UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

COMMERCIAL LEGAL REFORM ASSESSMENTS FOR EUROPE AND EURASIA

Workshop Materials
Prague, Czech Republic
December 6-8, 1999

USAID Omnibus II-C: Policy/Legal/Training
Contract No. EPE-I-95-00071
Task Order No. EPE-I-09-95-00071-00

BOOZ·ALLEN & HAMILTON INC.
INTERNATIONAL CLIENT SERVICE TEAM

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UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

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Synthesis Report

USAID Omnibus II-C: Policy/Legal/Training
Contract No. EPE-I-95-00071
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November 15, 1999

BOOZ·ALLEN & HAMILTON
INTERNATIONAL CLIENT SERVICE TEAM

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I. Executive Summary

USAID has been providing economic reform assistance to emerging economies of the Europe/Eurasia region since 1990. Key areas of focus include banking and capital markets development, privatization, tax and fiscal reform, and commercial law and associated institutional reform activities ("C-LIR").

USAID's primary objective in supporting C-LIR efforts in the region has been to help accelerate the transition to a market economy by promoting the development of an appropriate legal and regulatory environment for commercial activity. As explained in the following section of this report, approaches and results in this area to date have been mixed. Overall, progress has been made in strengthening the commercial law environment throughout the region, yet in many cases these laws are being poorly implemented, and unevenly enforced. This phenomenon, which we refer to as the implementation/enforcement gap, remains a key development challenge throughout the region, with little consensus on what can be done to address it effectively.

USAID is seeking to better understand the dynamic forces that affect the content and pace of transition to the market, and to develop approaches that can help further strengthen and accelerate commercial law and associated institutional development in the region. To accomplish this, in 1998 USAID commissioned assessment studies in each of the key areas of activity mentioned above. This synthesis report presents the methodology, data, and interpretative results of four C-LIR diagnostic assessments that were performed between December 1998 and June 1999.

The four countries we studied in this assessment - Poland, Ukraine, Romania, and Kazakhstan - were selected to provide a diverse sample based on considerations of location, geography, size, relative wealth, economic structure, legal traditions, and relative progress in transition toward a market-oriented economy. In each country, we evaluated seven areas of commercial law - bankruptcy (insolvency), collateral (secured transactions), company, competition, contract, foreign direct investment, and international trade. In each substantive area of commercial law, we then assessed four "dimensions" of development - Framework Law, Implementing Institutions, Supporting Institutions, and the internally driven process of change that we refer to as the "Market" for reform.

One of USAID's desired principal outputs of this activity is the development of a set of common indicators that can be used for country-specific and cross-regional comparisons of C-LIR development. As explained in greater detail in the body of this report, these indicators were developed as a tool to help development professionals at various levels within USAID and other donor organizations make relatively quick, cost-effective, and accurate judgments concerning C-LIR development needs, priorities, and appropriate responses.

This Synthesis Report, four Country Diagnostic Reports, and the C-LIR indicator results upon which they are based, will be presented for discussion, comment and refinement at USAID's Regional Commercial Law Reform Workshop, Prague, the Czech Republic, December 6 - 9, 1999. Based on the results of this workshop, the C-LIR indicators and diagnostic methodology will be refined and made available for wider use within USAID and the larger donor community.

II. GLOSSARY OF KEY TERMS & CONCEPTS

Bankruptcy - Mechanisms intended to facilitate orderly Market exit, liquidation of outstanding financial claims on assets and rehabilitation of insolvent debtors. Should be read to include "insolvency".

Collateral - Laws, procedures and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets. This term should be read to include "secured transactions".

Companies - Legal regime(s) for Market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.

Commercial Law- Any one or more of seven areas of substantive law defined for the purposes of this study to include Bankruptcy, Collateral, companies, Competition, Contract, foreign direct investment, and International Trade laws, and associated institutions.

Competition - The legal and regulatory regime consisting of a body of rules, policies and Supporting Institutions intended to help promote and protect open, fair and economically efficient Competition in the Market, and for the Market.

Contract - The legal and institutional framework for the creation, interpretation and enforcement of commercial obligations between one or more parties.

Foreign Direct Investment - The laws, procedures and institutions that regulate the treatment of foreign direct investment.

"Dimension" - One or more of four elements that together make up the legal and institutional environment for modern commercial life. These include "Framework Laws", "Implementing Institutions", "Supporting Institutions" and, the "Market" for C-LIR.

End Users - Individuals and firms who use, or rely upon, the provision of goods (e.g., laws, regulations, licenses, certifications, etc.) or services (e.g., administration, adjudication, enforcement, etc.) provided by government (or its agents) that relate to commercial activity.

Implementing Institution - One of four Dimensions that together make up the legal and institutional environment for modern commercial life. The administrative body with primary responsibility for implementation and enforcement of framework and subsidiary laws, regulations, and policies governing one or more of the seven areas of commercial law assessed in this study. For example, Bankruptcy courts are the Implementing Institution for the Bankruptcy Framework Law.

Indicator - A point of reference or benchmark, whether quantitative or qualitative, against which a sample can be compared, measured, or evaluated.

Indicator Result - The value of an indicator's raw score divided by the reference value for that indicator. For example, a raw score of 54, divided by the indicator's reference value of 140, would yield an indicator result of 39%.

International Trade - The laws, procedures and institutions governing cross-border sale of goods and services.

"Market" for C-LIR - One of four Dimensions that together make up the legal and institutional environment for modern commercial life. The "Market" for C-LIR is a conceptual framework that helps characterize the dynamic of modern pluralistic society in which End Users "demand" and government "supplies" certain public goods and services that are necessary for modern commercial activity. For example, rent seeking by a local bread monopoly can give rise to demand by consumers (End Users) for specific remedial action by the government (i.e., enforcement of antimonopoly regulations) against offending firms.

Raw Score - The point value score of an indicator based on the data collected for that indicator.

Supporting Institution - Firms, individuals, or activities without which Framework Laws cannot be fully or efficiently implemented or enforced. Examples include notaries, bailiffs, trustees, banks, consumers groups, business support organizations, professional associations, and other similar ancillary service providers.

III. Summary Indicator Results

The following table contains a summary of the indicator raw scores and results derived the four country diagnostic assessments. The scores reflect a "snapshot" of what our survey team found

Development Indicators: Total Scores by Dimension

	SUBSTANTIVE AREA	REF.	POL		ROM		UKR		KAZ	
A.	**BANKRUPTCY**			***78%***		***54%***		***37%***		***50%***
1.	Legal Framework	**280**	224	*80%*	166	*59%*	114	*41%*	168	*60%*
2.	Implementing Institutions	**170**	136	*80%*	105	*62%*	76	*45%*	87	*51%*
3.	Supporting Institutions	**200**	151	*76%*	104	*52%*	66	*33%*	97	*49%*
4.	Market - Bankruptcy	**290**	225	*78%*	130	*45%*	81	*28%*	119	*41%*
B.	**COLLATERAL**			***77%***		***32%***		***48%***		***35%***
1.	Legal Framework	**140**	126	*90%*	62	*44%*	107	*76%*	79	*56%*
2.	Implementing Institutions	**210**	165	*79%*	27	*13%*	118	*56%*	49	*23%*
3.	Supporting Institutions	**190**	123	*65%*	66	*35%*	59	*31%*	58	*31%*
4.	Market - Collateral	**310**	234	*75%*	114	*37%*	92	*30%*	87	*28%*
C.	**COMPANY**			***79%***		***62%***		***44%***		***59%***
1.	Legal Framework	**190**	153	*81%*	119	*63%*	90	*47%*	118	*62%*
2.	Implementing Institutions	**270**	205	*76%*	198	*73%*	140	*52%*	182	*67%*
3.	Supporting Institutions	**100**	82	*82%*	70	*70%*	42	*42%*	58	*58%*
4.	Market - Company	**270**	211	*78%*	117	*43%*	89	*33%*	130	*48%*
D.	**COMPETITION**			***80%***		***60%***		***41%***		***62%***
1.	Legal Framework	**210**	172	*82%*	138	*66%*	115	*55%*	135	*64%*
2.	Implementing Institutions	**220**	178	*81%*	136	*62%*	92	*42%*	141	*64%*
3.	Supporting Institutions	**160**	122	*76%*	82	*51%*	59	*37%*	74	*46%*
4.	Market - Competition	**290**	226	*78%*	142	*49%*	80	*28%*	162	*56%*
E.	**CONTRACT**			***80%***		***63%***		***45%***		***64%***
1.	Legal Framework	**90**	75	*83%*	67	*74%*	45	*50%*	66	*73%*
2.	Implementing Institutions	**180**	150	*83%*	132	*73%*	89	*49%*	119	*66%*
3.	Supporting Institutions	**70**	55	*79%*	46	*66%*	35	*50%*	38	*54%*
4.	Market - Contract	**310**	234	*75%*	114	*37%*	92	*30%*	192	*62%*
F.	**FDI**			***77%***		***57%***		***41%***		***66%***
1.	Legal Framework	**290**	253	*87%*	278	*96%*	259	*89%*	240	*83%*
2.	Implementing Institutions	**190**	155	*82%*	110	*58%*	35	*18%*	129	*68%*
3.	Supporting Institutions	**200**	131	*66%*	76	*38%*	56	*28%*	100	*50%*
4.	Market - FDI	**310**	234	*75%*	114	*37%*	92	*30%*	201	*65%*
G.	**TRADE**			***68%***		***54%***		***33%***		***52%***
1.	Legal Framework	**280**	260	*93%*	252	*90%*	158	*56%*	221	*79%*
2.	Implementing Institutions	**180**	128	*71%*	96	*53%*	61	*34%*	109	*61%*
3.	Supporting Institutions	**180**	88	*49%*	72	*40%*	35	*19%*	58	*32%*
4.	Market - Trade	**310**	188	*61%*	107	*35%*	66	*21%*	111	*36%*
	AGGREGATE TOTALS			***77%***		***55%***		***41%***		***55%***
1.	Legal Framework	**1480**	1263	*85%*	1082	*70%*	888	*59%*	1027	*68%*
2.	Implementing Institutions	**1420**	1117	*79%*	804	*56%*	611	*42%*	816	*57%*
3.	Supporting Institutions	**1160**	808	*71%*	570	*52%*	385	*35%*	553	*48%*

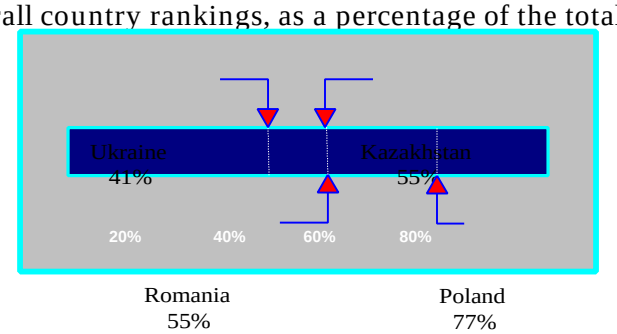
4.	Market for Reform	**2090**	1552	*74%*	838	*40%*	592	*28%*	1002	*48%*

at the time of their visit; these scores have not been updated and so do not reflect any recent changes. The seven subject matter areas analyzed appear in the left-most column of the table. Within each subject matter area (e.g., Bankruptcy), four Dimensions of C-LIR are considered. The total number of possible points that scored against an indicator appears in the adjacent column entitled "REF". The remaining columns of the table below are organized by country, in the order in which the in-country diagnostic assessments were conducted.

For each country analyzed, *raw scores* (the number of points assessed against the indicator) appear next to the associated indicator *result* (stated as a *percentage of the total possible raw score for that category)*. For ease of reference, indicator results columns are shaded. "Tier I" indicator raw scores and associated indicator results appear in the rows highlighted in light blue in the table below. Similarly, "Tier II" scores and results appear in the four rows immediately beneath the highlighted Tier I rows of the table. The reader is urged to carefully read Section V, Indicator Design and Development, before attempting to draw any specific conclusions either from the raw scores, or the associated indicator results, that appear in the summary table below.

The following general observations can be made about the data summarized in the table above:

1. ***Overall Rankings:*** Overall country rankings, as a percentage of the total possible raw score, are:



At this general level, the overall rankings confirm what prevailing wisdom - that is, in relative terms, Poland's C-LIR environment is significantly more developed than Kazakhstan's; that Kazakhstan's and Romania's C-LIR environments, while quite different, are at the same aggregate level of development; and, that Ukraine is the least developed in terms of its overall C-LIR overall environment.

2. Subject Matter Rankings: Subject matter rankings track the overall scores stated above. They clearly show that Poland and Ukraine are the bookends in each category, except for collateral, where Ukraine ranked above Romania and Kazakhstan.

	1st	2nd	3rd	4th
Bankruptcy	**P**	**R**	**K**	**U**
Collateral	**P**	**U**	**K**	**R**
Company	**P**	**R**	**K**	**U**
Competition	**P**	**K**	**R**	**U**
Contract	**P**	**K**	**R**	**U**
FDI	**P**	**K**	**R**	**U**
Trade	**P**	**R**	**K**	**U**

The only anomaly we find in the general pattern of results (shaded cells) is in Collateral, where Ukraine is ranks higher than both Kazakhstan and Romania. Tier II results suggest that a strong Framework Law, combined with a comparatively stronger Implementing Institution explain this difference. Recent enactment of a Framework Law based on international best practices, combined with the establishment of a modern registry system, are the primary causes of this result. We believe that the assessment results reflect the positive impact that USAID's sustained support to Ukraine in developing these dimensions of its system for Collateral. The comparatively weak results for Dimension III, Supporting Institutions [31%], and Dimension IV, Market for Reform [30%], suggest that any possible future technical assistance interventions in this area should focus on bolstering results primarily in these Dimensions.

3. High-Low Spread: Another possible metric for cross-regional comparative purposes is high-low spread (or disparity between countries) within subject matter areas. As reflected in the table below, the greatest high-low spread was found in Collateral, where Poland scores 44 points higher than Romania. The closest high-low spread was found in FDI, with a 33-point differential. One possible interpretation of this result is that, again *in relative terms*, FDI is the most developed area of commercial law within the sample. This may be due in part to a political consensus in each country that FDI is important (with policymakers thus generating to a greater "supply" of laws), to a relative lack of controversy over the shape of reform, to greater harmonization (or approximation) in international law and practice in this area, or to other factors. The importance of "exogenous" demand for FDI reform -- from foreign financial institutions and donors -- should also be considered as a possible factor driving change in this area.

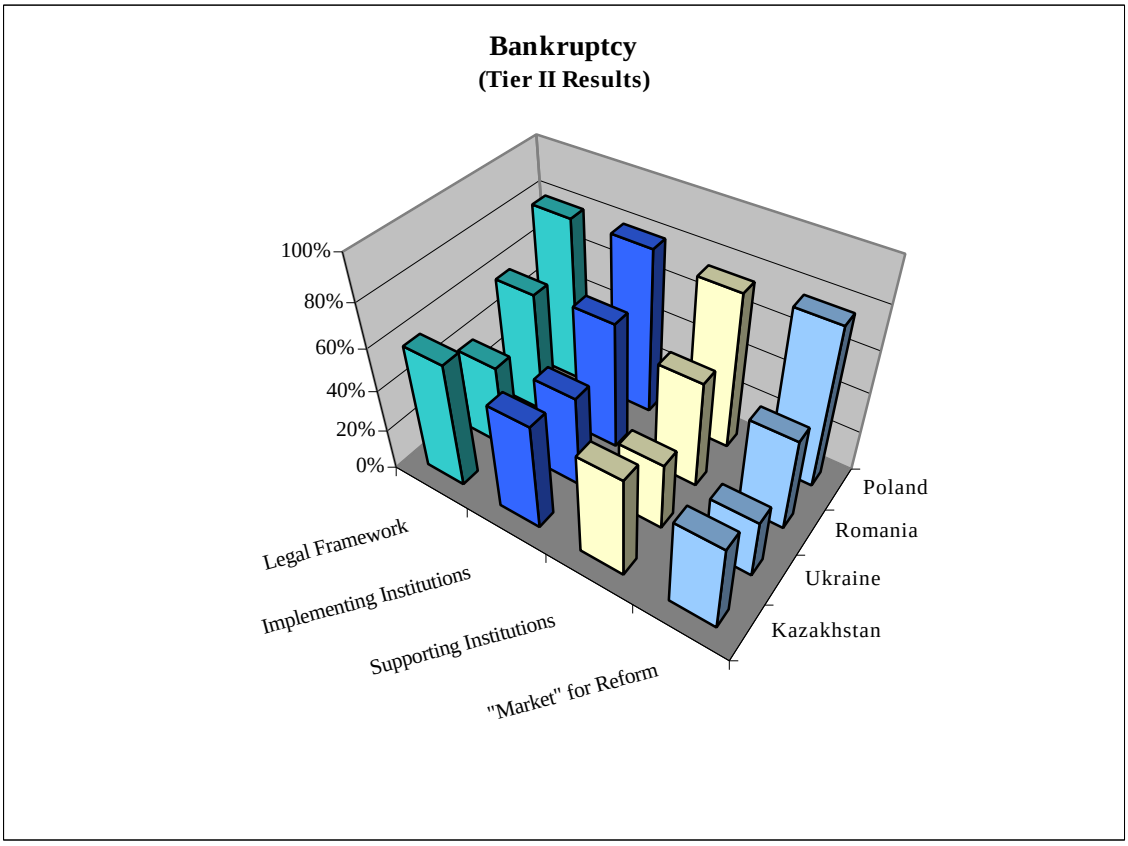
	High-Low Spread	Rank[1]	Total Average Score	Rank
Bankruptcy	**37**	**3**	**55%**	**5**
Collateral	**45**	**1**	**48%**	**7**
Company	**35**	**5**	**61%**	**2**
Competition	**39**	**2**	**61%**	**3**
Contract	**35**	**5**	**63%**	**1**
FDI	**36**	**4**	**60%**	**4**

[1] Rankings based on total spread between high and low Tier I rankings by subject matter area.

Trade	**35**	**5**	**52%**	**6**

4. Total Average Score by Subject Matter Area: Total average score by subject matter area may be another useful metric for cross-regional comparative purposes. Based on the findings of the four country assessments, Contract ranked the highest with an average Tier I result of 63%. Collateral and International Trade, in contrast, had the lowest average Tier I results at 48% and 52% respectively. Based on this measure, Collateral and International Trade might be viewed by assistance partners as possible priority areas on a regional basis, relative to the other areas assessed.

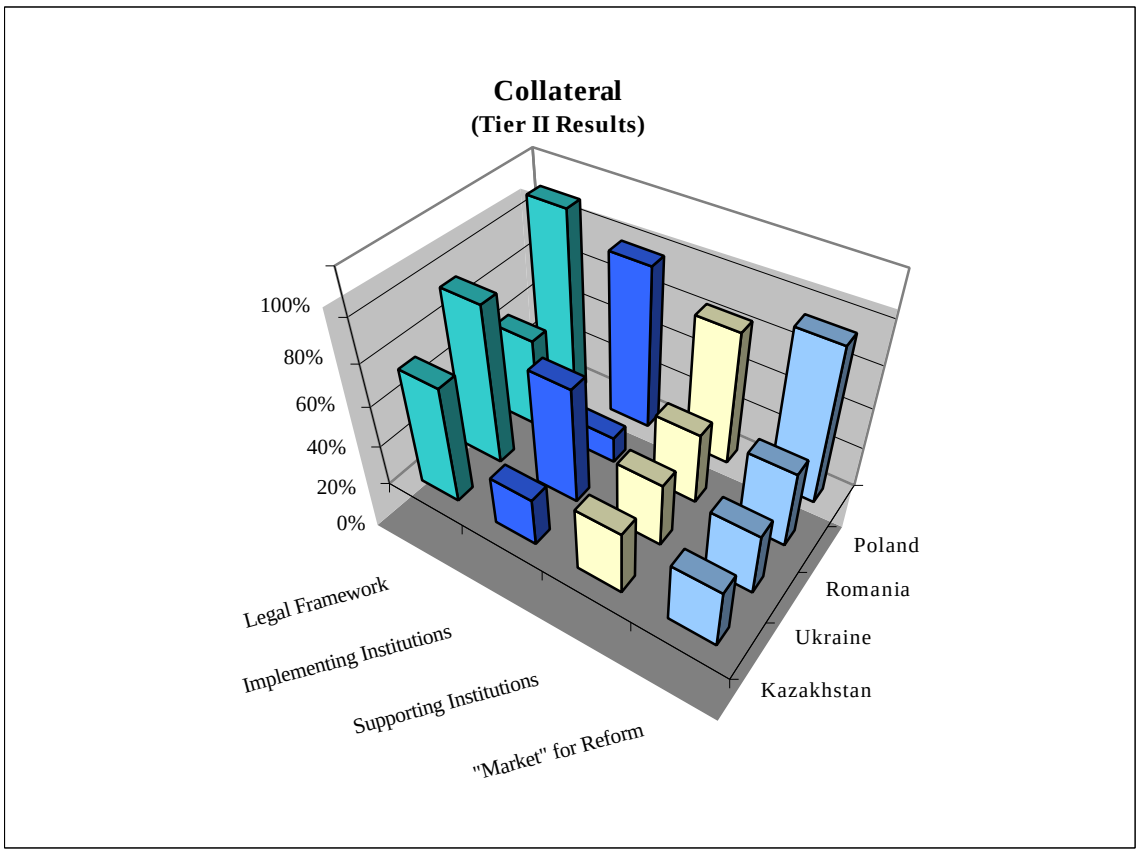
5. Rankings By "Dimension" : The following tables summarizes the country rankings for each of the four "Dimensions" of C-LIR based on Tier II indicator results for each of the seven subject matter areas analyzed. Generally speaking, ranking patterns are consistent across subject matter areas. Pattern divergences are indicated by shaded cells in the tables. Column height in the accompanying charts represents the percent total possible raw score for each dimension within the subject matter area by country:



Bankruptcy	POL	ROM	UKR	KAZ
1. Legal Framework	*80%*	*59%*	*41%*	*60%*
2. Implementing Institutions	*80%*	*62%*	*45%*	*51%*
3. Supporting Institutions	*76%*	*52%*	*33%*	*49%*

4. Market for Effective Bankruptcy System	*78%*	*45%*	*28%*	*41%*

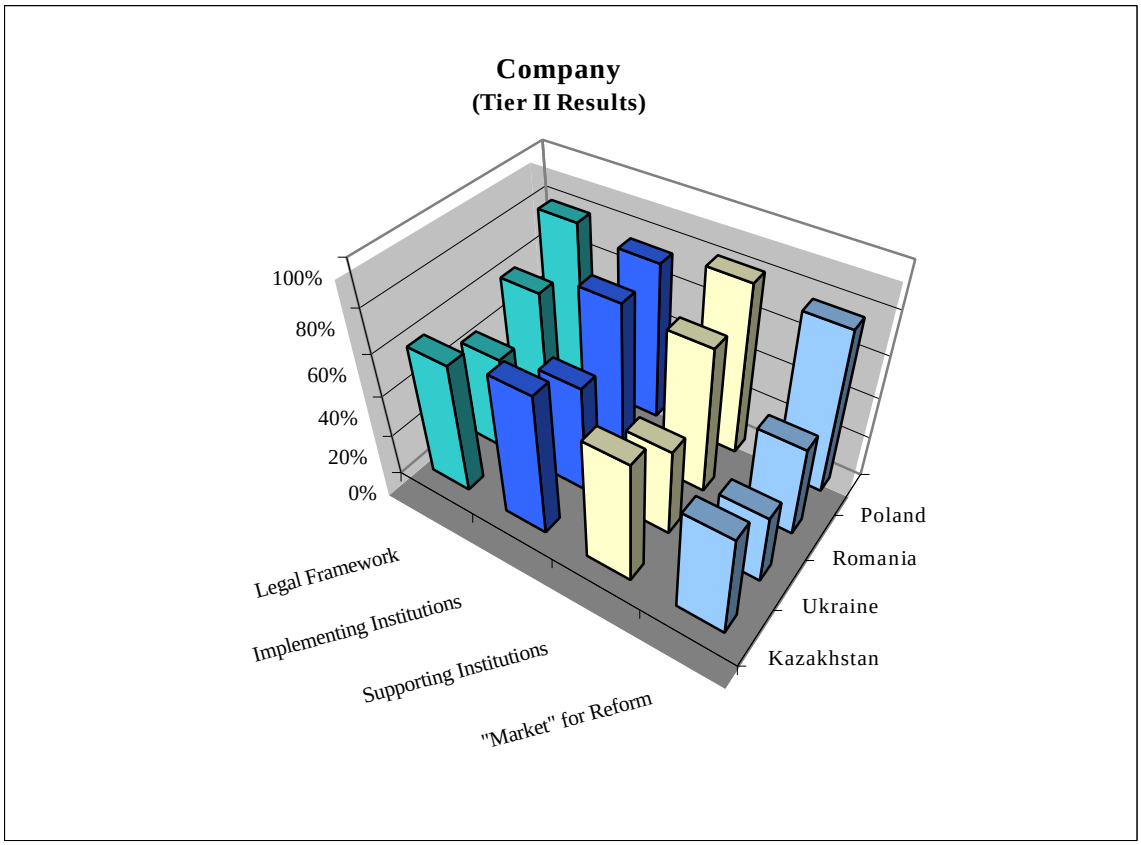
The chart above shows that Poland dominates the rankings in all four Dimensions and that, in comparative terms, the Market Dimension is the weakest of the four considered. Similarly, in all four Dimensions, Ukraine's scores were lowest among the group sampled. These basic patterns emerge with relative consistency in most of the charts that follow for the remaining six subject matter areas.



Collateral	POL	ROM	UKR	KAZ
1. Legal Framework	*90%*	*44%*	*76%*	*56%*
2. Implementing Institutions	*79%*	*13%*	*56%*	*23%*
3. Supporting Institutions	*65%*	*35%*	*31%*	*31%*
4. Market for Effective Collateral System	*75%*	*37%*	*30%*	*28%*

As in Bankruptcy, Poland's results in all four Dimensions outpace the rest of the sample group. In Dimensions I and II, Romania's Tier II results are clearly well below the other countries assessed, reflecting the absence of an appropriate Framework Law, and associated Implementing Institutions. Shortfalls in Dimension III indicator results for Kazakhstan, Romania, and Ukraine indicate a relatively less well developed supporting environment for commercial activity generally. Supporting Institutions, therefore, might be area where the experience of Poland, in comparative terms, might yield greater insights into this Dimension of C-LIR. Similarly, the weak

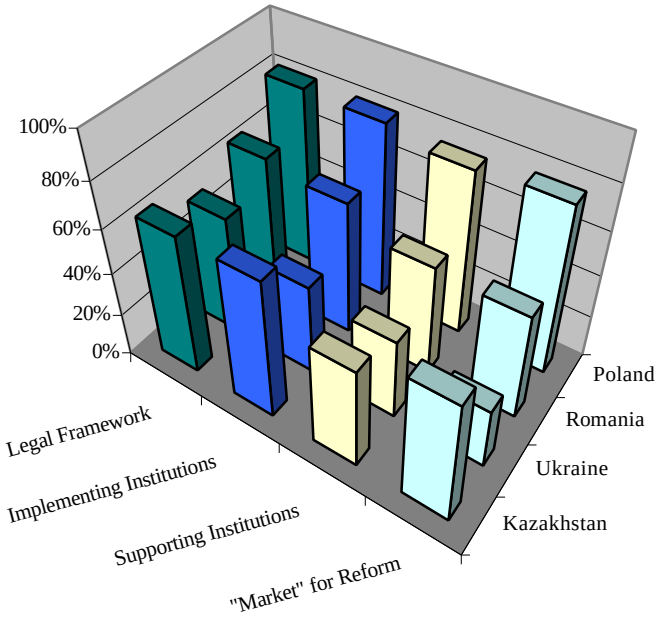
Market Dimension results suggest an area of possible priority in future C-LIR interventions in Kazakhstan, Ukraine, and Romania.



Company	POL	ROM	UKR	KAZ
1. Legal Framework	*81%*	*63%*	*47%*	*62%*
2. Implementing Institutions	*76%*	*73%*	*52%*	*67%*
3. Supporting Institutions	*82%*	*70%*	*42%*	*58%*
4. Market for Effective Company Law	*78%*	*43%*	*33%*	*48%*

Tier II Company results show a greater degree of uniformity cross-regionally than Bankruptcy and Collateral. Overall, Ukraine's results are consistent with the overall results of the assessment, and reflect weakness in the Framework Law Dimension attributable to on-going debate and uncertainty concerning the enactment of a new Commercial Code. Implementing Institutions (e.g., commercial courts of general jurisdiction) were found to be performing below those of Kazakhstan and the other countries sampled. Particular areas of concern noted during the in-country diagnostic assessment were inefficient case management, corruption, and a weak culture of corporate governance underpinned by notions of fiduciary responsibility and shareholder rights.

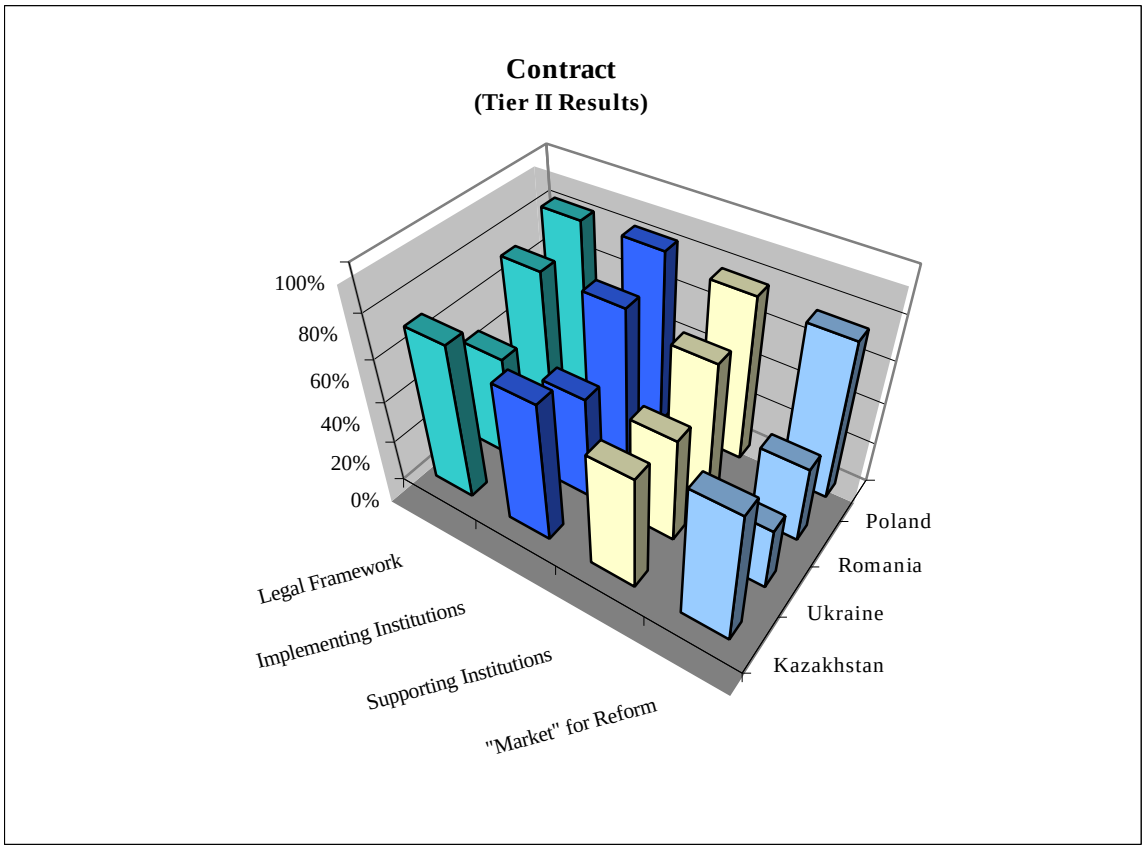
Competition



Competition	POL	ROM	UKR	KAZ
1. Legal Framework	*82%*	*66%*	*55%*	*64%*
2. Implementing Institutions	*81%*	*62%*	*42%*	*64%*
3. Supporting Institutions	*76%*	*51%*	*37%*	*46%*
4. Market for Increased Competition	*78%*	*49%*	*28%*	*56%*

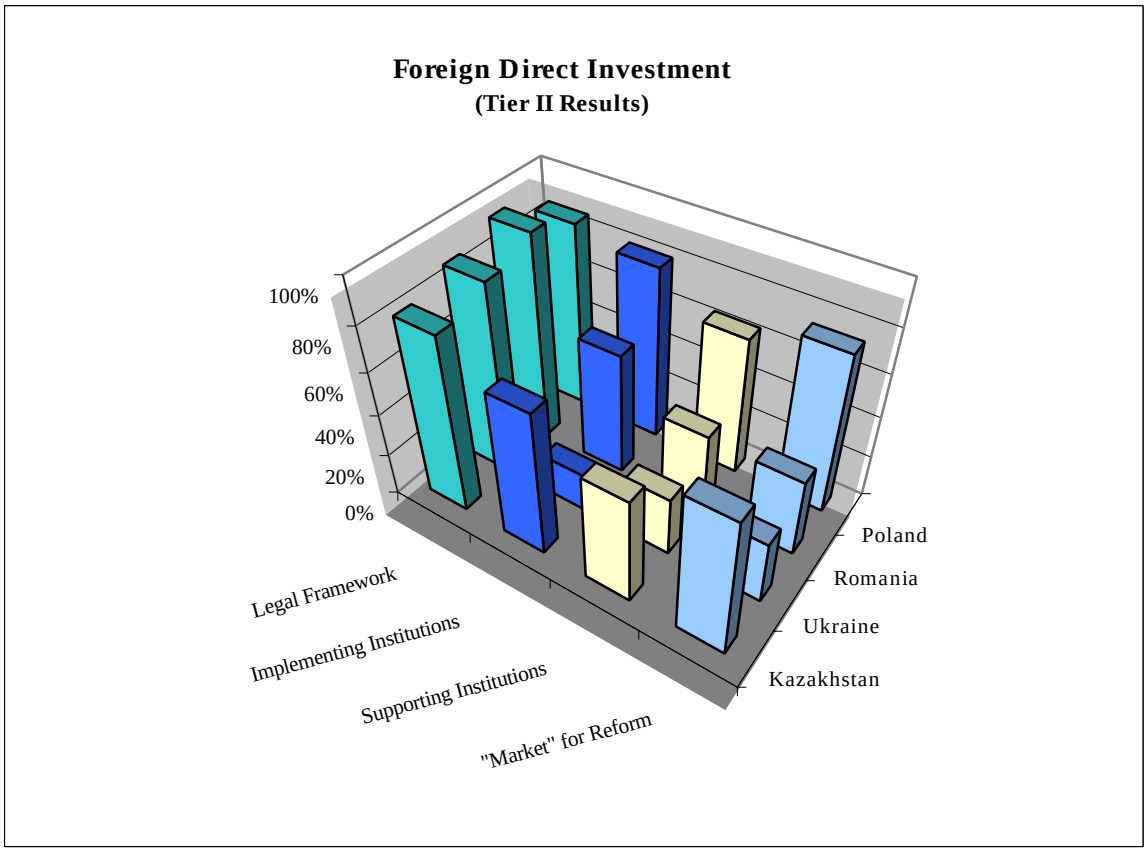
Poland's high scores in all four Dimensions of Competition suggest that this subject matter area is one of the most developed in the region. While these scores are comparatively strong, significant improvements will be required if Poland's competition policy regime is to meet EU standards for accession by 2002. This apparent contradiction between the diagnostic findings and EU perceptions of Competition in Poland is explained by the fact that EU standards are higher than those established as a benchmark for comparative purposes in this study.[2] Ukraine's Tier II results for Competition may reflect the high degree of concentration in Ukraine's economy, and also suggest that demand for an open, competitive market is quite low when compared to other countries in the sample group.

[2] For a more detailed explanation of the strategy employed in designing these indicators, please see Section V below.



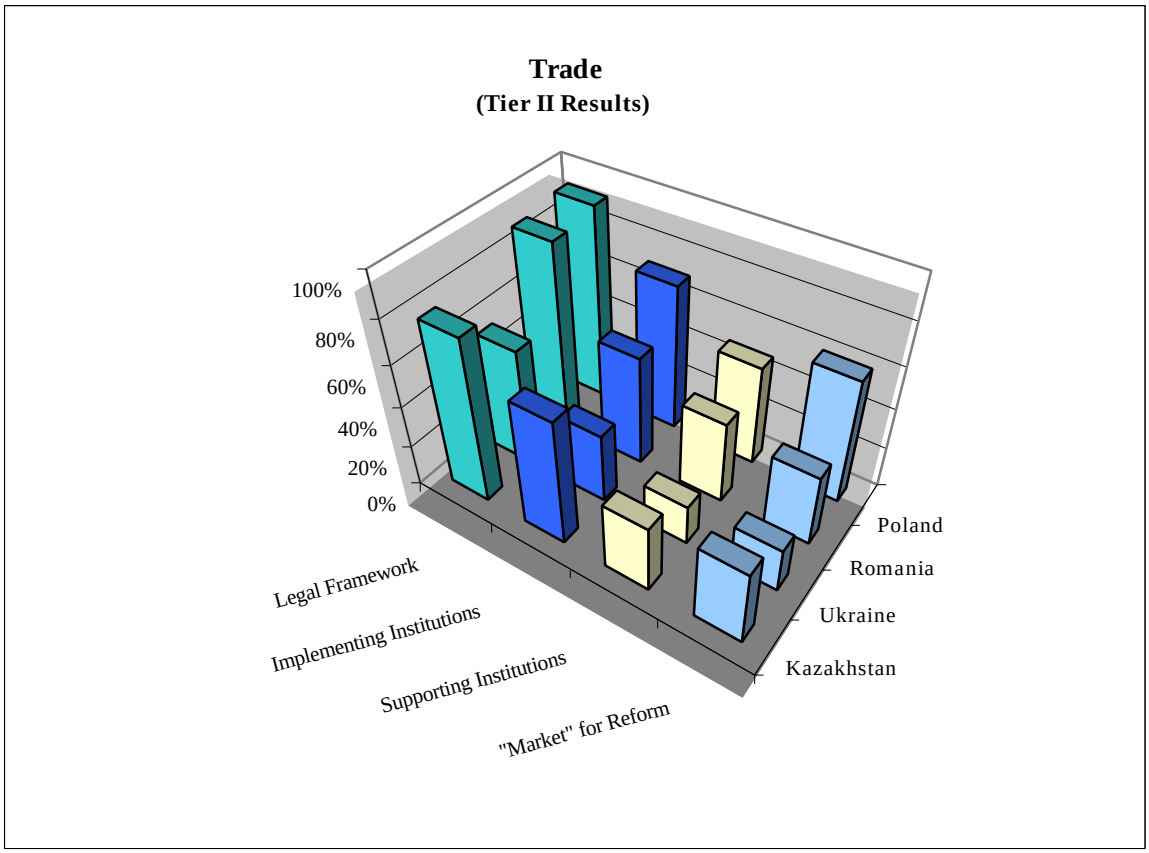
Contract	POL	ROM	UKR	KAZ
1. Legal Framework	*83%*	*74%*	*50%*	*73%*
2. Implementing Institutions	*83%*	*73%*	*49%*	*66%*
3. Supporting Institutions	*79%*	*66%*	*50%*	*54%*
4. Market for Reform	*75%*	*37%*	*30%*	*62%*

Ukraine's Tier I results in for Contract are only slightly better than for Company (45% and 44% respectively) and points up a fundamental weakness in the overall environment for commercial activity that is broadly attributable to a lack of broad political consensus on the direction and content of economic reform generally. Tier II Contract results show a degree of uniformity cross-regionally that is similar, but somewhat less pronounced, than that found in the Company subject matter area. Romania's relatively strong overall result is brought down by a weak result [37%] in Dimension IV. Implementing Institutions (e.g., commercial courts of general jurisdiction) were likewise found to be under-performing in Ukraine due to a significant degree to concerns relating to inefficient case management, corruption, and weak judicial enforcement of contractual agreements



FDI	POL	ROM	UKR	KAZ
1. Legal Framework	*87%*	*96%*	*89%*	*83%*
2. Implementing Institutions	*82%*	*58%*	*18%*	*68%*
3. Supporting Institutions	*66%*	*38%*	*28%*	*50%*
4. Market for Increased FDI	*75%*	*37%*	*30%*	*65%*

Tier II indicator results for FDI show a strong degree of uniformity in Dimension I, and great disparity in Dimension IV. In the former case, we believe that emerging standards for admission and treatment of FDI can partly explain this result. Interestingly, the disparity in Dimension IV results across the sample group may be attributable in part to a basic lack of consensus concerning the terms under which foreign investment should be made. Frequent changes to Romania's Law on Foreign Investment, for example, seems to support this hypothesis. In Ukraine, ambivalence concerning FDI is more pronounced, and the number of disputes involving foreign investors is an indicator of this attitude. Finally, for both Kazakhstan and Poland, who in per capita terms have received a great deal more FDI than Romania or Ukraine, the consensus concerning the desirability of attracting and retaining FDI appears to be much stronger, thus supporting the general result obtained here.



Trade	POL	ROM	UKR	KAZ
1. Legal Framework	*93%*	*90%*	*56%*	*79%*
2. Implementing Institutions	*71%*	*53%*	*34%*	*61%*
3. Supporting Institutions	*49%*	*40%*	*19%*	*32%*
4. Market for Open Trade Regime	*61%*	*35%*	*21%*	*36%*

Tier II results for International Trade are generally uneven, and particularly weak in Dimensions III and IV. Supporting Institutions, designated as the customs service and national standards agency for this subject matter area, is a Dimension where weakness was found across the sample group. The relatively weak Market results for Dimension IV, however, should not be interpreted as reflecting ambivalence or hostility to international trade in general, but perhaps could be ascribed to general lack of knowledge concerning the various commitments under which these countries are obligated in the sphere of international trade. This issue surely merits further discussion.

IV. Summary Findings & Narrative

The summary results presented above are offered as a general point of departure for discussion and further analysis of the country-specific findings contained in each of the four diagnostic reports that serve as the foundation for this Synthesis Report. In the following sections, a detailed look at the specific findings, analytical design, and diagnostic methodology are presented.

A. By "Dimension" of C-LIR

	POL	ROM	UKR	KAZ
Tier I Results for All Subject Matter Areas	**77%**	**55%**	**41%**	**55%**
1. Legal Framework	85%	70%	59%	68%
2. Implementing Institutions	79%	56%	42%	57%
3. Supporting Institutions	71%	52%	35%	48%
4. Market for Trade Liberalization	74%	40%	28%	48%

Poland serves as a logical benchmark for the sample group studied in this diagnostic effort given that it achieved the highest indicator results in all four Dimensions of the seven subject matter areas evaluated in this study. Poland's overall Tier I result is 77% of the total possible raw score.[3] Romania and Kazakhstan place behind Poland at 55% each. Ukraine's overall result was lowest, with 40% of the total possible raw score for all indicators. Broadly speaking, we believe the assessment results support what many already believe based on practical experience - Poland's legal and regulatory environment for commercial activity is relatively well advanced when compared to this sample group. Based on these results, one could say that Poland is approximately three-quarters of the way toward achieving a fully developed legal and institutional environment for modern commercial activity based on the benchmarks established by the C-LIR indicators.

