemed export-control regulations. In passing, beginning at the same time, Corning also hired a large number of Chinese expatriate scientists.

2. In addition to the successful use of former Soviet scientists outside Russia described under (1), Corning entered into multi-year research contracts with scientists in two former Soviet research institutes in St. Petersburg, whose funding sources had collapsed with the USSR. The structure of these contracts was that Corning paid the institutes for the scientists' work, and thereby owned the results of the R&D.

3. The technical results from the contracts under (2) were successful, so to have more effective interface with Corning's scientists elsewhere in the world Corning formed a wholly-owned laboratory on Vasilevsky Island in St. Petersburg and spent a significant amount of money to renovate the building. Only the worldwide collapse of the telecommunications business in late 2000-2001 forced Corning to shut down this subsidiary. However, Corning continues to have certain technical work performed by Russian scientists in this same laboratory building (now owned by others), but on a contract basis.

In addition to the laboratory in St. Petersburg, Corning had two other successful research project works performed in Russia (in Moscow and Dubna) by Russian scientists for several years during the 1990s, and in one case a project is continuing. Again, though, this type of successful use of Russian scientific/technical talent provided no direct benefit to Russian companies' development.

4. Unlike the successes experienced by Corning with Russian scientists described in (1), (2) and (3) above (which were similar to what other western companies had done in Russia), for a 2-3 year period after the collapse of the USSR Corning established in Kaliningrad (outside Moscow) a systematic procedure to search for already-developed Soviet industrial know-how, patents or designs. Corning would then either purchase, license or enter into a joint development agreement for more work on these. However, the company was not able to locate any technology that was of sufficient interest even to serve as the basis for entering into negotiations. As an aside, there would admittedly have been a concern for Corning in any such negotiation of determining the actual owner of the developed technology (specifically, the extent to which the successor to the Soviet entity where the research had been performed could claim rights in the invention).

Although it would probably not be wise to reach too broad a conclusion from Corning's failure to find any suitable former Soviet inventions as described in this clause (4), at the very least it is another example of how difficult it was to develop Soviet technology which had been in virtual isolation from western businesses. If the results would have been useful to Corning, it is almost as if this would have been by coincidence—certainly not by design. China, with its open, flexible and welcoming approach to foreign investment since the early 1980s, and by extension to foreign technology, did not experience this problem.

Initial Russian Federation Policy—Privatization

In making comparisons between China and Russia, it is important to note a specific Russian Federation policy decision that has hurt the country's economic development—similarly damaging as was the USSR favoring Perestroika reforms to Western investment in the 1980s, as noted above. That is, in China—given the country's government's continuity—there was no privatization of state-owned assets. Rather, private businesses developed more or less on their own, benefiting from favorable government policies and often with investment from Western companies. In Russia, the country's assets were effectively given away to a very small group of people, in what can only be viewed as poorly conceived and poorly delivered "auctions" and "voucher privatizations," between 1991 and 1993. It appeared at the time that the driving impetus for this small group of people, benefiting from the windfall receipt of these "free" assets, was to derive as much out of these assets as quickly as possible rather than linking up with selected Western companies to acquire the technology needed to grow (certainly beyond oil and gas). There were no serious tax concessions introduced to develop technology or to modernize equipment (and very little government revenues to do so directly, with oil selling for a small fraction of its current value).

In short, this entire privatization process unfortunately resulted in very little lasting benefit to the Russian Federation's development. I cannot recall anything relating to this privatization that would have been of interest to Corning or came to Corning's attention as a possible investment vehicle of any nature. At that time, Corning would have been interested in investigating any such possibility (as indeed would have any company with a sincere and longstanding interest in Russia).

China's Relative Resurgence Compared to the USSR/Russia—After 1972

As illustrated by the above discussion, the main difference between Soviet/Russian and Chinese economic developments as they relate to Western business has been the former's ongoing reluctance to adopt a stable and hospitable pro business development environment versus the openness and (relative) transparency of China in this regard. Again, as noted at the outset of this paper, this key difference has been and continues to be a direct causation for the markedly evident development success of China as opposed to the Russian Federation.

From that late 1970s and early 1980s until today, China has dramatically overtaken the U.S.S.R/Russian Federation in economic development. Some of the important policy and legal differences followed by the two countries from the late 1970s and early 1980s which have had an ongoing impact on China's relative growth and Russia's relative stagnation, are as follows:

1. China's retention of its Communist government could have meant that Corning would continue to interface with the country's inefficient state-owned enterprises (SOEs)

for a much longer time than in Russia. However, this was not the case. Fortunately in retrospect, Corning's second equity joint venture in China (and the first foreign joint venture registered in Beijing) was an engineering company, formed on a half-and-half basis with an arm of a federal ministry. The failure of that joint venture was (from Corning's viewpoint) caused in large part by the joint venture management, which had been seconded by our Chinese partner, acting in the interests of that Chinese partner rather than of the joint venture. Corning had a similar experience, also in the mid 1980s, with another engineering joint venture formed with Shanghai SOEs. In part due to this experience, for Corning's next equity investment (and first manufacturing entity) the company terminated negotiations when the Chinese city government demanded a joint venture with an SOE. Negotiations only resumed when it was clarified that the equity structure would be a WFOE. Corning could not have insisted at this time on this optimal wholly owned structure in Russia, as explained above.