Dimension I (Legal Framework) is the area where all four countries' rankings were closest. Poland's score was 85%, while Romania's [70%] and Kazakhstan's [68%] were essentially even, and Ukraine placed fourth [59%]. We feel that the distribution of results in this first dimension is instructive. Poland's scores were generally consistent (ranging only from 80% to 93%), while there were great fluctuations or "unevenness" in scores for the other three countries. Romania's indicator results ranged from a high of 96% for FDI to a low of 44% for Collateral. Ukraine's highest Dimension I result is in FDI [89%], while Bankruptcy and Company were 41% and 47%, respectively.

Overall, the assessment indicator results for Dimension I seem to suggest that opportunities for 1st Generation interventions in this sample group are limited. Except in the case of Romania's lack of a modern framework law for Collateral, and Ukraine's current lack of adoption of a proposed Civil Code, the basic legal norms for each of the seven subject matter areas are substantially in place. This seems to be particularly true for FDI, Contract, and Company. Neverthe-

[3] For a more complete discussion of how these results were generated and interpreted, please see Section V, below.

less, Dimension I indicator results at the Tier III level do point up need for specific amendments or revisions to existing framework laws that constrain commercial activity. One case where this is true is Poland's Law on Bankruptcy, where the order of priority among secured creditors was identified as a major hindrance to the efficient operation of this vital mechanism for market exit.

In Dimension II (Implementing Institutions), Poland's results were again the highest among the sample group [79%]. Scores for the remainder of the sample group drop off significantly with Kazakhstan [57%], Romania [56%], and Ukraine [42%] results well below the level measured for Poland. This result highlights the general deficit in institutional capacity across the seven subject matter areas, and cross-regionally as well. In Collateral, the average Tier II result for Dimension II was only 43%, reflecting the lack of a formal Implementing Institution for this subject matter area. Another of relative softness across the sample is found in International Trade, where the average Tier II result for Implementing Institutions is 55%. We believe this result may be explained in part by the complex institutional and technical requirements of administering a trade regime. In this particular, Ukraine [34%] is far weaker as compared to the rest of the sample group whose averages result for this dimension is nearly double Ukraine's [62%].

For Dimension III (Supporting Institutions), all countries generally scored lower than the first two Dimensions (Legal Framework and Implementing Institutions) in most of the seven subject matter areas. Notable exceptions to this general trend are found in Collateral for Romania and Kazakhstan; Company for Poland; and FDI for Ukraine. We believe that the weakness observed in this Dimension across the sample group is a typical characteristic of economies in transition. Poland, which maintained a fairly significant level of private sector activity through the Communist period and started the transition to market earliest of the sample group, clearly had a head start in this development Dimension. It is interesting to note Romania's relative strength in this Dimension as compared to the results obtained for Ukraine and Kazakhstan. A question exists whether variables like the length of time under Communist rule, the geographic distance from Moscow, the degree of collectivization in agriculture, and the relative intensity of industrial concentration help determine the starting point and pace of development of the C-LIR environment in these countries. If this is the case, the Tier II results in this Dimension could be viewed as generally consistent with these possible variables of transition.

The greatest unevenness or divergence in results among the sample group, and between Poland and the other three countries, is found in Dimension IV (the Market for C-LIR).[4] Ukraine lags behind Poland by a whopping 46%, while Romania and Kazakhstan had similarly weak showings with results spreads of 34% and 26%, respectively. At the Tier II level, the only surprises were registered in Kazakhstan, where contract law and FDI went against the grain by scoring grades of 62% and 65%, respectively, in Dimension IV. The overall imbalance in the Market can be characterized by a relative "over-supply" of inadequate, incomplete, and often conflicting laws, regulations, and institutional arrangements for some legal areas and an "under-supply" in others, but in both cases is this in response to a weak and rather diffuse level of demand from the private sector.

[4] For a more detailed discussion of the market concept, please see Section IV of this report.

B. By Country

1) Poland

SUBSTANTIVE AREA	TOTAL	Legal Framework	Implementing Institutions	Supporting Institutions	Market
POLAND	**77%**	**85%**	**79%**	**71%**	**74%**
A. Bankruptcy	**78%**	80%	80%	76%	78%
B. Collateral	**77%**	90%	79%	65%	75%
C. Company	**79%**	81%	76%	82%	78%
D. Competition	**80%**	82%	81%	81%	78%
E. Contract	**80%**	83%	83%	79%	75%
F. FDI	**77%**	87%	82%	66%	75%
G. Trade	**68%**	93%	71%	49%	61%

Poland has far outpaced the other countries in this study in adopting and implementing legal and institutional reform, scoring at least 25% higher in most areas covered. Also, with higher absolute and per capita GDP, Poland has maintained strong economic growth since 1994 and attracts substantial foreign direct investment. Its neighbor to the east, Ukraine, lags far behind in the transition, despite close proximity, geographic similarities, and a high level of industrialization. These disparities raise numerous analytical questions, especially in trying to replicate successes in legal reform programs.

The average legal framework score for all subject areas was quite strong [85%], evidencing the positive legal reforms that have been underway this decade. The overall score for implementing institutions was only 6 points lower, at 79%, a relatively insignificant difference of only one-fourteenth. At the Tier II level, however, the difference between scores for law and implementation particularly stood out in two areas: collateral and trade law had implementation gaps of 11% and 22%, respectively.

For Dimension III, the assessment found supporting institutions generally strong. However, at the Tier II level, the supporting institutions for trade were quite weak, scoring only 49%, or 44 points lower than the legal framework for the same topic. FDI [66%] and collateral [65%] were also relatively weak, while supporting institutions for company law [82%] and competition policy [81%] boasted the highest scores for supporting institutions registered in the four-country study.

The market for commercial law reform in Poland is similarly strong in most areas. The only weak point was in trade [61%], which echoes the low scores for trade in Dimensions II and III.

In viewing Dimension IV, Poland's long and distinguished legal tradition of adaptation and survival is extremely relevant. When Poland regained its status as an independent nation following World War I, it was faced with the challenge of harmonizing a patchwork of various laws that were inherited from occupying powers including Russia, Prussia, Austria, and France. This mélange of traditions and influences apparently survives today. It is reported that judges

give different interpretations - French, Austrian, and German - to the Commercial Code of 1934 depending on the region within Poland where they receive their training. If the inter-war period can be viewed as one of adaptation and harmonization of law, the period of Poland's Nazi occupation and Communist rule can be viewed as one of a successful struggle for survival. Poland's communist rulers, instead of simply scrapping and replacing the prior legal system with socialist law, adapted the existing system to the state's needs. Other provisions of Poland's commercial law and traditions were allowed to survive, albeit in dormancy. Perhaps most significantly, the private sector continued to function throughout the Communist period, thus perpetuating "demand" for commercial law, even if this contradicted the prevailing ideology.

In considering Poland's speedy transition to a market economy, it seems credible that Poland's tradition of adaptation and survival played an important role. There is great pride, for example, in the Commercial Code of 1934, and a consensus that it remains generally serviceable, with some adjustment, for contemporary needs. The current process of "approximation" of Poland's legal regime in preparation for full membership in the EU seems to represent yet another period of adaptation and harmonization in Poland's legal tradition, and provides a strong gravitational influence on the drive and direction of Poland's overall commercial law reform effort.

2) Romania

SUBSTANTIVE AREA	TOTAL	Legal Framework	Implementing Institutions	Supporting Institutions	Market
ROMANIA	***55%***	*70%*	*56%*	*52%*	*40%*
A. Bankruptcy	**54%**	59%	62%	52%	45%
B. Collateral	**32%**	44%	13%	35%	37%
C. Company	**62%**	63%	73%	70%	43%
D. Competition	**60%**	66%	62%	62%	49%
E. Contract	**63%**	74%	73%	66%	37%
F. FDI	**57%**	96%	58%	38%	37%
G. Trade	**54%**	90%	53%	40%	35%

Our assessment detected a major disparity between Romania's laws and the institutions responsible for their implementation and enforcement. In Tier I, Romania scores 70% for Dimension I (Legal Framework), but then drops 14 points to 56% in Dimension II (Implementing Institutions), and from there continues to decline to 52% and 40% for Dimensions III and IV. While some of the specific laws are rated quite high, there is not a corresponding trend at the institutional level.

The weakest of all legal areas is Collateral, with an aggregate Tier I score of 32%. Romania lags behind other Central and Eastern European (CEE) countries and could benefit from a system of collateral legislation similar to those established in Bulgaria, Latvia, and Poland. Security interests in movable property would support the extension of commercial and consumer credit, both of which are essential for a market economy. Interestingly, while many CEE countries have developed a non-possessory pledge system, many have failed to carry this to the next logical step--creating a centralized registry to record secured interests. Romania has a sophisticated registry

system developed to handle company registration and more recently adapted to record bankruptcies. This registry system would be an ideal complement to a Romanian collateral system.

In Dimension II scores, Collateral is last [13%], followed by Trade [53%] and FDI [58%]. Unlike collateral law, however, the other two have very high Dimension I scores, in fact, some of the highest scores for all countries with FDI at 96% and Trade at 90%. Collateral is thus weak on all fronts, while FDI and Trade suggest that there is at least an effort to upgrade these areas, although this effort has not yet been translated into institutional development.

Breaking with the usual pattern, Romania's score for Company law implementing institutions clocks in at 10% *above* the score for Company law legal framework on the strength of recent improvements in the company registration process. The expense and delays of registration have been greatly reduced. With the exception of a single visit to the notary's office to certify the company's bylaws, all other contacts are with a single institution that has offices in Bucharest and each of the country's 40 counties.

In Dimension III, the assessment found a relatively wide range of development in the supporting institutions for the seven legal areas , from a low of 35% (Collateral) to 66% (Contract). Supporting institutions for trade scored only 40%, a 50-point difference from the legal framework score of 90%. FDI [38%] and Collateral [35%] were also weak. Supporting institutions can serve as effective focal points for capturing and voicing demand for reform, providing feedback and direction in the reform process. In Romania, however, the path of change has not been linear; reform has proceeded in spurts – advancing, stumbling, and then surging forward again.

The market for commercial law reform in Romania is imperfectly developed, scoring only 40% for the fourth Dimension. The *supply* of commercial laws has been volatile, often exceeding or failing to capture the *demand* for them. A frequent criticism of private sector companies and associations is that laws are changed too frequently, creating uncertainty for investors. Poorly conceived laws and regulations appear with no advance warning. This theme was echoed by Romanian business leaders, NGOs, lawyers, judges, government officials and ordinary citizens. Practically everyone agreed that it would be better for the government to concentrate on a lesser number of essential laws that are well prepared than to enact hastily-prepared drafts that only have to be corrected in the next legislative session. This would also allow the authorities more time to get the necessary implementing regulations into place. Currently an overly ambitious legislative program, combined with hastily-drafted and adopted Emergency Orders, leaves very little time to make the necessary implementation arrangements and to prepare the institutions involved in the implementation of the law for their new tasks, or to establish new institutions.

3) Ukraine

SUBSTANTIVE AREA	TOTAL	Legal Framework	Implementing Institutions	Supporting Institutions	Market
UKRAINE	***41%***	*59%*	*42%*	*35%*	*28%*
A. Bankruptcy	**37%**	41%	45%	33%	28%
B. Collateral	**48%**	76%	56%	31%	30%
C. Company	**44%**	47%	52%	42%	33%
D. Competition	**41%**	55%	42%	42%	28%
E. Contract	**45%**	50%	49%	50%	30%
F. FDI	**41%**	89%	18%	28%	30%
G. Trade	**33%**	56%	34%	19%	21%

A significant constraint to doing business in Ukraine remains the relative lack of transparency, stability, and predictability in the legal framework for private sector activity. Many of the problems encountered in Ukraine were found in the other countries surveyed, but with major differences in magnitude and nuance. The diagnostic team's findings support the widely held view that Ukraine's progress toward a market economy is not proceeding well. Despite the proliferation of McDonald's restaurants and upscale shops in Kiev, the environment for private commercial activity seems little changed since early 1994. In fact, the commercial environment in outlying *oblasts* and cities is reportedly eroding.

As reflected in the summary table of Tier I and Tier II indicators, Ukraine scored significantly below the three other countries across all four Dimensions. With a total aggregate score of only 41%, Ukraine's Tier I scores were 36 points below Poland and 13 below Romania and Kazakhstan. In Dimension I - the legal framework – bright spots for Ukraine were Collateral [76%] and FDI [89%]. Every other area under-performed the other survey countries.

For Dimension II, (Implementing Institutions), FDI [18%] and Trade [34%] ranked lowest, while Collateral was the highest [56%]. The first of its kind in the former Soviet Union, the new Ukrainian Pledge Registry is a state-of-the-art system designed to reduce the type of fraud resulting from the previous pledge law's ineffective provisions governing third-party notification of existing pledges or liens. Ukraine's registry has barely begun, but still, the past year's accomplishments are impressive for a country that in many reform areas has lagged behind its neighbors. Of course, it should be noted that this was the second attempt to introduce such a system.

Dimension III found supporting institutions weakest in the areas of Trade [19%] and FDI [28%], and strongest in Contract [50%]. Given the well-known difficulties of contract enforcement in Ukraine, this result may actually overstate the relevant importance of such supporting institutions as law firms, notaries, and bailiffs.

The market for commercial law reform in Ukraine is similarly weak across the seven subject matter areas. All seven areas fall within the range of 21% to 33%. The lowest is Trade. The limited progress Ukraine has made in meeting the requirements of WTO membership is just one indication of a lack of clear policy priority. The relative abundance of non-WTO compliant

regulatory measures, the weak institutional structures, and the general lack of transparency and consistency in applying internationally recognized standards all point to a significant mismatch between word and deed in this area. On the demand side, the strongest and most consistent advocates for reform are international donor institutions (such as IMF, World Bank and USAID), foreign trading partners (such as the United States and the European Union) and foreign businesses operating in Ukraine. General perceptions and attitudes remain surprisingly ambivalent to the potential benefits of foreign trade; a degree of xenophobia seems to be a part of this phenomenon. Unlike with its neighbor Poland, the "gravitational pull" of prospective WTO and EU membership is not as strong with Ukrainian lawmakers. It therefore seems unlikely that significant trade liberalization and associated institutional strengthening can be expected in the short term. Unfortunately for most Ukrainians, this will prove likely that the prospects of an improved living standard in the near term are also diminished.

4) Kazakhstan

SUBSTANTIVE AREA	TOTAL	Legal Framework	Implementing Institutions	Supporting Institutions	Market
KAZAKHSTAN	***55%***	***68%***	***57%***	***48%***	***48%***
A. Bankruptcy	**50%**	60%	51%	49%	41%
B. Collateral	**35%**	56%	23%	31%	28%
C. Company	**59%**	62%	67%	58%	48%
D. Competition	**62%**	64%	64%	65%	56%
E. Contract	**64%**	73%	66%	54%	62%
F. FDI	**66%**	83%	68%	50%	65%
G. Trade	**52%**	79%	61%	32%	36%

Assessment results for Kazakhstan indicate clear disparities between law and implementation. In most areas, the Legal Framework scores higher than the Implementing and Supporting Institutions. The gap is smallest in the areas of Company, Competition and Contract.

The weakest scores are in the two areas that may have the most significant long-term impact on the availability of credit: Bankruptcy and Collateral. In theory, a well designed, well enforced bankruptcy regime permits lenders to assess and control their risks more effectively. Likewise, collateral law permits lower-risk, secured lending. Together, the two laws contribute to the growth and availability of lower cost credit for both business and consumers. That both areas have very low scores in the Kazakhstani Market -- including demand -- for reform suggests that there may be a serious gap in understanding the function of these laws, or the benefits they can support. On the other hand, they could reflect a resistance to change, despite sufficient understanding. In either case, Kazakhstan must surmount the deficiencies in these areas to move beyond self-financed investment and create an environment for broad-based development.

As with all of the countries, Kazakhstan earns a high score [83%] for the legal framework for FDI. Policy-makers want and need to attract substantial foreign capital for the rich mineral industry in this country that has been characterized as a glorified quarry. The law also targets manufacturing, however, in recognition that commodity development is not enough to support

economic development. The second highest score for Dimension I is in Trade [79%], followed by Contract [73%]. Improvements in these three areas are often driven demand from foreign investors. Tier I aggregate scores in those areas that are needed to actually make investment attractive – Collateral [35%], Company [59%], and Contract [64%] – are very low, so, low, in fact that even FDI is discouraged. The overall diagnostic can be interpreted to suggest that the state is, perhaps, courting foreign money by passing laws oriented toward the foreign investor, but leaving domestic investors out of the picture by failing to bring about an environment that supports investment per se. This is not only a questionable economic strategy; it is poor sociology that can fuel xenophobia in the hinterland.

The legal framework for Trade scores relatively high marks with 79%, well ahead of Ukraine [56%] but behind Poland [93%] and Romania [90%]. Kazakhstan also has one of the higher overall scores for Implementing Institutions, with 57%. Viewed together with the scores for FDI, a picture emerges of reforms intended to bring Kazakhstan increasingly into the global marketplace, both as a magnet for investment and a crossroads for international trade. Again, the relatively low scores on Market [48%] and Supporting Institutions [48%], indicate that the reforms flow from upper-level leadership, with much work yet to be done in order for the country as a whole to embrace these changes.

Considering Kazakhstan's history of command economy and state controls, the scores for Competition are encouraging. The Legal Framework received marks of 64%, roughly even with Romania [66%], ahead of Ukraine [55%] and, as always, behind Poland [82%]. Implementing and Supporting Institutions are at approximately the same level of development. Internalization of the reforms is likely to take time, but the path seems headed in the right direction.

While Kazakhstan's scores are not stellar, the picture they sketch should not be characterized as bleak. The past two years have brought much positive change, and there appears to be a strong political commitment to continue on this road to reform. Success, however, will certainly require a growth in demand for these reforms at the bottom, not just a supply from the top.

V. Project Background & Context

Since the fall of communism, most of the countries of Central and Eastern Europe and the former Soviet Union have been making the difficult transition toward a market economy. Early on in this process, it became clear that commercial law reform was a critically important component in a broad range of reform initiatives needed to promote the efficient operation of a market economy. Intuitively, many realized that because commercial laws serve as the "rules of the game" for a market economy, it was critical to get them "right" if a free market was to flourish.

Recognizing this, reformist governments began to tackle legal reform generally, and commercial law reform specifically. As a partner in this process, USAID and its partner agencies in the U.S. government lent support by fielding an army of short- and long-term technical advisors to provide an array of technical advisory services. The success of these early efforts - referred to here as *1st generation* commercial legal and institutional reform (C-LIR) - were mixed. New laws were drafted (sometimes copied verbatim from advanced market economies) and enacted, but with little lasting change. Two important lessons were learned during this early phase of C-LIR. First, getting the legal framework "right" is an essential, but not sufficient, precondition for sustainable, market-driven economic growth. Second, without a supporting institutional framework, and associated capacity, commercial laws cannot be fully implemented or enforced.

These lessons served as the basis for the *2nd generation* in C-LIR as a distinct area of economic development theory and practice. During this second phase, practitioners' attention turned to rationalizing and strengthening the institutional framework for implementation and enforcement of commercial and other laws. This led to important advances in institutional and operational analysis, regulatory design, and capacity building. The international donor community to address institutional deficiencies marshaled policy advisors, technical training, and limited equipment procurements. The record of success for these 2nd generation interventions has been somewhat better - but still not what was hoped for. While significant gains were achieved in certain substantive areas (e.g., GATT/WTO accession, customs administration, collateral registries, and capital markets), there was little progress in others - notably in the enforcement of bankruptcy, antitrust, and intellectual property laws. This practical experience in the field brought to light the complexity and subtlety of the institutional dimension of C-LIR.

This project represents a tangible and significant commitment of resources by USAID to advance a "3rd generation" of C-LIR. Despite some success in the field, there is a growing recognition that the legal and institutional elements of C-LIR are perhaps two parts of a larger and more complex whole. The evidence to support this conclusion lies in the "implementation/enforcement gap" that has been observed even after technically competent 1st and 2nd generation C-LIR initiatives have been carried out. The 3rd generation of C-LIR will be distinguished by its focus on achieving sustainability in implementation and enforcement of legal and institutional reforms.

The challenge of the 3rd generation of C-LIR is to develop a cost-effective, results-oriented approach (or approaches) that will help close the implementation/enforcement gap described above. This project was developed with five principal objectives in mind:

1. Develop a more comprehensive understanding of the evolution and outcome of C-LIR in European and Eurasian countries;

2. Build USAID's internal capacity to define, measure, and evaluate C-LIR results by designing and testing appropriate quantitative and qualitative performance indicators;

3. Facilitate a discussion within USAID, and between USAID and host-country counterparts, on the impact of European and Eurasian C-LIR initiatives and implications for possible future interventions;

4. Develop and test new strategies for closing the "implementation/enforcement gap" through pilot and rapid-response C-LIR technical assistance interventions; and,

5. Design and construct a USAID C-LIR resource base containing the cumulative results of this initiative for use in the development, implementation and assessment of future LIR interventions in Europe, Eurasia and other regions in which USAID operates.

This report is intended to serve as the foundation for accomplishing Objective 3 stated above. The forum for evaluating and strengthening the results of this prototype is USAID's Regional Commercial Law Development Conference, scheduled for December 6 - 9, 1999 near Prague, the Czech Republic.

VI. Indicator Design & Development

A. Challenges of Indicator Design

Indicators are, by definition, comparative. The utility of indicators, particularly quantitative indicators, is that they permit ready comparisons between varying samples and over time. They are a useful shortcut - a means of *estimating* - without actually measuring every detail of a larger, complex whole. Indicators' usefulness, therefore, derives more from convenience than comprehensiveness. Viewed from this perspective, an "ideal" indicator is one that permits meaningful, reliable, and cost-effective comparisons between dissimilar examples.

Developing common indicators for commercial law development in the region implies the ability to compare "*apples with apples*". From an historical and practical standpoint, however, this approach is overly general. While the region as a whole falls within the Continental legal system that arose out of the Roman legal tradition, individual countries' commercial laws derive from different historical antecedents. Romania's commercial law follows the French tradition based on the *Code Napoleon*. Poland's commercial laws, in contrast, are based on the scientific rationalism of 19th Century Germany. Another layer of complexity is added in the form of Socialist legal theory and practice. While based on the German Rationalist tradition, "Socialist Law" has its own unique traditions and values that are distinct from the Continental legal system. The differences that each of these historical variations have on the development of modern commercial law and practice are subtle, yet real. It is therefore particularly important to develop indicators that focus on *outcomes*, rather than the relative advantages of one legal system over another.

"Development" implies growth and maturity -- a comparison to an ideal standard. Typically, such comparisons are stated in terms of "more" and "less" developed. On an intuitive level, this kind of comparative assessment is made every day when economies are classed as "more", "less" and "least" developed based on certain economic and social criteria. The key challenge of this work, therefore, is to determine whether it is possible to develop a common set of indicators that will allow temporal (e.g., "before" and "after") as well as spatial (e.g., "north" vs. "south") comparisons that meet the ideal of yielding results that are meaningful, reliable, and cost-effective.

One approach to this challenge is to measure "development" against roughly comparable countries and/or roughly comparable stages of economic development. This approach - *benchmarking* - is useful for general comparative purposes, yet assumes a degree of similarity that may or may not exist in practice. For example, can Poland's commercial laws and institutions be usefully compared against Germany's, given that they share a common border and considerable commonality in their commercial and legal traditions? Could Kazakhstan's be compared directly with that of France? Aside from the technical problems associated with such direct comparisons, the fundamental weakness of this basic approach is the normative content upon which they rely. Hence, if cross-regional comparisons are to be possible, the specific indicators of development have to common to all, and abstracted sufficiently to eliminate bias arising from the peculiarities of the sample.

Another approach to designing indicators for commercial law development is to focus less on the "*how*" and more on the "*what*" by measuring specific steps or obstacles in a *process-driven* environment that can be roughly correlated with efficiency and hence "progress". For example, the number of administrative steps, length of time in process, total cost, number of companies registered are all possible measures of the development of company law in a given country. Constraints analyses focusing on barriers to foreign direct investment (FDI), and competitiveness analyses focusing on opportunities for increased exports, are two other examples of process-oriented analysis. While this approach lends itself to quantification, it is severely limited by the availability, completeness, and reliability of data upon such comparisons are made. Of the four countries examined, only Poland had data readily available that could serve as a basis for a process-oriented analytical approach. In the remaining sample countries, relevant data were unavailable, inconsistent, or suspect, making process-oriented indicators an impractical design option in most cases.

Another particularly difficult aspect of this challenge lies in addressing the temporal dimension of development. This difficulty derives from the dynamic nature of commerce itself. The laws are, to a greater or lesser extent, reflective of contemporary commercial practice. The *Convention on International Sales of Goods* (CISG), for example, explicitly recognizes the importance of custom and usage in international commercial law.[5] As a body of norms based on behavior, the CISG is organic and therefore subject to change as commercial norms and practices change. The rapid increase in the use of the Internet as a medium of commerce, for example, is creating an entirely new set of commercial practices, and associated legal questions of first impression. Similarly, genetic engineering is giving rise to new areas of legal inquiry in the area of intellectual property, trade, investment and other key areas of commercial law. Viewed in this light, the design of commercial law indicators should be though as something approximating skeet shooting, where it is not the target, but its trajectory, that matters most.

B. Deciding What to Measure

Based on the above, it is possible to conclude that designing a common set of indicators for commercial law development is very much a process of approximation and compromise. Our design effort proceeded on the assumption that it is possible to broadly identify what "better" and what is "worse" based on generally accepted international best practices, and overall economic performance. For example, it is assumed that some causal relationship exists between Poland's advanced legal traditions prior to World War II, its geo-strategic position in Europe, its aggressive approach to market reform, and its strong economic performance during the past decade. The same can be said of other countries in the region whose profiles in these areas are less favorable than Poland's.

The common indicators presented are intended to:

[5] *Art. 9.2, United Nations Convention on International Sales of Goods (1980).*

(1) Provide a common gauge by which commercial law frameworks can be compared against a standard based upon generally accepted international "best practice";

(2) Collect information about both *institutional capacity* of primary implementation bodies and *individual capacity* (e.g., regulatory and enforcement personnel) to the extent that cross-comparative data are available;

(3) Obtain information about the development of *supporting institutions* necessary for the efficient implementation and enforcement of framework laws by implementing institutions (e.g., notaries, registries, lawyers' associations, academic institutions, etc.).

(4) Capture data on the level of *demand* for reform within the specific areas of commercial law development defined in this study; and,

(5) Characterize a government's ability to *supply* products (e.g., framework laws, implementing regulations, courts) and services (e.g., judicial rulings, enforcement of judgments by executive agents, training, outreach) appropriate for the development of commercial activity.

"Commercial law" encompasses a great number of specific legal disciplines. For the purpose of this study, commercial law has been defined more narrowly defined to include the following specific substantive areas of law and their associated institutions:

1. ***Bankruptcy*** - Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets and rehabilitation of insolvent debtors.
2. ***Collateral*** - Laws, procedures and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets.
3. ***Companies*** - Legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.
4. ***Competition*** - Rules, policies and supporting institutions intended to help promote and protect open, fair and economically efficient competition in the market, and for the market.
5. ***Contract*** - The legal regime and institutional framework for the creation, interpretation and enforcement of commercial obligations between one or more parties.
6. ***Foreign Direct Investment*** - The laws, procedures and institutions that regulate the treatment of foreign direct investment.
7. ***Trade*** - The laws, procedures and institutions governing cross-border sale of goods and services

Within each of these substantive areas, four "Dimensions" of C-LIR are proposed as a conceptual framework for comparison. These include:

1. ***Framework Laws*** - Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Pledge of Moveable Property);

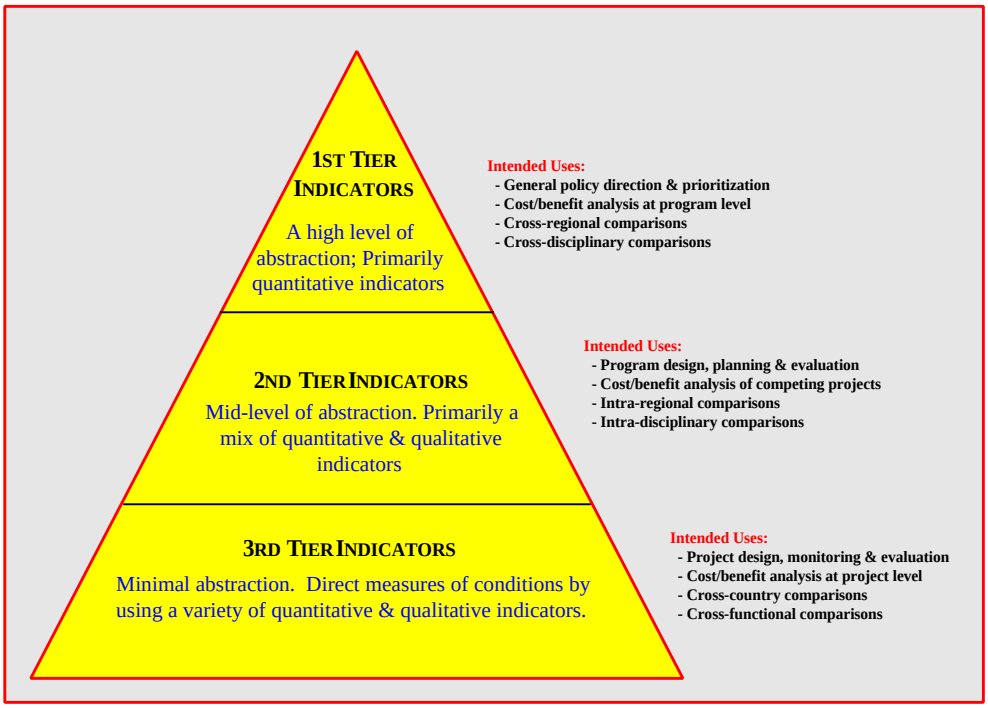
2. ***Implementing Institutions*** - Governmental, quasi-governmental or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework law(s) is vested (e.g., bankruptcy court, collateral registry);

3. ***Supporting Institutions*** - Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework law(s) (e.g., bankruptcy trustees, notaries); and,
4. ***Market For C-LIR*** - The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

C. Organization and Structure of the C-LIR Indicators

The graphic below provides a conceptual overview of how the development indicators are organized.

STRATEGY FOR C-LIR INDICATOR DEVELOPMENT & USE

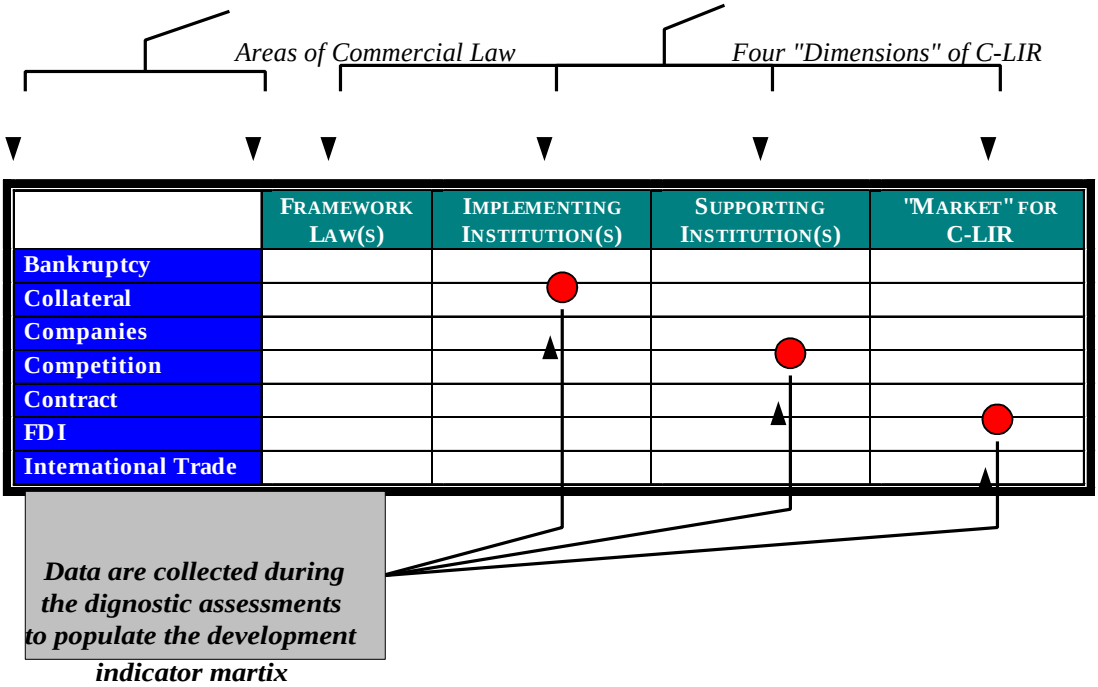


Each of the three sections or "tiers" of the pyramid in the diagram represent a different level of detail or "abstraction" generated by the indicators. The primary objective in creating three tiers of indicators is to provide varying levels of detail, depending on the needs of the user. Generally speaking, 1st Tier indicators are intended to be useful to high level policymakers who are responsible for establishing general policy direction and prioritization. 2nd Tier indicators are intended to be most useful to senior program- and country-level officials responsible for pro-

gram deign, planning, and evaluation. Finally, 3rd Tier indicators are designed to be most useful to those who need to make detailed analysis of specific areas of the commercial law environment in a given country, or between specific countries. In this case, those responsible for project design, monitoring and evaluation are most likely to find the level of detail at the Tier III level useful.

The organization of the data into tables that can be easily read and interpreted is also a challenge given the amount and complexity of the data required. As illustrated in the diagram below, basic indicator groups for a given country are organized into blocks of twenty-eight "cells". The four Dimensions of commercial law development appear across the top of the table, and the seven subject matter areas defined for this study appear in the far left column.

Conceptual Overview of C-LIR Development Indicators



Given that four countries have been selected for assessment under this project, a total of 112 indicator groups (containing subject-matter specific indicators) have been developed and populated. For this reason, it is important for the user to have a firm grasp of the organization and logic of the indicator tables before attempting to interpret speicific indicator scores or results.

D. How To Read the C-LIR Indicator Tables

The diagram below represents how Tier I and Tier II results are organized in the C-LIR indicator tables. The subject matter area ("Collateral") appears in the upper left portion of the table. Below it, the four Dimensions of commercial law are listed in their order of treatment. The column immediately to the right ("Ref.") contains a "reference value" (i.e., benchmark) against which the sample countries (i.e., "A" through "D") are compared. To illustrate, the total raw

scores for Country A and Country B are 228 and 235, respectively, as compared against the reference value of 638. These are referred to as Tier I *raw scores*. To obtain a Tier I *result*, the raw score is divided by the benchmark reference value (REF) to obtain Tier I results of 31% and 33% respectively. This example suggests that Country A's Collateral law system is comparable in relative terms to Country B's *when viewed at the highest level of abstraction*.

BASIC INDICATOR TABLE ORGANIZATION

SUBSTANTIVE AREA	REF.	A		B		C		D	
COLLATERAL LAW	**638**	**228**	**31%**	**235**	**42%**				
Legal Framework	120	85	*71%*	90	75%				
Implementing Institution	226	72	*32%*	25	11%				
Supporting Institution	154	34	*22%*	67	44%				
"Market" for C-LIR	138	37	*27%*	53	38%				

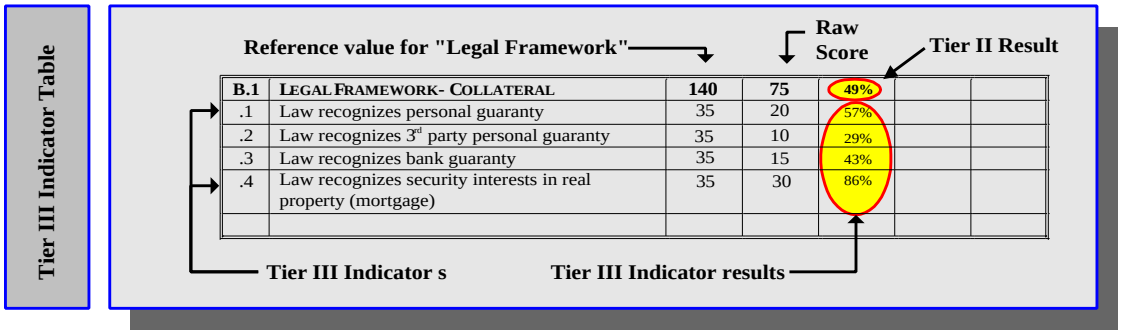
4 "Dimensions" of C-LIR

Tier II Reference Value

Tier I Indicator Results = the Average of Tier II Results

The same exercise can be performed at the Tier II level. If, for example the "Market for Collateral law reform in Country A is compared to that of Country B, a result of 27% and 38% respectively is obtained. From this it may be possible to infer that the Market Dimension for this subject matter area (Collateral) is *relatively* stronger in Country B than in Country A in aggregate terms, but relatively weak in comparative terms. It must be emphasized that a more detailed analysis of the underlying Tier III indicator raw scores and results would be required to draw more specific conclusions (e.g., a relative quality of policies "supplied" in Country A).

The Tier I and Tier II indicators in the example above are derived from the raw data collected in the course of the diagnostic assessments. This raw data is collected and scored against Tier III indicators. As a result, Tier III indicators provide the foundation for this analysis. In the illustration below, Tier III indicator results for the "Legal Framework" for Collateral are averaged to yield associated Tier II results. Individual Tier III indicator results provide the highest level of detail in the analysis. In this example, the result for Indicator B.1.3 ("Law recognizes bank guaranty.") is 43%, which can be interpreted to mean that this particular aspect of the Legal Framework for Collateral was found to fall well short of the benchmark Reference Value of 35. Where pertinent, a more detailed discussion of the basis on which this particular Tier III scoring was made would appear in the narrative portion of the diagnostic report.



B.1	**LEGAL FRAMEWORK- COLLATERAL**	**140**	**75**	**49%**		
.1	Law recognizes personal guaranty	35	20	57%		
.2	Law recognizes 3rd party personal guaranty	35	10	29%		
.3	Law recognizes bank guaranty	35	15	43%		
.4	Law recognizes security interests in real property (mortgage)	35	30	86%		

These examples are intended to help show how indicator results "roll up" from one level to the next in terms of abstraction. This design is intended to dilute the impact that any single indicator *raw score* may have on the overall indicator *result*. It is our intention that the impact of a small discrepancy (or bias) in scoring at the Tier III level from one country to the next would be minimized provided the assessment methodology is applied consistently in each case.

VII. Organization of the Diagnostic Assessments

In order to facilitate in-country data collection, preliminary research on background information was completed prior to the diagnostic. Generally, background information obtained included translations of relevant laws and legislation, statistical economic and trade information, earlier assessments of general and specific legal reform progress, and identification of relevant institutions and people to interview during the diagnostic. Information was gathered via the Internet, international financial institutions and donor organizations, academic and legal sources, embassies, and discussions with business organizations and lawyers knowledgeable about the particular countries. Both general and specific meetings and interviews were arranged in advance so as to "hit the ground running" upon arrival in country, and gaps could be filled and indicator-specific questions answered as the diagnostic progressed.

In order to provide an accurate diagnostic, taking into account regional traditions and historical influences, the diagnostic teams were comprised of both expatriate and local professionals. Expatriate members included senior lawyers from the United States and CEE who had practiced both in the region and the U.S., and cooperating country national (CCN) lawyers and experts. The advantage of using CEE lawyers was the unique comparisons they could draw between the region, in general, and the specific countries in particular to U.S. and western European legal systems. CCN lawyers practicing in the respective countries not only provided key background information and input on the indicators, but also attended meetings and provided the local view on legal traditions and reforms, as well as useful feedback on the team's findings. In addition, when necessary the team used local junior lawyers to complete additional research and translations.

The subject areas of commercial law were divided so that the team could split up and cover the most ground possible during the two-week diagnostic. The diagnostic teams attempted, where possible, to focus on an area of familiarity and reported on the findings of the laws they covered. As many of the indicators cut across several areas of law, often a visit to a given Ministry or government office or public/private organization yielded information on more than one area of law. In order to ensure that the relevant areas were covered, the team conferred frequently to compare notes, assess progress, and make mid-course adjustments.

In-country data collection was conducted on a "360 degree" basis. That is to say that for each data point sought, an effort was made to obtain information from as many relevant perspectives as possible, given limitations of time and resources. To take bankruptcy law as an example, small and large debtors and creditors, lawyers, judges, scholars, government officials, and business and legal advocacy groups were consulted in an effort to gain as complete a picture as possible of the development and adequacy of the framework law and relevant implementing and supporting institutions.

The diagnostic assessments were conducted during the period October 1998 and June 1999. The purpose of the assessments was to field test and refine a diagnostic methodology for measuring commercial law development in transition economies.

The dates of the assessments were:

Poland	October 5-23, 1998
Romania	December 4-18, 1999
Ukraine	March 3-17, 1999
Kazakhstan	June 3-19, 1999

VIII. Next Steps

The assessment methodology and the development indicators will be the subject of a regional workshop to be held in Prague during December 6-9, 1999. In attendance will be highly qualified local experts in commercial law, associated institutions (e.g. courts, registries, bar associations) or other relevant subjects (e.g. foreign trade, banking, SMEs) who could make substantial contributions to the discussion. Representatives of USAID, the World Bank, the EBRD, the European Union, and other international organizations concerned with commercial law reform will also be invited.

During the workshop, the participants will explore country-specific, subject matter specific, and cross-regional findings as a springboard for discussion and debate on the root causes of the implementation / enforcement gap and its implications for USAID and other donors. The objectives of the workshop are to:

1. Validate the conceptual approach (four dimensions, seven areas);

2. Consider refinements in the methodology and the development indicators;

3. Test the conclusions reached in the four country reports and the synthesis report based on participant experience and subject matter-specific knowledge;

4. Explore the implications of these diagnostic findings for USAID, other donors, and host-country counterparts throughout the region; and,

5. Develop possible approaches to test, refine, and improve strategies for closing the "implementation / enforcement gap"

The workshop is intended to promote a frank and constructive exchange of views that will help the contractor refine the concepts in these draft reports. Insights from experience throughout the region may be distilled into practical lessons learned that can be used in the design, implementation and evaluation of future C-LIR interventions.

АГЕНТСТВО СОЕДИНЕННЫХ ШТАТОВ АМЕРИКИ ПО МЕЖДУНАРОДНОМУ РАЗВИТИЮ

Общий Отчет

Оценка Реформ Коммерческого Права в Европе и Евразии

Омнибус ЮСАИД II-С: Служба Обучения и Консалтинга
No. Контракта ЕПЕ-I-95-00071
7 ноября 1999

Буз-Аллен и Гамильтон
Группа по Работе с Международными Клиентами

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I. Введение

ЮСАИД оказывал содействие в проведении экономических реформ в странах Европейского/ Евразийского регионов с 1990 года . Ключевыми сферами, на которых было сфокусировано содействие - это развитие банковской сферы и рынков капитала, приватизация , налоговые и фискальные реформы, а также коммерческое право и деятельность, связанная с институциональными реформами. (КПИР).

Первичной целью поддержки усилий, связанных с КПИР являлось оказание помощи по ускорению процесса перехода к рыночной экономике путем продвижения развития соответствующей правовой и регуляторной среды для коммерческой деятельности. В соответствии с представленными разъяснениями в настоящем разделе отчета на момент его подготовки подходы и результаты в данной области были смешанные. В целом, был достигнут значительный прогресс в области совершенствования коммерческого права по всему региону, хотя во многих случаях принятые законы очень слабо проводятся в жизнь и исполняются. Данный пробел в “исполнении/осуществлении” останется основной проблемой по всему региону, а также той проблемой, по которой практически нет консенсуса в отношении путей ее эффективного разрешения.

ЮСАИД пытается найти лучшее понимание существующих динамических сил, влияющих на содержание и продвижение перехода к рынку, а также развитие подходов, которые укрепят и ускорят развитие коммерческого права, и связанных с ним институциональных структур в регионе. Для достижения этой цели, ЮСАИД произвел оценку исследований по каждой из ключевых областей, упомянутых выше. Этот общий отчет представляет методологию, данные и результаты четырех предварительных оценок, касающихся КПИР, которые были выполнены в период с декабря 1998 по июнь 1999.

Четыре страны, по которым была проведена такая оценка - это Польша, Украина, Румыния и Казахстан, они были выбраны таким образом, чтобы представить разнообразные модели, основывающиеся на критериях различного географического положения, размеров, относительного благосостояния, экономической структуры, правовых традициях и различных стадиях на пути продвижения к рыночной экономике. В каждой стране оценивались семь сфер коммерческого права - банкротство (неплатежеспособность), залог (обеспечение сделок залогом) , компании, конкуренция, контракты, прямые иностранные инвестиции и международная торговля. В каждой из рассмотренной независимой сфер коммерческого права, были оценены четыре “аспекта” развития - Основополагающий Закон, исполняющие организации, вспомогательные организации, и такой феномен как “рынок (спрос/необходимость)” реформ, зависящий от внутренних изменений.

Одним из важных результатов такой деятельности - это разработка ряда “общих показателей”, которые могут быть использованы для сравнений по странам и перекрестных сравнений по регионам в отношении развития КПИР. Как далее объясняется в данном отчете, эти показатели были выведены в качестве инструмента для специалистов разного уровня ЮСАИДа и других донорских организаций в целях относительно быстрого, с наименьшими затратами и точного анализа касающегося нужд, приоритетов и соответствующих действий при развитии КПИР.

Общий отчет, отчеты по четырем странам, и показатели результатов КПИР на которых они основываются будут представлены для дискуссий, комментариев и доработки в ЮСАИД на региональном семинаре по коммерческому праву в Праге, Чешская Республика в период с 6-9 декабря 1999. Основываясь на результатах этого семинара, показатели КПИР и диагностическая методология будут доработаны и представлены широкому кругу пользователей ЮСАИДа и других донорских организаций.

II. Общие результаты по показателям

Нижеприведенная таблица содержит обобщение по показателям и результатам , которые были получены во время подготовки диагностической оценки по четырем странам. Семь сфер, которые были подвергнуты анализу перечислены в левом столбце таблицы. Внутри каждого раздела (например, банкротство) рассматриваются четыре аспекта КПИР. Общее количество возможных баллов, выставлены рядом с показателем в прилегающей колонке называемой “PEF” (контрольный показатель).

Оставшиеся колонки таблицы распределены по странам в порядке в кототром была проведена диагностическая оценка.

	ОБЛАСТЬ ПРАВА	PEF.	ПОЛ		РУМ		УКР		КАЗ	
A.	**БАНКРОТСТВО**	**940**	**736**	***78%***	**505**	***54%***	**337**	***37%***	**471**	***50%***
1.	Законодательство	**280**	224	*80%*	166	*59%*	114	*41%*	168	*60%*
2.	Исполняющие организации	**170**	136	*80%*	105	*62%*	76	*45%*	87	*51%*
3.	Вспомагательные организации	**200**	151	*76%*	104	*52%*	66	*33%*	97	*49%*
4.	Рынок - Банкротство	**290**	225	*78%*	130	*45%*	81	*28%*	119	*41%*
B.	**ЗАЛОГИ**	**850**	**648**	***77%***	**269**	***32%***	**376**	***48%***	**273**	***35%***
1.	Законодательство	**140**	126	*90%*	62	*44%*	107	*76%*	79	*56%*
2.	Исполняющие организации	**210**	165	*79%*	27	*13%*	118	*56%*	49	*23%*
3.	Вспомагательные организации	**190**	123	*65%*	66	*35%*	59	*31%*	58	*31%*
4.	Рынок - Залоги	**310**	234	*75%*	114	*37%*	92	*30%*	87	*28%*

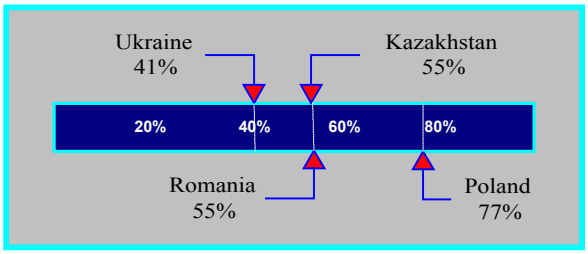
C.	**КОМПАНИИ**	**830**	**651**	***79%***	**504**	***62%***	**361**	***44%***	**488**	***59%***
1.	Законодательство	**190**	153	*81%*	119	*63%*	90	*47%*	118	*62%*
2.	Исполняющие организации	**270**	205	*76%*	198	*73%*	140	*52%*	182	*67%*
3.	Вспомагательные организации	**100**	82	*82%*	70	*70%*	42	*42%*	58	*58%*
4.	Рынок - Компании	**270**	211	*78%*	117	*43%*	89	*33%*	130	*48%*
D.	**КОНКУРЕНЦИЯ**	**940**	**754**	***80%***	**552**	***60%***	**379**	***41%***	**582**	***62%***
1.	Законодательство	**210**	172	*82%*	138	*66%*	115	*55%*	135	*64%*
2.	Исполняющие организации	**220**	178	*81%*	136	*62%*	92	*42%*	141	*64%*
3.	Вспомагательные организации	**220**	178	*81%*	136	*62%*	92	*42%*	144	*65%*
4.	Рынок - Конкуренция	**290**	226	*78%*	142	*49%*	80	*28%*	162	*56%*
E.	**ДОГОВОРЫ**	**650**	**514**	***80%***	**359**	***63%***	**261**	***45%***	**415**	***64%***
1.	Законодательство	**90**	75	*83%*	67	*74%*	45	*50%*	66	*73%*
2.	Исполняющие организации	**180**	150	*83%*	132	*73%*	89	*49%*	119	*66%*
3.	Вспомагательные организации	**70**	55	*79%*	46	*66%*	35	*50%*	38	*54%*
4.	Рынок - Договоры	**310**	234	*75%*	114	*37%*	92	*30%*	192	*62%*
F.	**ПИИ**	**990**	**773**	***77%***	**578**	***57%***	**442**	***41%***	**670**	***66%***
1.	Законодательство	**290**	253	*87%*	278	*96%*	259	*89%*	240	*83%*
2.	Исполняющие организации	**190**	155	*82%*	110	*58%*	35	*18%*	129	*68%*
3.	Вспомагательные организации	**200**	131	*66%*	76	*38%*	56	*28%*	100	*50%*
4.	Рынок - Конкуренция	**310**	234	*75%*	114	*37%*	92	*30%*	201	*65%*
G.	**ТОРГОВЛЯ**	**950**	**664**	***68%***	**527**	***54%***	**320**	***33%***	**499**	***52%***
1.	Законодательство	**280**	260	*93%*	252	*90%*	158	*56%*	221	*79%*
2.	Исполняющие организации	**180**	128	*71%*	96	*53%*	61	*34%*	109	*61%*
3.	Вспомагательные организации	**180**	88	*49%*	72	*40%*	35	*19%*	58	*32%*
4.	Рынок - Конкуренция	**310**	188	*61%*	107	*35%*	66	*21%*	111	*36%*
	СУММА	**6150**	**4740**	***77%***	**3294**	***55%***	**2476**	***41%***	**3398**	***55%***
1.	Законодательство	**1480**	1263	*85%*	1082	*70%*	888	*59%*	1027	*68%*
2.	Исполняющие организации	**1420**	1117	*79%*	804	*56%*	611	*42%*	816	*57%*
3.	Вспомагательные организации	**1160**	808	*71%*	570	*52%*	385	*35%*	553	*48%*
4.	Рынок - Конкуренция	**2090**	1552	*74%*	838	*40%*	592	*28%*	1002	*48%*

По каждой стране по которой был сделан анализ, предварительный счет находится рядом с соответствующим результатом по показателям (представлено как процентное соотношение возможного предварительного счета по категории). Для удобства, колонки результатов затемнены. Данные по показателю " Уровень 1" и

связанные с ним результаты по показателям представлены в строках , которые затемнены голубым в таблице ниже. Аналогичным образом, счет и результаты "Уровня 2" находятся четырьмя строками ниже выделенной предыдущей строки " Уровень 1" таблицы. Читатель должен внимательно прочитать Раздел 5, "Показатель Разработки и Развития", прежде чем делать какие-либо выводы согласно представленным данным или результатам по показателям, представленным в общей таблице ниже.

Следующее общее наблюдение может быть сделано по данным приведенным в таблице выше :

1. Общий рейтинг. Общий рейтинг по странам в процентном соотношении от общих возможных баллов следующий:



На этом общем уровне такие сравнения подтверждают очевидность того, что в сравнительной степени правовая и институциональная среда для коммерческой деятельности в значительно большей степени развита в Польше, нежели в Казахстане, а среда КПИР в Казахстане и Румынии, хотя и различается, но находится примерно на одном уровне совокупного развития, и наконец, на Украине по сравнению с остальными странами, правовая институциональная среда для коммерческой деятельности, развита менее всего.

2. Рейтинг по дисциплинам: При распределении рейтингов по дисциплинам прослеживается общий счет указанный выше. Совершенно очевидно, что Польша и Украина находятся на полярных концах по каждой категории, за исключением законодательства о залоге, поскольку здесь Украина занимает место перед Румынией и Казахстаном.

	1	2	3	4
Банкротство	П	Р	К	У
Залоги	П	У	К	Р
Компании	П	Р	К	У
Конкуренция	П	К	Р	У
Договоры	П	К	Р	У
ПИИ	П	К	Р	У
Торговля	П	Р	К	У

Отклонением от общей модели результатов мы находим в законодательстве о залоге (см. заштрихованную часть таблицы), где Украина имеет более высокий рейтинг, нежели Казахстан и Румыния. Результаты Уровня 2, показывают, что Основополагающий закон в сочетании с относительно сильными исполнительными организациями объясняют эту разницу. Недавнее принятие Основополагающего Закона, основанного на лучшей международной практике в сочетании с современной системой регистров являются основной причиной этого результата. Мы полагаем, что оценка результатов отражает положительное влияние ЮСАИДа при поддержке, оказанной в отношении некоторых аспектов, касающихся системы законодательства о залоге. Сравнительно слабые результаты аспекта 3 - Вспомогательные организации (31%), и аспекта 4, Рынок для реформ (30%), предлагают, что любая возможная будущая техническая помощь должна быть сфокусирована на улучшении результатов этих аспектов.

3. ***Разбивка результатов.*** Другим возможным методом для целей сравнения по регионам является разбивка результатов (или расхождения между странами) в определенных областях. Как это отражено в таблице ниже, наибольшее расхождение было выявлено в области законодательства о залоге, где у Польши на 44 балла больше, чем у Румынии. Наименьшее расхождение было выявлено в области иностранных прямых инвестиций, с разницей в 33 балла. Одно из возможных объяснений такого результата - это то, что *при относительных условиях*, Иностранные Прямые Инвестиции являются одной их наиболее развитой областью коммерческого права в данной группе. Это, частично, связано с политическим консенсусом в каждой стране в отношении важности Иностранных Прямых Инвестиций (ПИИ) (хотя и политики стремятся к большему набору законов), а также с отсутствием полемики по поводу формы реформы, и с большей гармонизацией (приближенностью) к международному законодательству и практике в данной области, или прочими факторами. Важность “эхо генной” востребованности реформ в сфере ПИИ с стороны иностранных финансовых институтов и доноров следует рассматривать как возможный ведущий фактор в данной области.

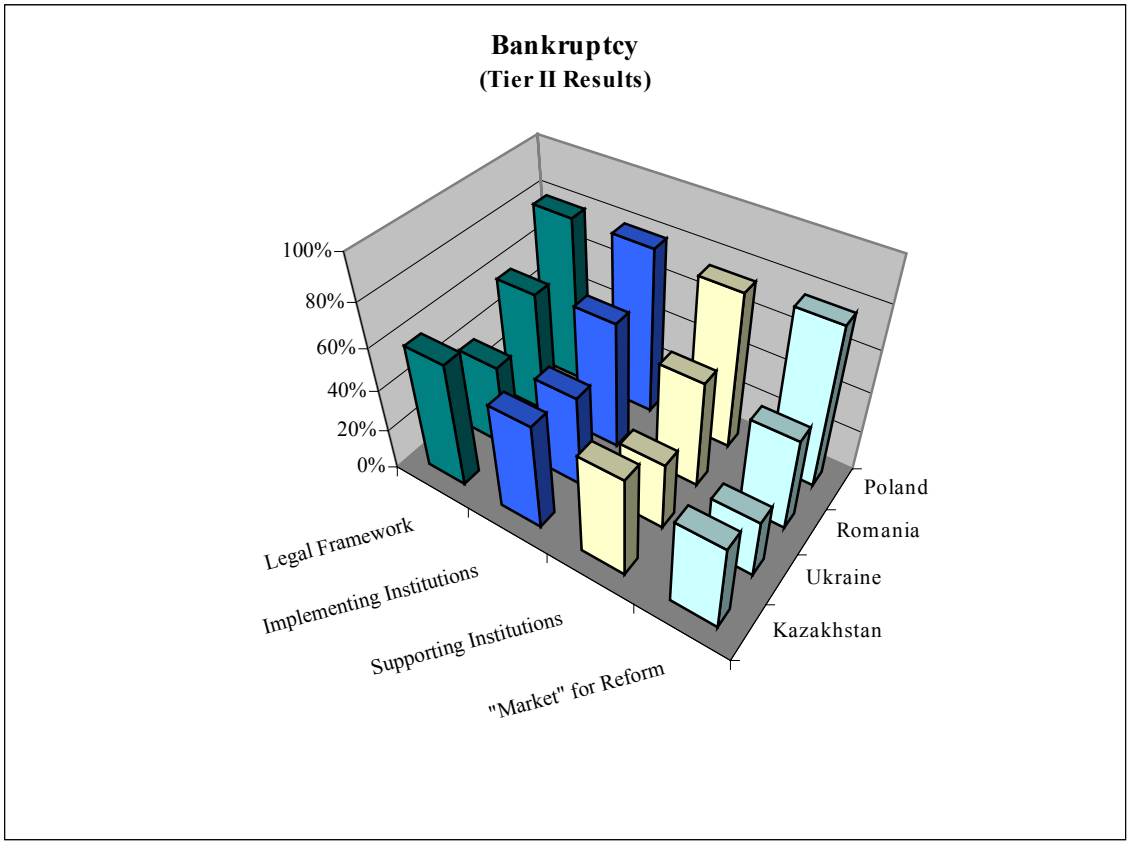
	Разница между лучшим и худшим результатом	Рейтинг[1]	Общий средный балл	Рейтинг
Банкротство	37	3	55%	5
Залоги	45	1	48%	7
Компании	35	5	61%	2
Конкуренция	39	2	61%	3
Договоры	35	5	63%	1
ПИИ	36	4	60%	4
Торговля	35	5	52%	6

[1] Рейтинг основан на общей разницы между самым высоким и самым ниским баллом на Уровне I сообразно области права.

4. Общий средний счет по дисциплинам

Общие средние данные по дисциплинам могут быть полезны для целей перекрестного сравнения по регионам. Основываясь на выводах оценки по четырем странам, “Контракты” имеют наивысший результат при среднем результате 63% в Уровне 1. Законодательство о Залоге и Международной торговле, напротив имеет наименьшие результаты, 48% и 62% соответственно. Основываясь на этом, законодательство о залоге и международной торговле может рассматриваться партнерами по оказанию содействия в качестве приоритетных сфер на региональных основе соотносительно с другими оцененными сферами.

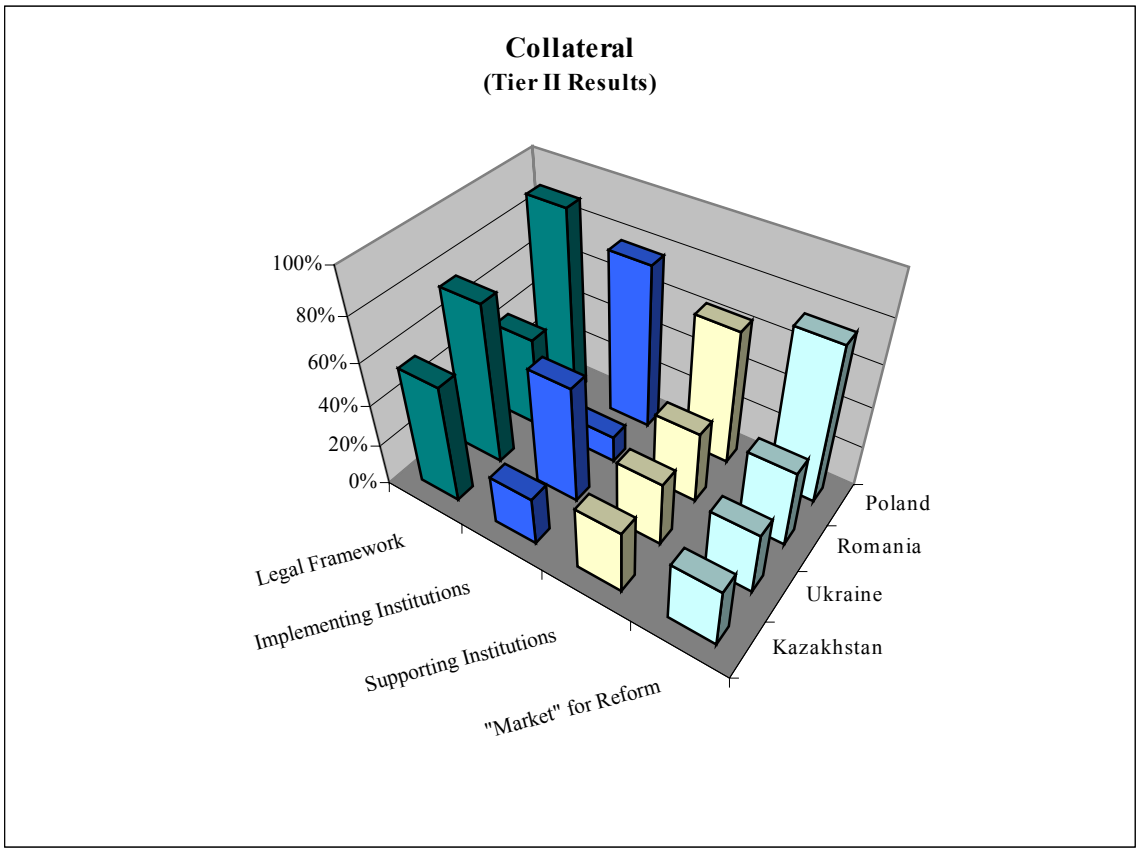
5. ***Классификация по “Сферам” :*** Следующие таблицы представляют классификацию по странам каждой из четырех “Сфер” КПИР, основываясь на результатах показателей Уровня 2 по каждой из семи проанализированных сфер. Говоря в общем, модели классификации находятся в соответствии друг с другом по дисциплинам. Расхождения в моделях выделены в таблице затемнением. Высота колонок сопутствующего графика представляет процентное соотношение возможного предварительного счета по стране в каждой сфере в пределах дисциплины.



Банкротство	ПОЛ	РУМ	УКР	КАЗ
1. Законодательство	80%	59%	41%	60%
2. Исполняющие организации	80%	62%	45%	51%
3. Вспомагательные организации	76%	52%	33%	49%
4. Рынок - Банкротство	78%	45%	28%	41%

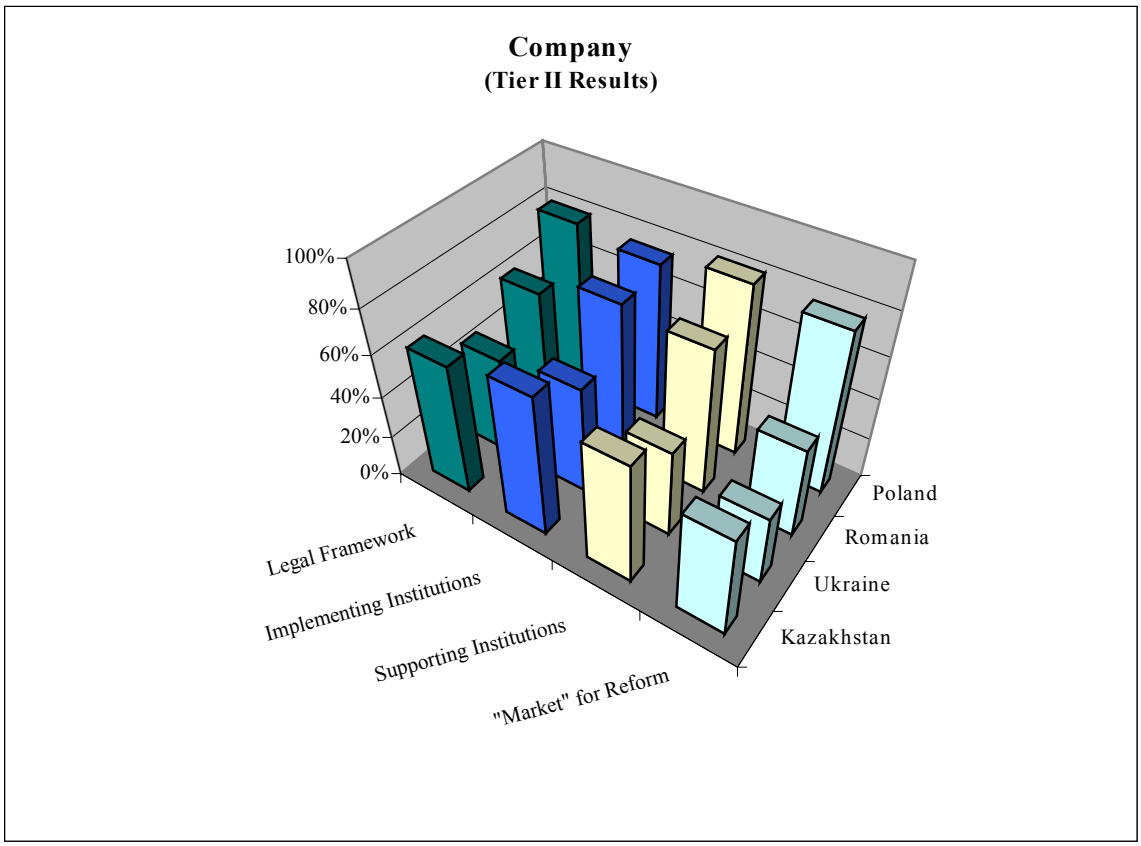
Выше приведенный график показывает, что Польша доминирует по всем четырем сферам, и при сравнении, сфера “Рынок” является наиболее слабой из всех четырех рассмотренных сфер.

Аналогичным образом, по всем четырем сферам рейтинг Украины среди всей группы наименьший. Все основные модели находятся в относительном соответствии с большинством графиков по оставшимся шести сферам .



Залоги	ПОЛ	РУМ	УКР	КАЗ
1. Законодательство	90%	44%	76%	56%
2. Исполняющие организации	79%	13%	56%	23%
3. Вспомагательные организации	65%	35%	31%	31%
4. Рынок - Залоги	75%	37%	30%	28%

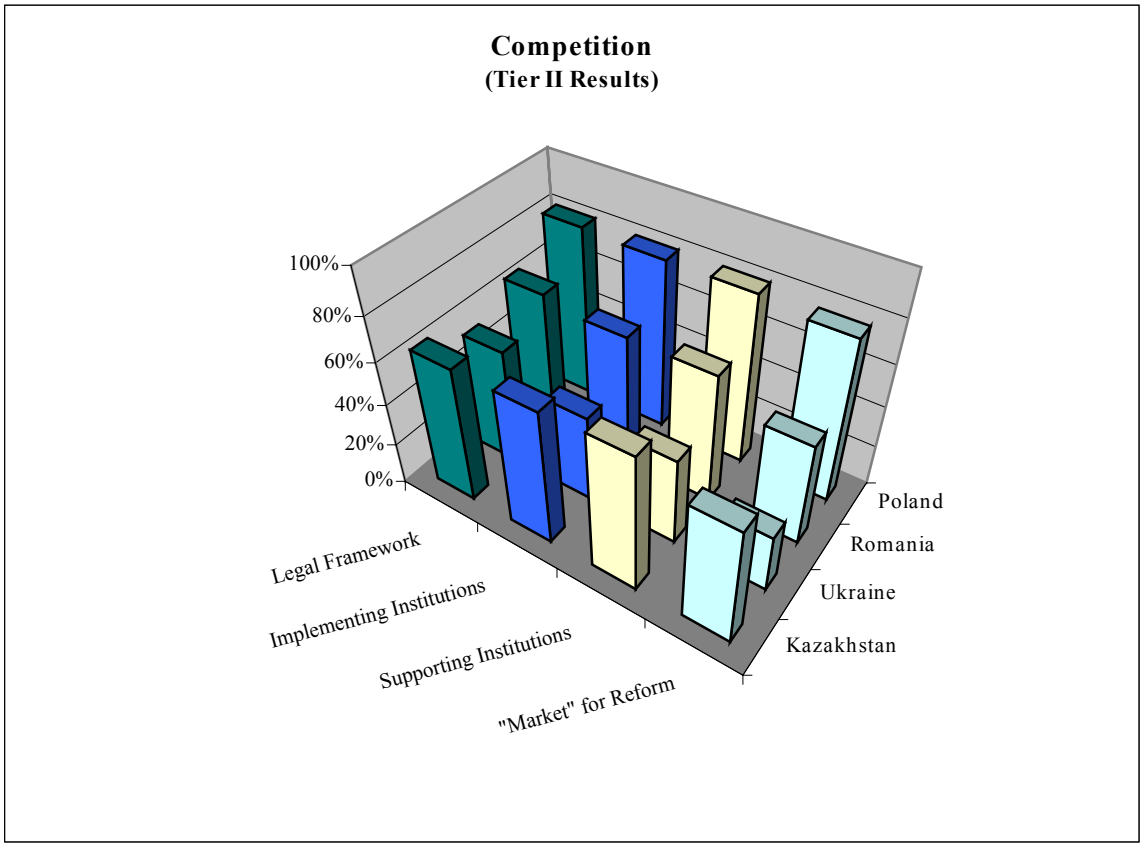
Как и в "Банкротстве", результаты Польши во всех четырех сферах превосходят остальные результаты группы. В сферах 1 и 2, результаты Румынии Уровня 2 гораздо ниже других оцененных стран, что отражает отсутствие соответствующего Основополагающего Закона, и, соответственно Исполняющих организаций. Малые результаты показателей Сферы 3 по Казахстану, Украине, и Румынии указывают на сравнительно менее развитую среду поддержки коммерческой деятельности. Сопутствующие организации поддержки могут быть той сферой где опыт, который имеет Польша поможет большему пониманию сферы КПИР. А также, слабые результаты по “Рынку”, предполагают одну из возможно приоритетных областей будущего оказания содействия по КПИР в Казахстане, на Украине и в Румынии.



Компании	ПОЛ	РУМ	УКР	КАЗ
1. Законодательство	81%	63%	47%	62%
2. Исполняющие организации	76%	73%	52%	67%
3. Вспомагательные организации	82%	70%	42%	58%
4. Рынок - Компании	78%	43%	33%	48%

Результаты Уровня 2 раздела "Компании" указывают на большую степень единообразия перекрестно по регионам, нежели в сфере “Банкротства” и законодательства о залоге. В целом, результаты Украины соответствуют общему результату и отражают несовершенство Основополагающего закона, что связано с происходящих дебатами и неясностью по поводу принятия нового Коммерческого

Кодекса. Исполняющие организации (например, суды общей юрисдикции, занимающиеся рассмотрением коммерческих споров) были признаны по рейтингу ниже таковых в Казахстане и других странах. Области, которые вызывали озабоченность во время диагностической оценки по стране- это неэффективное управление дел, коррупция, слабая культура корпоративного руководства и неразвитые понятия фидуциарной (доверительной) ответственности и прав акционеров.

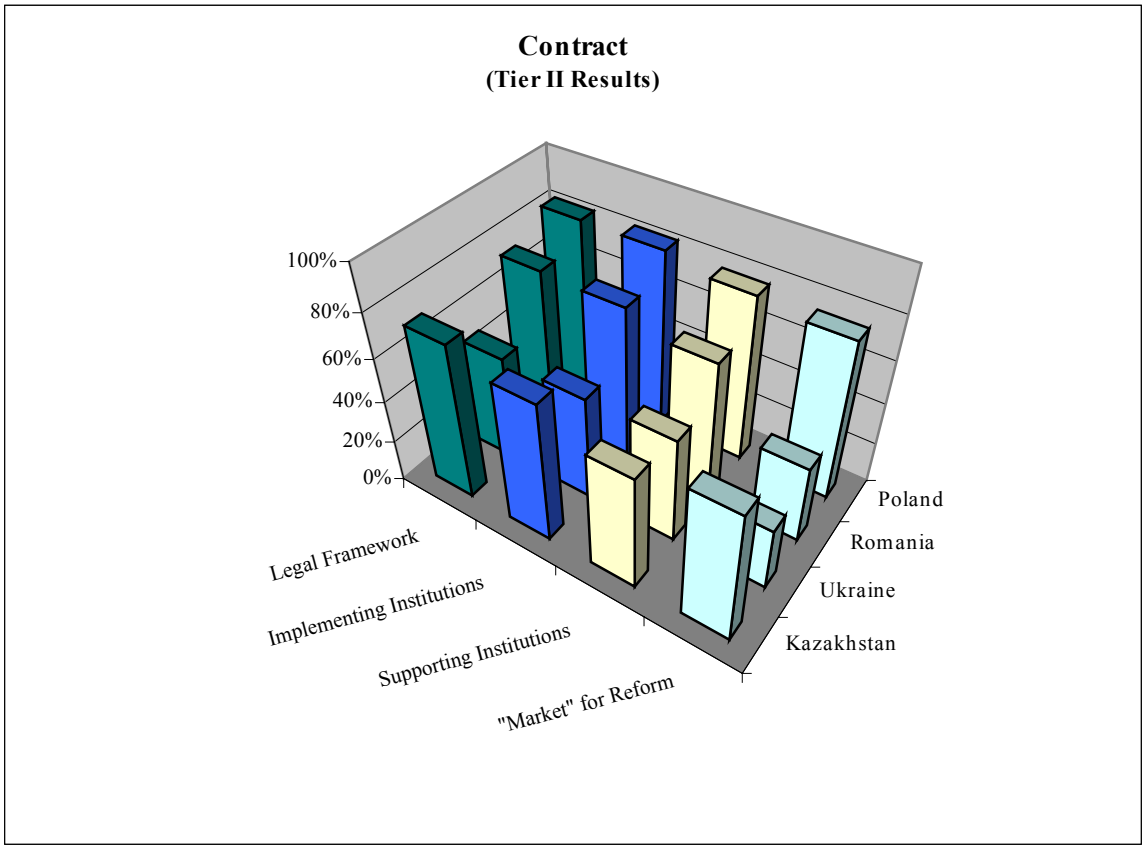


Конкуренция	ПОЛ	РУМ	УКР	КАЗ
1. Законодательство	82%	66%	55%	64%
2. Исполняющие организации	81%	62%	42%	64%
3. Вспомагательные организации	81%	62%	42%	65%
4. Рынок - Конкуренция	78%	49%	28%	56%

Высокий балл Польши по всем 4 аспектам “Конкуренции” означает, что эта сфера является одной из наиболее развитых в регионе. Хотя такой балл достаточно высок, но Польше будет необходимо значительное совершенствование режима политики конкуренции для приведения ее в соответствие с стандартам ЕС по вступлению к 2002 году. Это очевидное противоречие между нашими диагностическими выводами и оценкой ЕС закпнодательства о конкуренции в Польше объясняется

тем фактом, что стандарты ЕС выше, чем те, которые установлены в качестве контрольного показателя для целей сравнения в данном исследовании. [2]

Результаты Украины Уровня 2 “ Конкуренция” могут отражать высокую степень концентрации в экономике Украины, как и факт, что спрос на открытый, конкурентный рынок достаточно слаб по сравнению с другими странами группы.

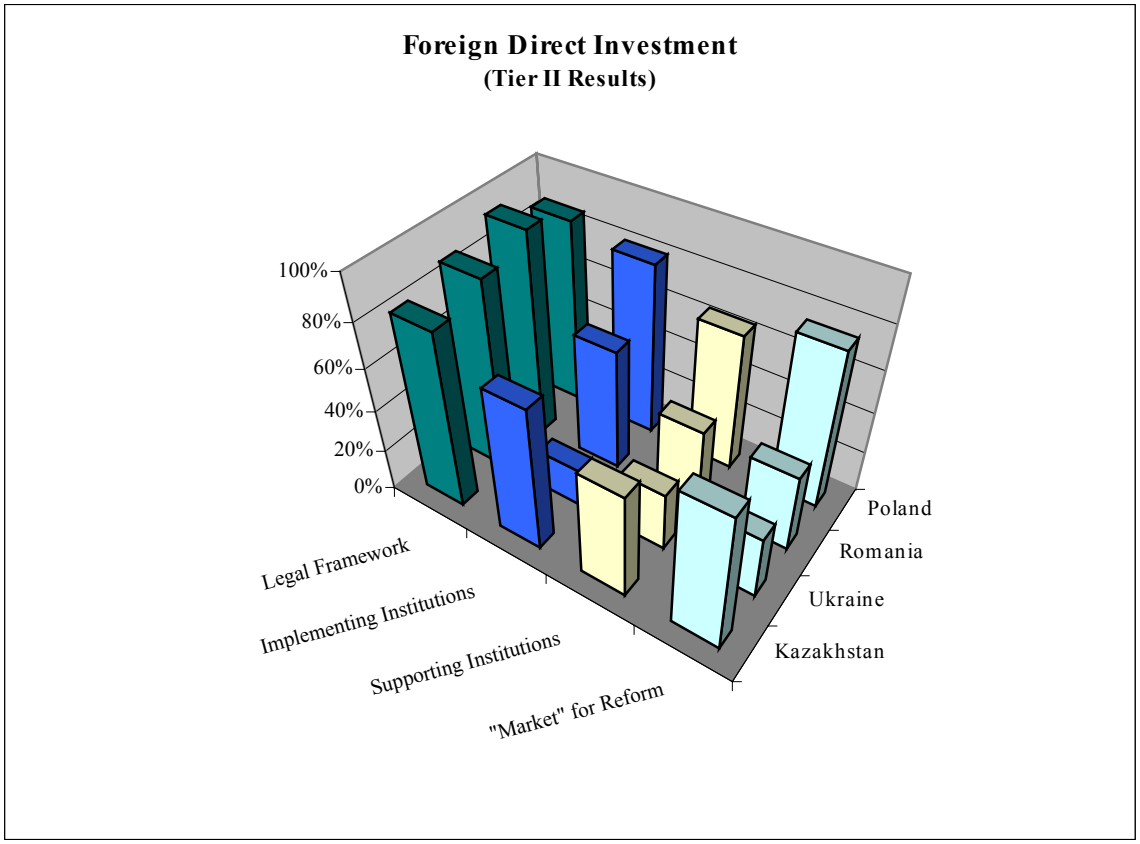


Договоры	ПОЛ	РУМ	УКР	КАЗ
1. Законодательство	83%	74%	50%	73%
2. Исполняющие организации	83%	73%	49%	66%
3. Вспомагательные организации	79%	66%	50%	54%
4. Рынок для реформ	75%	37%	30%	62%

Результат Украины Уровня 2 “Контракты” лишь незначительно выше, чем показатели “Компаний” (45% и 44% соответственно), он указывает на фундаментальное несовершенство всей среды коммерческой деятельности, что непосредственно относится к отсутствию политического консенсуса по

[2] Для более детальных объяснений стратегии, использованной по данным показателям, см Раздел 5 ниже.

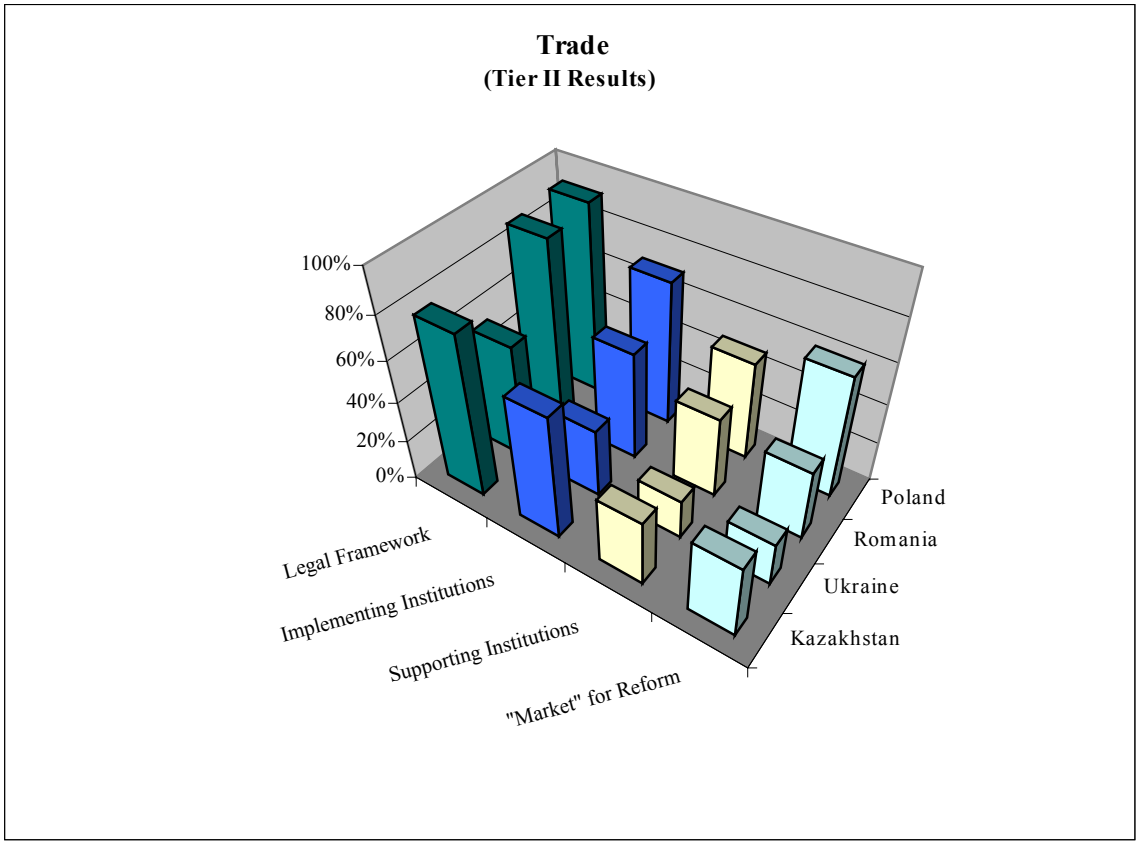
направлению и по содержанию экономических реформ в общем. Результаты Уровня 2 показывают степень единообразия и сходство по регионам, но это в меньшей степени очевидно, чем в сфере “Компании”. При относительно неплохом общем результате Румынии, Сфера 4 значительно портит полученную картину своим слабым результатом (37%). Исполнительные организации (суды общей юрисдикции, занимающиеся рассмотрением споров по сделками) на Украине, похоже, не работают должным образом, что связано с проблемами управления делами, коррупции и слабого судебного исполнения договоров.



ПИИ	ПОЛ	РУМ	УКР	КАЗ
1. Законодательство	87%	96%	89%	83%
2. Исполняющие организации	82%	58%	18%	68%
3. Вспомагательные организации	66%	38%	28%	50%
4. Рынок - ПИИ	75%	37%	30%	65%

Результаты по показателям Уровня 2 “Прямые иностранные инвестиции” (ПИИ) показывают высокую степень единообразия в Сфере 1 и значительные расхождения в Сфере 4. В предыдущем случае, мы полагаем, что появляющиеся стандарты по получению и использованию ПИИ могут частично объяснить данный результат. Интересно, что различия в результатах Уровня 4 по всей группе стран могут быть объяснены отсутствием консенсуса, касающегося условий, при которых производятся иностранные инвестиции. Частые изменения в законе “Об

иностранных инвестициях” Румынии, похоже, также подтверждают нашу гипотезу. На Украине, двойственность, касающаяся ПИИ, наиболее ярко выражена, и количество споров с иностранными инвесторами являются показателем такого отношения. Наконец, как Казахстан, так и Польша, которые получили большее количество инвестиций на душу населения, чем Румыния и Украина, похоже имеют большее стремление и желание привлекать и удерживать прямые иностранные инвестиции, что и подтверждают полученные в данном разделе общие результаты.



Торговля	ПОЛ	РУМ	УКР	КАЗ
1. Законодательство	93%	90%	56%	79%
2. Исполняющие организации	71%	53%	34%	61%
3. Вспомагательные организации	49%	40%	19%	32%
4. Рынок - Торговля	61%	35%	21%	36%

Результаты Уровня 2 “Международная Торговля” неравномерны и особенно невысоки по Уровням 3 и 4. Вспомогательные организации, определяемые в качестве таможенной службы и национальное агентство по стандартизации - это те сферы, в которых было выявлено слабое положение дел по всей группе стран. Сравнительно слабые результаты по Сфере 4 “Рынок” (спрос) однако, не должны истолковываться как отражающие двойственность или враждебность по отношению к международной торговле в целом, а должны рассматриваться только

с точки зрения общего отсутствия знаний, касающихся различных обязательств, принятых этими странами в сфере международной торговли.

III. Общие выводы и изложение фактов

Обобщенные результаты, представленные выше, предлагаются в качестве стартовой площадки для обсуждений и последующего анализа особенностей данных по странам, которые содержатся в четырех диагностических отчетах, послуживших основанием для Общего Отчета. В данных разделах предоставлено детальное рассмотрение выводов, аналитических выкладок и диагностической методологии.

A. По сферам КПИР

	ПОЛ	РУМ	УКР	КАЗ
Уровень I Результаты для всех областей	**77%**	**55%**	**41%**	**55%**
1. Законодательство	85%	70%	59%	68%
2. Исполняющие организации	79%	56%	42%	57%
3. Вспомагательные организации	71%	52%	35%	48%
4. Рынок - Торговля	74%	40%	28%	48%

Польша является логическим контрольным показателем группы стран, изучаемых при проведении диагностических исследований, учитывая, что был достигнут самый высокий результат по показателям по всем 4 сферам всех семи дисциплин в данном исследовании. Общий результат Польши Уровня 2 составил 77 процентов от общего возможного предварительного количества баллов. [3] Румыния и Казахстан занимают место сразу за Польшей на уровне 55% в каждой стране. Наименьший результат у Украины (40%) от общего возможного количества баллов по всем показателям. Говоря в общем, мы полагаем, что результаты оценки подтверждают то, о чем многие уже знают с практической точки зрения. Основываясь на этих результатах, можно сказать, что Польша находится на 3/4 пути по достижению хорошо развитой правовой и институциональной среды современной коммерческой деятельности, согласно контрольного уровня, установленного показателем по КПИР.

Сфера 1 “Законодательная база” является той сферой, в которой рейтинг всех четырех стран ближе всего. Счет Польши 85%, Румынии 70%, Казахстан 68%, Украина на четвертом месте 59%. Мы полагаем, что распределение результатов по первой сфере является поучительным. Счет Польши находится в общем соответствии (варьирует только от 80% до 93%), хотя наблюдалось незначительное колебание или “неровность” в количестве по другим трем странам. Результаты показателей Румынии варьируют от высоких 96% по ПИИ до низких 44% по

[3] Для более полной информации о том, как были получены эти результаты по Разделу 5 ниже

“Залогу”. Самый высокий результат Украины - ПИИ 89%, но “Банкротство” и “Компании”-41% и 47%, соответственно.