2. In Chinese and Russian turnkey plant negotiations in which I was involved throughout the 1980s, although both negotiations were conducted with foreign trade organizations (FTOs), the link between the FTOs and the factory where the foreign supplied plant would be installed was much closer in China, the level of technical data demanded by the Chinese was markedly more detailed than in Soviet negotiations, and the number of technical specialists involved in Chinese negotiations was far greater than in the USSR.

3. The foreign turnkey factories that I was involved with were much more successfully integrated into the Chinese economy than they were into the Soviet economy and hence were longer lasting and more successful. Part of this difference in success may be attributed to the fact that in the 1980s the Chinese were concerned about Japanese influence in their economy (especially since the yen/dollar exchange rate heavily favored Japanese compared to U.S. companies in China), and hence were much more attuned to the need of international quality of domestically produced products to be able to compete with incumbent Japanese products. From China's 20th century chaos, there was no domestic industry to build on, and the Chinese did not attempt to hide this from the Corning negotiators. In the USSR, by contrast, turnkey plants with Western assistance were intended for the virtually hermetically sealed (and inherently inefficient) Soviet economy, with limited CMEA country involvement—which, in any event, was firmly under Soviet control. Hence, there was no corresponding Soviet need to push for quality products made to Western technology standards.

4. Conceivably the relative stability of the Soviet economy since 1917 may have helped to establish a Soviet pride that too frequently bordered on hubris (*nashi luche*—ours is better), that resulted in a much more closed mindset than that of China, making it more difficult for the Soviets to acknowledge their need for Western technology. In fact, too fervent an acknowledgement of this need to a Westerner may well have caused political problems for any Soviet making the acknowledgment. This Soviet attitude arose fairly frequently during negotiations and contract implementation, primarily from non-technical personnel based in Moscow—for example, not acknowledging clearly inferior materials the Soviets insisted be used in the civil work for a turnkey plant, insisting on meaningless technical parameters for a plant's final acceptance test, or second-guessing key aspects of the technology being transferred. However, I never saw this attitude in China; in fact, to the opposite there was an

open acknowledgement of the country's relative backwardness and an overriding desire to obtain whatever technology tools were needed from the West to permit China to compete, initially in particular against Japan. In passing, this Chinese desire grew to result in the very real current problem of theft of Western companies' intellectual property—from manufacturing know-how to patent, trade mark and copyright infringement.

Also, there is conceivably a national difference in psychology that affects the perceived difference in the preceding paragraph. That is, to the extent Russian businesspeople see themselves as part of Western culture (and I believe that they do) and their technology as being a part of that culture, it is hurtful to his pride for a Russian to view himself as a disadvantaged member of the developed Western family, and he reacts accordingly. The Chinese, in contrast, have the self-esteem of the country's centuries of development and progress separate from the West, and hence do not have a similar feeling of hurt pride at having to use western technology for a relatively short period of time (in the Chinese mind) to continue the country's development.

I interfaced with numerous Chinese, beginning with my initial negotiations there in 1983, who expressed resentment about Japan's feeling of economic superiority over China. China, to its credit, realized that to compete with Japan it needed to open up willingly to foreign investment, even though this investment would also come in part from Japan itself. Hence, even before the Soviets had permitted equity investments by Western companies in 1987 (and expecting such joint ventures to prosper in a state-planned Soviet economy), the Chinese permitted majority-owned joint ventures from the initial 1979 Joint Venture Law, then WFOEs in 1986.

5. Beginning in the early 1980s, the Chinese strongly encouraged foreign investment and worked diligently to maintain a detailed legal and financial system to support this, as detailed above. However, there has been a cost to foreign investors for this support. That is, the governmental approval process in China for foreign investments has been much more onerous substantively to the Western company than the process in Russia. The federal Chinese Ministry of Commerce (MOC) would have to approve any foreign equity investment of at least US$30 million, and regional MOC's investments of lesser amounts. In either case, the MOC would as a matter of course require that substantive changes be made to investment agreements which had already been negotiated between the parties, and in my experience these changes were invariably in favor of the Chinese party. The USSR or the Russian Federation has had no analogous procedure. This rigorous MOC intrusion into investment agreements, though irritating to the foreign investor, undoubtedly has served its intended purpose in the aggregate of having foreign investment agreements be more favorable to China, both commercially and technologically. In addition, generous tax concessions were granted to foreign investors and "special economic zones" were set up (initially along the coast, not unlike the Qing Dynasty's treaty ports) to further encourage foreign investment. These preferences for foreign investment came before China's entry into the World Trade Organization (WTO), and have since been phased out in order to comply with WTO requirements. The Chinese realized (correctly) that Western technology would be more readily and thoroughly transferred to China (and then updated) if done as part of an equity investment. This was in contrast to the approach in the USSR/Russia.

6. There were more U.S. statutory obstacles to U.S. companies doing business in the USSR than in China—for example, the Jackson-Vanik Amendment, which effectively

blocked the USSR from being granted "most favored nations" (MFN) treatment; the Stevenson Amendment, which prohibited the use of U.S. Export Import Bank credits for U.S.-Soviet trade; and the U.S. grain-shipment embargo against the USSR under President Jimmy Carter. One reason for this discrepancy is that these were adopted in the 1970s, before U.S./China trade developed. I do not believe that these U.S. provisions inhibited Soviet development for at least four reasons: (a) U.S. firms were nonetheless quite successful in Soviet trade; (b) the Soviets (based on oil and gas revenues at a time of relatively high prices) from all appearances had sufficient cash to purchase the industrial goods and technology they wanted from the U.S. (consumer goods imports being virtually nonexistent); (c) even with MFN status, the Soviets would have had few manufactured goods of a quality acceptable to the U.S. market; and (d) the Soviets were only too happy to purchase what they needed from Western European or Japanese sources, often with favorable state credits, in response to U.S. legislative restrictions.

Corning's U.S. export license applications for its turnkey plants in the USSR received more stringent review than applications for China. In three Soviet applications, the U.S. government's objections were not substantive and were easily refuted. In one case, the government claimed that Corning's technology was intended for a military installation in Ukraine—the Soviet ministry permitted (in fact encouraged) a U.S. embassy representative to go to the Ukraine city and this representative confirmed the ministry's position. In another case, the U.S. government alleged that technology for lighting glass tubing could also be used for lasers or to illuminate nighttime battlefields. The government's position in the third case was that blood gas analyzers could be used for chemical and biological warfare. I do not believe, however, that this more stringent approach to Soviet licenses could be deemed as a factor giving China a developmental advantage over the USSR. Quite simply, in each of these three instances, the export license in question was obtained. In the end, the U.S. export licensing regime for both countries (in my experience) was neutral.

7. Of significant benefit to U.S. trade and investment with both the USSR and China was that both were highly visible within Western companies and to the general public. Thus, Western companies had such a great desire to enter each market that they would too often enter into transactions (termed "strategic") that would not have been justifiable economically for these companies if proposed in virtually any other country. Specifically, too many Western companies were so anxious to "get into the Chinese market" or "get into the Soviet market" that during the mid-1990s (if not still ongoing) for China, and throughout the 1970s for the USSR, numerous transactions were concluded without sufficient due diligence, or with an unrealistically positive idea of projected profitability. This type of "political investment" was done sufficiently frequently in both countries, though longer in China, that it probably favored China's development over Russia's. In any event, companies entering into such transactions (ignoring the very real country and transaction risks) often lost substantial amounts on them in both countries.

8. The saying "success begets success" is shown in the relative importance of Chinese and Russian patents to most Western companies. That is, as China became increasingly important to Corning and other Western companies, companies in turn would place China in a higher category for patent filing than Russia. This, in turn, would permit companies to take into consideration these patents in negotiations, including any eventual licensing or joint development negotiations. Also, a company's development of a strong Chinese

patent (and trademark/copyright) portfolio, and having the confidence that these patents can be enforced in Chinese courts, are important factors in the company's being able to be more aggressive in its Chinese investments, including in higher levels of technology to the extent covered by its patents. This increasing importance of patents, trademarks and copyrights has very much played to the advantage of China, in contrast to Russia, in terms of attracting international business.

This is even the case with the extensive publicity given to the problem of western intellectual property theft by Chinese companies. There had been an occasional concern for some foreign companies, at least in the late 1980s through the mid-1990s, about key employees of foreign invested companies leaving joint ventures to start their own companies. This was a major reason why certain foreign companies insisted on WFOEs for their equity investments. Of course, this type of theft of trade secrets was much less of a concern in Russia, since the level of foreign investment there was so much lower than in China and the domestic technological development level in Russia was not conducive to the growth of world-class domestic technology companies.