В целом, показатель оценки по сфере 1, похоже, предполагает, что оказание помощи “первого поколения” по данной группе достаточно ограничено. За исключением случая с Румынией, т.е. отсутствие современного основополагающего закона о залоге, а также существующая неуверенность Украины по поводу пересмотра Коммерческого Кодекса, основные правовые нормы по всем семи областям права уже приняты. Это особо верно в отношении ПИИ, “Компаний”, и “Контрактов”. Тем не менее, показатели результата сферы 1 Уровня 3 указывают на необходимость внесения опрделенных поправок или пересмотра существующих основополагающих законов, которые сдерживают коммерческую деятельность. Это например в значительной мере относиться к польскому Закону “О банкротстве”, где определен список кредиторов, которые имеют преференции, что, как мы считаем является значительной помехой работы этого жизненно важного механизма по выходу из рынка.

На уровне 2, исполнительные организации, результаты Польши опять-таки являются самыми высокими по группе (79%). Счет остальных в группе - Казахстана (57%), Румынии 56% и Украины 42% - в значительной степени ниже уровня, определенного в Польше. Этот результат явно указывает на общий дефицит институциональных возможностей по всем семи вопросам, а также по всем регионам. Результаты Уровня 2, Сферы 2 “Залог” составляет только 43%, что отражает отсутствие официальных исполнительных организаций в этой сфере. Другое слабое место по группе - это международная торговля., где средний результат сферы 2 “исполнительные организации” - всего 55 %. Мы полагаем, что этот результат может быть частично объяснен сложным институциональными и техническими требованиями осуществления торгового режима. В частности, на Украине (34%) особенно плохое положение дел (34%) по сравнению с остальной группой, чьи средние результаты в данной сфере вдвое выше Украины (62%).

Согласно оценки по Сфере 3, “Вспомогательные организации/институты”, все страны в общем имеют счет ниже первых двух сфер (“Основополагающий закон” и “Исполнительные организации”) по большинству из семи вопросов. Заметные исключения по этому основному направлению выявлены в “Залоге” в Румынии и Казахстане; “Компаниям” - Польша; ПИИ- Украина. Мы полагаем, что проблемы, наблюдаемые в данной сфере по всем группам - это типичные характеристики экономики переходного периода. Польша, в которой был относительно высокий уровень активности частного сектора во время социалистического строя, и которая раньше всех начала переход к рынку в данной группе, имеет лучший результаты развития данной сферы. Важно отметить относительное благополучное состояние дел в данной сфере по сравнению с результатами, полученными по Украине и Казахстану. Однако, здесь возникает вопрос продолжительности времени социалистического правления , географической удаленности от Москвы, степени коллективизации сельского хозяйства, сравнительной плотности промышленной концентрации, который может помочь определить начальную точку и скорость

развития “коммерческой среды” в этих странах. Если это тот случай, результаты уровня 2 этой сферы могут рассматриваться как находящиеся в соответствии с данными возможными переменными переходного периода.

Самая большая “неравномерность” или разброс в результатах по группе и между Польшей и остальными странами может быть прослежена в сфере 4 по “Рынок” на КПИР.[4] Украина отстает от Польши на целых 46%, тогда как Румыния и Казахстан имели сравнительно невысокие результаты 34% и 26% соответственно. На уровне 2 сферы 4 был зарегистрирован единственный “сюрприз” в Казахстане, где контрактное право и ПИИ шли вразрез с общим направлением при количестве набранных очков 62% и 65% соответственно. Общий дисбаланс по рынку может в общем характеризоваться относительно “чрезмерным количеством” неадекватных, неполных и противостоящих друг другу законов, постановлений, институциональных соглашений в некоторых сферах, а с другой стороны нехваткой законов в других сферах, но в обоих случаях - это объясняет слабый и рассеянный спрос со стороны частного сектора.

B. По странам

1) Польша

ОБЛАСТЬ ПРАВА			TOTAL	Законодательство	Исполняющие организации	Вспомагательные организации	"Рынок"
ПОЛЬША			77%	85%	79%	71%	74%
	A.	Банкротство	78%	80%	80%	76%	78%
	B.	Залоги	77%	90%	79%	65%	75%
	C.	Компании	79%	81%	76%	82%	78%
	D.	Конкуренция	80%	82%	81%	81%	78%
	E.	Договоры	80%	83%	83%	79%	75%
	F.	ПИИ	77%	87%	82%	66%	75%
	G.	Торговля	68%	93%	71%	49%	61%

В принятии и осуществлении правовых и институциональных реформ Польша значительно опережает другие страны в различных областях, в большинстве слчаев набирая по крайней мере на 25% баллов больше, чем другие страны. Имея более высокий абсолютный и на душу населения ВНП, Польша поддерживала более высокий экономический рост с 1994 года, а также привлекает немалые прямые иностранные инвестиции. Ее соседка на востоке - Украина значительно отстает в переходном периоде, несмотря на близость, географическое сходство и высокий уровень индустриализации. Такие различия поднимают многочисленные

[4] Для более полной информации, о концепции “Рынок”, пожалуйста см. Раздел 4 данного отчета

аналитические вопросы, особенно при попытке повторить успех программ правовых реформ.

Средний балл по законодательной базе по всем дисциплинам достаточно высок 85% , что свидетельствует о позитивных юридических реформах, которые были проведены в этом десятилетии. Общий счет по исполнительным организациям был только на 6 баллов ниже, 79%, где сравнительно незначительна разница в 1/14. Однако, на Уровне 2 , различия в баллах по законодательству и исполнению наблюдается в 2 сферах: залог и торговое законодательство соответственно имеют пробелы в исполнении 11% и 22% соответственно.

Согласно оценки, по уровню 3, сопутствующие организации признаны достаточно сильными. Однако, по Уровню 2 сопутствующие организации в сфере торговли признаны достаточно слабыми, 49% или на 44 балла ниже, чем они же в сфере законодательной базы. ПИИ (66%) и законодательство о Залоге также признаны достаточно слабыми сферами, в то время как институты поддержки по "Компаниям" имеют 82% , а в политике конкуренции 81%, что является самым высоким счетом по сопутствующим организациям, зарегистрированном в данном исследовании по четырем странам.

"Рынок" для правовых реформ по коммерческому законодательству в Польше является относительно сильным по сравнению с другими сферами. Единственное слабое место было выявлено в торговле (61%), что откликнулось эхом низкого счета по торговле в Сфере 2 и 3.

При рассмотрении Сферы 4 учитывались укоренившиеся и специфические правовые традиции адаптации и выживания Польши. Когда после первой мировой войны, Польша приобрела статус независимого государства, она столкнулась с проблемой гармонизации "перемешанных" законов, которые были унаследованы от оккупации такими странами как Россия, Пруссия, Австрия и Франция. Это смешение традиций и влияний все еще прослеживается и сегодня. Как зафиксировано в отчете, судьи трактуют по разному Коммерческий Кодекс 1934 года- согласно французскому, австрийскому и германскому праву в зависимости от того, в каком регионе страны они получили свое образование. Если период между войнами может быть рассмотрен как период адаптации и гармонизации законодательства, то период между нацисткой оккупацией и коммунистическим правлением может быть рассмотрен как борьба за выживание. Коммунистические правители Польши, вместо простой замены предыдущей юридической системы на социалистические законы, адаптировали существующую систему для нужд государства. Ключевым положениям традиционной практики и польского законодательства о коммерции "было разрешено" выжить, хотя они и находились в состоянии "дремоты". Вероятно, самое важное то, что частный сектор продолжал существовать во время социалистического периода, таким образом как бы "увеличивая" спрос на коммерческое законодательство, даже если оно противоречило политической ортодоксальности.

При рассмотрении скорости продвижения Польши к рынку, совершенно ясно, что традиции адаптации и выживания сыграли очень важную роль. Факт, что Коммерческий Кодекс 1934 года остался в силе, есть источник большой гордости, при том сложился консенсус, что он остается еще пригодным для современных нужд, при некоторых поправках. Существующий процесс " приближения" польского правового режима в процессе подготовки к полноправному членству в ЕС, похоже представляет собой другой период адаптации и гармонизации польских правовых традиций, что оказывает сильное влияние на ход и направление всеобщих реформ.

2) Румыния

ОБЛАСТЬ ПРАВА		TOTAL	Законодательство	Исполняющие организации	Вспомагательные организации	"Рынок"
РУМЫНИЯ		*55%*	*70%*	*56%*	*52%*	*40%*
A.	Банкротство	54%	59%	62%	52%	45%
B.	Залоги	32%	44%	13%	35%	37%
C.	Компании	62%	63%	73%	70%	43%
D.	Конкуренция	60%	66%	62%	62%	49%
E.	Договоры	63%	74%	73%	66%	37%
F.	ПИИ	57%	96%	58%	38%	37%
G.	Торговля	54%	90%	53%	40%	35%

Наша оценка выявила значительное расхождение между румынским законами и организациями, ответственными за их применение и приложение. На Уровне 1, Сфера 1, Основополагающий закон, Румыния имеет 70%, затем в сфере 2 , Исполняющие организации наблюдается спад на 14 баллов до 56%, и отсюда продолжается спад до 52% и 40% в сфере 3 и 4. Некоторые законы имеют достаточно высокий рейтинг, но, при этом нет такой же тенденции на институциональном уровне.

Самой слабой из всех сфер является сфера законодательства о залоге, с общим счетом Уровня I 32%. Румыния отстает от других Центральных и Восточно-европейских стран и может извлечь пользу, связанную с законодательством о залоге, имеющимся в Болгарии, Латвии и Польше. Обеспечение залогов по недвижимой собственности окажет поддержку расширению коммерческих и потребительских кредитов, оба вида которых имеют существенное значение для развития рыночной экономики. В то время, как многие страны Центральной Европы разработали и организовали системы залога без передачи заложенного имущества кредитору, многие другие страны не довели развитие их залоговых систем до такого логического завершения, т.е. создания централизованного реестра в целях регистрации всех обеспеченных сделок. В Румынии существует развитая система регистрации, осуществляющая регистрацию предприятий и компаний, которую в течение последнего времени адаптировали для целей регистрации

банкротств. Такая система была бы идеальным дополнением румынской залоговой системы.

По показателям второго уровня, законодательство о залоге набрало меньше всего баллов (13%), вслед за законодательством о торговле (53%) и о прямых иностранных инвестициях (58%). Однако, в отличие от законодательства о залоге, согласно показателям первого уровня, баллы других двух (торговля и ПИИ) - самые высокие среди четырех исследованных стран - прямые иностранные инвестиции 96% и торговля 90%. Законодательство о залоге таким образом оказалось наименее развитым по всем фронтам (направлениям), в то время как торговля и прямые иностранные инвестиции указывают на то, что, по крайней мере, предпринимаются усилия по улучшению ситуации в них, хотя и без каких-либо результатов, которые бы каким бы то ни было образом отразились на институциональном развитии.

Идя в разрез со всей системой и моделью, баллы, полученные Румынией в отношении органов и институтов, отвечающих за исполнение законодательства о компаниях (торговых обществах), находятся на 10% выше, чем количество баллов, полученных за законодательную базу в этой области, благодаря осуществленных недавно улучшений в процесс регистрации предприятий и компаний. Стоимость и продолжительность времени регистрации были значительно сокращены в последнее время. Практически, необходимо посетить только две организации - нотариальную контору, в которой утвердить документы компании и еще одну организацию, филиалы которой расположены в Бухаресте и во всех сорока районов (уездов) страны.

Согласно показателям третьего уровня, развитие вспомогательных организаций и структур в семи сферах исследованного законодательства колеблется от 35% результата для законодательства о залоге (занимает последнее место) до 66% законодательство контрактах. В плане вспомогательных организаций и структур в торговле было получено 40% с 50% разницей от законодательной базы для той же категории (90%). Иностранные прямые инвестиции (38%) и законодательство о залоге (35%) оказались также слабыми. Вспомогательные организации и структуры могут быть использованы в качестве фокуса для определения, формулирования и выражения уровня спроса (востребованности) на реформы, предоставления отзывов и направления процесса реформ. В Румынии, однако, русло, по которому проходят реформы, никогда не было прямолинеиным - реформы проходят скачкообразно - ускоренно, спотыкаясь и буксуя, и снова ускоряясь.

Рынок в отношении реформ коммерческого законодательства в Румынии совершенно неразвит, что нашло свое отражение в баллах, полученных согласно показателям четвертого уровня, которые составили только 40%. *Поставки* (предложение) реформ коммерческого права были непостоянными, зачастую отставая или опережая *спрос* на них. Большинство жалоб частных компаний и предприятий заключается в том, что частые изменения законодательства создают чувство неуверенности иностранных инвесторов в завтрашнем дне. Слабо

продуманные и разработанные законы появляются неожиданно. Эта мысль прозвучала неоднократно в высказываниях румынских предпринимателей, неправительственных организаций, юристов, судей, государственных чиновников и простых граждан. Практически все слои населения согласны, что было бы лучше, если бы правительство сфокусировалось на меньшем количестве законов, чем в спешке принимало ряд полуготовых законодательных актов, требующих доработки на последующих сессиях законодателей. Это бы также предоставило властям больше времени для подготовки необходимых постановлений и других актов о введении в действие такого законодательства. В настоящее время слишком амбициозная законодательная программа в купе с разработанными и принятыми наспех проектами законов не позволяет и не дает достаточно времени на подготовку необходимых вводящих в действие актов и соответствующих органов и институтов по отслеживанию за исполнением вводимых законов.

3) Украина

ОБЛАСТЬ ПРАВА			TOTAL	Законодательство	Исполняющие организации	Вспомагательные организации	"Рынок"
УКРАИНА			*41%*	*59%*	*42%*	*35%*	*28%*
	A.	Банкротство	37%	41%	45%	33%	28%
	B.	Залоги	48%	76%	56%	31%	30%
	C.	Компании	44%	47%	52%	42%	33%
	D.	Конкуренция	41%	55%	42%	42%	28%
	E.	Договоры	45%	50%	49%	50%	30%
	F.	ПИИ	41%	89%	18%	28%	30%
	G.	Торговля	33%	56%	34%	19%	21%

Значительным препятствием на пути развития бизнеса на Украине остается недостаточная прозрачность, нестабильность и непредсказуемость в плане законодательной базы относительно деятельности частного сектора. Многие проблемы, обнаруженные на Украине, свойственны и другим исследованным странам, хотя и в другом масштабе и со своими особенностями. Результаты проведенного исследования свидетельствуют в пользу широко распространенного мнения о том, что процесс перехода Украины к рыночной экономике не проходит гладко. Несмотря на распространение ресторанов McDonald's и появление высококлассных магазинов, значительных изменений с начала 1994 года в плане среды для занятия частной деловой деятельностью не наблюдается. В действительности, в *отдаленных* областях и городах Украины среда для деловой коммерческой деятельности ухудшается по поступающей информации.

Как показано в таблицах показателей первого и второго уровня, Украина набирает гораздо меньше очков, чем другие исследуемые страны по четырем критериям. Набрав 41% из всех возможных очков на первом уровне показателей, Украина получила на 36 очков меньше, чем Польша и на 13 очков меньше, чем Румыния и

Казахстан. В разреза первого критерия - законодательная база - наиболее удачными для Украины оказались законодательство о залоге (76%) и о прямых иностранных инвестициях (89%). По другим направления результаты хуже, чем в сравниваемых стран.

В отношении исполнительных органов, по второму критерию прямые иностранные инвестиции (18%) и торговля (34%) оказались на самом низком уровне, а показатель законодательства о залоге на самом высоком (56%). Будучи первой своего рода системой в странах СНГ, украинский реестр залогов представляет собой современную систему, созданную в целях снижения различного рода мошенничества, возникшего на почве предыдущих неэффективных положений законодательства о залоге в отношении уведомления третьих сторон о наличии предыдущих залоговых обязательств или аресте закладываемой собственности. И хотя свою работу украинский реестр начал совсем недавно, за последние годы были достигнуты впечатляющие результаты. И это при том, что по многим другим направлениям реформ страна отстала от своих соседей. Конечно, необходимо отметить, что эта система была создана в ее существующей форме со второй попытки.

Согласно третьего критерия, вспомогательные организации и структуры вышли особенно слабыми в области торговли (19%) и в области прямых иностранных инвестиций (50%). Зная сложности с выполнением контрактов на Украине, возможно, что данные результат может несколько завышать значение таких вспомогательных организаций и структур как юридические фирмы, нотариальные конторы и судебные исполнители.

“Рынок” (востребованность) реформ коммерческого права на Украине приблизительно одинаково слаб по всем семи исследованным областям. По всем этим направлениям были набраны результаты в пределах от 21% до 33%. Самый низкий показатель - это показатель торговли. Наглядным примером отсутствия ясных приоритетов может послужить ограниченное продвижение Украины по пути выполнения требовании для вступления в ВТО. Относительно большой объем мер регулирования, которые не соответствуют требованиям ВТО, слабая институциональная структура и отсутствие общей прозрачности и последовательности при применении международно-принятых стандартов указывают на значительные расхождения слова с делом в этой области. Самими последовательными сторонниками реформ являются международные донорские организации (такие как МВФ, Всемирный банк и ЮСАИД), иностранные торговые партнеры (такие как США и ЕС), а также иностранные предприятия и предприниматели, работающие на Украине. Общее отношение к потенциальным преимуществам внешней торговли и их восприятие остается удивительно противоречивым; определенная степень ксенофобий, думается, является частью этого феномена. В отличие от Польши, “гравитационное притяжение” возможного членства в ВТО и ЕС не оказывает такого большого влияния на законодатели Украины. Поэтому, кажется, что вряд ли приходиться ожидать какой-либо значительной торговой либерализации и укрепления соответствующих институтов

в ближайшее время. К сожалению для большинства украинцев шансы на улучшение уровня жизни также уменьшаться при таком положении дел.

4) Казахстан

ОБЛАСТЬ ПРАВА			TOTAL	Законодательство	Исполняющие организации	Вспомагательные организации	"Рынок"
КАЗАХСТАН			*55%*	*68%*	*57%*	*48%*	*48%*
	A.	Банкротство	50%	60%	51%	49%	41%
	B.	Залоги	35%	56%	23%	31%	28%
	C.	Компании	59%	62%	67%	58%	48%
	D.	Конкуренция	62%	64%	64%	65%	56%
	E.	Договоры	64%	73%	66%	54%	62%
	F.	ПИИ	66%	83%	68%	50%	65%
	G.	Торговля	52%	79%	61%	32%	36%

Полученные результаты в Казахстане показали наличие заметного расхождения между законодательством и его исполнением. В большинстве случаев, баллы, полученные за имеющееся действующее законодательство, были выше, чем баллы, полученные за исполняющее и вспомогательные организации и структуры. Наименьшие пробелы были обнаружены в сферах законодательства о конкуренции, предприятиях и контрактах.

Самое низкое количество баллов было получено в двух областях, которые могут оказать долгосрочное влияние на кредитование: банкротство и залог. Теоретически, хорошо разработанный, хорошо исполняемый режим банкротства позволяет кредиторам оценить и контролировать свои риски более эффективно. Также, законодательство о залоге может обеспечить безопасность кредитования с меньшими рисками. Два этих вида законодательства вместе могут стимулировать рост и доступность низко стоящих кредитов как для производства, так и для потребителей. Обе эти области получили самое небольшое количество баллов в плане востребованности реформ на казахстанском рынке указывают на возможное наличие серьезных пробелов в понимании функций, целей и задач этих законов или в понимании преимуществ, которые они несут с собой. Кахастану необходимо преодолеть такие пробелы в этих разделах законодательства в целях преодоления самофинансирования инвестиции и создания условий для широкомасштабного развития.

В сравнении со всеми исследуемыми странами, Казахстан получил высокое количество баллов (83%) за развитость законодательства о прямых иностранных инвестициях. Создатели и разработчики стратегии развития хотят и нуждаются в привлечении значительных иностранных средств для использования в богатой казахстанской минеральной промышленности. Законодательство также направлено и на производителей, с учетом того, что производство сырья само по себе

недостаточно для поддержания экономического развития. Вторым по количеству набранных баллов первого аспекта была торговля (79%), а затем исполнение контрактов (73%). Улучшения в этих областях связаны зачастую с требованиями и давлением со стороны иностранных инвесторов. Общие показатель первого слоя, в сферах, развитие которых необходимо для привлечении инвестиций - залог (35%), компании (хозяиственные общества) (59%) и контракты (64%) - настолько низкие, что даже отталкивают некоторых прямых иностранных инвестиций. В целом, результаты анализа могут быть истолкованы следующим образом: возможно, что страна, в погоне за иностранным капиталом, принимает законы, ориентированные на иностранных инвесторов в первую очередь, забывая об отечественных инвесторах, что не приводит к созданию благоприятной среды для инвестиций как таковых. И это не только представляет собой спорную экономическую стратегию, но и слабую социальную политику, которая может привести к росту ксенофобии в стране.

Законодательство в отношении международной торговли набрало достаточно высокое количество очков - 79%, значительно больше украинского (56%), но значительно ниже польского (93%) и румынского (90%). У Казахстана также большее количество баллов в плане исполняющих организаций и структур - 57%. Учитывая это в купе с количеством баллов за прямые иностранные инвестиции, в целом можно увидеть картину, говорящую о том, что осуществляемые реформы направлены на интеграцию Казахстана в мировой рынок как в качестве инвестиционного “магнита”, так и торгового перекрестка. Однако, низкие показатели по востребованности (48%) и вспомогательным организациям и структурам (48%) указывают на то, что реформы проходят с верху в низ, что говорит о том, что еще необходимо сделать многое, чтобы страна восприняла реформы как повсеместное явление.

Учитывая опыт Казахстана во времена командной экономики и государственного контроля, баллы , полученные страной за развитие конкуренции, производят очень приятное впечатление. Законодательная база получила 64%, что приблизительно одинаково с Румынией (66%), выше, чем Украина (55%), и заметно ниже, чем Польша (82%). Исполняющие и вспомогательные организации и структуры в плане их развития находятся приблизительно на одном уровне. Укоренение реформ очевидно займет значительное количество времени, однако, направление их проведения было выбрано правильно.

Хотя набранные Казахстаном баллы не являются блестящими, их нельзя назвать блеклыми. За последние два года было сделано много положительных изменений, подтверждая серьезные намерения правительства продолжить реформы. Однако, успех реформ будет зависеть от их востребованности снизу, а не только от их обеспеченности из высших эшелонов.

IV. Предпосылки и контекст проекта

После развала коммунистической системы большинство стран Центральной и Восточной Европы, а также страны бывшего Советского Союза, находятся на пути сложного переходного периода к рыночным отношением. В начале этого процесса стало очевидно, что реформы коммерческого права являются критически важным компонентом широкомасштабного реформирования, необходимого для развития эффективных рыночных отношений в этих странах. Многим стало ясно, что в условиях перехода к рыночной экономике нормы коммерческого права составляют основные “правила игры”, и по этому их правильное понимание и претворение в жизнь является гарантией прочного установления рыночных отношений.

Принимая это во внимание, реформистки настроенные правительства начали осуществлять не только общие правовые реформы, но и реформы в области коммерческого права. Будучи частью процесса, ЮСАИД и другие агентства правительства США оказывают помощь посредством целой армии технических советников, которые, в свою очередь, предоставляют консультационные услуги по широкому спектру вопросов. Результаты, полученные в начале всего процесса - упоминаемые в настоящем отчете в качестве первого поколения реформ коммерческого права и институциональных реформ (КПИР) - были различными. Были спроектированы новые законы (в отдельных случаях их дословно скопировали с законов, действующих в более развитых странах) и введены в действие, что не повлекло каких-либо долгосрочных изменений. Несмотря на это, из первой фазы реформ КПИР были вынесены два важных урока. Во-первых, развитие и установление “правильной” законодательной базы является существенным элементом, который, однако, не представляется сам по себе достаточной предпосылкой для устойчивого развития рыночных механизмов и роста всей экономики. Во-вторых, в условиях отсутствия соответствующей институциональной базы и соответствующих структур невозможно полное введение в действие и исполнение коммерческих законов.

Эти два урока послужили основой для второго поколения реформ КПИР в качестве отдельной сферы в рамках теории и практики экономического развития. В ходе второй фазы реформ внимание практиков было приковано к вопросам, связанным в развитием и укреплением институциональной базой, необходимой для введения в действие и исполнения коммерческих и других законов. Это привело к значительному прорыву в области институционального и операционного анализа, регуляторной организации и развития соответствующих структур. В целях решения существовавших институциональных недостатков международные доноры привлекли к работе широкие массы советников, организовали и провели обучение, а также обеспечили ограниченные поставки оборудования. Успех второй стадии реформ был более значительным, хотя и не принес ожидаемых результатов. Несмотря на то, что были достигнуты определенные результаты по отдельным направлениям (например, присоединение к ГАТТ/ВТО, таможенная сфера, залоговые реестры и рынки капитала), имеется ряд других, по которым не было достигнуто заметного прогресса - особенно в области исполнения законов,

относящихся к банкротству, монополиям и интеллектуальной собственности. Практический опыт, полученный на второй фазе реформ, показал всю сложность и деликатность институционального компонента реформ КПИР.

Настоящий проект представляет собой выделение значительных ресурсов со стороны ЮСАИД для осуществления “третьего поколения” реформ КПИР. На этом этапе преобладает мнение о том, что правой и институциональный аспекты КПИР скорее всего являются двумя частями большого и более сложного целого. Доказательством тому может послужить пробелы в области “введения в действие/исполнение”, замеченные и существующие даже после завершения процесса осуществления КПИР “первого и второго поколений”. Отличительной особенностью КПИР третьего поколения будет то, что фокус работы будет направлен на достижение устойчивости в плане запуска и осуществления правовой и институциональной реформ.

Основной задачей КПИР третьего поколения является разработка экономичного и результативного подхода (или подходов), которые помогут заполнить пробелы, описанные выше. Проект будет разработан с учетом пяти основных задач:

1. Составление более полного представления о развитии и результатах реформ КПИР в Европейских и Евроазиатских странах;

2. Развить внутреннюю способность ЮСАИД по определению, измерению и оценке результатов реформ КПИР посредством разработки и тестирования соответствующих качественных и количественных показателей;

3. Содействовать развитию диалога внутри ЮСАИД, и между ЮСАИД и соответствующими правительствами по вопросу влияния реформ КПИР на Европейских и Евроазиатских стран и возможностей продолжения оказания помощи в будущем;

4. Разработать и протестировать новые стратегии и подходы по устранению пробелов в сфере “введение в действие/исполнение” посредством экспериментальных и краткосрочных программ технического содействия реформам КПИР; и

5. Разработать и создать ресурсную базу КПИР ЮСАИД по сбору материалов по результатам КПИР для использования в целях разработки, осуществления и заключительного анализа последующих программ правовых и институциональных реформ в Европе, Евразии и других регионах, в которых работает ЮСАИД.

Настоящий отчет составлен в качестве базы по достижению Задачи 3, указанной выше. Оценка и предложения по совершенствованию этого проекта (прототипа) будут предоставлены на Региональной конференции по развитию коммерческого права, которая пройдет в Праге, в Чешской Республике, с 6 по 9 декабря.

V. Структура показателей и развитие

A. Сложности структуры показателей

Показатели, по совей сути, относительны. Полезность показателей, особенно качественных показателей, заключается в том, что они позволяют быстро провести сравнение между различными образцами в различные периоды времени. Они - наиболее короткий путь - средство оценки - позволяющие провести сравнение без измерения каждой отдельно взятой частицы большего и более сложного целого. Полезность показателей, поэтому, происходит в большей степени от удобства их использования, а не от их полноты. С этой точки зрения, "идеальный" показатель это тот показатель, который позволяет провести содержательное, надежное и с наименьшими затратами сравнение двух непохожих примеров.

Проектирование общих показателей по развитию коммерческого права в регионе означает способность сравнить *"яблоко с яблоком"*. С исторической и практической точек зрения, однако, этот подход представляется слишком общим. Несмотря на то, что в целом регион в плане права попадает в единую континентальную правовую систему, возникшую на основе традиции римского права, системы коммерческого права отдельных стран региона происходят из разных источников. Румынская система коммерческого права следует французской школе права, основанной на *кодексе Наполеона*. Польская система коммерческого права напротив основана на научном рационализме Германии 19 века. Еще один слой, усложняющий систему, происходит из бывшей социалистической правовой теории и практики. Будучи основанной на идеях германского рационализма 19 века, "социалистическое право" имеет свои уникальные традиции и ценности и отличается от континентальной системы права. Такие различия исторического характера тонкие, но они оказывают заметное влияние на развитие коммерческого права и практики. Поэтому, особенно важно разработать такие показатели, которые в большей степени опирались бы на *результаты*, а не на относительные преимущества одной правовой системы над другой.

"Развитие" означает рост и зрелость - сравнение по отношению к идеальному стандарту. Обычно, такие сравнения выражаются через термины "более" и "менее" развитые. Для наглядности, такие сравнения проводят каждый день при классификации стран на "более", "менее" и "наименее" развитые согласно определенным экономическим и социальным критериям. Основной трудностью в этой работе является определение того, насколько можно разработать общий комплекс показателей, которые позволят учесть временной фактор (например, "до" и "после") и пространственное развитие (например, "север" и "юг"), что помогло бы достичь идеала значимого, достоверного и экономически оправданного (в смысле затрат) результата.

Одним из подходов к решению этой задачи являются попытки измерения “развития” по отношению к приблизительно сходным странам и/или приблизительно одинаковым стадиям экономического развития. Такой способ - *установление контрольных точек* - очень полезен для целей общего сравнения, хотя и опирается на наличие или отсутствие сходности до определенной степени. Например, имеет ли смысл проведение сравнения системы коммерческого права и институты Польши с той же системой и институтами Германии, даже с учетом того, что у них есть общие границы и очень много общего в их коммерческих и правовых традициях? Возможно ли сравнить коммерческое право и институты Казахстана с французскими? Кроме того, что существует ряд технических проблем при проведении такого прямого сравнения, при чем основной слабой стороной этого простого подхода заключается в нормативном содержании, на который он опирается. Поэтому, для того, чтобы сделать межрегиональное сравнение возможным, необходимо разработать специальные показатели развития достаточно общего характера и в тоже самое время достаточно абстрактные с тем, чтобы исключить влияние необъективного, которое может возникнуть в силу индивидуальных особенностей каждой из сравниваемых стран.

Другой подход к решению проблемы разработки показателей развитости коммерческого права заключается в том, что основной упор делается не на том “*как*”, а на том “*что*” посредством оценки конкретных действий или препятствий, существующих в условиях трансформирующейся среды, и которые могут быть связаны с эффективность и, следовательно, “прогрессом”. Например, количество административных процедур, продолжительность сроков обработки и рассмотрения документов, общая стоимость, количество зарегистрированных компаний - все это может послужить показателями развитости коммерческого права данного государства. Анализ факторов, сдерживающих приток иностранных прямых инвестиций (ПИИ), и анализ конкурентоспособности о возможностях увеличения экспорта могут послужить еще одним примером анализа самого процесса. И хотя такой метод в конечном итоге логически заканчивается определением количества, он ограничен характером используемых данных, их наличие, полнота и достоверность. Из всех четырех исследованных стран, только в Польше имелись готовые данные, которые могут послужить основой для применения аналитического подхода, ориентированного на процесс развития. В остальных странах, соответствующие данные либо отсутствовали, либо были неполными, либо не внушающими доверия, что сделало практически неприменимым метод оценки при помощи показателей развития в большинстве случаев.

Особенно сложным аспектом этой задачи представляется вопрос рассмотрения и оценки временного фактора развития. Эти сложности происходят из динамичного характера самой торговли. Законы, в большей или меньшей степени, отражают современную торговую практику. Конвенция о международной торговле товарами (КМТТ), например, в ясной форме признает важность использования обычаев в международной торговой практике[5]. Предусматривая ряд норм, основанных на

[5] *Статья 9.2 Конвенции ООН о международной торговле товарами (1980).*

добросовестном ведении торговли, КМТТ является органичным международным актом и, поэтому, развивается и меняется в соответствии с изменениями международных норм торговли и практики торговли. Например, быстрое распространение сети интернет и ее широкое использование в торговли создает целей рад новых методов торговли и затрагивает многочисленные правовые вопросы. Аналогичным образом, генетический инжиниринг расширяет круг вопросов правового характера в области интеллектуальной собственности, торговли, инвестиций и других ключевых сферах коммерческого права. С этой точки зрения, разработка показателей развитости коммерческого права должна стать чем-то наподобляющим стрельбу по летающим объектам, при которой самое важное не цель, а траектория.

B. Что измерять (оценивать)

Учитывая вышесказанное, можно прийти к выводу, что разработка комплекта показателей для уровня развития коммерческого права - процесс приближения и компромисса. Наши усилия были основаны на предположении о том, что возможно дать, в широком смысле слова, определение того, что такое “лучше” и что такое “хуже” по отношению к лучшим примерам из мировой практики и экономическом развитии в целом. Например, предполагают, что существует некоторая случайная взаимосвязь между развитыми правовыми традициями Польши до начала Второй Мировой войны, ее гео-стратегическим положением в Европе, ее агрессивным подходом к рыночным реформам и ее мощному экономическому развитию за последнее десятилетие. Тоже самое можно сказать и о других странах, по которым представлены обзоры в настоящем отчете, хотя и в менее положительном свете в отличие от Польши.

Представленные общие показатели предназначены в целях:

(1) обеспечения общей шкалы, по которой можно было бы сравнить законодательные базы по коммерческому праву по отношению к стандартам, основанным на общепринятой международной “лучшей” практике;

(2) сбора информации о *институциональных возможностях* первичных исполнительных органов и *индивидуальной способности* (например, регуляторный и исполнительный персонал), конечно в том случае, если имеется сравнительные данные;

(3) получения информации о развитии *вспомогательных структур*, необходимых для эффективного введения в действие и исполнения основополагающих законов исполнительными органами (например, нотариальных контор, реестров, ассоциаций юристов, академических организаций и т.п.);

(4) получения данных об уровне *спроса* (степени востребованности) на такие реформы в определенных областях развития коммерческого права согласно настоящему отчету (исследованию);

(5) обеспечения характеристики способности правительства *предоставлять* продукт (например, основополагающие законы, постановления о введении в действие, судебную систему) и услуги (например, судебные решения, исполнение принятых решений правоохранительными органами, обучение, распространение информации) в целях развития коммерческой деятельности.

"Коммерческое право" вбирает в себя целый ряд особых правовых норм. В целях настоящего исследования, коммерческое право определяется в менее широком смысле и включает следующие отдельные области права и соответствующие структуры:

1. **Банкротство** - механизмы, предназначенные для организации спокойного выхода субъекта с рынка, ликвидации неоплаченных финансовых долговых обязательств за счет имеющихся активов и реабилитация неплатежеспособных дебиторов.

2. **Залог** - законы, нормы, порядок и структуры, созданные для развития торговли посредством продвижения прозрачности, предсказуемости и простоты при создании, определении и погашении процентов по обеспечению активов.

3. **Компании** - правовой (-вые) режим (-мы) по доступу на рынок и работы на рынке, которые определяют нормы по организации официальной коммерческой деятельности, осуществляемой двумя и более лицами.

4. **Конкуренция** - правила, политика и вспомогательные структуры, созданные для оказания помощи в распространении и охраны открытой, добросовестной и экономически эффективной конкуренции на рынке и для рынка.

5. **Контракт** - правовой режим и институциональные рамки для создания, толкования и исполнения коммерческих обязательств между одной или несколькими сторонами.

6. **Иностранные прямые инвестиции** - законы, порядок и структуры, которые регулируют режим прямых иностранных инвестиций.

7. **Торговля** - законы, порядок и структуры, контролирующие трансграничную торговлю товарами и услугами.

В рамках этих отдельных областях права предлагается четыре направления реформ КПИР в качестве концептуальной основы проведения сравнения:

1. **Основополагающие законы** - основные законодательные документы, которые определяют и регулируют отдельные права, обязанности и обязательства заинтересованных сторон и обеспечивают организационные полномочия исполнительным институты (например, закон о банкротстве, закон о залоге на движимое имущество);

2. **Исполнительные институты** - правительственные, неправительственные и частные институты, основные полномочия которых заключаются в воплощении в жизнь, исполнении, толковании и осуществлении основополагающих (-щего) законов (-а) (например, залоговые реестры, отделы по делам о несостоятельности (банкротству));

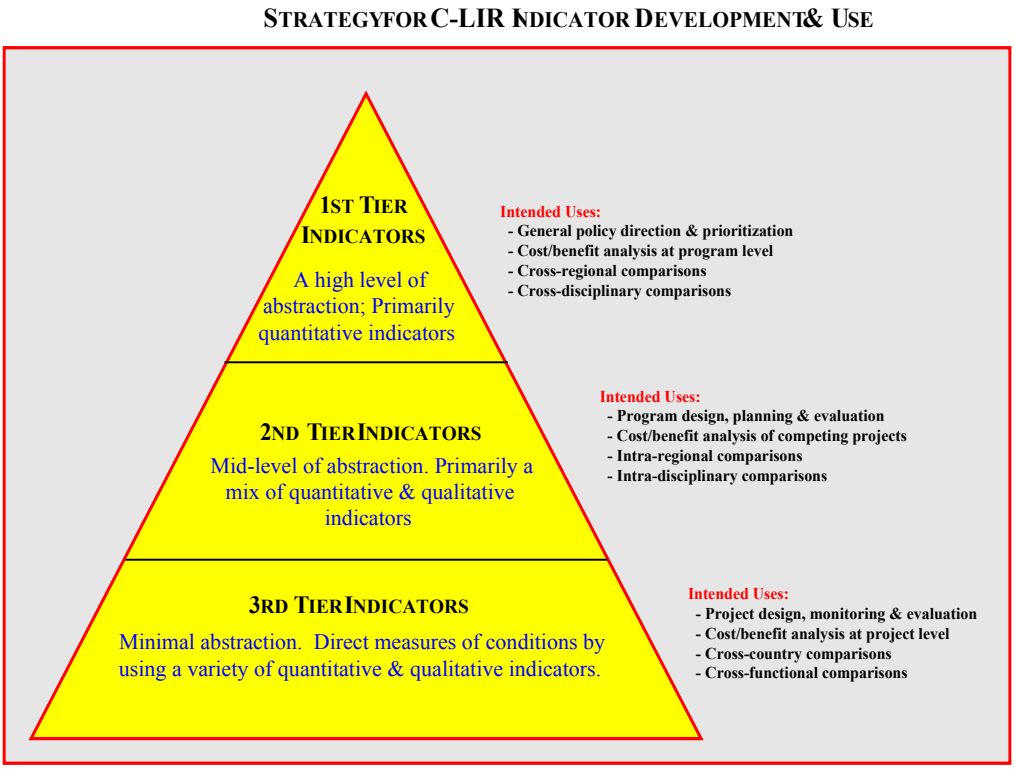
3. **Вспомогательные структуры** - правительственные, неправительственные и частные институты, которые либо поддерживают либо содействуют исполнению, выполнению, толкованию или осуществлению основополагающих законов (например, нотариальные конторы);

4. **“Рынок” на реформы КПИР** - взаимодействие заинтересованных лиц в рамках какого-либо общества, или группа, которая, в целом, оказывает влияние на суть, темп и направление реформ коммерческого права.

C. Организация и структура показателей реформ КПИР

Ниже на рисунке представлена в сжатой форме концепция организации показателей развития.

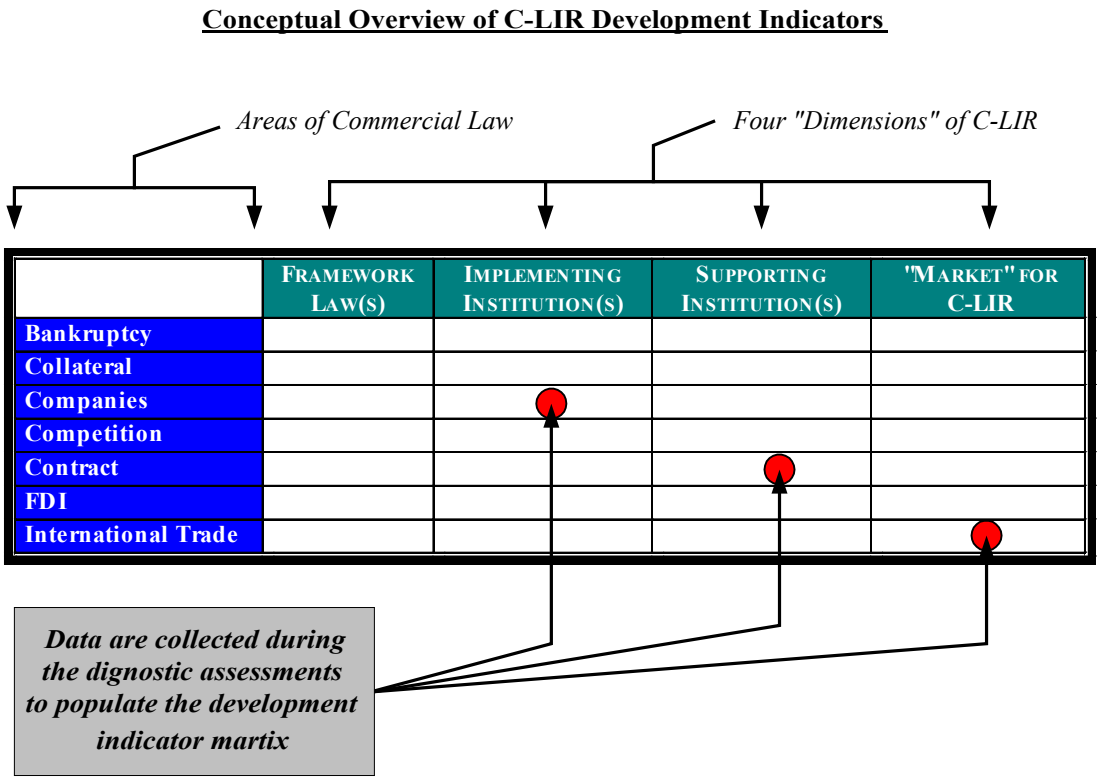
Стратегия разработки и использования показателей реформ КПИР



Каждым из трех разделов или “слоев” пирамиды, изображенной на схеме, представлен различный уровень детализации или “абстрагирования”, полученного посредством показателей. Основной задачей создания трех слоев показателей было обеспечение отличающихся уровней детализации в зависимости от нужд пользователя. Говоря в общем, показатели первого слоя предназначены для использования руководителями высшего звена - тех, кто определяет общее направление политики и устанавливает приоритеты. Показатели второго уровня предназначены для использования старшими руководителями программ и местных руководителей, которые отвечают за составление программ, планирование и оценку. И наконец, показатели третьего уровня предназначены для использования тех, кому необходимо провести детальный анализ конкретных областей по состоянию коммерческого права в данной стране или в сравнении с несколькими странами. В этом случае, отвечающие за разработку проекта, контроль и оценку скорее всего найдут необходимые им показатели на третьем уровне пирамиды.

Наряду с этим, сложность представляет расположение данных по таблицам, которые можно было бы легко читать и толковать, т.к. необходимые и используемые данные очень сложны и объемны. Как показано на диаграмме ниже, основные группы показателей по данной стране расположены по блокам, состоящих из 28 клеточек. Четыре “стороны” развития коммерческого права расположены в верхней части таблицы, а семь основных сфер, являющихся основным предметом настоящего исследования, расположены в крайней левой колонке.

Концептуальное обозрение показателей развития реформ КПИР



Учитывая то, что оценка проводилась по четырем странам в рамках настоящего проекта, были разработаны и разнесены в таблицы 112 групп показателей (содержащих конкретные показатели). По этой причине, пользователю необходимо ознакомиться с тем, чтобы хорошо разобраться в организации и логике таблиц с показателями перед тем, как он предпримет попытки толкования полученных результатов и указанных показателей.

D. Как читать таблицы с показателями реформ КПИР

Ниже на диаграмме представлена организация результатов показателей первого и второго слоев таблиц показателей реформ КПИР. Области изучения (“Залог”)

расположены в верхней левой части таблицы. Ниже под ней расположены четыре “стороны” коммерческого права по порядку изучения. Следующая колонка с права (“Контрольное значение”) содержит “контрольный показатель” (т.е. контрольную точку) относительно других изучаемых и сравниваемых стран (т.е. с “А” по “Г”). Например, общее значение для страны А и страны В равно 228 и 235 соответственно по сравнению с контрольным значением 638. Такие значения называются *предварительными очками первого слоя*. Для того, чтобы получить результаты первого слоя, предварительные очки первого слоя делят на контрольное значение и получают результаты первого слоя 31% и 33% соответственно. На этом примере видно, что залоговая система страны А сравнима с системой страны В, при их рассмотрении на уровне наивысшего абстрагирования.

Организация основных показателей таблиц

BASIC INDICATOR TABLE ORGANIZATION

SUBSTANTIVE AREA	REF.	A		B		C		D	
COLLATERAL LAW	**638**	**228**	**31%**	**235**	**33%**				
Legal Framework	120	85	*71%*	90	75%				
Implementing Institution	226	72	*32%*	25	11%				
Supporting Institution	154	34	*22%*	67	44%				
"Market" for C-LIR	138	37	*27%*	53	38%				

4 "Dimensions" of C-LIR

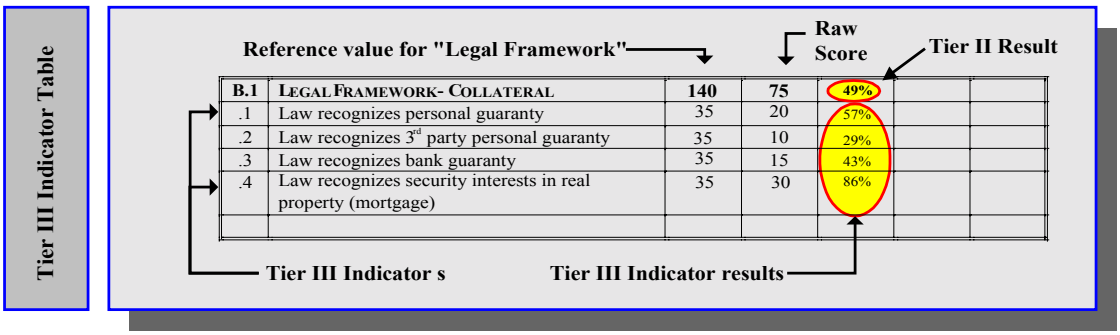
Tier II Reference Value

Tier I Indicator Results = the Average of Tier II Results

То же самое можно проделать и на втором уровне. Если, например, “Рынок” на реформы законодательства о залоге с стране А сравнить с его аналогом в стране В, получается результат равный 27% и 38% соответственно. Из этого можно сделать вывод о том, что аспект “Рынок” в данной сфере (*залог*) относительно сильнее в стране В, чем в стране А в целом, но *относительно* слаб сравнительно с эталоном. Необходимо подчеркнуть, что необходим более детальный анализ предварительных показателей и результатов третьего слоя для того, чтобы сделать более конкретные выводы (например, относительное качество политики (стратегии/курса), “поставляемого в стране А).

Показатели первого и второго слоя в вышеописанных примерах были получены на основе необработанных данных, собранных в ходе проведения диагностической оценки. Эти необработанные данные собраны и просчитаны по отношению к показателям третьего слоя. В результате, показатели третьего слоя обеспечили фундамент для проведения настоящего анализа. На иллюстрации ниже результаты показателей третьего уровня в отношении “Законодательной базы” о залоге усреднены с тем, чтобы получить связанные с ними результаты показателей второго слоя. Результаты отдельных показателей третьего слоя обеспечивают более высокий уровень подробности (детальности) анализа. В нашем примере результат показателя В.1.3. (“Законом признаны банковские гарантии”) равняется 43%, что

можно толковать как то, что данный конкретный аспект законодательной базы о залоге не была заложена достаточно основательно и не отвечает контрольному показателю равному 35. По мере необходимости и далее по отчету будет более подробно описано то, каким образом этот конкретный расчет был проведен на основе третьего слоя.



B.1	LEGAL FRAMEWORK- COLLATERAL	140	75	49%		
.1	Law recognizes personal guaranty	35	20	57%		
.2	Law recognizes 3rd party personal guaranty	35	10	29%		
.3	Law recognizes bank guaranty	35	15	43%		
.4	Law recognizes security interests in real property (mortgage)	35	30	86%		

Эти примеры были приведены для того, чтобы наглядно показать то, каким образом результаты (значения) показателей увеличиваются (ползут вверх) с одного уровня до другого в смысле абстракции. Идея такой организации показателей и их структуры заключается в том, чтобы нейтрализовать возможное непропорциональное влияние, которое могут оказать на конечные результаты отдельно взятые первичные необработанные данные. Нашей основной задачей является сведение влияние небольших расхождений (или необъективности) до минимума в процессе выведения окончательных результатов в рамках третьего слоя в отношении сравниваемых стран, при условии, что методология оценки применяется постоянно и последовательно в каждом отдельном случае.

VI. Организация диагностической оценки

В целях проведения сбора данных в изучаемых странах было проведено предварительное исследование имеющейся информации до проведения диагностического анализа. В целом, в такие данные вошли переводы соответствующих законов и законодательных актов, статистическая и экономическая информация, торговые данные, ранее проведенные оценки общего и конкретного характера по процессу правовых реформ, а также определение заинтересованных институтов (организаций/структур/ведомств) и лиц с целью проведения собеседований. Информация была получена из интернет, международных финансовых организации и донорских организации, академических кругов, юридических источников, посольств и бесед с представителями деловых кругов и юристами, знакомыми с положением дел в исследуемых странах. Общие и конкретные встречи и совещания были запланированы заранее с тем, чтобы, не теряя времени, приступить к работе по прибытии на место в целях скорейшего сбора недостававшей информации и данных и получения ответов на вопросы, непосредственно связанные с показателями в ходе диагностического исследования.

В целях обеспечения точности данного исследования и с учетом местных традиций и исторического влияния, диагностические группы состояли как из иностранных, так и местных специалистов. Иностранные члены групп состояли из старших юристов из США и стран центральной и восточной Европы, которые имели опыт работы как в регионе, так и в США, а и так называемые сотрудничающие юристы и эксперты из стран диагностики (CCN – cooperating country nationals). Преимущество использования юристов из стран диагностики (CCN) заключалось в том, что они могли провести уникальные сравнения не только в целом, но и в отношении какой-либо определенной страны, особенно относительно правовых систем США и стран центральной и восточнй Европы (CEE). Местные юристы, практикующие в соответствующих странах, не только предоставили ключевые исторические данные, но и внесли вклад относительно показателей. Они также посещали многочисленные встречи и совещания, на которых они поделились своими знаниями о правовых традициях и реформах, а также сделали полезные замечания касательно изысканий группы. Кроме того, при возникновении необходимости, группой были использованы местные юристы в целях проведения дополнительных исследований и в целях перевода.

Исследуемая сфера коммерческого права была разделена таким образом, что группа могла разделиться на части с тем, чтобы охватить как можно большую территорию в течение двухнедельного исследования. Диагностические группы, при необходимости, концентрировались на схожих вопросах и проблемах и рапортовали о своих находках в законах, которые они успели проанализировать. Так как большинство показателей имеют отношение к нескольким разделам права сразу, то, как правило, посещение одного министерства или государственного агентства, общественной или частной организации заканчивался получением

информации и данных по нескольких направлениям. В целях обеспечения того, что были проработаны все направления, группа постоянно сверяла свои записи, конспекты, оценивала достигнутый прогресс и проводила корректировки в своей работе.

Сбор данных на местах был проведен широкомасштабно. Другими словами в отношении каждого источника информации были предприняты усилия по получению информации из как можно большего количества источников с учетом ограниченности времени и ресурсов. Например в случае с законодательством о банкротстве, были проведены консультации с широким рядом крупных и мелких дебиторов, кредиторов, юристов, судей, ученных, государственных чиновников, бизнесменов и правозащитников в целях получения как можно более полной картины для разработки адекватной законодательной базы и организации соответствующих исполнительных и вспомогательных институтов и организаций.

Диагностические оценки были проведены в период с октября 1998 по июнь 1999 года. Целью оценок было изучение ситуации на местах и дальнейшее совершенствование методологии для измерения/оценки развитости коммерческого права в странах с переходной экономикой.

Расписание проведения оценок:

Польша	5-23 октября 1998
Румыния	4-18 декабря 1999
Украина	3-17 марта 1999
Казахстан	3-19 июня 1999

VII. Следующие шаги/действия

Методология оценки и разработка показателей станут темой регионального семинара в Праге с 6 по 9 декабря 1999. Ожидается, что в работе семинара примут участие высококвалифицированные местные эксперты в области коммерческого права, представители заинтересованных организаций (таких как суды, реестры, ассоциации юристов), представители других заинтересованных кругов (например, внешней торговли, банковской деятельности, кругов, малого бизнеса), которые могут внести существенный вклад в развитие дальнейшей дискуссии по этому вопросу. Для участия в работе семинара будут также приглашены представители ЮСАИД, Всемирного банка, Европейского банка реконструкции и развития, ЕС и других международных организаций.

В ходе работы семинара, участники обсудят конкретные и индивидуальные особенности каждой страны, ознакомятся с результатами исследований и используют их в качестве отправной точки в дебатах по причинам возникновения проделов в плане исполнения и осуществления, а также сделают выводу и

рекомендации по работе ЮСАИД и донорских организаций. Задачи семинара включают:

1. утвердить концептуальный подход (4 стороны/аспекта, 7 разделов);

2. рассмотрят возможные пути дальнейшего совершенствования методологии и разработки показателей;

3. проверят правильность выводов, полученных и представленных в отчетах о проделанной работе в каждой из стран, а также в общем отчете относительно опыта самих участников и их собственных знаний;

4. исследуют участие ЮСАИД и донорских организаций и местных сотрудничающих агентств, органов и организаций;

5. разработают возможные методы проверки, совершенствования и улучшения мер для “заполнения существующих пробелов в области исполнения и осуществления”.

Этот семинар позволит провести открытый и конструктивный обмен мнениями, что позволит подрядчику провести дальнейшее совершенствование этих проектов отчетов. Опыт участников семинара из всех уголков региона возможно приведет к конкретным выводам и рекомендациям, которые можно будет использовать при разработке, проектировании, исполнении и оценке помощи реформам КПИР в будущем.

UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

COMMERCIAL LEGAL REFORM ASSESSMENTS FOR EUROPE AND EURASIA

Final Diagnostic Assessment Report for Poland

USAID Omnibus II-C: Policy/Legal/Training
Contract No. EPE-I-95-00071
Task Order No. EPE-I-09-95-00071-00
January 1999

BOOZ·ALLEN & HAMILTON INC.
INTERNATIONAL CLIENT SERVICE TEAM

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I. Overview

The diagnostic assessment that serves as the basis for this study was conducted in Poland between October 5-23, 1998. This diagnostic provides the first component in a four-country study to assess the current commercial law environment in the CEE and the NIS regions. Each country included in this assessment - Poland, Romania, Ukraine, and Kazakhstan - was selected for its unique characteristics including location, geography, size, economic base, legal traditions and relative progress in transition toward a Market-oriented economy.

Poland was selected for inclusion in the sample for this study for many reasons including its size, geo-strategic position, and its comparative successes in meeting the challenges of making the transition to an open Market economy. Poland also serves as an informal "benchmark" for the sample selected for this study for several key reasons. First, it had one of the strongest pre-World War commercial legal traditions in Europe, and many of its core legal texts, including the Civil Code, managed to survive the Communist era intact. Second, the fact that Poland has pursued reform aggressively over the past decade and has attained among the highest sustained economic growth rates in the region suggested that Poland can serve as a useful benchmark for evaluating commercial law development in the region. Third, because Poland has anchored its future squarely within the broader political and economic framework of the European Union, it was judged to have a high degree of political consensus on the long-term direction of its political and economic development.

The purpose of this assessment is to better understand the dynamics of commercial law development generally, and what can be done to better assist transition economies in developing a pro-business legal and regulatory environment specifically. More than 160 years ago, Alexis De Tocqueville studied America as a newly emergent democracy and commercial power. In searching for an explanation for America's phenomenal success, he concluded that the manners and customs of the people were a the fundamental differentiating factor, and that natural endowments of productive factors, and good laws were significant, but less important determinants of economic growth.[1] More recently, Landes has suggested that culture and institutions explain many of the differences in economic development between nations. Among other characteristics, he opines that if a society pursues stable growth and development, its social and political institutions must:

- Secure rights of property;
- Secure rights of personal liberty;
- Enforce rights of Contract;
- Provide stable, responsive and honest government; and,
- Provide moderate, efficient, and cost-effective government.[2]

What makes Poland "special" from the point of view of commercial life? Why has Poland managed the transition to a Market economy more quickly and successfully than almost any other country in the region? Do laws matter, or as De Tocqueville and Landes would have it, is it the "customs of the people" that matter most? Finally, if one accepts this as true, what are the implications for USAID, other donors, and the countries of the region themselves?

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1 Democracy in America, Vol. I, Ch. XVII

2 Landes, David S., THE WEALTH AND POVERTY OF NATIONS – WHY SOME ARE SO RICH AND SOME SO POOR. (New York. W.W. Norton & Company, 1998), pp. 215-18.

II. Summary Indicator Results

The following table contains a summary of the indicator results derived from the Poland diagnostic assessment. The total possible raw score appears in the "REF" column of the table. Each country's raw score will appear in two forms in the adjacent columns; first the raw indicator score, and next as the raw score *stated as a percentage of the total possible raw score for that category*. The reader is urged to carefully read Section IV ("Notes on Scope and Methodology") before attempting to draw any specific conclusions either from the raw scores, or their associated results.

	SUBSTANTIVE AREA	REF.	POL		ROM		UKR		KAZ	
A.	**BANKRUPTCY**			***79%***						
	1. Legal Framework	**280**	224	*80%*						
	2. Implementing Institutions	**170**	136	*80%*						
	3. Supporting Institutions	**200**	151	*76%*						
	4. Market - Bankruptcy	**290**	225	*78%*						
B.	**COLLATERAL**			***77%***						
	1. Legal Framework	**140**	126	*90%*						
	2. Implementing Institutions	**210**	165	*79%*						
	3. Supporting Institutions	**190**	123	*65%*						
	4. Market - Collateral	**310**	234	*75%*						
C.	**COMPANY**			***79%***						
	1. Legal Framework	**190**	153	*81%*						
	2. Implementing Institutions	**270**	205	*76%*						
	3. Supporting Institutions	**100**	82	*82%*						
	4. Market - Company	**270**	211	*78%*						
D.	**COMPETITION**			***81%***						
	1. Legal Framework	**210**	172	*82%*						
	2. Implementing Institutions	**220**	178	*81%*						
	3. Supporting Institutions	**220**	178	*81%*						
	4. Market - Competition	**290**	226	*78%*						
E.	**CONTRACT**			***80%***						
	1. Legal Framework	**90**	75	*83%*						
	2. Implementing Institutions	**180**	150	*83%*						
	3. Supporting Institutions	**70**	55	*79%*						
	4. Market - Contract	**310**	234	*75%*						
F.	**FDI**			***78%***						
	1. Legal Framework	**290**	253	*87%*						
	2. Implementing Institutions	**190**	155	*82%*						
	3. Supporting Institutions	**200**	131	*66%*						
	4. Market - FDI	**310**	234	*75%*						
G.	**INT'L TRADE**			***69%***						
	1. Legal Framework	**280**	260	*93%*						
	2. Implementing Institutions	**180**	128	*71%*						
	3. Supporting Institutions	**180**	88	*49%*						
	4. Market - Trade	**310**	188	*61%*						
TOTAL		**6150**	**4740**	***78%***						

III. Narrative Assessment Results Overview

Initial results of the in-country diagnostic assessment confirm that Poland has strong overall legal, institutional, and "market" framework for commercial activity when compared to the baseline established for this assessment. Poland's total result (the average of Tier I results in each of the seven areas of commercial law examined) was 78%. Tier I results for each of the seven subject matter areas ranged from a low of 69% in International Trade, to a high of 81% for Competition. Other areas of relative strength include Contract (80%), company (79%), and Bankruptcy (79%). It should be emphasized that these results should not be interpreted as an indicator of progress toward a specific or idealized commercial system. Instead, the percentage values are intended to help evaluate existing conditions against a general "baseline" requirement for modern commercial activity.

Although these results are preliminary, a few interesting patterns emerge that are worth noting. First, as expected, the "Framework Law" Dimension is stronger, in relative terms, than any other Dimension of this analysis. Poland has received a significant amount of technical support in developing Framework Laws for Bankruptcy, Collateral, and FDI. The high results achieved in company and Contract law may be attributable, in part, to the survival of Poland's pre-war jurisprudence and practice in these areas. Interestingly, although Poland's trade laws scored highest in this Dimension, the Tier II result was the lowest of the seven subject matter areas. This can be explained in part by the fact that "Supporting Institutions" received the lowest Tier II score (49%) for the assessment. Finally, the process of approximation of laws in preparation for EU accession explains in part the relatively high result (82%) Poland's Framework Law for Competition received in the analysis.

Except in the case of company, the results for Implementing Institutions ranked second highest among the four Dimensions of this analysis. Overall, inadequate institutional capacity in the Implementing Institution Dimension was a common theme across all subject matter areas. In general terms, Poland's Implementing Institutions are viewed as overly bureaucratic, inefficient, and in the worst cases, arbitrary. Corruption, while it exists, was reported to be a relatively minor impediment to day-to-day commercial activity. Except perhaps in the area of Bankruptcy, end users reported that they were more likely than not to work through the bureaucratic channels of the Implementing Institution, than to circumvent them through self-help or avoidance. Areas of particular overall weakness were found in the commercial courts of general jurisdiction, and in the area of International Trade, with customs administration and regulation.

Because of the variety of forms that Supporting Institutions take across the seven subject matter areas, it is difficult to generalize the results obtained in this Dimension of the analysis except to say that the number of Supporting Institutions, and their overall level of their activity in Poland, were encouraging. In the areas where Poland's legal traditions are strongest, Contract and Company, Supporting Institutions were found to be the strongest. Here banks, notaries, bar associations, chambers of commerce, arbitration councils, lawyers' associations, law firms, business consultancies, and special interest groups were found to be playing an important, if sometimes indirect, facilitating role in these spheres of commercial activity. In the areas of

Collateral and International Trade, the results for this Dimension were comparatively lower. In the former, this result may be attributable to the relative newness of the Collateral system. In the latter, the result was brought down by a strong consensus that Poland's Custom's Service is an area where significant reforms remain to be implemented.

The "Market" for commercial law reform in Poland is similarly strong in most areas. In relative terms, the result for Poland's Market for trade liberalization was somewhat low (61%), given the general consensus that seems to exist concerning Poland's future role in a wider Europe. Generally speaking, the low score in this Dimension may be attributable more to a lack of specific knowledge concerning Poland's obligations under various trade agreements, than of a lack of support for liberalized trade. Additionally, micro- and small-sized trading firms, important contributors to Poland's economic rebirth since the early 1990s, have been viewed by Polish society with a degree of suspicion as this sector has been a focal point for criminal and quasi-criminal activities. This lingering suspicion against entrepreneurial activity seems to be receding steadily, and would appear to be a lingering.

IV. Notes on Scope & Methodology

This diagnostic assessment was designed to help achieve the following objectives:

1. To provide a factual basis for characterizing the degree of development and the level of effectiveness of the commercial law reforms initiated in Poland since independence;
2. To provide a methodologically consistent foundation for drawing cross-country comparisons in an effort to identify and describe the root causes of the "implementation/enforcement" gap; and,
3. To provide analytical and planning tools and metrics that will help USAID design new approaches to sustainable, cost-effective C-LIR interventions in the region and elsewhere.

For the purposes of this effort, "commercial law" is defined to include the following substantive legal areas:

1. ***Bankruptcy*** - Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets and rehabilitation of insolvent debtors.
2. ***Collateral*** - Laws, procedures and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets.
3. ***Companies*** - Legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.
4. ***Competition*** - Rules, policies and supporting institutions intended to help promote and protect open, fair and economically efficient competition in the market, and for the market.
5. ***Contract*** - The legal regime and institutional framework for the creation, interpretation and enforcement of commercial obligations between one or more parties.
6. ***Foreign Direct Investment*** - The laws, procedures and institutions that regulate the treatment of foreign direct investment.
7. ***International Trade*** - The laws, procedures and institutions governing cross-border sale of goods and services

Each of these substantive areas will be assessed by collecting data across the four sample countries. Within each of these substantive areas, four "Dimensions" of C-LIR are proposed as a conceptual framework for comparison. These include:

- ***Framework Laws*** - Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for Implementing Institutions (e.g., Law on Bankruptcy, Law on Pledge of Moveable Property);

- ***Implementing Institutions*** - Governmental, quasi-governmental, or private institutions in which primary legal mandate to implement, administer, interpret, or enforce Framework Laws is vested (e.g., Bankruptcy courts, Collateral registry);

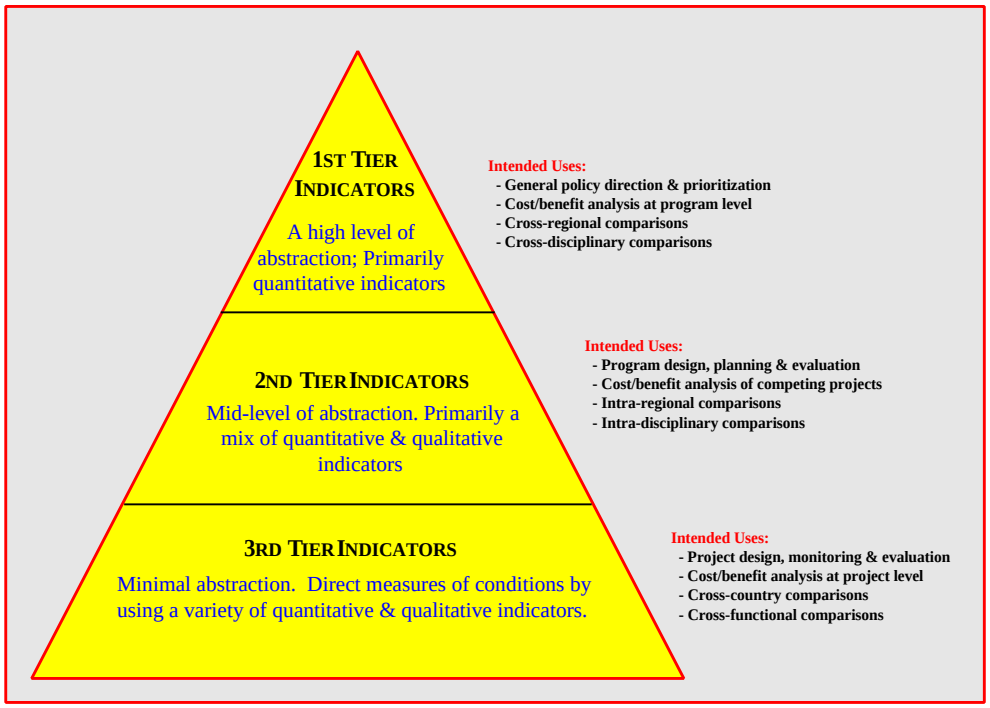
- ***Supporting Institutions*** - Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of Framework Laws (e.g., Bankruptcy trustees, notaries); and,

- ***"Market" For C-LIR*** - The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

Within each substantive area, development indicators have been defined for each of the four "Dimensions" of C-LIR. The figure below provides a conceptual overview of how the development indicators are organized. The twenty-eight "cells" below represent groups of development indicators that collectively are designed to provide a "snapshot" of the current state of commercial law reform in each subject area. From a practical standpoint, the diagnostic assessment itself is performed by collecting and analyzing data through published sources, and face-to-face interviews, that are used to populate the development indicator tables.

The graphic below provides a conceptual overview of how the development indicators are organized.

STRATEGY FOR C-LIR INDICATOR DEVELOPMENT & USE

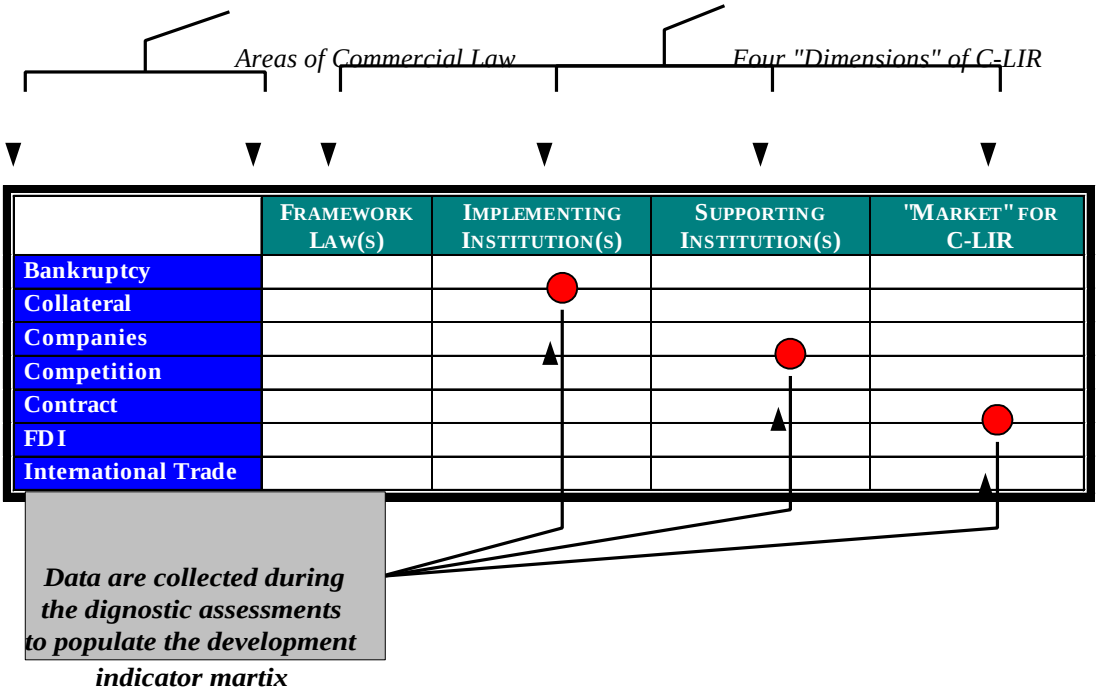


Each of the three sections or "tiers" of the pyramid in the diagram represent a different level of detail or "abstraction" generated by the indicators. The primary objective in creating three tiers of indicators is to provide varying levels of detail, depending on the needs of the user. Generally speaking, Tier I indicators are intended to be useful to high level policymakers who are

responsible for establishing general policy direction and prioritization. Tier II indicators are intended to be most useful to senior program- and country-level officials responsible for program deign, planning, and evaluation. Finally, Tier III indicators are designed to be most useful to those who need to make detailed analysis of specific areas of the commercial law environment in a given country, or between specific countries. In this case, those responsible for project design, monitoring, and evaluation are most likely to find the detail at the Tier III level useful

The organization of the data into tables that can be easily read and interpreted is also a challenge given the amount and complexity of the data required. As illustrated in the diagram below, basic indicator groups for a given country are organized into blocks of twenty-eight "cells". The four "Dimensions" of commercial law development appear across the top of the table, and the seven subject matter areas defined for this study appear in the far left column.

Conceptual Overview of C-LIR Development Indicators



Given that four countries have been selected for assessment, a total of 112 indicator groups (containing subject-matter specific indicators) have been developed and populated. For this reason, it is important for the user to have a firm grasp of the organization and logic of the indicator tables before attempting to interpret speicific indicator scores or results.

V. How To Read the C-LIR Indicator Tables

The diagram below represents how Tier I and Tier II results are organized in the C-LIR indicator tables. The subject matter area ("Collateral") appears in the upper left portion of the table. Below it, the four "Dimensions" of commercial law are listed in their order of treatment. The column immediately to the right ("Ref.") contains a "reference value" (i.e., benchmark) against which the sample countries (i.e., "A" through "D") are compared. To illustrate, the total raw scores for Country A and Country B are 228 and 235, respectively, as compared against the reference value of 638. These are referred to as Tier I *raw scores*. To obtain a Tier I *result*, the raw score is divided by the benchmark reference value (REF) to obtain Tier I results of 31% and 33% respectively. This example suggests that Country A's Collateral law system is comparable in relative terms to Country B's *when viewed at the highest level of abstraction*.

BASIC INDICATOR TABLE ORGANIZATION

SUBSTANTIVE AREA	REF.	A		B		C		D	
COLLATERAL LAW	**638**	**228**	**31%**	**235**	**33%**				
Legal Framework	120	85	*71%*	90	75%				
Implementing Institution	226	72	*32%*	25	11%				
Supporting Institution	154	34	*22%*	67	44%				
"Market" for C-LIR	138	37	*27%*	53	38%				

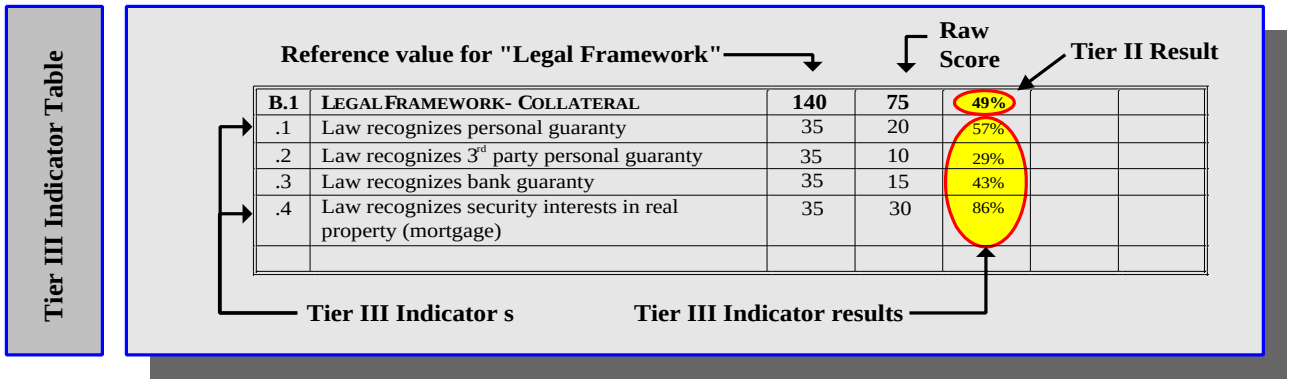
4 "Dimensions" of C-LIR

Tier II Reference Value

Tier I Indicator Results Are The Average of Teir II Results

The same exercise can be performed at the Tier II level. If, for example the "Market for Collateral law reform in Country A is compared to that of Country B, a result of 27% and 38% respectively is obtained. From this it may be possible to infer that the "Market" Dimension for this subject matter area (Collateral) is *relatively* stronger in Country B than in Country A in aggregate terms, but relatively weak in comparative terms. It must be emphasized that a more detailed analysis of the underlying Tier III indicator raw scores and results would be required to draw more specific conclusions (e.g., a relative quality of policies "supplied" in Country A).

The Tier I and Tier II indicators in the example above are derived from the raw data collected in the course of the diagnostic assessments. This raw data is collected and scored against Tier III indicators. As a result, Tier III indicators provide the foundation for this analysis. In the illustration below, Tier III indicator results for the "Legal Framework" for Collateral are averaged to yield associated Tier II results. Individual Tier III indicator results provide the highest level of detail in the analysis. In this example, the result for Indicator B.1.3 ("Law recognizes bank guaranty.") is 43%, which can be interpreted to mean that this particular aspect of the Legal Framework for Collateral was found to fall well short of the benchmark Reference Value of 35. Where pertinent, a more detailed discussion of the basis on which this particular Tier III scoring was made would appear in the narrative portion of the diagnostic report.



B.1	**LEGAL FRAMEWORK- COLLATERAL**	**140**	**75**	**49%**		
.1	Law recognizes personal guaranty	35	20	57%		
.2	Law recognizes 3rd party personal guaranty	35	10	29%		
.3	Law recognizes bank guaranty	35	15	43%		
.4	Law recognizes security interests in real property (mortgage)	35	30	86%		

These examples are intended to help show how indicator results "roll up" from one level to the next in terms of abstraction. This design is intended to dilute the impact that any single indicator *raw score* may have on the overall indicator *result*. It is our intention that the impact of a small discrepancy (or bias) in scoring at the Tier III level from one country to the next would be minimized provided the assessment methodology is applied consistently in each case.

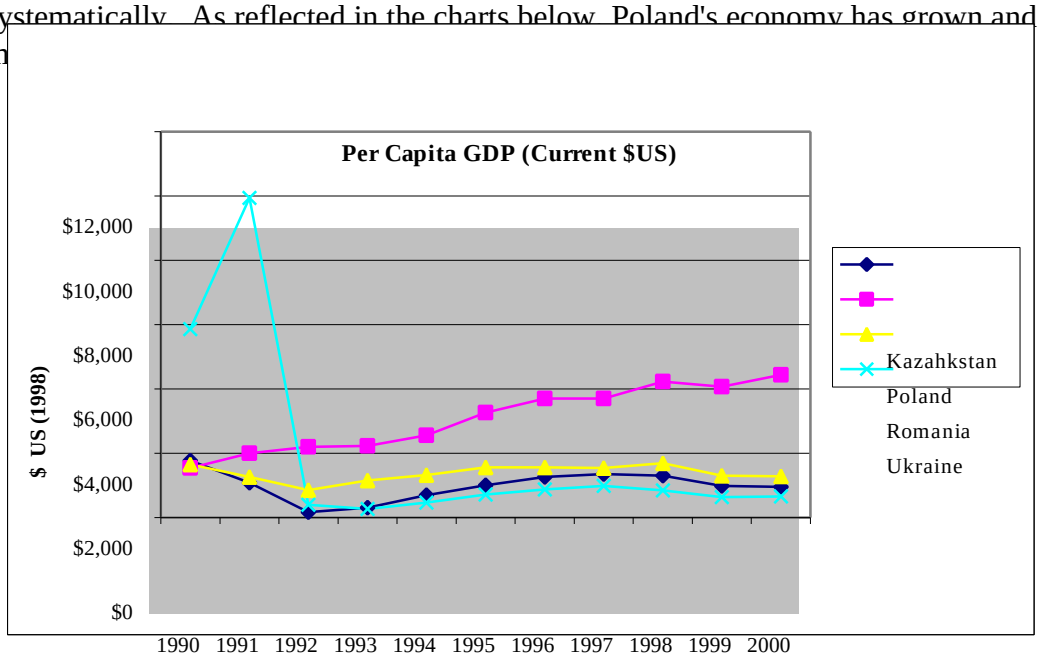
VI. Narrative Summary of Diagnostic Findings

A. Overview

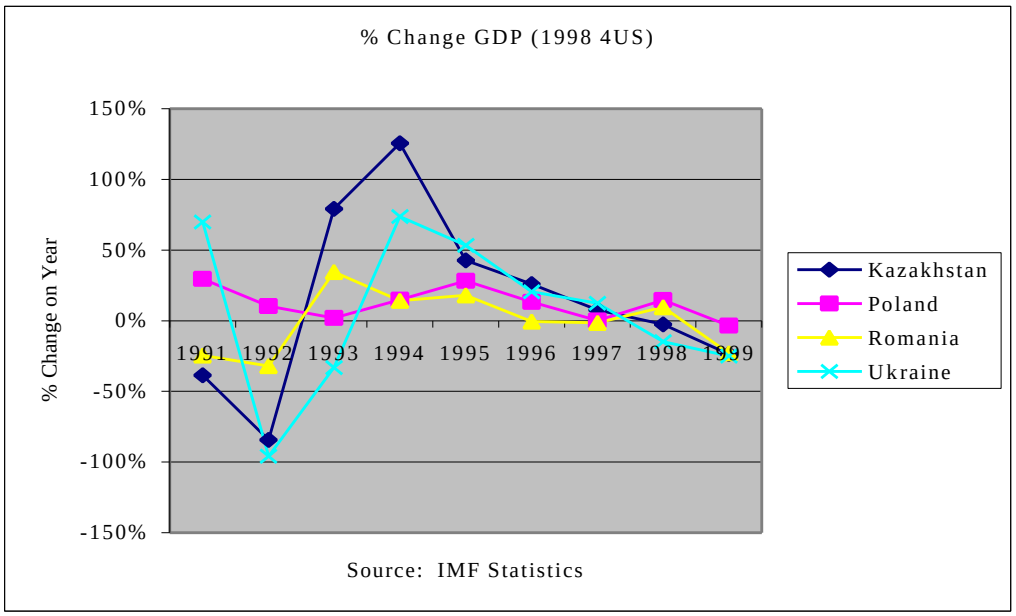
> ***"Yet having begun, we must go forward to the rough places of the law...."***
>
> **Plato's Republic, Book V.**

Poland is a leader in the political and economic transition of Central and Eastern Europe and has been a recipient of substantial USAID technical assistance. The technical assistance has focused on overcoming what remains of major impediments to sustainable, long-term economic growth and resilient democracy, building on lessons learned and a strategy that employs the mutually reinforcing objectives of private, public, financial and democratic sector development. USAID has provided extensive assistance for key aspects of Poland's transition to a viable market economy and democratic civil society, such as economic restructuring, private and financial sector development and governmental decentralization. In addition, USAID has promoted and fostered private sector development through assistance to small and medium scale enterprises, and by supporting privatization and restructuring, and addressing barriers to commercial activity.

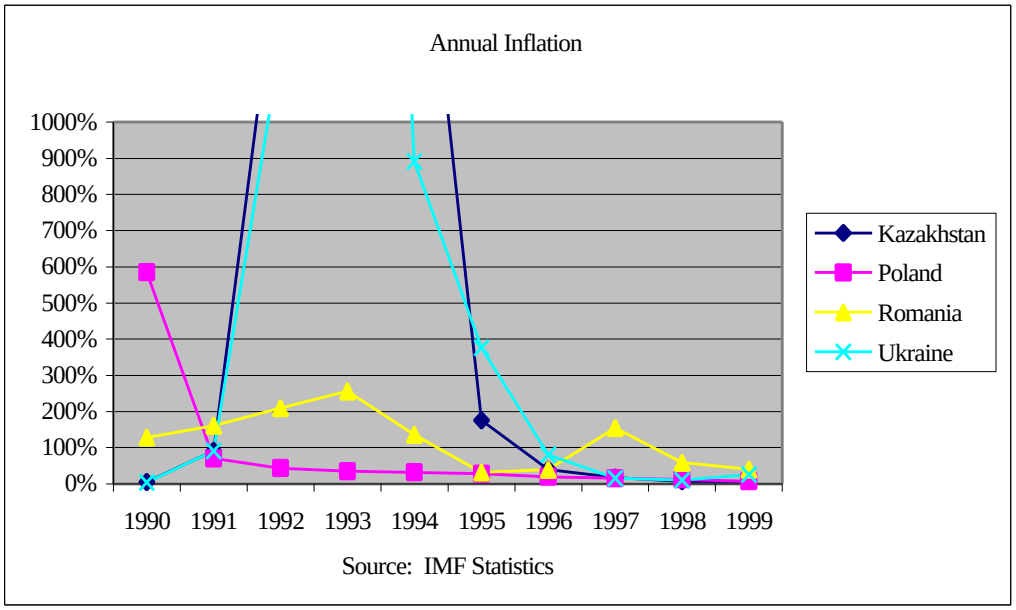
Poland's GDP has expanded by 5% or better in every year since 1994. Private direct foreign investment has continued to grow, with the U.S. leading at over 30% of the current total of just under $4 billion. Legislation conducive to free enterprise has been enacted, and a vibrant private sector is now estimated to employ 64% of the work force (including the shadow economy) and to account for about two-thirds of the GDP. Capital markets have evolved slowly, but systematically. As reflected in the charts below, Poland's economy has grown and stabilized as m



Source: IMF Statistics



Poland has enacted some of the most profound reforms in the region, resulting in major productivity increases within the private sector. Its relative success in avoiding sustained periods of hyper-inflation, developing an improved policy climate for private sector growth, promoting greater competition within the banking sector, opening up opportunities for capital market formation, and the introduction of new financial instruments to mobilize domestic savings all contributed to Poland's current situation.



Other broad indicators of Poland's position relative to the three other countries contained in the sample are also instructive:

Broad Indicator	Poland	Romania	Ukraine	Kazakhstan
Population (millions)[3]	38.7	22.6	51.2	16.9
Area (km2)	312,683	237,500	603,700	2,717,300
Corruption Index[4]	4.2	3.3	2.6	2.3
Credibility Index[5]	68.05	52.96	>40	48.04
EBRD Legal Transition Index[6]	4/4	¾	2/2	2/2
Moody's Emerging Mkt. Rating	Baa3	B3	B3	Ba3

Poland's long and distinguished legal tradition is one of adaptation and survival. When Poland regained its status as an independent nation following World War I, it was faced with the challenge of harmonizing a patchwork of various laws that were inherited from occupying powers including Russia, Prussia, Austria, and France.[7] This mélange of traditions and influences survives today - it is reported that judges give different interpretations - French, Austrian, and German - to the Commercial Code of 1934 depending on the region within Poland where they receive their training.[8] In the area of commercial law, German and French influences are still very much in evidence in the Polish Commercial and Civil Codes respectively.

If the inter-war period can be viewed as a period of adaptation and harmonization of law, the period of Poland's Nazi occupation and Communist rule can be viewed as one of survival. Under Communist rule, the Polish legal systems were adapted to the state's needs, rather than scrapped and replaced with an entirely new socialist legal system. Key provisions of Poland's commercial law and traditions were allowed to survive, even if in dormancy.[9] Perhaps most significantly, the private sector continued to function throughout the Communist period, thus creating "demand" for commercial law, even if contradicting the prevailing political orthodoxy.[10]

Considering the scope and pace of Poland's transition to a market economy, the notion that Poland's tradition of adaptation and survival played an important role seems credible. There is great pride, for example, in the Commercial Code of 1934, and a consensus that it remains

[3] Population Division and Statistics Division of the United Nations Secretariat, 1998 (http://www.un.org/Depts/unsd/social/poptn.htm).
[4] Transparency International Corruption Perceptions Index (CPI) 1999. Scale = 1 - 10. Higher scores indicate less corruption.
[5] Euromoney Magazine, December 1997. Scale = 1 - 100. Higher scores indicate greater credibility of government offerings and undertakings.
[6] European Bank for Reconstruction & Development, 1998 Transition Report. Scale = 1 - 4+, where 4+ is most advanced. 1997 and 1998 figures are included. Of those countries included in the Sample, only Romania's score changed between 1997 and 1998.
[7] Taking The Other Road: Polish Legal Education During The Past Thirty Years, Gostynski, Z., Garfield, A., 7 Temp. Int'l & Comp. L.J. 243, Fall, 1993.
[8] Brzezinski, C., The EC-Poland Association Agreement: Harmonization of an Aspiring Member State's Company Law, *34 Harv. Int'l L.J. 105, 108, n. 16 1993 (* "Warsaw judges tend to apply a French interpretation, Krakow judges an Austrian interpretation, and Wroclaw judges a German interpretation").
[9] Poland's Commercial Code of 1934 is a good example. Although it was not used during the Communist period, Polish law schools continued to teach the Commercial Code to law students.
[10] In contrast with Ukriane, for example, collectivization of agriculture was never accomplished in Poland. Per Gostynski, et al., approximately 70% of agricultural land remained in private hands during the Communist era. In addition, a class of small entrepreneurs remained active throughout the period.

generally serviceable for contemporary needs, with some adjustment.[11] The current process of "approximation" of Poland's legal regime in preparation for full membership in the EU seems to represent yet another period of adaptation and harmonization in Poland's legal tradition, and provides a strong gravitational influence on the pace and direction of Poland's overall commercial law reform effort.