9. Corruption affecting foreign businesses has been pervasive in both countries, as widely reported in the Western press. Corning has always had a "zero tolerance" policy regarding not participating in any form of bribery or other forms of corruption. The company clearly enunciated this policy in China and Russia, and, as a result, was not subjected to requests for bribes or other payoffs. Also, Corning was never threatened for its unwillingness to participate in any such scheme. In China, in fact, Corning did not proceed with a potential equity investment when, as a result of its initial due diligence, it could not get comfortable with whether or not the target Chinese company was materially in compliance with its national and regional tax filings.

Corruption, by nature, is much more a matter of perception than other issues dealt with in this paper. In my opinion, the perception is that Russia poses a greater problem to foreign businesses in this regard than China. One reason for this is that with the collapse of the USSR, the rush to gain control over Russia's natural resources, without a strong system of laws controlling this rush, set a tone that increased with former President Vladimir Putin's push to have more centralized Kremlin control over the economy. With this push, I became aware, from discussions with other lawyers, of a marked increase in the instances of requests for payments as a preliminary condition to contracts being signed. These types of requests did not come to my attention with any frequency in China. One reason for this may well be that China has had, for many years, very strong anti-bribery laws that carry severe (and broadly publicized) penalties.

If the above perceptions accurately reflect a broader reality in both Russia and China (and I believe they do), then the corruption issue is one more reason for Russia's comparative weakness to China in attracting foreign investment.

10. From all of the above, it is no coincidence that China became a member of the WTO long before Russia—which is still negotiating for WTO entry. Ongoing compliance with WTO requirements will, I believe, pose more of a problem for Russia than it has for China; Russia, once a member, will take a number of years merely to catch up to where China is with its WTO compliance status. For example, WTO compliance during Corning's recent two-year successful anti-dumping defense was a major matter of ongoing concern for China's Ministry of Commerce.

Conclusion

The theme of this paper has been to provide my opinion, from my experience, of the reasons that Russia has so dramatically fallen behind China in economic development over the past 30-35 years. It is certainly beyond the scope of this paper to predict relative future developments. Of course, most Western businesspeople very much want to see Russia grow and develop. However, if there is any substance to the points made in this paper, then Russia will have to make fairly dramatic changes (the sooner the better) in its business-law regime and government policies to encourage research and development in what will hopefully be a vibrant private sector—which, in turn, will be able to flourish in a stable, transparent and legally based economic system. At the same time, Russia should not worry about China's economic development; in fact, it should welcome such development, in part as an example to follow.

NOTES

1. On a personal note, I was treated with unfailing kindness (and indeed, friendship) in my interactions with both Russians and Chinese during my many years working in both countries. In fact, I never had an unpleasant experience in either country.

2. Gilbert H. Grosvenor, "Young Russia–The Land of Unlimited Possibilities," *National Geographic*, November 1914, 423-520.

3. My great-uncle was the chief accountant for BAT, present in Shanghai from the late 1880s to 1911. I have a significant amount of his family correspondence from China during this period. For a description of BAT (and, by extention, foreign investment in general in China during this period) I recommend *Big Business in China: Sino-Foreign Rivalry in the Cigarette Industry, 1890-1930* by Sherman Cochran of Cornell University.

4. Treaty ports were Chinese ports opened to foreign trade by the so-called Unequal Treaties. The first such port was opened in 1842 by the Treaty of Nanjing concluding the First Opium War. Eventually more than 80 treaty ports were established, granting extensive rights and privileges to foreign traders. Foreigners typically lived in separate areas in these ports and enjoyed legal extraterritoriality.

5. Of significance in this regard, Coca-Cola was one of the initial American companies investing in China; in April 1981 it opened its first plant in China since the 1940s. My uncle was instrumental in this effort by Coke, which included organizing Coke's support of Cambridge Professor Joseph Needham with a five-year grant for his ongoing seminal China work. "It [the need for Coke to cope with and absorb Chinese culture] was the wisdom of Coca-Cola management…principally in the head of C.A. Shillinglaw." From Ron Dorfman, "Soda Pop Diplomacy," *Atlanta Weekly*, June 28, 1981.

6. At an October 1988 International Law Institute sponsored symposium entitled "The Role of Contract Law in U.S.-U.S.S.R. Joint Ventures," I spoke (even at that time) of Corning's willingness to invest in China, but noted that the USSR had serious drawbacks compared to China, based on the company's joint-venture experiences in China—China's more developed statutory framework, a more creative Chinese foreign exchange regime, more Chinese tax concessions, Chinese bank financing, more lenient U.S. export-control policies toward China, a joint venture in China not having to rely on a centrally planned raw-material supply system, China mandating at least 25% foreign equity (to encourage western technology transfer) rather than a then widely perceived Soviet imposed 49% foreign equity limitation.

7. "The Mysteries of Russia's Economy," *Economist*, February 28, 2008.