[11] Id. The Civil Code of 1964 repealed many aspects of the Commercial Code of 1934. A debate arose early during the reforms as to whether the Code had been repealed in part, or in whole. It seems that a consensus was reached that the Code did survive. As a result, the Polish government determined to update the Code, rather than replace it with an entirely new body of law.

B. Bankruptcy

1. Overview

The liberalization of state-controlled economies is a fundamentally messy process. State enterprises, who for decades produced what they were told to produce, find themselves suddenly faced with a bewildering state of affairs. Their inputs supply chain is disrupted, their market outlets disappear, and their products are typically viewed with indifference (or outright disdain) by consumers. Financial crisis, if not inherited from the former times, soon arrives with a thud.

The process of transition - while exceedingly complex - can be viewed narrowly (for the purposes of this analysis) as a process by which new participants enter the market, and others exit it. In most cases, a reformist government need only stabilize the macroeconomic environment and eliminate state controls in order to spark a flood of new entrants. The more difficult process to manage, understandably, is how under- and non-performing enterprises *exit* the market. Properly done, a well designed Bankruptcy system provides an efficient market clearing mechanism that helps assure orderly Market exit and equitable liquidation of insolvent debtors obligations.

Bankruptcy legislation is for this reason one of the more contentious areas of legal reform for transition economies. Reform implies a tradeoff between short-term economic dislocation (e.g., increased unemployment, decreased micro-economic activity, etc.) and long term economic growth - the tangible benefits of which will be felt long after the next election cycle. It is not surprising, therefore, that political pragmatism frequently wins out over visionary leadership in this area of commercial law reform.

In addition to providing a mechanism to mediate conflict between and among debtors and creditors, bankruptcy laws also provide an economically and socially beneficial systems of triage for worrying - but not necessarily terminal - cases of financial dyspepsia. Thus, Bankruptcy is distinguished from Collateral and secured transactions law, both of which address an individual creditor's interest in property and collection remedies relating to that property. The two sets of law converge in the area of priorities, where multiple, conflicting claims may be made on the same assets.

There are several different approaches to Bankruptcy that have emerged from the CEE/NIS region. These range from "straight" bankruptcy on one extreme, to insolvency proceedings geared toward rehabilitation at the other. These models also vary in the type of debtors covered. The alternative models encompass individuals and registered for profit entities. These models include a disaggregation of the classification of covered enterprises – e.g., agricultural, financial and nonprofit entities - that may be excluded from bankruptcy. Other key differences include:

- Who may initiate a bankruptcy proceeding; and,
- How large an estate needs to be prior to allowing the creditor and/or debtor access to the Bankruptcy code.

There is also considerable variation in terms of the substantive prerequisites for bankruptcy proceedings. Variations here may include the following:

- Cessation of payments;
- Inability to cover current indebtedness with current assets;
- Inability to pay all debts taking into account all prospective liabilities;
- General nonpayment of maturing debts that are not covered by legitimate disputes;
- Inability to pay on a regular basis ones' liabilities, and,
- Undertaking certain acts that clearly signal insolvency.

Among the many issues examined in these diagnostics of the current state of the region's Bankruptcy law and institutions are exempt versus non-exempt assets; title to property in Bankruptcy proceedings; preferences; and creditor priorities.

2. Diagnostic Findings

Legal Framework
Like the Commercial Code, Poland's bankruptcy law dates from 1934, [12] and retains many characteristics of the prewar period, yet it has also been significantly updated to reflect modern continental practice and emerging international norms for bankruptcy proceedings. In addition to the Bankruptcy Act, Poland has retained the Arrangement Proceedings Law[13], which provides a mechanism for restructuring and rehabilitation of insolvent debtors. Under the existing Bankruptcy Act , a person or entity may be declared bankrupt when:

- Debt service has ceased; and,
- Where assets are not sufficient to satisfy outstanding debts.

Under Polish law, bankruptcy applies to "entrepreneurs". Pursuant to the law of December 23, 1988 on Economic Activity (as amended), the term "entrepreneur" includes: natural persons conducting economic activity, entities regarded as "legal persons", for example, corporations, state-owned enterprises, and registered partnerships and limited partnerships. A declaration of bankruptcy may be demanded by a debtor or by any of his creditors. Such demand may be also made by:

- Any partner of a registered or limited partnership;
- Legal representatives (e.g., directors and other members of the management board) of legal persons;
- For state-owned enterprises - the founding authority (e.g., a member of the Council of Ministers, or *voivod* - the head of province, as well as the Minister of Finance, acting on behalf of the State Treasury); and,

12 Regulation by the President of the Republic of Poland of October 24, 1934 on Bankruptcy Law, amended Dziennik Ustaw, 1990, No. 14, item 81; 1991, No. 118; 1992, No. 1, 1995, No. 85, 1996, No. 6, et seq.
13 Ordinance of President of the Republic of Poland, October 24, 1934.

- For partnerships or companies being liquidated - the creditors.

Under current law, a debtor must file for bankruptcy within fourteen (14) days of meeting either of the two conditions for insolvency. Where the debtor fails to file within the specified period, the court has the right to refuse any future reorganization plans and to impose criminal and civil penalties. Where the debtor petitions for reorganization, the fourteen day filing requirement does not apply.

The institutional framework established by the bankruptcy law is organized around specialized courts and the utilization of trustees (*syndyk*) similar to the practices of the North American and European systems. Where the court finds sufficient grounds for bankruptcy, an order will issue that identifies:

1. The name and legal residence of the debtor;
2. Notice to creditors with instruction to register claims within a specified period;
3. The bankruptcy judge or judge commissar appointed to the case;
4. The bankruptcy trustee or lawyer appointed; and,
5. The factual and legal grounds upon the order is based.

Public notice and service on interested parties is required.

The principal deficiencies of the existing Legal Framework were identified by End Users' as follows:

Order of priority of claims on debtors' assets. Under the current scheme, secured creditors effectively stand seventh in line in terms of priority. The practical effect is that there is very frequently nothing left to recover against the secured creditor's claims are addressed.

After asserted claims by government authorities. End Users' also reported that under the current law there is little incentive on the part of government authorities (e.g., tax authorities) to give notice of, or timely assert, outstanding claims against debtors. The net result is that a creditors have pursued claims against insolvent debtors assets only to have their claims superceded after bankruptcy proceedings are well underway.

Timely notice of insolvency. Creditors reported that insolvent debtors often do not comply with the fourteen day notice requirement contained in the law. It was unclear whether this can be attributed to any weakness in the existing Framework Law, or in the willingness of courts to enforce these requirements.

Implementing Institutions
Poland's Implementing Institutions for Bankruptcy are specialized commercial courts at the *voivodship* level. Since 1992, the bankruptcy courts have been processing approximately 2,400-2,700 cases each year. Although official statistics show that bankruptcy cases are pending an average of 14. 5 months in 1997, the actual average pendency is reported to be between 18 and 36 months, depending on the size, complexity, and number of claims made against the bankrupt.

BANKRUPTCY CASES Number of cases filed		
	1996	**1997**
Total in Poland	2,710	2,368
In Warsaw only	611	378

Source: Statistical Data form the Ministry of Justice, Warsaw, 1998, p. 631

BANKRUPTCY CASES Case duration (in months)		
	1996	**1997**
Total in Poland	12.3	14.5
In Warsaw only	4.3	6.2

Source: Statistical Data from the Ministry of Justice, Warsaw, 1998, p. 613

Poland's bankruptcy judges received training on various aspects of bankruptcy law, practice, and case administration under USAID-funded and EU Phare technical assistance initiatives. Like other non-specialized judges in the commercial courts of general jurisdiction, bankruptcy courts are plagued by resource constraints, inadequate staffing, unevenness in the quality of court personnel, and inefficient court management systems. Despite this, from a cross-regional comparative standpoint, Poland's bankruptcy courts do appear to be fulfilling a significant portion of their organizational mandate. This conclusion is reflected in part by the Tier II diagnostic result of 80% for this Dimension.

From an operational standpoint, the courts are established and operating regularly [90%];[14] their mandate is clearly defined in terms of their responsibilities in implementing the Framework Law [90%]; and a general consensus seems to within government about the Implementing Institution's basic functions and role [80%]. Similarly, within the bankruptcy courts themselves, and the wider legal community, there seems to be broad agreement concerning the basic role and functions of the bankruptcy courts [80%].

In terms of institutional mandate and authority, we found that the Ministry of Justice clearly has the authority to administer (if not adequately fund) the bankruptcy courts; that bankruptcy courts had received donor-funded technical or financial assistance in the previous year [100%]; and, that judicial training programs have been conducted [80%].

Poland's bankruptcy courts were found to be generally accessible to End-Users, and copies of relevant laws and regulations were relatively easy to obtain [80%]. Bankruptcy courts were found to collect data or information relevant to their operations, however these data were only available through the Ministry of Justice, and somewhat more difficult to obtain [80%]. Bankruptcy courts were viewed by End-Users interviewed during the assessment as doing a

[14] Tier III results are included in brackets where relevant.

relatively good job of disseminating information (through the Ministry of Justice) on pertinent legal or operational developments.

Supporting Institutions
Poland's Tier II result for Bankruptcy's Supporting Institutions Dimension is 76%. In terms of specific Tier III results, court-based enforcement mechanisms were judged reasonably accessible by End-Users [80%]. The court's enforcement agents (e.g., bailiff) authority to execute judgments against debtor estate property is perceived by End-Users as somewhat adequate [70%], however problems concerning priority of claims, obscure this metric. The supply of notaries is viewed as sufficient to meet end user demand [80%] and notarial fees are not viewed as an impediment to registering security interests [70%]. The bankruptcy fee structure does not encourage misuse of bankruptcy system for ordinary debt collection [70%] and recourse to extra-legal enforcement mechanisms (e.g., organized crime) are not generally utilized [90%]. Finally, we found that businesses (e.g., trustees, services in bankruptcy recordation and central filing, collateral instrument document filing, document retrieval, lien tracking, investigative services, law firms, consulting firms) are facilitating use of bankruptcy law system [80%].

"Market" for Bankruptcy Reform
In comparative terms, the Market for Bankruptcy reform in Poland is strong, and many of the basic macro-level reforms needed for the system function have been implemented. Large scale privatization has been carried out; a stable macroeconomic policy has been implemented; Poland has a freely convertible currency; successive Governments have adhered to a broad policy of promoting private sector development; measures have been taken to limit corruption; and EU accession remains a cornerstone objective of Poland's foreign policy agenda. In short, the general policy and economic framework for modern commercial activity are in place.

On the "supply" side of the market equation, we found that an annual legislative reform agenda was published, and that additional reforms in this area were included on it. Based on interviews with the business community, responsible government bodies, and other stakeholders, we found that they are generally afforded notice of draft laws before they are submitted to legislature for a vote. In this respect, business and professional associations, banks, consumers groups, small business advocacy groups, and academics were found to be providing input to policymakers on how Poland's bankruptcy system can be improved. In this respect, we found that in addition to notice, stakeholders were generally given a meaningful opportunity to provide comment on pending legislative changes. We did find that the lower the rulemaking authority resided, the less likely it was that those directly affected would be provided notice and an opportunity to comment. Hence, in our view, while the supply of policies for bankruptcy is quite good on a macro-level, there is clearly a good deal of work that could be done to strengthen the process by which implementing regulations are developed, interpreted and enforced. We found that copies of the Bankruptcy Law were readily available in academic bookstores in Warsaw. Copies of regulations, instructions, application forms and similar subsidiary instruments were harder to come by, but were available through the courts. However, our sample size was not large enough to provide any reliable basis for judging how widely such information was made available, particularly outside Warsaw.

As discussed in the preceding sections, we found that the order of priority established in the Framework Law creates a significant disincentive for End-Users to actually use the bankruptcy system. In this respect, the End-Users we interviewed generally did not feel that the services provided by the state in this regard were adequate to their needs. Delays of up to thirty-two months, and the lack of certainty about the possibility for recovery, were most often cited as areas that needed reform. Additionally, the lack of clearly defined rules and procedures governing trustees was cited as a weakness in the current system. Additionally, it was reported that the threat of bankruptcy proceedings was frequently used by creditors as a means of collecting overdue obligations. The threat of liquidation is therefore being used by creditors as a means for forcing workouts.

From the perspective of End-User demand, we found that business managers, lawyers, law professors, judges, and others we interviewed during the in-country diagnostic generally felt that they had a meaningful role to play in shaping policy reform in the subject matter area. We found that End-Users are participating in the formulation of policy relating to bankruptcy, by providing direct, substantive input (e.g., draft laws, comments on regulations, suggested amendments, etc.). In this respect, End-Users actively lobby the Government for policy or institutional reforms when necessary. We also found that End-Users are represented by various non-governmental membership organizations, in particular the National Chamber of Commerce, the Supreme Bar Council, and others.

The principal complaint lodged against the bankruptcy courts by End-Users was the delay in obtaining an adjudication of claims. In particular, the role, qualifications, and financial incentives of the trustee under the current systems were identified as sore spots. The qualifications of bankruptcy judges were not called into question during our interviews, however, the general administration of courts was frequently cited as a area of End-User dissatisfaction. Supporting institutions for bankruptcy, particularly private law firms, accountancy firms, notaries, and bailiffs, were generally viewed by End-Users as satisfactory in meeting their needs with regard to the bankruptcy system.

Legal environment for Bankruptcy was viewed by End-Users as reasonably stable, and predictable, with less that one major legislative revision per year on average. We did not receive any reports of corruption or favoritism in the administration of the bankruptcy system, however it did appear that judges are generally reluctant to use the full extent of their coercive powers in implementing the Framework Law.

Our overall indicator result of 78% for this dimension of Bankruptcy clearly indicates that the basic Market mechanisms are in place and functioning. We expect that over time these patterns of behavior will strengthen, and that improvement in the areas of subsidiary regulatory instruments would be an area where progress would be both welcome and useful.

C. Collateral

1. Overview

Collateral law is intended to facilitate commerce by standardizing transactions and fostering predictability and simplicity in them. More specifically, secured transactions are intended to structure the dealings of debtor and creditor so as to preserve the rights of some creditors against the rights of others. Standardization is intended to assure familiarity and thus encourage commercial transactions.

The ability to use security interests in movable property to support the extension of credit is essential for a market economy. Commerce and industry need inexpensive capital to thrive, and lending that is secured by a pledge represents one of the most economical means of procuring financing because it significantly *reduces* the creditor's risk. Secured lending goes beyond the borrower's contractual agreement to repay since it provides a second source of payment. In fact, a legal system that assures the lender that it can maintain a secured interest is just as essential as a system of contract law.

2. Diagnostic Findings

Legal Framework
USAID support of collateral law development in Poland has been both extensive and effective. This activity, initiated in September 1992, concentrated on developing a domestic consensus in support of a draft law on Collateral. This effort was led by the Commission for Reform of the Civil Code, and supported by the Ministry of Justice, the National Bank of Poland and the Union of Polish Banks. A distinguishing feature of this effort was the extent to which Polish (as opposed to expatriate) experts were utilized in defining the scope and direction of the reform effort.

In Poland, as in other countries, there are two general types of rights used to secure credit provided to a debtor: real and personal security rights. Personal security rights are attached to the debtor as an individual and entitle the creditor to enforce his rights against the entire assets of the debtor. The disposal or loss of assets by the debtor results in impossibility of turning claims against other person. The most commonly used are personal guaranties (*poreczenie*), bank guaranties (*gwarancja bankowa*) and promissory notes.

The Polish Civil Code of 1964 provides for a third party to guarantee personally the performance of a debtor's obligation towards a creditor. In such case the guarantor enters into a written agreement with the creditor in which the guarantor obliges himself to perform the obligation of the debtor in the event that the debtor fails to do so. A guarantor may likewise agree to guarantee a future debt, in which case the agreement must specify the amount of the guarantee. Where a guarantee for a future debt is given for an indefinite period of time, it may be revoked at any time before the debt comes into existence. The scope of the obligation of a guarantor is determined by

the scope of the obligation of the debtor, though a debtor may not increase the scope of a guarantor's obligation through a legal transaction between the debtor and the creditor. Unless otherwise stipulated, a guarantor and a debtor are jointly are severally liable towards the creditor. Although a creditor must notify the guarantor in the event that the debtor fails to perform his obligation, the creditor does not have to demand payment by the debtor before demanding payment by the guarantor. If the guarantor satisfies the creditor, the guarantor then acquires the claim of the creditor against the debtor up to the amount paid.

Bank guarantees are not regulated by the Civil Code. However, bank guarantees have been defined in the Banking Law (currently - of July 21, 1997) and in the ordinance of the President of the National Bank of Poland. According to the law, a bank may undertake to perform the obligation in the event that the debtor fails to perform such obligation towards the creditor. The parties must define the duration of the guarantee and any restrictions concerning the transfer of the guarantor's obligation. The agreement establishing a bank guarantee must be in writing. A bank's obligation under a bank guarantee may only be transferred together with a transfer of the debtor's obligation being secured by the bank guarantee. The feature that distinguishes a bank guarantee from a civil law guarantee is that a bank's liability is independent from the obligation of the debtor. It is therefore not possible for the bank to raise any defense to the claim which the debtor might have.

Promissory notes may be issued by a debtor, a third person (guarantor), or both. The promissory notes used most commonly for the purpose of securing a credit are "in blanco" and bear only the signature of the debtor or guarantor. Along with a promissory note, the debtor or guarantor usually signs a so-called 'promissory note declaration' in which the promisor authorizes the creditor to fill in the amount corresponding to the amount of outstanding principal and interest. This procedure is quicker and simpler than ordinary court proceedings.

Real security rights are attached to certain objects, and the liability connected with the right is limited to the value of the object in question. Real security rights are only effective against the owner of the objects, and upon transfer of the ownership of the assets any real security rights are in principle transferred as well. The real security rights available under Polish law include real estate mortgage and various types of pledge.

Both pledges and mortgage may be employed to secure the debts of the owner of the object to be encumbered or the debts of a third person. Pledge may secure any performance of any obligation, while mortgage and registered pledge may only be established to secure possessory pecuniary obligations. The express differentiation between a pledge as a right that may be established on a movable assets or transferable rights, and a mortgage that may be established on real property is a characteristic of the Polish law. The only transferable right on which a pledge may not be established is a mortgage claim (Art.107-109 of the Act on Land and Mortgage Register and Mortgages).

A real estate mortgage may be established on real property, the right of perpetual usufruct of land (a kind of quasi-ownership, or 99-year lease), certain cooperative rights, as well as on a claim secured by a mortgage (*subintabulat*). The concept of a mortgage in the Polish law derives its

roots in the Roman *hypotheca*. It does not transfer the title to the property but creates an encumbrance (real right) effective against any person. Granting a mortgage to one party does not prevent the title holder from further encumbering the property, or to transfer ownership to a third party, provided this is not done to defraud creditors. Mortgage under Polish law is a legal interest in a particular parcel of real property used to secure payment of a debt. Therefore, in the process of establishing a mortgage there has to exist a principal monetary obligation to which the mortgage accedes. The repayment of the monetary obligation extinguishes the mortgage.

The following three steps are required to create a mortgage under Polish law:

1. Both mortgagor and the mortgagee have to enter into a bilateral contract;
2. The mortgagor has to make a motion for entry of the mortgage in the land register; and,
3. The appropriate court has to enter the mortgage in the land register.

Pursuant to the theory of the so-called "constitutive entry" mortgage is created at the moment of actual making the entry by the court in the respective mortgage book.

Land registers are open to public inquiry. As the rule of public faith of the land register, all the data in the public register are believed to be correct and true. Thus, a good faith purchaser is protected against any claims by a third party. In spite of increasing numbers of transactions in Poland, the process of mortgage creation works well. Most delays are encountered in Warsaw due to a large volume of transactions.

Enforcement (foreclosure) under the real estate mortgage involves three distinct phases and the process is rather lengthy. A mortgagee must first obtain an executory title (*tytul egzekucyjny),* which is a civil court judgment against the mortgagor. The mortgagee then has to apply for an enforcement title (*tytul wykonawczy*) which entails the court placing a seal, called an enforcement clause (*klauzula wykonalnosci*), upon the executory title and the judge signing it. The enforcement title is an official court document signed and sealed by a judge. The execution order is then forwarded to the court's execution officer, a bailiff (*komornik*) with the instruction to make a final demand for payment and, thereafter, to execute the judgment against it.

If the mortgagor fails to pay the obligation within two weeks, the bailiff will hire a court approved expert to prepare a description and an appraisal of the real estate. Both the description and the appraisal are subject to legal challenge by the mortgagor. If the mortgagor fails in these challenges, the property is offered for sale at the public auction.

Security interest on the personal property ("movables" and rights) are commonly called pledges. Under current Polish law pledges are regulated by the provisions of the Civil Code of 1964, the Law on registered pledges and the registry of pledges of 1996, maritime code of 1962, and other laws. Despite the name, only some of pledges provide for the transfer of possession of collateral: so-called "possessory pledges", the other form is referred to as a "non-possessory pledge" or "registered pledge" that resembles English legal concepts of fixed and floating charges that do not require actual transfer of the collateral to the creditor. Under Polish law, therefore, proper registration of a security interest is an acceptable substitute for possession.

Polish law regarding possessory pledge is contained in articles 306-335 of the Civil Code. Article 306 states that a pledge is a property right on a movable asset or transferable right which is security on a given claim. The creditor may vindicate satisfaction of his claim from pledged asset or right irrespective of whose property is has become and with priority over other debtors' personal creditors with the exception of those who by law have a particular priority. The Civil Code describes two types of contractual pledge: the pledge on movable assets (Arts. 306-) and the pledge on rights (Arts. 328-335).

In the Civil Code we also find further distinctions relating to the pledge on movable assets. The provisions contemplate an ordinary pledge, usually called a "possessory pledge" which may be established by an agreement between the creditor and the owner of the asset and transfer of possession of the pledged asset to the creditor or a third party.

A possessory pledge may be established on movable, tangible objects. In order to establish a pledge, a creditor and an owner must enter into an agreement and the encumbered object must be delivered to the creditor or third party. This requirement renders the institution of pledge on movable objects under Polish law impractical for securing business transactions. However, an exception to the rule that the pledged object must be delivered to the creditor or third party is provided by the Civil Code in the case of banks, which are permitted to establish a non-possessory pledge. Transferable rights may also be the object of a pledge. To establish a pledge, an agreement must be concluded in written form and a certified date must be placed thereupon by a notary. The sole exception to the rule that a pledge on movables may be established only where the movables are delivered to the creditor or a third party is in connection with the securing of a bank credit. A bank may establish a lien over a movable property of a debtor without taking physical possession of the movables.

The rights of a creditor in the pledged shares are in general the same as in other objects encumbered by pledge. However, Polish company law is governed by the Commercial Code, which does contain certain modifications. The shares of either a limited liability company (Spolka zoo), or a joint stock company (*spolka akcyjna*) may be pledged. In the case of limited liability company, restrictions may be contained in the deed of association as to the shareholders' rights to pledge their shares in the company or conditioning any pledge upon the consent of the company. The Commercial Code does not contain provisions regarding the limitation of the right to pledge shares in joint stock companies. Shares in limited liability companies are registered shares which are not incorporated in any kind of document. The establishment of a pledge must be made in written form. The pledges become effective as against the company only from the moment that the company receives notice from the interested party. Joint stock companies may issue both registered and bearer shares. The parties must enter into a written agreement and shares must be handed to the creditor or a third party during the process of establishing a pledge.

The new form of security interest, adopted fairly recently and very promising to the business community in Poland is the registered pledge. The law on the Registered Pledge and the Pledge Registry was enacted in December 1996 and became effective in January 1998.

Collateral under the registered pledge law may include any transferable movable or property right, including property acquired in the future and proceeds from the disposition of the collateral. The exception is seagoing vessels. The law is neither exhaustive nor specific on this point, so generic descriptions of collateral are possible. With regard to priority, Poland's system is based on a "first in time" order of priority determined by the date and time the secured interest is registered.

The number of changes in the Code of Civil Procedure and the Civil Code strengthen the position on a secured creditor upon a debtor's default. The new law on non-possessory pledges allows parties to a secured transaction to contractually determine the terms upon which recovery will be made against the collateral in the event of default. This is an important departure from the earlier law which required court execution proceedings and did not allow the parties to dispose of this requirement by contract. In case of non-possessory interests in movables, transfer of ownership becomes effective upon a notice to the debtor given after a fourteen-day period expires. In the case of non-possesory pledges on transferable rights and real property mortgages, the transfer becomes effective upon giving notice to the courts administrating the appropriate land or pledge registers.

In cases when the debtor cooperates with the secured party, the enforcement of the pledge or mortgage proceeds without any need for judicial intervention. The secured party, having obtained ownership and possession is entitled to keep the Collateral as the owner or to dispose of it at will. The secured party, having obtained ownership and possession, is entitled to keep the collateral as the owner.

In cases when the debtor is not cooperative and unwilling to turn over possession of the collateral to the creditor, the latter can ask for the assistance of a court execution officer (i.e., bailiff). An enforcement title is prepared by the court execution officer and signed by the judge. An agreement in the form of a notary deed qualifies as an executory title. It serves as a substitute for a civil court judgment against the debtor.

In addition to Civil Code execution procedures, the Polish law contains effective and practical choices for extra-judicial enforcement of a creditor's rights. The parties have some leeway as to how enforcement will occur based on the possibilities stated in the law, while the law specifies the exact procedures. The creditor's options are: 1) acceptance of the collateral, 2) public sale by a notary or a court pursuant to court procedures, and, 3) for banks - "the protection procedure." In the context of a pledged enterprise, satisfaction can be by collection of profits or by lease payments. The creditor may also request that the collateral be attached if the creditor has reason to believe that the debtor will default or damage the collateral.

There is no principle under Polish law which provides for classes of creditors in both the Civil Procedure Code and the Bankruptcy Act. Also, the Tax Code provides that any amounts due to the State Treasury are automatically secured by a statutory lien on all of the movable property and amounts provided in decisions of tax authorities are secured by a statutory mortgage on all of the immovable property of the taxpayer. Such mortgage and pledge are granted priority over

those of all other creditors. Article 1025 of the Polish Civil Procedure Code governs the priority in which claims will be satisfied in the event of the execution of a court judgment against a debtor. For example, in the event of the enforcement of a mortgage or pledge, Article 1025 provides that claims are satisfied in the following order:

1. Costs of the executory proceedings;
2. Wages, family maintenance, indemnities;
3. Taxes;
4. Payments due to the State Treasury connected with the perpetual usufruct of parcels of state land and payments due for the use of state buildings;
5. Repayments of bank credits;
6. Secured creditors, if the security was established prior to the commencement of executory proceedings; and,
7. Other payments.

Implementing Institutions
Poland has developed one of the best collateral registration systems in Central and Eastern Europe. The establishment of the collateral registry is considered adequate by the practicing professionals. This success demonstrates that the system is compatible with the Polish legal tradition and the existing Civil Code. Even so, the system has its problems, complexity being one of them. Certainly the implementation arrangements can be improved and simplified.

The Collateral registry in Poland is located in specialized courts, of which there are six throughout the country, and managed by the Ministry of Justice. All six registries are linked electronically with the central registry; entries made in each are reflected in the central registry within one business day. Room for abuse is minimal and no such cases have been recorded so far.

Judges, transferred from other divisions of the courts, supervise all entries. They do not, however, have previous experience and are trained by local trainers.

Registration is not automatic. Instead, the judge in charge has three days to examine the case in closed session. The court may refuse the registration not only if the formal requirements of the application are not met, but also if the court finds that the underlying contract is contrary to the requirements of the law. This arrangement reflects several policy considerations:

1. Company and commercial registers in Poland have been traditionally located in the courts. As in most European jurisdictions, the registration process in Poland is based on the premise that the state has a role in guaranteeing the quality of the data in the registry by verifying it before registration.
2. The Ministry of Justice views the registries as a potential source of income. All registration fees are transferred to the Ministry and it is expected that in the future the fees will increase beyond the operation cost of the registry.
3. At the time the registry was established, it was assumed that most practicing attorneys would not be familiar with the system and will not be prepared to properly handle the

registration documents. The system was, therefore, designed to rely on the ability of the judges in charge to correct all possible errors.

The current organization of the Collateral registry presents two significant problem: first, judges are involved in non-core activities; and, second, over - reliance on the entries in the registry.

Judges in non-core activities. The judiciary by definition is an institution designed to resolve arguments and dispense justice, not to review documents in the absence of a conflict. In the case of the commercial registry the judges are asked to review documents and to decide whether they are correct or not. At this point, there is no argument between the parties, who have already agreed to enter a particular transaction and to submit the documents for registration. Yet an argument may result between the parties and the judge if the registration court decides not to register the transaction. Such decisions may be appealed in the district court of the same level. To date, there is no body of judicial rulings in registration cases that can provide guidance to courts in implementing and enforcing the Framework Law's requirements.. In the opinion of practicing attorneys, those professionals involved in the process (bank officers, credit users and lawyers) have adjusted their practices to the requirements of the registration courts, rather than trying to resolve the disputes in the appeal process, which is costly and time consuming. As a result, judges have the power, though not the right, to amend the requirements of the law governing registration.

Over-reliance on the entries in the registry. The Collateral registry is fairly similar in functions and organization to the notarial registries, which is typical for most of the European jurisdictions. The data in the Collateral registry are deemed absolutely reliable and are covered by the revocable presumption of correctness. The registration documents are not merely a confirmation of a statement of the parties, but rather an absolute proof of the existence of certain facts. Because of the implied state guarantee for the correctness of the facts, the system of Collateral registration requires rigid examination of all facts stated by the parties. A diligent and prudent lender would have been expected to verify all the facts prior to providing a loan, and this is the situation in most cases in Poland. Yet the same re-examination of the facts, based on the same set of documents and statements, is carried one more time by the court of Collateral registration. This makes the process slower, more costly and less efficient. Ultimately, in case of defaults, it does not provide better protection for the parties.

In any case, the establishment of an operational Collateral registration system is a major achievement and an excellent example of the potential adaptability of common law concepts to the Continental legal system, especially when the local traditions and experience are taken into account.

Supporting Institutions

After the beginning of the political and economic liberalization that began in the late 1980s, the banking sector in Poland changed dramatically. Not only was the state monopoly over banks terminated, but also banks began offering a wide range of new services that had not previously been available or were very limited in the socialized economy. As a result, banks became exposed to new risks. At the same time, some of the privileges granted to banks in the former

centralized economy were removed. It was not possible to maintain them for the state banks only yet the government considered the regulations to be too favorable for the banks and could not extend them to the private sector as well.

The new situation in the Market demanded that the banks form an organization protecting their interests. The banks needed a forum for exchange of information and experience. In 1990 the Union of Polish Banks was formed in accordance with the regulations of the law on Chambers of Commerce.[15] The Union plays an important role as a Supporting Institution in the areas of Contract law, particularly in Collateral transactions. The Union provides training for loan officers and exchange of information between members on related issues, including increased credit risks. It promotes the funding opportunities existing in the banking sector and is active in the development of banking infrastructure and standardized bank products and services. This helps reduce the transaction costs and makes loans more affordable for the business community. The Union was very actively involved in the preparation of the new Collateral legislation[16] and provides experts in related cases before the courts. It has an important role in conciliatory procedures involving banks and may assist the courts when necessary in case of bank insolvency (no such cases have been recorded so far). The work of the Union is central in the effort to provide better access to the public to affordable credit, while increasing the guarantees provided to the banks through a well operating Collateral registration system.

The favorable investment climate and the stable macroeconomic conditions in Poland prompted the establishment of other commercial institutions with important support role. Poland has an active exchange for commercial paper, which is a clearinghouse where bonds, bills of lading and other negotiable documents can be discounted to specialized brokers.

The Union of Banks was instrumental in the establishment of the Bureau for Credit Information, a commercial agency affiliated with the Central European Center for Rating and Analysis, which is involved in the preparation of credit ratings and provides critical information on creditworthiness of potential borrowers. Such services were non – existing in centrally planned economies and their availability is vital for the core activities of the commercial banks.

Unlike most of the reforming economies Poland developed also institutions which serve to protect bank consumers. This increases the confidence of the borrowers and credibility of the banking sector. At the end this gives better business opportunities to the banks and better access to services to the clients.[17]

After almost ten years of economic reforms Poland has a full range of developed support institutions, including self–governing non–profit entities and commercial organizations providing services to the banking sector.

"Market" for Collateral Law Reform

The Market for Collateral is perhaps one of the most interesting of the seven subject matter areas examined in this study. In subject matter areas like Bankruptcy and International Trade, there are

[15] Law on the Chambers of Commerce, dated May 30, 1989
[16] Law on Registered Collateral and Collateral Registries, dated December 19, 1996
[17] Please see the discussion in the Contracts section.

very often clearly identifiable "winners" and "losers" who, depending upon their interests, line up either for or against change in the status quo. For Collateral, this does not seem to be the case. Lenders and borrowers both benefit when a quick, cost-effective, and reliable means of securing debt is available. The regulatory burden, in terms of the cost of establishing a registry system and overseeing its use is, in comparative terms, relatively insignificant when compared to the cost of administering a country's trade regime. Finally, an effective system of securing debt against a variety of assets also liberates capital in the form of domestic savings. This effectively expands the amount of capital available, and implies a potential welfare gain to the economy as a whole. In such "win - win" scenarios, one would expect that reform would be easily achievable.

Supply - A specialized administrative body, the Ministry of Justice's Committee on De-bureaucratization has been established to review existing or proposed laws and regulations with the aim of reducing the regulatory burden on End-Users [80%]. Legal and regulatory environment for subject matter area is perceived by End-Users as being somewhat stable, largely because the legal and institutional regime for Collateral is new [60%]. According to those interviewed, there is a perception that conflicting laws and regulations do reduce End-Users' ability to use the Collateral system with confidence [50%].

Those within the business community that were interviewed during the in-country diagnostic generally felt that the new Collateral system was adequate to meet their needs [90%]. USAID- and Norwegian-funded technical support played a critical role in helping Poland shape its Framework Law and establish the registry system. It is not clear to what extent, therefore, that this reform can be seen as being driven by wholly "endogenous" demand, or a combination of "exogenous" (i.e., donor) and endogenous demand. In any event, the technical assistance that was provided by USAID was generally seen by those interviewed as being highly relevant and useful. In this regard, a great deal of emphasis was placed on identifying and including key stakeholders in the development process from the earliest stages [70%].

Demand - End-User participation in the design and implementation of the Collateral reform agenda appears to have been a key both to its ultimate success, and the general level of support the reform seems to enjoy from the business community [80%]. Satisfaction with the current legal and institutional regime was high within the group interviewed during the diagnostic assessment [80%]. There seemed to be no major issues concerning the stability, predictability, or transparency of the Collateral system [70% - 80%] and there seems to be a consensus among those interviewed that the system put in place was responsive to End-User needs [90%].

Poland's "Market" for Collateral is still forming. However, it is expected that within a period of a few years, the practice of securing debt against moveable property will be increasingly integrated into Poland's commercial life. The development of this reform seems to have been driven as much by endogenous as exogenous demand. Nevertheless, the importance of donor assistance in this case should not be underestimated. An overall indicator result of 75% for this Dimension suggests strong fundamentals, with room for further development as the practice of securing debt against moveable property becomes more widely understood and accepted as a routine commercial practice in Poland.

D. Company

1. Overview

Company law plays a key role in market economies as it establishes guidelines for the internal organization of private companies and for corporate governance. Along with securities legislation, company law tries to protect outside investors and the public by specifying minimum requirements for capital and for the publication of information about the company. It also aims to encourage entrepreneurship by setting limits on the liability of investors. In this sense, it is the bedrock of the commercial system.

It is well established that for-profit enterprise development (e.g., partnerships, corporations, sole proprietorships, etc.) cannot flourish without active governance mechanisms that help assure stability, predictability, and transparency in the rules that govern how firms are created and operate in the market. If for example, the rights of shareholders are not defined, or enforced, can a market-based privatization on a national scale succeed? Experience in the region with various experiments in privatization is mixed, and a debate continues on what worked and what did not. In one sense, this is a classic "chicken or the egg" argument, where the need for sound governance mechanisms arises (in theory) after privatization, yet privatization itself requires a mechanism through which to operate. Did the existence, or non-existence, of sound corporate governance mechanisms in some countries help, or hinder, the transformation to the market?

2. Diagnostic Findings

Legal Framework
Company formation in Poland is regulated by the Commercial Code[18], which recognizes several company forms, common to the Continental legal tradition: the general partnership, the limited partnership, the Limited Liability Company and the Joint – Stock company.

General Partnership - The general partnership in Poland is called “registered partnership” and is defined as partnership, operating for profit in the joint name of the partners and which does not constitute any other form of a commercial company. It has several important features, which are designed to identify this kind of entity as a commercial operation. It has to be registered in the Commercial Register. The partnership deed needs to be made in writing. Alterations of the partnership deed require the agreement of all partners, independently of their share in the venture. Most importantly, the provisions of the general law on obligations do not apply to this partnership. The partnership is treated for all practical purposes as an entity separated and distinct from the partners, it can acquire rights and assume obligations, may sue and be sued. The property, brought in by the partners, as well as the property acquired during the existence of

18 The most precise reference is to the “provisions of the former Commercial Code, as maintained in force by the introductory act to the Civil Code “ The Commercial Code in Poland was repealed in 1964, and only parts of the provisions relevant to company formation remained in force. The legislator considered the integrity of the Code compromised and opted for a definition reflecting this development.

the entity, constitutes the estate of the partnership. There is no minimal capital requirement for the partnership. All partners are liable to the creditors of the partnership with their entire property, jointly and severally.

The general partnership is designed as a business entity with close relations between the partners, and with the possible minimum of formal and predetermined legal requirements as to the way the partnership is managed. While it is a flexible and simple form for small enterprises, the unlimited liability of all partners makes it somewhat inconvenient for larger undertakings.

Limited Partnership - The limited partnership is defined as a commercial entity (operated for profit), under a joint business name, where at least on partner holds unlimited liability for the operations of the business, and at least one partner has limited liability (limited to the initial contribution made by this partner and any subsequent increases, which may be agreed between the partners). The amount of such liability is expressed in cash and reflected in the registration deed for the partnership. Unless specific regulations exist for the limited partnership, all regulations for the registered (general) partnership are applicable.

The limited partners have no right or obligation to manage the affairs of the partnership, unless otherwise provided by the partnership deed, but their consent is required for all acts, exceeding the scope of ordinary activities of the business. This business form is rarely used in Poland.

Limited Liability Company - The Limited Liability Company is commercial enterprise (formed for economic purposes – to derive profits), by one or more persons, unless otherwise provided by the law and having legal personality. It resembles closely the German GmbH, the French S.A.R.L. and is roughly the equivalent of the Anglo – American closely held corporation or private company. The sole shareholder in a limited liability company cannot be another limited liability company consisting of one shareholder. The capital of the company is divided into shares of equal or different values. If a shareholder (or partner) has more then one share, all shares should be equal in value and indivisible. The minimal capital requirement for limited liability partnership is PLZ4,000 (about $1,800 USD).

The shareholders (partners) are not liable for the obligations of the company and have no obligation to participate in the management. The capital of the company may be formed by cash and non-cash contributions. Cash contributions must be made prior to the registration. Non-cash contributions must be committed and a declaration made by the management of the company that such contributions will be transferred to the company upon registration. Prior to the registration all persons, who acted on behalf of the company, bear joint and several liability.

All shares (parts) of the capital are registered and cannot be represented by negotiable documents. While all stated contributions must be made at the time of incorporation, the deeds of the company may require the shareholders to make additional contributions to the capital, in proportion to their shares.

The shares in limited liability companies are transferable, but the transfer or pledge over the share of the company may be conditional on the agreement of the company. Unlike in some

other jurisdictions, in Poland such permission is given by the management board of the company. Even if the Board of the company refuses the permission, the court of registration may permit the transfer for important reasons. In such situation the board of the company may present a new buyer. If the proposed price, or the price, approved by the court (absent an agreement between the shareholders), is not paid within the time limit fixed by the court, the shareholder is free to dispose with the share.[19]

While the management provisions, related to the Limited Liability Company are more relaxed in comparison to those for the Joint Stock Company (JSC), there are several important legal requirements:

- Tenure of office for the members of the board expires at the date of the general meeting of the shareholders held to approve the annual report and balance of the company;

- Limitations upon the rights of members of the board to represent the company have no legal effect with respect to third parties;

- All correspondence of the company shall contain the name, address, registration number and court of registration of the company, the names of the board of management and the initial capital of the company; and,

- Members of the board may not be involved in competing business, unless specifically authorized by the company to do so.

Unlike other jurisdictions, the number of shareholders/partners in the Limited Liability Company in Poland is not restricted by the law, but special, more stringent provisions are applicable for companies with more than 50 shareholders or with capital larger than PLZ25,000 (approximately $7,032 USD).

The law provides considerable autonomy for the shareholders/partners to establish the rules for company management, but in the same time has a comprehensive set of alternative provisions, applicable in cases in which the Articles of Incorporation have not provided solutions. The Limited Liability company is by far the most popular company form in Poland.

Joint Stock Company - The Joint stock company (similar to the German *Aktiengeselschaft* or the French *societe anonyme* and to the Anglo–American public corporation) is a company, the capital of which is divided into shares of equal value. In some cases (utility companies, other companies of national importance, banking enterprises), the Minister of Industry and Trade, or the Minister of Finance must approve the Articles of Association of the company. The JSC company is designed as a large corporate form, geared to attract substantive amount of capital from people with little or no interest in the day–to-day management of the company. Therefore it

[19] The restrictions on transfers of shares reflect the idea that the partners/ shareholders of the Limited Liability Company are selected based not only on the capital contribution, but also on some personal qualities. Thus, the Limited Liability Company is often referred as “company of persons” as opposed to the “company of capital” – the JSC.

has some substantial differences from the Limited Liability Company. The capital of the JSC may be raised through public offer. It may consist of registered and bearer shares, and of different classes of shares. Registered shares may be exchanged for bearer's shares without restrictions (unless the law or the Articles of the company provide otherwise). The transfer of registered shares may be subject to permission by the company, but if permission is not granted, the company must name a transferee. The Articles of association shall provide the terms of fixing and paying the price and the time limits for that. In the absence of such provisions registered shares may be transferred without restrictions. Bearer's shares can be transferred without restrictions and may be issued only upon full payment. Registered shares may be issued prior to the making of full payment, the shareholder being liable for the rest to the company or to the creditors in case of liquidation. All shares, issued in exchange for non–cash contributions are registered until the general meeting of the shareholders approves the financial report for the second year of operation.

The management provisions for JSCs are much more detailed and reflect the fact that most of the shareholders are not able and willing to participate in the management. Besides, the large number of shareholders makes it difficult to secure their meaningful participation except in the election of the officers of the company and the approval of most general policy issues and financial statements.

The Polish management system permits the establishment of one– or two-tier management structures. Under the first, the company has a management board, which is responsible for the day–to-day management of the company affairs, and an auditing board, responsible for the auditing of the financial situation of the company. Alternatively, instead of an auditing board, the company may have a supervisory board, with broader authority to supervise all activities of the enterprise, including the right to suspend members of the management board. Larger companies with capital over PLZ 500,000 ($140,647 USD) must have a supervisory board, but may also have an accounting board.

The Polish company law provides adequate protection for minorities shareholders and mandates their representation in the management. It allows cumulative voting and partial renewal of the accounting board or the supervisory board at different times, as it may be provided by the Articles of association. The law regulates the transformation of companies from Limited Liability to Joint – stock and vice versa, and provides effective protection of the rights of third parties. The basic principle in such transformations is that third parties should not be affected adversely by it.

The Polish JSC is adequately designed as a major enterprise, the shares of which are traded at a capital Market and which serves as investment vehicle for large number of shareholders.

Implementing Institutions
Polish business entities are registered by the relevant district (*voivodship*) court. The registration procedure includes review of the Articles of association or other documents, establishing the company or the partnership, in a close session of the court.

The formation and registration of the two most popular business forms - the LLC and JSC - are accomplished as follows:

1. Execution of the Deed of Formation and the Charter of the company (JSC only). Those documents are roughly the equivalents of the Articles of Association and serve the same purpose – to establish the future entity, to specify the rights and obligations of the shareholders and the way in which the company will operate. They must be executed as notarial deeds. The notarial fees and stamp duties are in proportion to the proposed capital of the company.
2. Company registration in the court. The registration takes place in the Economic Court in the place of formation of the company. The company acquires legal personality upon being entered into the commercial register. Joint – stock companies must raise their capital prior to the registration and in some cases obtain the relevant permissions from the Securities Commission (when raising the capital through initial public offering).
3. Publication of the company registration in the Court and Economic Monitor (*Monitor Sadowy i Gospodarczy*).
4. Assigning of the statistical number for the company and registration of the company with the social security establishment and the tax authorities.

In some cases licenses may be required, if the company is involved in special activities for which permits or concessions are required. The licenses are given on non-discriminatory basis and a list of the areas for which they are needed is available.

Registration cost consists of notary fees and stamp duties. For the two company forms it is usually around $800, but may be as high as $2,500, if the company is being registered with large capital.[20] The costs are high by U.S. standards. All notary fees are subject to 22% VAT. Registration of partnerships is also subject to notary fees and stamp duties, but those are not related to the amount of capital contributed to the partnerships.

The chief deficiency found in this Dimension was an overly bureaucratic and formalistic approach to regulating the corporate form. Generally speaking, the registration of a company is a relatively simple matter, however, several practicing lawyers interviewed noted that interpretations of what formalities are required can vary significantly from one court to another. A corporate charter, for example, can be rejected on highly technical grounds leading to delays of up to several months. In addition, relatively minor changes in ownership or management structure required judicial intervention. From an efficiency standpoint, this was viewed as a largely unnecessary but inevitable "cost" of doing business.

The basic administrative efficiency of Poland's commercial courts is also an issue. To a large extent, as discussed elsewhere in this study, Poland's administrative management systems - especially in the courts of first instance - do not have the capacity to meet the demand for their services. Beyond resource allocation issues, there are clearly significant administrative inefficiencies that could be addressed to improve overall operational performance. As with the

[20] The functions of the court and the notary are absolutely the same in the course of registration of large and small companies.

proposed amendment to raise the threshold for pre-merger review by the OCCP, an easing of formal requirements for detailed judicial scrutiny of any change to the basic corporate form could help ease the administrative burden now placed on these courts. In addition to possible cost savings, this could also help reduce the amount of judicial discretion in approval of corporate forms, thus increasing predictability and transparency of the process.

Finally, Poland's courts could substantially benefit from the modernization of record keeping and information management capabilities. As in many countries in the region, the vast majority of the administrative processes are paper-driven. The greatest challenge (and greatest drag on efficiency) ahead in this Dimension is the modernization of its information management capabilities. In addition to efficiency gains from the perspective of process, significant gains in terms of predictability and transparency could also be expected.

Supporting Institutions

Supporting Institutions for Company include the community professional service firms that play a key role in supporting and facilitating the implementation of those portions of Poland's Civil Code that comprise the Framework Law for companies. The overall Tier II result of 82% for this Dimension reflects a comparatively strong overall supporting environment for creating and operating the various forms of enterprise recognized under Polish law.

The chief deficiency in this area is the day-to-day bureaucratic burden that is placed on businesses in creating and managing enterprises, regardless of the legal form. Broadly speaking, there were no significant impediments to commercial activity found in this Dimension. The bar is well developed, and there is no apparent shortage of qualified lawyers to select from in seeking assistance in establishing and operating a commercial venture under the Civil Code. Similarly, there is an abundance of notarial firms, some operating as wholly owned subsidiaries of established law firms, that were reported to operate quite efficiently. The professional services sector was reported to be relatively well developed in all of Poland's larger urban centers, and a wide variety of accountancy, management, marketing, public relations, and similar consultancies were in evidence in Warsaw, Krakow, Radom, and elsewhere.

Supporting Institutions is also defined to include ancillary executive and regulatory arms of national, regional, and local arms of government. The chief complaints given by private firms, lawyers, and others interviewed during the diagnostic were over-aggressive interpretation and enforcement of tax, health, environmental, and safety regulations. As elsewhere throughout the region, a hyper-bureaucratic approach to regulating business prevails, with the corresponding incentives for evasion and corruption. As discussed elsewhere in this study, a lack of notice and opportunity to comment on proposed changes to implementing regulations is the norm below the national level. Reports of arbitrary, conflicting, inconsistent, and variable interpretations of regulatory requirements, especially in revenue generating areas, were common across the sample of those interviewed during the assessment. Areas of tax enforcement and customs valuation stood out as the two areas where those interviewed felt they were most commonly subject to selective and "creative" interpretation and enforcement of regulatory requirements.

Market for Company Law Reform

Our finding indicate that Poland's Market for Company is generally strong, as reflected by the Tier II result of 78% for this Dimension. Detailed regulations (beyond the requirements of the Civil Code) concerning the steps required for venture formation were generally available [70%]. Overall, those interviewed during the diagnostic felt that their basic needs were being met within the existing system [90%], and that to the extent relevant, End-Users had a meaningful role to play in shaping basic policy in this subject matter area [70%] as evidenced by their providing direct input to the policymaking process [80%] through subject-matter or professional membership organizations [80%]. This area, the American Chamber of Commerce, the Supreme Bar Council, the Polish Foundation for SME Promotion and Development, Polish Chamber of Commerce, the Federation of Consumers, numerous private companies, lawyers, and others have been active in promoting reforms that affect how businesses are registered and operate in Poland [80%].

As reflected in the preceding sections of this analysis, the legal environment governing companies is perceived by End-Users as stable [70%], predictable [70%], and transparent [70%]. Some of those interviewed felt that certain aspects of the Commercial Code governing LLCs were being mist-interpreted, or inconsistently interpreted, thus explaining the relatively low Tier III result of 60% for this indicator. Despite these issues, the overall favorable rating given by End-Users interviewed was 90%.

E. Competition

1. Overview

Fair competition in the provision of goods and services is the cornerstone of the free market. Creating an environment in which such competition could flourish was one of the primary challenges facing the CEE/NIS in their programs of economic and legal reform. In the transition from the former state monopoly system, the passage of anti-monopoly laws became the focus of many legal reform efforts. In fact, foreign donors and client governments have often treated the passage of a new antimonopoly law as the chief benchmark of progress in law reform, and have commonly viewed implementation and institutional development as an afterthought. Detailed understanding of institutional constraints to implementation has been lacking. Our approach to the Competition subject matter area will examine these constraints paying particular attention to Supporting Institutions, enforcement strategy, competition advocacy programs, and the problem of over-regulation.

Supporting institutions are critical to proper development of a regulatory and enforcement regime for competition policy. To cite just a few key linkages, skilled lawyers or consumer groups may be needed to identify and bring to the attention of antimonopoly authorities various antitrust violations; academics on law, business, and economics faculties may be helpful in advancing the state of understanding of local markets and the application of law; trained judges are needed to rule on antimonopoly cases; compulsory process is necessary to obtain business records; business records must be kept in a format consistent with modern accounting methods; and so on. While development of none of these institutions is as critical to implementation as internal development of an antimonopoly agency's capabilities, their evolution is ultimately of great significance to the establishment of the rule of law and must be tracked in some detail to present an accurate picture of the complexity of a functional enforcement regime.

A phased, targeted enforcement strategy ensures that an antimonopoly agency -- especially one lacking in certain resources -- does not attempt to assume more responsibilities than it can handle. It also ensures that it attacks some of the most important, yet politically attainable, problems first, thereby boosting its credibility and gaining public trust. An enforcement portfolio needs to include both critical actions against government restraints on competition as well as a handful of politically more palatable, yet less helpful, cases (e.g., antimonopoly cases, if they fall within the agency's purview). It also needs to include voluntary compliance programs and public education efforts that lay the groundwork for an enforcement program that is perceived as fair, justified, and sensitive to business community views.

A Competition advocacy program is often overlooked in the midst of client government and donor preoccupation with high-profile enforcement actions. Yet this kind of education, publicity, and policy advocacy program is arguably the most critical type of activity that an antimonopoly agency can take in a transition economy. The reason is simple: most of the post-Soviet world suffers from excessive regulation and *government-directed restraints on trade that impede easy*

market entry (e.g., exclusive licensing arrangements). Perhaps the highest-priority and most effective steps that an antimonopoly agency can take are to lobby assiduously for the elimination of over-regulation generally and removal of particular restraints. Such activities will not only have a beneficial effect on competition, but will also tend to stem some of the worst corruption problems stemming from exclusive dealing arrangements brokered by ENI governments.

Finally, a trenchant inquiry into competition policy implementation must examine whether antimonopoly authorities are reflexively *exercising regulatory powers -- e.g., industrial policies that tend to affect price and output -- that are precisely contrary to the central objectives of a competition policy agency.* In many transition economies, antimonopoly agencies are often pressured by domestic business fear of foreign competition or by consumer outrage over high prices to engage in result-oriented manipulation of market structures. Often, donors are unaware of such interventions or fail to appreciate its political or cumulative economic, impact. It is therefore critical to ascertain the degree to which this is occurring in order to critically assess overall implementation of competition policy.

Antimonopoly laws encompass one part of the legal framework that is an essential element in any free market economy. Competition increases market efficiency by leading to lower prices, reduced inflation, improved technology, a broader array of product offerings, and a reasonable supply of goods. Markets remain open through a combination of open International Trade, and domestic laws and international treaties that limit monopoly behavior. Domestic legislation typically includes laws that assure market information transparency, public regulation of so-called natural monopolies such as electric utilities, the deregulation of prices, and the supervision of markets by government bodies to assure competition.

2. Diagnostic Findings

Legal Framework

Poland's competition law, the Act of February 24, 1990 *"On Counteracting Monopolistic Practices"*, as amended, provides the basic legislative framework for competition policy in Poland. Under Europe Agreement (EA) Competition and Approximation of Laws provisions, Poland agreed to bring its competition and consumer protection policies in line with that of the EU by February 1, 1997. This has been accomplished through a series of three principal amendments enacted between 1995 and 1997.[21] The current law contains definitions of monopolistic practices, abuse of dominant position, and other relevant concepts outlined in Articles 85, 86 and 92 of the Treaty of Rome.. The law also defines the institutional role and powers of the Office of Competition and Consumer Protection (OCCP)[22] in some detail, specifying mechanisms for pre-merger control, investigations, administrative hearings, issuance of executive orders, imposition of fines and judicial appeals to a court of special jurisdiction. In the main, Poland's legal framework for competition is judged generally consistent with EU standards, and therefore consistent with international practice.

[21] *Journal of Laws*, No. 80, Item 405, 12 July 1995; No. 106, Item, 496, Art. 32, 30 August 1996; and, No 49, Item 318, No. 118, Item 754, and No 121, Item 770, 1997.

[22] This agency, founded in April 1990, was known as the Anti-Monopoly Office until its name was changed in 1997 and its mandate expanded to include consumer protection.

It is reported that a new law on competition is being developed. A copy of the draft was not available at the time of the diagnostic, and it remains unclear when and if this might ultimately make its way to Parliament. In any event, it is reported that the proposed draft will attempt to remedy several key deficiencies that are perceived in the existing Framework Law. First, Poland has yet to adopt a law addressing state aid (i.e., subsidies) and, in this particular, is clearly lagging behind in the EU accession agenda.[23] It seems that despite a stated commitment to this reform,[24] the politically sensitive nature of transfers to industry and agriculture has made passage of this reform particularly difficult to complete.[25] Any comprehensive reform of Poland's legal framework for competition policy should seek to fill this important gap.

A second area where a degree of consensus seems to exist concerning a shortcoming of the current legal framework is the definition of conditions that trigger pre-merger review.[26] In particular, those interviewed felt that the minimum sales volume trigger of ECU 5m[27] forced the OCCP to review far too many transactions of little consequence from an economic standpoint. It has been estimated that by raising this threshold to ECU 25m, and eliminating the 10% shareholding the OCCP's pre-merger control caseload could be reduced by approximately 40%. Third, some of those interviewed felt that the agency should be insulated from direct political pressure by providing a "for cause" limitation on the power of the Prime Minister to remove the OCCP President and Vice Presidents. Second, the threshold criteria triggering mandatory pre-merger review is seen by several of those interviewed as being too low.[28] In this case, the OCCP has proposed an increase the minimum sales volume trigger for mandatory pre-merger review from 5m ECU to 25m ECU that would reduce case volume by an estimated 40% of the current workload. Finally, the EU has identified the extension of exclusive rights (block exemptions) in certain key sectors - particularly telecommunications - and the licensing regime for oil, alcohol and tobacco products as being inconsistent with membership requirements and requiring remediation.

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[23] See, e.g., *Agenda 2000 - Commission Opinion of Poland's Application for Membership of the European Union*, No. 97/16, p. 50, July 1997. A draft law is now before Parliament, however, it is not expected to be enacted before June 1999.

[24] Deputy Prime Minister and Minister of Finance Leszek Balcerowicz acknowledged the government's commitment to this necessary reform in a press conference in mid-1997. While draft laws have been developed and circulated, it still remains unclear when a state aid law might be adopted. The text of his remarks can be found at http://www.masterpage.com.pl/outlook/balceriw.html.

[25] Despite the lack of the required legislative framework, a state aid monitoring capability was established in the Ministry of Economic Affairs in early 1997. It reportedly has a staff of six and is working to create a database of state aid programs extended by the Ministry of Finance as well as those of other government agencies.

[26] See, e.g., Ch. 3, Art. 11.1 et seq., *Act on Counteracting Monopolistic Practices*, as amended.

[27] Id. at Art. 11.2.1.

[28] In this particular, there seems to be a consensus between private and public sector representatives interviewed during the diagnostic. Generally, speaking, the prevailing view expressed during interviews was that the OCCP was far too involved in reviewing mergers that could have little real impact on competitiveness in the given market.

Implementing Institution(s)
The OCCP is a government agency subordinated to the Council of Ministers. Its president, and vice presidents for Competition and consumer protection[29] respectively, serve at the pleasure of the Prime Minister. The OCCP currently employs approximately 187 civil service staff distributed among is headquarters in Warsaw and nine regional branch offices.[30] Of these, 131 (70%) hold advanced degrees, including 51 law, 50 economic and 30 in other disciplines. Turnover at the OCCP is high, running as much as 72%. At present, 31% of the staff have worked at OCCP for less than a year; 30% have been employed for two to five years and 36% have been employed more than 5 years.

At the end of 1996, the OCCP's antimonopoly case backlog stood at 125 total, of which 55% were pending in regional offices. During 1997, 197 new cases were submitted to the OCCP for determination (90% of these were handled in the regional offices). A total of 210 cases were closed during the year, resulting in a net decline of about 13% the OCCP's backlog. The high proportion of antimonopoly cases determined in the regional offices reflects the delegation of greater authority in these matters to the regions. In total, approximately 30% of the cases investigated were negative determinations whereas an equal share did lead to OCCP action of one type or another. Of the cases pending in 1997, 16% were determined in less than 2 months, 45% were closed within 6 months, 25% between six to twelve months, and 14% more than one year. In those cases pending longer than 2 months, interested parties were informed of the cause for the delay.[31]

On the merger control side of OCCP's operations, 469 cases were submitted in 1996 and a total of 377 opinions issued. In 1997, the OCCP's case load increased significantly to 1,399 investigations and 1,225 related opinions. By law, all administrative proceedings of the OCCP are governed by relevant provisions of the Polish Code of Civil Procedure.

As with many Polish government agencies, the OCCP suffers from a lack of capacity to administer and enforce the law efficiently and consistently. Inadequate budgetary resources, a lack of modern equipment, and high turnover OCCP among talented staff were identified by the OCCP as the chief constraints to increased operational performance. Views expressed by the business community generally agreed with the OCCP's self-assessment that routine reviews took approximately two to four months to complete, whereas "complicated" cases can take upwards of two years to complete. Based on the interviews conducted in the business community, the OCCP's enforcement activities were not seen as overly aggressive or arbitrary. Instead, there seemed to be general agreement that the OCCP was involved in reviewing too many mergers and

[29] The OCCP was given responsibility for consumer protection matters in October 1996. The Consumer Policy Department is comprised of 9 staff and processed approximately 2,300 consumer complaints in 1997. Consumer protection law is beyond the scope of this assessment and will not be addressed in detail.
[30] The regional offices were located in university towns so they might take advantage of the expertise resident in their respective faculties of economics. They include: Warsaw, Bygdoszcz, Gdansk, Katowice, Krakow, Lublin, Lodz, Poznan and Wroclaw.
[31] Including multiple parties, need for additional data and analysis, failure of a party to respond to requests for information, and verification of data supplied by the parties.

transformations and that this simply created a bureaucratic "drag" on bringing these transactions to closure.

In terms of resource allocation, approximately 50% of the OCCP's budget is spent on headquarters operations, with the remainder dedicated to supporting the nine regional offices. The Polish government co-located these regional offices with Poland's major universities in order to tap into the economics faculties in the regions by retaining academics on a part-time basis to assist the agency. This strategy worked well until, predictably, these individuals were lured to more lucrative positions. Despite this, the OCCP has reportedly been able both to attract talented economists by increasing salaries and convincing several to relocate to the main office in Warsaw.

As a whole, the OCCP seems to view itself as a somewhat passive body that reacts to cases brought before it, rather than as a proactive investigative body that determines its own enforcement agenda and priorities.[32] In this vein, there appears to be a tendency by OCCP to place an institutional emphasis on vertical restraints of trade, to the possible exclusion of other matters within its jurisdictional mandate. This may be the case because there seems to be a constituency within the business community demanding "fair and just" decisions on vertical conduct (typically involving unequal Contract terms) instead of the longer-term (and more politically difficult) structural cases that (by definition) do not have a well formed constituency demanding change.

This "bias" toward vertical restraints is viewed as natural, and to some extent, appropriate in a transition setting where certain entities may, following privatization, still wield considerable Market power relative to smaller businesses. Nevertheless, there is a corresponding "cost" associated with this bias since the relatively large volume of conduct cases brought by aggrieved businesses can have a disproportionate claim on the agency's already thin resources. In the long-term, therefore, it seems that this bias may lead to a misallocation of resources where more difficult - yet economically significant - matters such as state-sanctioned barriers to entry, horizontal restraints, and mergers by new competitors are sidelined by less economically significant yet more politically palatable vertical restraints cases.

Like many aspects of the Polish government, the OCCP does not have a set of well developed internal administrative and operational guidelines and procedures beyond those afforded by the Civil and Administrative Codes. This lack of clearly defined internal processes contributes to two inefficiencies that are, by several accounts, pandemic in Poland's public sector. First, with a lack of clearly defined procedural and substantive guidelines, operational personnel are forced to operate in a partial vacuum. In an environment that does not generally reward innovation, junior staff must repeatedly seek direction from more senior staff. In addition to the duplication of

[32] Although well beyond the scope of this analysis, an interesting question exists concerning the apparent reluctance of state enforcement authorities generally to utilize the coercive powers granted under the law. Intrusive search and seizure, for example, is viewed warily as those exercising these powers may be seen as using the tactics of socialist-era authorities.

effort and operational bottlenecks this creates, the lack of internal procedures and guidelines also makes staff development and training exceptionally difficult and uneven.[33]

Another problem associated with a lack of well developed internal procedures and guidelines is a related lack of consistency and transparency in interpreting and enforcing the law. While this is by no means a problem unique to OCCP, it does seems to affect operational performance. Without well defined methodologies for geographic and product Market analyses in place, the individual capabilities and inclinations of investigative staff can lead to unpredictable and inconsistent findings at best, and aggressive rent seeking at worst.

Supporting Institution(s)
As noted above, the Framework Law provides for judicial appeal of the OCCP's administrative determinations. For this purpose, a court of special jurisdiction, the Antimonopoly Court, was established within the 7th Division of the Warsaw *Voivodship*[34] Civil Court. This court has one full-time judge and three part-time judges who share responsibility for hearing appeals from OCCP determinations.[35] During 1997, fifty-seven OCCP decisions were appealed to the Antimonopoly Court, resulting in forty-nine rulings. In ruling on such appeals, the Antimonopoly Court may remand the case to the OCCP for further proceedings or, under appropriate circumstances, issue a ruling of its own. In such cases, the affected party may appeal an adverse determination to Poland's Supreme Court. Given that the challenges facing the Antimonopoly Court are substantially similar to those faced by the courts of general jurisdiction in Poland, the reader is referred to Section IX F 2 (Contracts, Legal Framework, Implementing Institutions) at page 47, below, for additional discussion of the relevant diagnostic findings for this Dimension of the analysis.

Market for Competition Policy Reform
The Market for Competition policy reform is, in relative terms, one of the stronger areas of this analysis with a Tier II indicator result of 78%. An area of relative weakness was found to be the extent to which the business community was afforded an opportunity to comment on proposed implementing regulations before they are adopted [50%]. Generally speaking, when the opportunity is presented, it appears that End-Users have participated in policy dialog with policymakers [70%]. An example of this is the public-private sector dialog on the need to adjust the pre-merger control mechanism upward, thus freeing the OCCP from the need to review transactions that are unlikely to have an significant impact on the competitive structure of the market.

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[33] High turnover among staff only magnifies this problem. The Market selects the "best and brightest" who seek increased wages in the private sector. With every departure, the agency loses not only qualified staff and its training investment, but the institutional memory as well.

[34] A *voivodship* is an intermediate unit of political organization similar to a department in France or a county in the United Kingdom. In line with EU *aquis* on administrative organization, Poland recently reduced the number of voivodships from 49 to 17.

[35] Judicial personnel at the Antimonopoly Court were described as knowledgeable and dedicated to their work. The relationship between the OCCP and the Court does not appear to be one-sided in favor of the OCCP. In this respect the Court was described as "demanding" as OCCP lawyers are required to cite relevant EU legal authority and precedent to support their positions.

Generally speaking, access to relevant laws and regulations seemed to be good [70%], although there is not sufficient evidence to generalize this beyond the Warsaw area. Overall, we believe that the legal and regulatory environment contains effective incentives that generally induce the intended response by the business community or (end user) [70%], in this case discouraging anti-competitive behavior [70%]. Overall, those interviewed reported that they were generally well served by the OCCP, except to the extent that a degree of over-regulation was evident due to the requirements of the existing Framework Law [90%]. As noted earlier, End-User participation in developing refinements to policy framework for Competition in Poland seemed good [70%]; while NGOs were found to be active in representing membership interests in this dialog [80%].

Overall, those interviewed reported that the overall policy and institutional framework for Competition was generally well-suited to their needs [70%], stable, predictable, and transparent [70%] in its application. Overall, those interviewed from the business community seemed to understand the basic regulatory requirements, and view them as being complete, if somewhat overly developed.

F. Contract

1. Overview

No field of law is more essential to the operation of a free market than the law of contract. A consistent, predictable set of principles binding parties to the terms of their agreements underlies all of commercial law. It is, thus, an obvious and indispensable component of this analysis of commercial law reform in the CEE/NIS.

The countries examined in this assessment are at various degrees of transition from a system of state planning where contract law played only a peripheral role. Normal contract law did not exist in the planned sector of the economy. It did exist, however, in two limited areas including foreign trade relations (conducted by a limited number of state agencies) with non-communist countries, and in non-business agreements between private citizens (e.g., sale of a house with payment in installments). With these and a few other minor exceptions, it was forbidden to make all types of business agreements.

With the end of communism, laws were passed allowing contractual agreements. The starting point in our research is the nature of this basic Contract legislation. Some elementary questions concerning these laws include:

- Whether the Framework Law embodies a market-oriented approach to contractual relations based on freedom of contract;
- Whether economically (or commercially) significant types or classes of contract, such as those for buying and selling land, prohibited or unenforceable;
- Whether imperative rules limiting the freedom of parties to set terms exist (e.g., as in Russia where some critics have claimed that the imperative rules on franchise law are so slanted toward the franchisee that they discourage the use of franchising);
- Whether parties are free to agree on customized terms relating to liquidated damages, arbitration, choice of law, and related matters; and,
- Whether adequate enforcement mechanisms are available in the event of breach (e.g. penalties, money damages, specific performance).

A major area of inquiry will concern contract enforcement. This involves four issues:

- Quality of court personnel;
- Training of court personnel;
- Independence of the courts from government intervention, and,
- Enforcement powers.

Given that the institutional capacity of the commercial courts cuts across most of the areas under study, it will be dealt with separately below.

2. Diagnostic Findings

Legal Framework

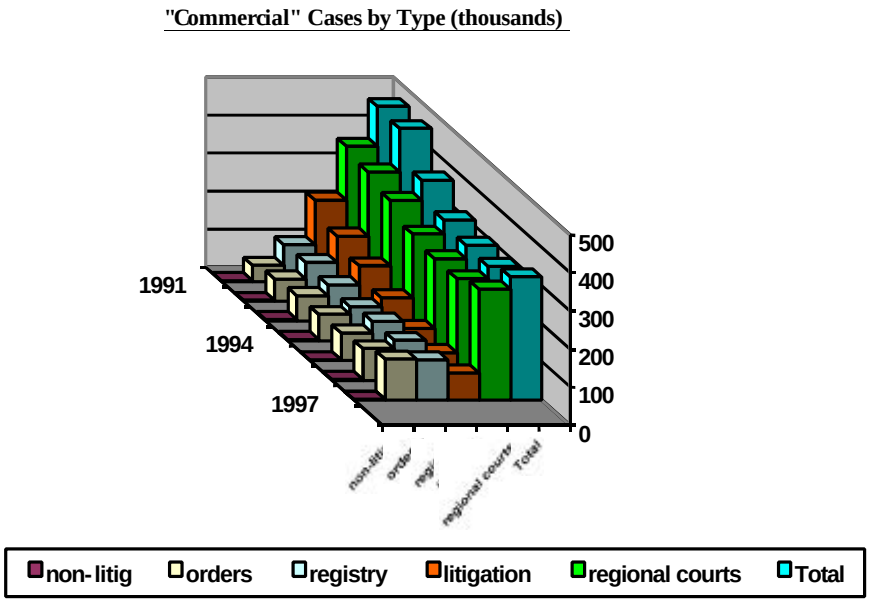
Contract law in Poland is governed by the Civil Code of 1964. Despite the fact that it was enacted during the Communist era, the Code is generally viewed as being well suited to contemporary needs. The law itself is modeled on the Poland's earlier Code of Obligations that dates to 1933. The Civil Code primarily follows the French model, yet some characteristics of German law are also said to be discernable. The Book III of 1964 covers general issues such as torts, unjust enrichment, performance of obligations, change of creditor or debtor, set off, renewal release from a debt, etc. We also find a catalogue of specific agreements which are defined and regulated in detail. One of the basic examples is a sale and purchase Contract which involves regulations from Articles 535-602, and to some degree recalls well-known Article 2 of the Uniform Commercial Code.

Implementing Institutions

Poland's judicial system has been transformed from an instrument of state control, to what appears to be an independent, co-equal branch of government free from direct political influence and control. While the focus of this analysis is on the operational performance of the commercial courts, there are several relevant aspects of the judiciary that should be highlighted. First among these is the mechanism for judicial appointment and promotion. In Poland, judges are appointed by the President of the Republic, on motion of the National Council for the Judiciary, a self-governing body established in 1989 that acts as a nominating committee. Under this system, the President has the right to reject an appointment, however, he may not appoint a judge without the prior nomination of the Council. In addition, the Council is responsible for judicial promotions. This mandate extends to Supreme Court appointments.

Second, administrative actions taken by the courts are governed by the “Code of Administrative Procedure”. Appeals from administrative determinations may be taken in the administrative department of the intermediate and Supreme appellate courts. A third relevant feature is that of internal audit control that is carried out by the Supreme Chamber of Control. This body has responsibility for administrative and financial audit of all government financed activities at the national, regional and local levels. Poland has an Ombudsman appointed by the lower house of Parliament (*Sejm*), with the consent of the Senate, for a four-year term of office. As the name implies, the Ombudsman receives complaints of official mistreat or misconduct from citizens and may refer appropriate matters to the Constitutional Tribunal for review.

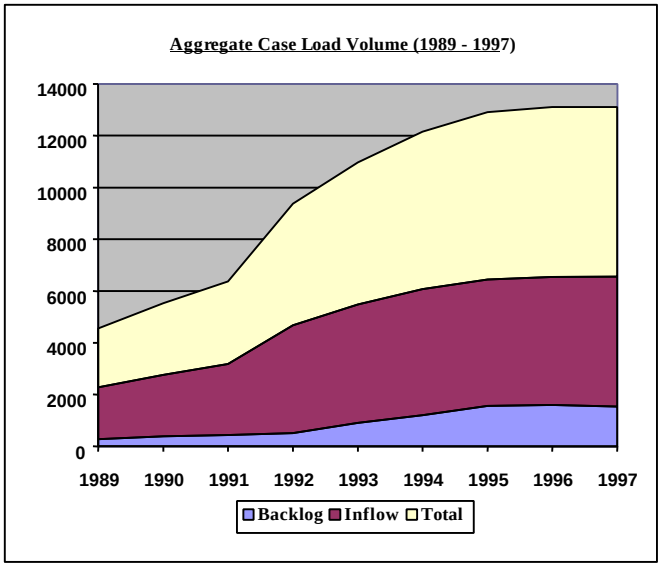
As discussed in greater detail below, Poland's commercial courts have a basic lack of



Source: Ministry of Justice Statistical Annual, 1997.

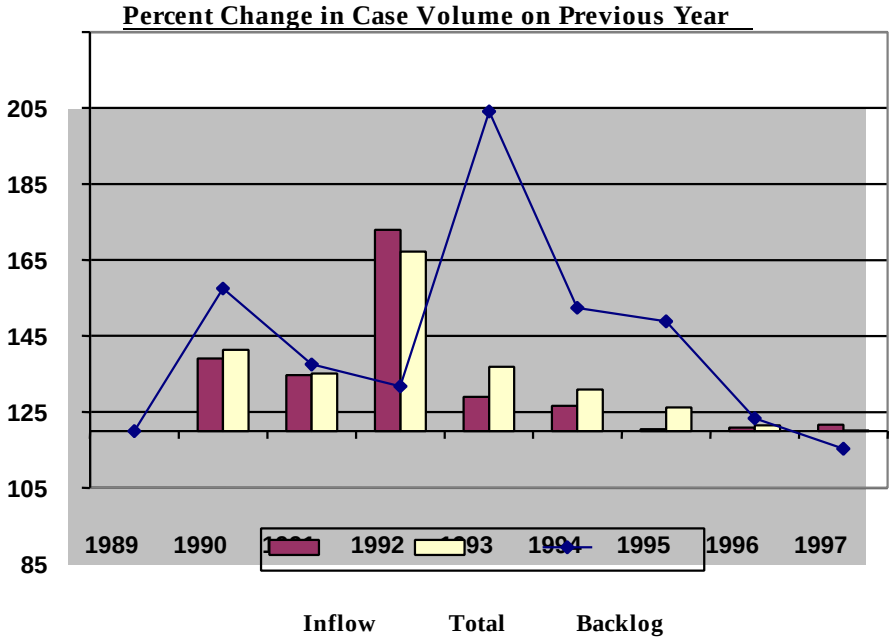
administrative and management capacity that is translating into significant case backlogs. A relatively recent reform, adopted in August 1997, introduced the office of judicial clerk (*referendarz*) to help alleviate the burden of purely administrative duties that have been traditionally performed by judges themselves. While the reform is much needed, there was no evidence in the commercial courts visited during the diagnostic that this reform has been effectively implemented yet.

A significant constraint to commercial activity identified during the diagnostic was a lack of



judicial capacity to quickly consider and dispose of routine commercial matters. While the causes for this phenomenon are many and complex, a few trends are worth highlighting here. First, as in many developed and transition countries, the volume of matters brought before the courts is increasing annually. Official Ministry of Justice statistics show that between 1991 and 1995, the total case volume for Poland's ordinary courts more than doubled.

Several factors may have contributed to this general increase in volume. First, Poland's Market reforms sparked a rapid expansion of entrepreneurial and private sector activity.[36] The reallocation of ownership rights and liberalization of Markets created both opportunity and uncertainty for new Market entrants. Second, during this period, Poland's economy grew in real terms at an annual average rate of 3.2%, representing an aggregate increase in the volume of commercial activity. Third, the jurisdiction of Polish commercial courts has been expanded and newly introduced substantive legal matters including insurance, leasing, and franchise are now being considered. Simultaneously, the technical and administrative complexity of other matters - particularly real estate transactions - is also increasing. Third, the courts' scope of involvement in otherwise routine commercial matters including company registrations, amendment of corporate statutory articles, recording secured interests and similar matters is relatively high. Fourth, during this period, a number of commercial laws were either enacted or significantly amended. It is also expected that these reforms would create a degree of uncertainty early in the reform process that could lead to an increase in commercial disputes.



In 1997, the courts handled 5,058,000 cases or 44,000 more cases (0.9 %) than during 1996. Civil cases represent the single largest element of the courts' overall case load (55.4%). The remainder of the case load is comprised of domestic, criminal, commercial, and other cases. Of

[36] e.g., The massive influx of micro- and small-scale traders following demonopolization of Poland's foreign trade sector.

the commercial matters brought before the courts in 1997, approximately 107,000, or 66.8% were land- and mortgage-related matters. At the appellate level, 631 appeals from *voivodship* commercial courts were taken in 1997, of which 393 were disposed of, leaving a backlog of 248 cases of approximately 39%.

Cases closed during the period exceeded cases docketed by 41,000, thus representing a reduction in backlog for the year by 2.3 % to 1,499,000. Of this backlog, 49.3% consisted of real estate matters (738,000). The figure above illustrates a sharp increase in total backlog between 1992 and 1996. While the national trend seems to show a leveling off both in terms of total case load and backlog as a percentage of the total, this picture is somewhat misleading. According to official statistics, the national average in 1997 for resolution of commercial cases of all types is 4.6 months, the average in Warsaw was 13.2 months, representing an increase of approximately 28% over 1996,[37] even though the Warsaw region reported a drop in case volume of approximately 3% for the period.

Whilst official data regarding the length of procedures indicate an average of 5 months for a case to be terminated, the reality suggests that procedures can take several years. As a result of the heavy workload of courts and tribunals and the general lack of infrastructure and technical means, the treatment of cases suffers considerable delays which increase every year to reach a record of 6 years in Warsaw.

Supporting Institutions

Poland maintains a notary system, which follows closely the European legal tradition. It is based on the same principles as the systems in most European jurisdictions. The legislation on notaries and notarial services was substantially modernized in 1991[38]. The new Law on Notarial Services liberalized access to the profession and provided for the establishment of a self–governing, self–regulated professional institution which is in charge of the organization of notarial work – the *Chamber of Public Notaries*.

The most important and progressive change in the law of 1991 is that Poland completely privatized the profession. Under the present system, qualified lawyers are admitted to the profession and licensed to practice in designated notarial districts, without being directly subordinated to the Ministry of Justice. The notaries in Poland are similar in their position to attorneys in private practice. The state does not employ notaries, but sets the requirements for their licensing and confers on them the right to carry out some important quasi-administrative functions (registration of transactions with real estate for instance). The maximum amount of all notarial fees is fixed by the Ministry of Justice (most recently in 1997).

Polish notaries have important rights and obligations in all transactions for which the law requires to be notarized. The notaries prepare the respective documents (designated by the law as

[37] By comparison, Katowice's case load, reported at 12,060 for 1997, has an average rate of pendency of 3.3 months, significantly lower than that of Warsaw.

[38] Law on Notarial Services, dated February 14, 1991 (Official Gazette - Dziennik Ustaw Nr 22, 1991, as amended most recently, Dz.U/1997 r. Nr 28, pos. 153).

notarial deeds), and are responsible for the contents. The notaries are also responsible for the preparation of affidavits, depositions, preservation of documents for safekeeping, preparation of official copies of documents, presented to them, and a number of other activities, required by law, and related to the need to obtain an official certification for certain acts. The notaries are obliged to refuse the preparation of deeds, contrary to the law, or to refuse the certification of such deeds. This provision of the law permits the notaries to refuse the certification of certain documents, because in the understanding of the notary they are not in accordance with the law, even if prepared by the attorneys of the parties. In that respect the problems of the Polish system are the same as the problems in most other European jurisdictions.

Another problem of the system exhibited not only in Poland is the high fees, assessed based on the value of the transaction and not on the services provided. Such fees represent in fact taxes, collected by the notaries on behalf of the State.[39] In some cases they may discourage the parties from notarizing certain transactions (e.g. loan agreements). Notarial fees in Poland are established by the Ministry of Justice, but notaries are also allowed to provide consultations on issues related to their practice (which is in fact a way to allow some additional charges).

Polish notaries have some important corporate functions. They are in charge of the preparation of the minutes of general meetings of different corporate bodies, primarily the general assembly of shareholders in joint – stock companies, in the cases when this is provided by law.

Another important Supporting Institution is the Polish Bar Association. The Bar Association was founded in 1918 and remained self governing and relatively independent from the authorities during the Communist period. Because of this it was in fact the first self–governing professional organization, which started operating effectively in the transition period. All practicing attorneys must be members of the Bar Association in order to appear in front of the courts. The Association maintains rigid standards for professional admission and ethics, and organizes continuing legal training for the members. An important aspect of the Association is the existence of specialized sections, which provide the members with the opportunity to discuss problems of major interest according to their area of specialty.

Market for Contract Reform

We found the Market for Contract reform somewhat difficult to assess given the degree of consensus among all of those interviewed that it was quite sufficient to meet most existing needs. In areas where gaps have existed in the Framework Law (e.g., leasing, franchising) theses seem to have been addressed fairly efficiently. In these specific cases, automobile dealers, equipment leasing firms, chain restaurants, and others similarly situated seem to have successfully raised these issues (either directly or through representative organizations) within existing mechanisms for public-private sector dialog (e.g., parliamentary commissions and the Ministry of Justice). The overall Tier II result for this Dimension was 75%, which is lower than the foregoing discussion might suggest, reflects a general level of dissatisfaction that we observed among End-Users concerning the efficiency of the commercial courts in adjudicating contractual claims and enforcing judgments. The process is viewed by End-Users as lengthy, costly, and unpredictable.

[39] Please also see the Company section – registration fees for companies are in proportion to the registered capital.

Because judges are reported to be very reluctant to use the coercive powers afforded them by law, litigants are generally able to deploy a variety of tactics to delay proceedings, and thus wear down the party claiming compensation. As was the case in Bankruptcy, there clear preference among parties to a dispute was to avoid formal judicial intervention in all but the most stubborn cases.

F. Foreign Direct Investment

1. Overview

Our analysis is based on the premise that the more an FDI regime resembles internationally accepted norms, the more attractive it will be to potential investors. As in the other substantive legal areas, our FDI indicators are intended to inquire beyond the formal legal guarantees. This includes an examination of whether government agencies and the courts afford equal treatment in practice to foreign corporations. Our Team also met with private business executives both local and foreign to obtain their insight into the investment climate. It will be important to distinguish between those bureaucratic hurdles that restrict investment generally and those that are aimed at foreign investors. A regulation that is investor neutral on its face, if selectively enforced, may become a de facto restriction on foreign investment. We will also investigate whether there are unwritten agreements to exclude foreign corporations from certain Markets, or whether the "cost of doing business" is significantly higher for those companies. Finally, we will compare the results of FDI research with the results of our analyses of trade laws and company law.

The challenge of developing meaningful comparative indicators for FDI lies in the diversity, breadth and complexity of the subject area. The indicators developed for this purpose place heavy emphasis on compliance with international obligations and norms, rather than the details of specific national legislation. This emphasis reflects the broad trend toward international harmonization of law and practice governing cross-border direct investment. It is also based on the assumption that a correlation exists – all other things being equal – between the degree that a country's FDI regime reflects international standards and its ability to compete for and retain FDI.

The emphasis placed on international obligations, rather than on a detailed analysis of national legislation is useful for several important practical reasons. First, the data required can be obtained relatively easily and cost-effectively via widely published sources. This reduces the cost of assessment significantly and makes monitoring development and updating the analysis simpler. Second, for comparative purposes, the quality of the data is relatively uniform since in many cases a single source (e.g., WTO Secretariat; MIGA, OECD can be used. Third, focusing on consistency with international norms provides a useful means of limiting the subjectivity inherent in comparative analysis of national legislation. This approach therefore creates an opportunity to emphasize the quantitative element to the analysis by distilling development indicators into performance measures that can be stated in relatively simple yes/no propositions for comparative purposes.

The expediency of focusing on adoption of international conventions and norms as a basis for drawing cross-country comparisons has significant limitations, however. First, a gulf generally exists between formal accession to treaty obligations and compliance with those obligations. In a practical sense, therefore, it is misleading to consider treaty accession without explicit reference to treaty compliance. In developing these indicators, an effort has been made to control for this

shortcoming in two ways: 1) by attempting to capture the extent to which obligations have been limited or reserved by the acceding country during negotiations (e.g., the number of conditions placed on right to national treatment); and, 2) by focusing on regulatory barriers to entry as a basis for characterizing the climate for foreign investment.

A second difficulty arises in the selection of international norms to be included in the analysis. Poland has made full membership in the EU a central foreign policy objective. EU membership is likely to have a significant impact in terms of Poland's future FDI flows.[40] Nevertheless, including EU membership as an indicator of commercial law development is problematic from the standpoint of cross-regional comparisons given that access to membership is not universal.

Eliminating EU (and OECD) accession from the analysis, however, poses the risk that an artificially narrow and potentially distorted view of commercial law development in Poland will be presented.[41] There is no doubt that Poland's accession to both the OECD and the EU offer significant benefits in terms of credibility, consistency, predictability and durability of the reforms.[42] Because membership in these organizations is conditioned upon meeting certain legal and administrative conditions precedent (i.e., "reforms"), membership confirms, rather than necessarily determines, Poland's emergence from "transitional" to "developed" status in terms of its legal regime for FDI.

2. Diagnostic Findings

Legal Framework

The Act on Companies with Foreign Shareholdings[43] provides the basic domestic legal framework for FDI in Poland. From an international perspective the EA, governs Poland's treatment of capital flows and commits it to liberalization in advance of full EU membership. Poland's membership in the OECD,[44] MIGA, ICISD and WTO all further bind Poland to the international norms for FDI. Finally, Poland is signatory to over 50 bilateral investment treaties (BITs) (notably with the United States and the EU) that provide an additional reinforcing framework of legal norms governing FDI.

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[40] To date, EU countries have invested $12.2b in Poland, representing 54.1% of total FDI in Poland as of June 1998. By comparison, U.S. investments – currently the largest in terms of volume – comprise 20.8% ($4.7b) of the total FDI in Poland; and Asian investments, led by South Korea, stand at $1.5b, or 6.6.% of the total. Polish Market Review, No. 5 (21), October 1998, Polish Agency for Foreign Investment.

[41] Put differently, the level of abstraction required to developing cross-regional comparative measures for FDI that permit "apples with apples" comparisons may yield insights of limited analytical value (e.g., "apples are fruit").

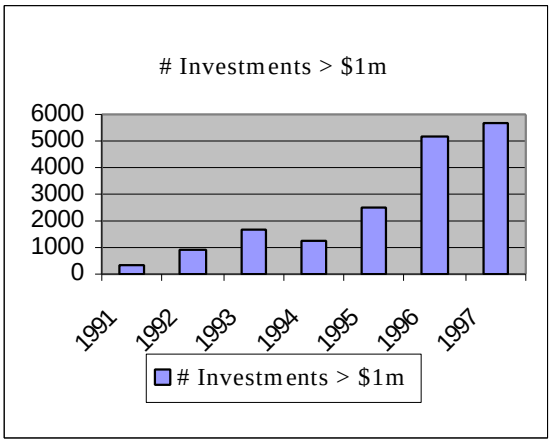
[42] Institutional Investor Credibility Index.

[43] Dziennik Ustaw 1991, No. 60, item 253, as amended, Dziennik Ustaw 1991, No. 80, item 350 and No. 111, item 480; 1993, No. 134, item 646; 1996, No. 45, item 199, January 1, 1997. Other relevant acts, not treated in detail in this analysis, include: *Act on the Acquisition of Real Estate by Foreigners*, Dziennik Ustaw 1996, No. 54 item 245, January 1, 1997; *Act of the Foreign Exchange Law in Poland*, Dziennik Ustaw 1994, No. 136, item 703, as amended, Dziennik Ustaw 1995, No. 132, item 641; *Order of the Minister of Finance*, 16 January, 1996, *Concerning General Foreign Exchange Permits*, Monitor Polski No. 6, item 73, as amended, Monitor Polski No. 21, item 244, No. 27 item 290.

[44] Poland acceded to the OECD in November 1996.

As illustrated in Figure 4 below, Poland's has been quite successful in attracting FDI to date. A series of reform measures adopted by Poland in 1996 (and effective January 1, 1997) liberalized, or at least partially liberalized, restrictions on foreign participation in the Polish economy with respect to direct investment, commercial credits, long-term financial credits and loans and personal capital movements. Partial reforms were also introduced in the areas of foreign ownership of real estate, and securities trading. Foreign ownership of real estate, however, remains an area where further reform is necessary.

Fig.4 FDI 1990 -1997



Source: Ministry of Economy, 1998.

Concerning *admission* of FDI, most approvals have been removed. As in many countries, foreign direct investment in certain areas (e.g., subsurface materials extraction, explosives manufacture and sales, pharmaceuticals, alcohol, tobacco, public conveyance, etc.) require special permission from a designated regulatory body. At present, there are 26 activities designated under the Economic Activity Act that require a special permit (concession).[45] It should be noted, however, that national treatment is accorded to FDI in these sectors.

The number of legally mandated approvals or steps required for FDI is the same required for registration of any business in Poland, therefore, the regime for admission of FDI is consistent with European standards.

As concerns *treatment* of FDI, national treatment is accorded to all FDI and no limitations are placed on shareholdings (e.g., local participation requirement) and foreign investors may operate in Poland in one of four ways:

1. Through a representative office;
2. By establishing a wholly owned LLC or JSC ;
3. By forming an LLC or JSC with local partners; or
4. By acquiring shares in an existing Polish company.

As discussed in Section IV, C, 2(a) above, Polish law does specify minimum capital contributions for foreign-owned companies. It should be noted, however, these are essentially the same in form as those required for domestic companies and generally consistent with continental practice. No restrictions are placed on employment of foreign employees beyond normal immigration requirements. As a general matter, there are no formalized "profile" or workforce retention requirements for FDI, however, in a given transaction, these might be negotiated as a condition of sale. No limitations are placed on the conversion and expatriation of

[45] At present, there is a draft bill, *On Economic Activity*, before Parliament. It is reported that under the proposed bill, only six activities would required special approval.

after-tax profits, wages, dividends or proceeds. Under the Law on Companies with Foreign Participation, payment of compensation for nationalized assets is guaranteed.

Implementing Institutions
The Polish Agency for Foreign Investment (PAIZ) is an exceptionally well-organized, technically sophisticated and effective organization. PAIZ is a government-funded investment promotion agency that has received significant financial and technical advisory support from the EU's Phare program under a joint project known as "Investprom".

PAIZ operates with a staff of approximately 50 who are organized in 10 departments that have both sector specific and region specific foci. PAIZ is a full service investment promotion agency that provides information on the investment climate in Poland through its *Monthly Economic Data Sheet* series, a bimonthly newsletter *Polish Market Review* and various other publications including its web site (www.paiz.gov.pl/), a CD ROM *Thinking Investment, Think Poland!*

As a quasi-government agency, PAIZ utilizes its direct relationships with members of Parliament and national and local government officials to help facilitate FDI. By all accounts, PAIZ is operating very effectively in this role.

PAIZ provides a wide range of investment promotion services. In addition to the information dissemination activities described above, PAIZ actively Markets Polish investment opportunities in Europe, North America and Japan. PAIZ staff also provides direct support to potential foreign investors by helping identify and qualify active investment opportunities in various regions around Poland. PAIZ also sponsors foreign trade missions and provides an investor matching service. Finally, PAIZ has established and maintains close working relationships with sister organizations throughout Europe, North America and elsewhere.

Overall, PAIZ' institutional capacity to promote and facilitate FDI in Poland is impressive. The EU Phare program of assistance to the organization is clearly a key factor in this impressive success, however, this support is now ramping down. The proof of sustainability, therefore, will be the extent to which PAIZ is able to transition into a fee-for-service mode to help support its operational capacity. As discussed below, Competition from a variety of non-profit and for-profit business promotion organizations are providing competing services that will almost certainly impact on PAIZ' future activities and performance.

Supporting Institutions
The Polish business community has been successful in establishing a number of viable Supporting Institutions in a relatively short time. This success is due to several factors—familiarity with Market business practices, cooperation with the government, general independence from political considerations, a large Polish Diaspora (which provided financial support and experience), general public agreement on the policy towards foreign investors, and ability to absorb the available technical assistance. As a result, a number of non-government organizations function in Poland and are valuable partners of the government in policy formulation and identification of the problems of the investment community.

After more than 40 years of restrictions and subordination to the needs of the centralized economy, the Polish Chamber of Commerce was quickly reborn as the principal self-governing institution of corporate Poland. It has 160 members, most of which are local chambers of commerce. The Chamber is not directly involved in promotion of foreign investment, yet it provides important services for the entire investment community and contributes significantly to the improvement of the investment climate in Poland.

The most important institution, supported by the Chamber, is the Court of Arbitration. This court is the designated standing court of conciliation under the Civil Code. It provides arbitration services for the parties to international commercial disputes under two different procedures. Conflicts may be resolved under the "in house" Rules of the Court Of Arbitration (the 1970 procedure) or under the rules selected by the parties to the dispute (the UN recommended 1976 UNCITRAL Arbitration rules serve as a default if no rules have been specified by the parties). The Court has separate procedure for disputes by Polish parties only. Poland is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

The Chamber of Commerce maintains a separate legal office – the Legal Services and Information Center -- which provides assistance in establishment of joint venture companies and representative offices, preparation and negotiation of Contracts and agreements, analytical work with respect to foreign investment and International Trade, and representation of parties in business cases.

Several bilateral and multilateral international Chambers are also members of the Chamber of Commerce, representing the business interests of most of the neighboring countries and of the principal trade and investment partners of Poland. There bilateral chambers with Germany, Russia, and Ukraine, as well as regional chambers with Belgian and Luxembourg, and the Balkans, to name but a few. The American and British Chambers of Commerce in Poland are particularly active and provide valuable services to members and even non-members. Unlike in other countries, however, they are not the only source of information about the problems of the Western business community.

The Foreign Investors Chamber of Industry and Commerce was established in 1989 as a response to the need for association in the emerging foreign investment community. The Chamber concentrates on protection of the specific interests of the foreign investment community. It achieved some prominence with the successful support of a case before the Constitutional Tribunal already in 1991. Since that time the Chamber has concentrated on the formulation of policy proposals related specifically to foreign investors, and on the provision of specialized information and services to the members. It is also active in organizing specialized training in the areas of tax law, custom regulations and accounting for the members and the general public.

All big accounting firms and several of the major international law firms have established successful practices in Warsaw. They provide the full range of services, similar to those in other major business centers in Europe. The major consulting companies are also present and are gradually moving from predominantly donor- financed projects to work with major corporate

clients on their core activities. The level of professional and organizational support for foreign business in Poland is similar to that in most developed Market economies.

Market for FDI Reform

Our findings for this Dimension should not be surprising based on Poland's well-publicized success in attracting large volumes of foreign direct investment (per capita) as compared to other countries in the region. The 75% Tier II result suggests that a comparatively healthy Market for FDI exists, however, significant progress still must be made in "debureaucratizing" government regulation of foreign investment. The foreign investment community in Poland is well organized and represented by various embassies, commercial attaches, representative offices, chambers of commerce, and industry groups. The consensus view reflected among those interviewed seemed to be that the national Government continues to be very supportive of foreign investment generally, even though a good deal of unnecessary bureaucratic overlay remains. As in other areas, discretionary interpretation and enforcement of ancillary regulatory requirements were a point where most agreed there was progress to be made. Tax, customs, and standards certification were most frequently identified as key areas where an unstable regulatory environment constrained day-to-day commercial activity. This is not to suggest that problems of this genera are unique to the foreign investment community. In fact, representatives of several multination corporations with operations in Poland expressed the view that their firms have greater leverage in advocating for specific reforms than domestic firms of a similar size. Whether this is the case or not, the problems faced by foreign investors in this regard were generally accepted as part of the "cost of doing business" in Poland. Among those interviewed relative to FDI, there seemed to be a general consensus that the situation had been improving and that future improvements could be expected over time.

G. International Trade

1. Overview

The sweeping political changes that began in 1989 were to have a profound impact on virtually every aspect of commercial life throughout the CEE and NIS regions. In particular, 1991 was a year of profound change throughout the region. By early 1991, Market prices, hard currency payments, and international commercial practices began to replace Soviet-era mechanisms of trade throughout most of the region. In July, the Council for Mutual Economic Assistance (CMEA) was formally dissolved. In late August, Ukraine declared itself a sovereign state. Three months later, Romania adopted a new constitution. Finally, Kazakhstan declared itself an independent nation in early December 1991.

This is particularly true in the foreign trade sector, which was both highly centralized and tightly controlled by specialized state trading organizations. With the collapse of the Soviet Union, individual firms found themselves cut off from at both ends - input supply on one hand, and Marketing outlets on another. Further, due to the segmentation and specialization common under the state trading system, firms were faced with a debilitating lack of information or experience upon which to draw in establishing their own foreign trade relations. Added to this, many state trading monopolies seized the opportunity spontaneously privatize under *perestroika*, and utilize special hard currency and commodity trading licenses to perpetuate their monopolistic position in the sector.

It is widely stated that a country's openness to foreign trade and investment is a major determinant in its overall rate of economic growth and the stability and vitality of its Markets. Empirical evidence tends to support this view,[46] however, the recent Asia Crisis has caused some to challenge this orthodoxy.[47] Despite this, a central organizing assumption upon which this analysis proceeds is that a legal regime consistent with international norms and practices is a fundamental requirement for a modern, market-oriented economy.

Trade law and the institutional framework for its implementation is an extremely broad and complex subject. As a result, it has been necessary to define the parameters of this analysis somewhat narrowly. One principal theme, however, will be the extent to which the country has embarked upon the process of accession to the World Trade Organization (WTO). The progress which a country has made in negotiating and enacting implementing legislation to accede to WTO agreements is a good preliminary indicator of the overall development of a country's International Trade law. Among the many areas addressed by these agreements are market access, subsidies, health standards, trade in services, intellectual property, and government procurement. Customs laws and procedures, especially the tariff levels, classification system,

46 See, e.g., Trade Liberalization in IMF-Supported Programs, Sharer, R. et al., International Monetary Fund World Economic & Financial Surveys, Washington 1998; Open Markets Matter - The Benefits of Trade & Investment Liberalization, OECD, Paris, France 1998.
47 Saving Asia, Krugman, P., Fortune Magazine. 9/7/98, www.pathfinder.com/fortune/investor/.

and whether Most Favored Nation (MFN) status is afforded to trading partners are also considered as a basis for comparison.

It is important to note the impact of many ancillary laws on the overall trade environment. Among those which could represent substantial non-tariff barriers are tax laws, currency convertibility restrictions, and immigration and banking laws. Obviously, a detailed investigation of each of these areas is well beyond the scope of this diagnostic assessment. It should, however, be possible to include specific examples of discriminatory treatment in an overall analysis of the country's receptivity to foreign trade.

From an institutional perspective, we have focused on the major trade regulatory bodies from the Ministry level to the customs point of entry. We will assess the degree of detail, consistency and transparency in agency procedures and compare statistics regarding enforcement. We will also attempt to gauge the degree of political support for open trade policies as expressed in public statements by government spokesmen, opposition leaders, legal academics and the popular media. Finally, we have attempted to assess the degree of satisfaction among those most affected by the trade laws and policies (e.g., import/export firms, foreign chambers of commerce) with the current regime

2. Diagnostic Findings

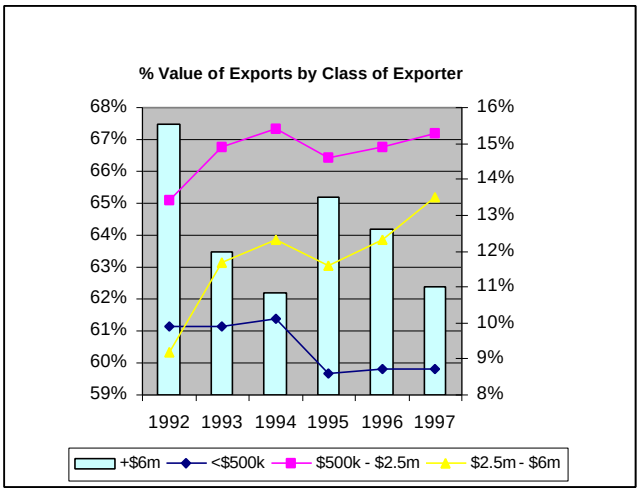
Legal Framework
Poland has made significant strides in liberalizing its trade regime since transition began in the early 1980s. Today, with relatively minor exceptions, it can be fairly characterized as an "open" economy. Since the early 1990's, Poland's primary foreign policy objective - EU accession - has provided a particularly strong gravitational pull in the area of trade policy reform. Upon accession to the EU, Poland's trade regime will be, for all practical purposes, harmonized with most relevant international norms.

Poland is signatory to various International Trade regimes that provide a comprehensive legal and institutional framework for regulation of trade and trade-related disputes. Principal Among these are the Europe Agreement, GATT/WTO, the Central European Free Trade Agreement (CEFTA), and the European Free Trade Association (EFTA). In addition to various bilateral trade and investment agreements, Poland is also actively pursuing free trade agreements with Estonia, Israel, Morocco, Turkey and the Faeroe Islands.

Diplomatic relations between the EC and Poland were first established in September 1988. A Trade and Cooperation Agreement (TCA) was signed in September 1989. This agreement provided for reciprocal MFN treatment, and the elimination of quantitative restrictions applied by the EU[48] on imports from Poland by 1994. Thereafter, in December 1991, Poland signed a bilateral agreement with the EC known as the ***Europe Agreement*** (EA). While the EA as a whole came into force on into force on February 1, 1994, the trade related aspects contained in

48 Under the terms of the Maastricht Treaty, the European Community (EC) became known as the European Union (EU) on November 1, 1993.

Chapter III became effective two years earlier (February 1992) under an Interim Agreement.[49] This agreement provided a mechanism for consolidating earlier trade concessions made under the (TCA) and establishing a timetable for gradual, asymmetric trade concessions in favor of Poland over a ten year period. In April 1994, Poland submitted its application for associate EU membership. This application was granted by the EU Intergovernmental Conference in June 1997.



Source: *Market Structure and Foreign Trade Performance in Poland*, Anna Wzi • tek-Kubiak, Institute of Economics, Polish Academy of Sciences, July 1998.

Within the context of Poland's progress toward full EU membership, a variety of trade reforms and concessions have been made by Poland that will bring it into compliance with both EU and WTO requirements. EU specific-concessions include tariff rate quota (TRQ) reductions and binding tariff concessions on a broad range of products.[50] For example, on accession Poland will be required to apply the EU's Common Customs Tariff, and the external trade provisions of the Common Agricultural Policy (CAP) that will require it bring the average MFN rate on industrial products down from 9.9% to 3.6%.

The ***Central European Free Trade Agreement*** (CEFTA) was signed by Poland, Hungary, the Czech Republic and the Slovak Republic in December 1992 and entered into force in 1993.[51] CEFTA was created to replace CEMA and the COMECON trading bloc under which members have agreed to the phased elimination of all customs duties on all industrial and agricultural

[49] The EA is not a trade agreement per se, but instead seeks to promote broader political and social agenda that is consistent with the requirement of EU membership. For example, Poland's EA includes chapters on political dialogue, general regulations, movement of workers, services, payments, capital, Competition, approximation of laws, economic and cultural cooperation and other subjects.

[50] For GSP products, tariff rate quotas (TRQ) were increased by 10% per year over the 5 year period, accompanied by 50% duty reductions over the first 2 years. Duties on products with no TRQs, were reduced by between 30% and 100%. For non-GSP products, concessions average a 10% per year increase in TRQ accompanied by a 20% decrease in duty over each of the first 3 years. Polish concessions to the EU also include an average tariff reduction of 10% on 247 agricultural products.

[51] Membership has since expanded to include Slovinia (1995), Romania (1997) and Bulgaria (1998). Likely prospective members include Latvia, Lithuania, FYR Macedonia and Croatia.

products within the FTA. Thus far, tariffs among CEFTA members have been eliminated on 80% of industrial goods and on approximately 50% of agricultural products. In 1994, CEFTA members agreed to accelerate tariff reductions by one year, so that tariffs on all non-agricultural goods would be eliminated by January 1,2000.

In addition to the above, Poland entered into a bilateral free trade agreement with Lithuania that became effective came in January 1997. Approximately half of all agricultural products included in the agreement are tax free for both countries. Some sensitive products for each of the countries (e.g. sugar, products containing sugar, mutton and some fruits and vegetables) are excluded.

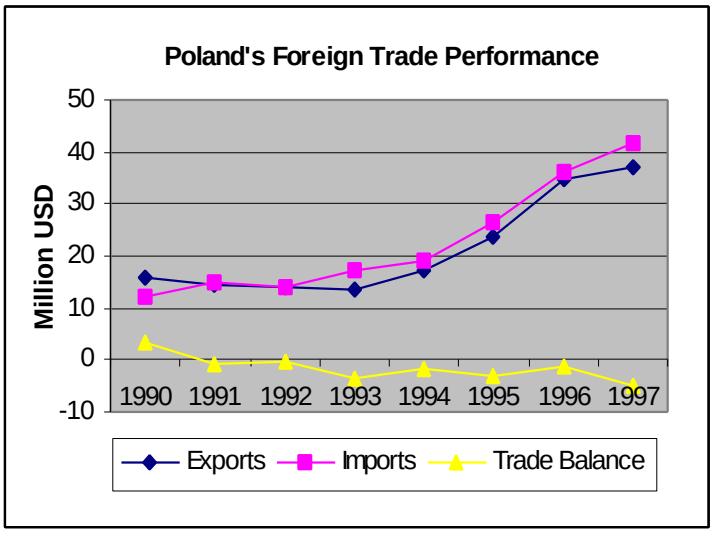
Poland became a signatory of the ***General Agreement on Tariffs & Trade*** (GATT) on October 18, 1968 and a member of its successor organization, the ***World Trade Organization,*** on July 1, 1995. New Polish anti-dumping legislation entered into force on 1 January 1998. Other relevant multilateral organization to which Poland has become a member include the ***Organization for Economic Cooperation & Development*** (OECD), the ***International Monetary Fund*** (IMF), ***the European Bank for Reconstruction & Development*** (EBRD) and various relevant United Nations organizations including the ***Conference on Trade & Development*** (UNCTAD).

A principle advantage enjoyed by Poland in this area of commercial law development - as in others - was that it started the reform process earlier than the other nations included in this study. Starting in the early 1980's, Poland began to dismantle its system of state control over foreign trade. Prior to 1982, Poland's foreign trade sector was organized on the principles for central planning and state control.[52] Under this system, foreign trade was restricted to specially licensed Foreign Trade Organizations (FTO). Accordingly, domestic producers had no direct access to foreign buyers, nor did they have access to current information on foreign trade opportunities.[53] By 1989, private firms and individuals were allowed to engage in import and export transactions without direct state control. Thereafter, in 1990, a majority of Poland's tariff and non-tariff barriers were eliminated. Since then significant progress has been made toward increasing transparency of remaining barriers to trade.

Demonopolization of Poland's export sector promoted a surge of new entrants in the foreign trade sector as illustrated in the accompanying charts. In the first instance, a period of sharp growth in new entrants, particularly in micro- and small-scale exporters, took place between 1992 and 1994. In absolute terms, the annual number of new entrants increased from slightly under 60,000 in 1992 to approximately 100,000 in 1997. In economic terms, the impact of this surge in micro- and small-scale exporters is somewhat less dramatic. As a percentage of total value of exports, the micro- and small-scale exporters combined share of exports increased from approximately 23% in 1992 to 24% in 1997. The value of total export volume attributable to large exporters (+$6m) declined from approximately $67.5% in 1992 to 11% in 1997. Despite increases in export volume during the relevant period, Poland's terms of trade eroded from $3.6m in 1990 at the time tariff liberalization was initiated to -$3.2m in 1995.

[52] This system was characterized by a small number of firms specialized by function (e.g., IMPEX banks) or product (e.g., metals and minerals).
[53] By contrast, vestiges of this system can still be found in many of the former Soviet republics.

Poland's progress in liberalizing its trade regime has been impressive. Restrictions on agricultural imports, for example, were converted into tariffs in May 1995. Most licenses, and all quantitative restrictions, have been eliminated. This is not to suggest, however, that liberalization has been easy—or smooth. In December 1992, for example, Poland instituted import surcharges to address a rapidly declining balance of payments situation. These were later reduced to 5% in 1995, 3% in 1996, and phased out completely in January 1997 in accordance with Poland's undertakings with the WTO. As with many other transition economies, Poland's government continues to face strong domestic pressure for protection, particularly in the agricultural, steel and petrochemicals sectors. Today, Poland has a variety of non-tariff trade restrictions[54] of imports in the form of licenses,[55] preferential tariff quotas,[56] and import prohibitions.[57] Non-tariff trade restrictions for exports include licenses[58], quotas,[59] and prohibitions.[60] Generally speaking, however, Poland's WTO membership and closer association with the EU are likely to be powerful forces weighing against the impulse to backslide on trade liberalization due to short-term trade and payments imbalances.



Source: World Bank, IMF.

The EA provides for the establishment of a free trade area between Poland and the EU accomplished through the progressive elimination of customs duties on a wide range of products. In line with this process, Poland is aligning its national goods nomenclature to the EU Combined Nomenclature and is in the process of preparing an integrated tariff that will facilitate comparison between Poland's tariffs and those applicable in the EU. Finally, Poland has moved forward to integrate its customs regime into the larger international framework by becoming a

[54] See, *Trade Barriers & Opportunities in Poland*, Michael, J., Central & Eastern European Economic Research Center, University of Warsaw, 1997.
[55] License requirements apply to alcoholic beverages, military equipment, radioactive materials, petroleum oils, tobacco products, natural gas and goods for assembly of automobiles.
[56] Including, inter alia, wheat, barley, oats, vehicles, paper, computers, paper containers for juice and milk, among other items.
[57] Including two-stroke engines, tractors, special purpose motor vehicles and other items.
[58] Including radioactive materials, military equipment, coal, petroleum products, natural gas and goods subject to quotas.
[59] Textiles to the EU, Canada and Norway, ferrous waste scrap, raw hides, and other products.
[60] Including geese eggs, non-food trade with Iraq, and trade with Libya on certain industrial items.

signatory to the EC/EFTA Common Transit and Simplification of Formalities Conventions in July 1997.[61]

Implementing Institution(s)
The lead Implementing Institution for International Trade is Poland's Ministry of Economy. Until recently, the key units within the Ministry responsible for International Trade-related matters included:

- ***Economic Strategy Department*** - Develops socio-economic policy with general, sectoral and regional impact;. Also collects data and prepares reports to the EU and WTO on state aid programs;

- ***Department for European Integration*** - Deals with trade policy issues as they relate to Poland's application for full EU membership;

- ***Multilateral Economic Relations Department*** - Responsible for implementation of treaty policy requirements and maintaining working relations with the WTO, OECD and other multilateral organisations;

- ***Bilateral Economic Relations Department*** - Primarily dealing with EFTA and CEFTA relations concerning cross-border and regional cooperation; and,

- ***Economic Policy Instruments Department*** - Entity within the Ministry responsible for interpretation and enforcement of defensive instruments (i.e., antidumping, countervailing, safeguards) and implementation and coordination of customs policy and administration.

As of January 1, 1999, however, the Ministry implemented a restructuring plan that reorganised functional departments along subject matter divisions. In effect, this reorganisation decentralises responsibility for trade policy and enforcement. A newly created administrative unit, the Trade Defence Department, will be responsible for enforcing Poland's antidumping, countervailing, safeguards provisions. This new unit is currently staffed by 12 experts and future growth is anticipated.

Supporting Institution(s)
For the purposes of this analysis, Poland's Customs Service will be evaluated as the primary "Supporting Institution" for the International Trade component of the analysis. The Tier II indicator result of 49% for this Dimension (the lowest of any Dimension evaluated in the assessment) reflects to a large extent our findings with regard to End-User perceptions concerning the Customs Service's effectiveness.

Poland's Customs Service is comprised of a Central Board of Customs, 19 regional customs offices and 400 frontier stations. The customs service currently employs approximately 14,000

[61] See, e.g., Agenda 2000 - Commission Opinion of Poland's Application for Membership of the European Union, No. 97/16, p. 39-40, July 1997.

staff. Despite advances in the areas of customs law reform noted above, the Customs Service is generally viewed as being significantly challenged in terms of institutional capacity to interpret and enforce the laws.

Generally speaking, the business community representatives interviewed during the diagnostic viewed customs administration in Poland as inefficient, unpredictable, and prone to petty corruption. The principal complaints registered concerned lengthy processing delays, inconsistent interpretation and application of regulations (especially relating to tariff classification), a general lack of transparency due to poor communication of policy changes, and petty corruption. While these difficulties are by no means unique to Poland, they do represent a significant challenge - and potential obstacle - as Poland lays the policy and institutional groundwork necessary for full membership in the EU.

As noted above, a series of legal and policy reforms have already been initiated in order to bring Poland closer to compliance with EU standards. The Customs Services' capacity to internalise and implement these policy changes seem to be overwhelmed. In this respect, additional capacity in the areas of information dissemination and staff development are certainly inadequate. The lack of adequate information technology infrastructure, however, appears to be the largest and most critical capacity constraint faced by the Customs Service. Without the needed information management capabilities, the Customs Service appears unable to coordinate and manage the operations of its regional offices and frontier stations at the level required for membership in the European Customs Union. Similarly, Customs Service management has not been able to develop an integrated strategy to remedy these deficiencies. So short-term prospects for rapid capacity improvement are not promising without significant outside financial, technical, and strategic planning support.

The Market for International Trade Liberalization

Poland's international trade sector offers a unique opportunity to examine the related concepts of "gravitational pull" and "exogenous demand" that we have used to help illustrate certain aspects of C-LIR. The concept of gravitational pull refers to a situation, like that found in Poland, where due to physical proximity (or other linkages such as complementary markets, shared cultural heritage, shared language, shared political orthodoxy, etc.), one country is "pulled" into the orbit of another, adopting norms and standards that approximate those in place in the dominant sphere. In addition to Poland's approximation of laws in anticipation of future EU membership, legislative changes in Mexico to clear the way for the North American Free Trade Agreement (NAFTA) could be viewed as an example of gravitational pull as that concept is used in this analysis. Countries of Eastern and Central Europe experienced a similar gravitational pull (push) when, following World War II, they were forced to conform their laws in varying degrees to the Soviet model. This could be viewed as ideological or political gravitational pull. Another possible example is the gravitational pull that multilateral regimes defined by subject matter or function exert on countries including the WTO, the World Intellectual Property Organization (WIPO), the International Standards Organization (ISO), and others. Within the context of the WTO, for example, an individual country's "weight" is determined (formally or informally) by its share of world trade volume based on purchasing power parity.

Exogenous demand is a related, but different concept. Exogenous demand for reform can come from a trading partner (e.g., current bilateral negotiations with Chine on WTO membership), a multilateral development agency (e.g., World Bank and IMF conditionalities), from regional groupings (e.g., EU, MERCIFUL, etc.) or potentially from a variety of other sources (e.g., industry and product standards, technical protocols, religious doctrine, etc.). Based on our findings, we feel that Poland's experience in the subject matter area of international trade illustrates both phenomena rather well.

Poland's membership in the WTO and prospective membership in the EU are two powerful gravitational forces that certainly are contributing to the relatively rapid and progressive agenda of trade liberalization that Poland has committed itself to. Interestingly, however, it is in the trade arena that some of Poland's greatest obstacles to EU membership exist. Within the framework of legislative approximation, we found that End-Users are generally given advance notice and an opportunity to provide input on major legislative initiatives relating to trade regulation [80%]. Although it was difficult to gauge based on the sample interviewed, the Government does appear to actively solicit and accept stakeholder input in the trade policy formulation process [70%].

As noted in the preceding section, specialized administrative bodies have been established within Government to review proposed legislative reforms to assess the regulatory burden placed on End-Users, as well as conformity with relevant EU legislation [80%]. With the exception of the Supporting Institutions discussed above, End-Users interviewed during the diagnostic did not feel that the existing trade regime was stable, and generally took a dim view of the trade regime's responsiveness to their needs [40%]. Similarly, End-Users reported that they did not feel that they had a meaningful opportunity to participate in setting the trade policy agenda [50%], however, they continue to actively lobby for reforms, particularly in the area of customs administration.

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UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

COMMERCIAL LEGAL REFORM ASSESSMENTS FOR EUROPE AND EURASIA

Final Diagnostic Assessment Report for Kazakhstan

USAID Omnibus II-C: Policy/Legal/Training
Contract No. EPE-I-95-00071
Task Order No. EPE-I-09-95-00071-00
July 1999

BOOZ·ALLEN & HAMILTON INC.
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APPENDIX A – CONTACT LIST **A-1**

I. Overview

"Oh, East is East and West is West,
And never the twain shall meet . . ."[1]

The Kazakhstan diagnostic provides the final component in a four-country study that has assessed the current commercial law environment in Central and Eastern Europe and the New Independent States (CEE/NIS). Each country included in this study—Poland, Romania, Ukraine, and Kazakhstan—was selected for its unique circumstances, including location, geography, size, economic base, legal traditions, and relative progress in transition toward a market-oriented economy.

Kazakhstan sits at an international crossroads, linked to Russia and Central Asia as well as the Indian Sub-continent, China, and the Middle East. Its mineral reserves (oil, gas, gold, and others) generate great interest from Western investors and international policy-makers. At various levels, it is a meeting ground of East and West. The success or failure of reforms can provide valuable lessons for reformers in other transition economies.

Kazakhstan is strongly committed, at the highest decision-making levels, to a market economy and its concomitant reforms. In the few years since independence, the government has adopted numerous new laws, courted foreign investment, and made substantial moves toward a market-oriented economy. One result of this work is that Kazakhstan has the highest level of per capita foreign direct investment of any of the former Soviet republics, including Russia.

A strong president who actively seeks input from the West has led these changes. This attitude is well characterized by his creation of the Council of Foreign Investors, in which representatives of Western multi-nationals and high-ranking Kazakhstan government officials meet regularly to analyze the investment environment and make recommendations for change.

But not all Kazakhstanis are so enamored of the changes. In the hinterlands—at the *oblast* level—there is much resistance to the new rules that come with market reform, though certainly not in all oblasts. Complaints are frequently heard that new laws are "Western" and ill fitting. Foreign invest333ors find poor treatment and unnecessary difficulties in dealing with regional officials. While there is a wide range of reactions to these changes, there is also a wide gap – as the diagnostic shows – between the new "modern" laws and their implementation and enforcement.

Perhaps Kipling was right, that Eastern and Western values do not interface, and Western "plugs" such as laws and market methods will not fit the Eastern "sockets" of communitarian cultural values. Or, perhaps a more universal influence is at work – the power of inertia and the status quo among people who may not understand the options, or among entrenched officials who do not wish to change. These questions will need additional scrutiny before lessons can be easily applied from the Kazakhstan experience; perhaps this diagnostic survey will provide one viewpoint from which to examine the causes of the gap between adopting laws and implementing them.

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[1] *The Ballad of East and West.* Rudyard Kipling (1865-1936)

The diagnostic assessment that serves as the basis for this study was conducted in Kazakhstan in June 1999. A team of three expatriate lawyers, supported by local experts conducted interviews and data collection. The diagnostic methodology employed during this assessment mirrored that of earlier assessments conducted in Poland, Romania, and Ukraine.

Broad Indicator	Poland	Romania	Ukraine	Kazakhstan
Population (millions)[2]	38.7	22.6	51.2	16.9
Area (km2)	312,683	237,500	603,700	2,717,300
1997 GDP Per Capita[3]	$6,400	$5,200	$3,170	$2,880
Ave. Δ GDP (1990 – 1996)	3.2%	0.0%	-13.6%	-10.5%
% GDP - Government	18.5	10.1	22.0	12.3
% GDP - Industry	30.7	38.7	40.1	30.4
% GDP - Agriculture	5.1	22.8	12.3	12.9
% GDP - Services	64.2	38.5	47.7	56.8
Foreign Aid Per Capita	$17	$9	$4	$8
Corruption Index[4]	4.6	3.0	2.8	--
Credibility Index[5]	68.05	52.96	>40	48.04
Economic Freedom Index[6]	2.95	3.30	3.80	4.05+
EBRD Legal Transition Index[7]	4/4	3/4	2/2	2/2
Moody's Emerging Mkt. Rating	Baa3	B3	B3	Ba3

As indicated by the table of general economic indicators and perception indices above, Kazakhstan ranks behind Poland in all areas, but rates fairly evenly with or ahead of Ukraine. The economy contracted substantially through 1996, though not as badly as Ukraine's. While the government portion of the economy is less than in Poland and Ukraine, the private sector has been unable to increase the overall GDP. Kazakhstan also trails Poland and Romania in credibility, while surpassing Ukraine, but is last in economic freedom. Government may be changing, but the investment in change at the top has not yet percolated through the country as a whole sufficiently to affect these indicators.

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[2] *Population Division and Statistics Division of the United Nations Secretariat, 1998 (http://www.un.org/Depts/unsd/social/poptn.htm).*

[3] *International Monetary Fund*

[4] *Transparency International 1998. Scale = 1 - 10. Higher scores indicate less corruption.*

[5] *Euromoney Magazine, December 1997. Scale = 1 - 100. Higher scores indicate greater credibility of government offerings and undertakings.*

[6] *1999 Index of Economic Freedom Rankings,* The Heritage Foundation (*www.heritage.org*). *Scale: 1-1.99, free; 2-2.99, mostly free; 3-3.99, mostly not free; 4-5, repressed.*

[7] *European Bank for Reconstruction & Development, 1998 Transition Report. Scale = 1 - 4+, where 4+ is most advanced. 1997 and 1998 figures are included. Of those countries included in the Sample, only Romania's score changed between 1997 and 1998.*

II. Summary Indicator Results

The summary table below contains the raw Tier I and Tier II indicator results. No attempt has been made to "balance" the four dimensions of this analysis, or give differential weighting to the subject matters areas. For a detailed discussion and analysis of the results, consult the Tier III tables and associated discussion for each subject matter area.

Based on the results of the in-country assessment, Kazakhstan ranks roughly equal with Romania, ahead of Ukraine, and behind Poland in most areas of legal reform. The scores indicate much room for improvement in attracting and maintaining investment and commercial development. Yet, without a time scale, it is easy to miss that these static numbers do not capture the dynamic nature of change over the past few years.

	SUBSTANTIVE AREA	Poland	Romania	Ukraine	Kazakhstan
A.	**BANKRUPTCY**	**78%**	**54%**	**37%**	**50%**
	1. Legal Framework	80%	59%	41%	60%
	2. Implementing Institutions	80%	62%	45%	51%
	3. Supporting Institutions	76%	52%	33%	49%
	4. Market for Effective Bankruptcy System	78%	45%	28%	41%
B.	**COLLATERAL**	**77%**	**32%**	**48%**	**35%**
	1. Legal Framework	90%	44%	76%	56%
	2. Implementing Institutions	79%	13%	56%	23%
	3. Supporting Institutions	65%	35%	31%	31%
	4. Market for A Modern Collateral System	75%	37%	30%	28%
C.	**COMPANY**	**79%**	**62%**	**44%**	**59%**
	1. Legal Framework	81%	63%	47%	62%
	2. Implementing Institutions	76%	73%	52%	67%
	3. Supporting Institutions	82%	70%	42%	58%
	4. Market for Efficient Company Law	78%	43%	33%	48%
D.	**COMPETITION**	**80%**	**60%**	**41%**	**62%**
	1. Legal Framework	82%	66%	55%	64%
	2. Implementing Institutions	81%	62%	42%	64%
	3. Supporting Institutions	81%	62%	42%	65%
	4. Market for Open, Competitive Economy	78%	49%	28%	56%
E.	**CONTRACT**	**80%**	**63%**	**45%**	**64%**
	1. Legal Framework	83%	74%	50%	73%
	2. Implementing Institutions	83%	73%	49%	66%
	3. Supporting Institutions	79%	66%	50%	54%
	4. Market for Efficient Contract Law	75%	37%	30%	62%
F.	**FDI**	**77%**	**57%**	**41%**	**66%**
	1. Legal Framework	87%	96%	89%	83%
	2. Implementing Institutions	82%	58%	18%	68%
	3. Supporting Institutions	66%	38%	28%	50%
	4. Market for Increased FDI	75%	37%	30%	65%

	SUBSTANTIVE AREA	Poland	Romania	Ukraine	Kazakhstan
G.	**TRADE**	**68%**	**54%**	**33%**	**52%**
	1. Legal Framework	93%	90%	56%	79%
	2. Implementing Institutions	71%	53%	34%	61%
	3. Supporting Institutions	49%	40%	19%	32%
	4. Market for Trade Liberalization	61%	35%	21%	36%
AGGREGATE TOTALS for all areas of law		**77%**	**55%**	**41%**	**55%**
	1. Legal Framework	85%	70%	59%	68%
	2. Implementing Institutions	79%	56%	42%	57%
	3. Supporting Institutions	71%	52%	35%	48%
	4. Market for Trade Liberalization	74%	40%	28%	48%

Kazakhstan clearly faces the challenge of an implementation/enforcement gap. In most areas, the legal framework is much stronger than the implementing and supporting institutions. Where the gap is smallest—such as Company law with a 67% score for implementing institutions and a 62% score for the law itself—the legal framework is weak. Perhaps this presents a target for reform—using the stronger institutions as a basis for strengthening the framework.

The weakest scores are in the two areas that may have the most significant long-term impact on the availability of credit: bankruptcy and collateral. A well-designed, well-enforced bankruptcy regime permits lenders to assess and control their risks more effectively. Likewise, collateral law permits lower-risk, secured lending. Together, the two laws contribute to the growth and availability of lower cost credit for both business and consumers. The fact that both areas have very low scores in the market for reform suggests that there is a serious gap in understanding the function of these laws, or the benefits they can support. Kazakhstan must surmount the deficiencies in these areas to move beyond self-financed investment and create an environment for broad-based development. Poland, which has much higher scores in both framework and implementation, also has much greater development.

As with all of the countries, Kazakhstan earns a high score for the legal framework for Foreign Direct Investment. Policy-makers want and need to attract substantial foreign capital for the rich mineral industry in this country. The law also targets manufacturing, however, in recognition that commodity development is not enough to support economic development. Even so, scores in those areas that are needed to make investment attractive—collateral, company, and contract—are much too low to support the level of investment desired or needed. The overall diagnostic can be interpreted to suggest that the state is, perhaps, courting foreign money while leaving domestic investors out of the picture. This is not only a questionable economic strategy, it is poor sociology that can fuel xenophobia in the hinterlands.

The legal framework for trade scores relatively high marks with 79%, well ahead of Ukraine (56%) but behind Poland (93%) and Romania (90%). Kazakhstan also has one of the higher scores for implementing institutions, with 61%. (Only Poland scores higher, with 71%; Romania and Ukraine lag far behind, with 53% and 34%, respectively.) Viewed together with the scores for foreign direct investment, a picture emerges of reforms intended to bring Kazakhstan increasingly into the global marketplace, both as a magnet for investment and a crossroads for

trade. Again, the low scores on market (36%) and supporting institutions (32%), indicate that the reforms flow from upper-level leadership, with much work yet to be done in order for the country as a whole to embrace these changes.

Considering Kazakhstan's history of command economy and state controls, the scores for competition are encouraging. The legal framework received marks of 64%, roughly even with Romania (66%), ahead of Ukraine (55%) and, as always, behind Poland (82%). Implementing and supporting institutions are at approximately the same level of development. Internalization of the reforms is likely to take time, but the path seems headed in the right direction.

While Kazakhstan's scores are not stellar, the picture they sketch should not be characterized as bleak. The past two years have brought much positive change, and there appears to be a strong political commitment to continue on this road to reform. Success, however, will certainly require a growth in demand for these reforms at the bottom, not just a supply from the top.

III. Notes on Scope & Methodology

This diagnostic assessment was designed to help achieve the following objectives:

1. To provide a factual basis for characterizing the degree of development and the level of effectiveness of the commercial law reforms initiated in Kazakhstan since independence in December 1991;

2. To provide a methodologically consistent foundation for drawing cross-country comparisons in an effort to identify and describe the root causes of the "implementation/enforcement" gap; and,

3. To provide analytical and planning tools and metrics that will help USAID design new approaches to sustainable, cost-effective C-LIR interventions in the region and elsewhere.

For the purposes of this effort, "commercial law" is defined to include the following substantive legal areas:

- ***Bankruptcy*** - Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets, and rehabilitation of insolvent debtors.

- ***Collateral*** - Laws, procedures, and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying, and extinguishing security interests in assets.

- ***Companies*** - Legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.

- ***Competition*** - Rules, policies and supporting institutions intended to help promote and protect open, fair, and economically efficient competition in the market, and for the market.

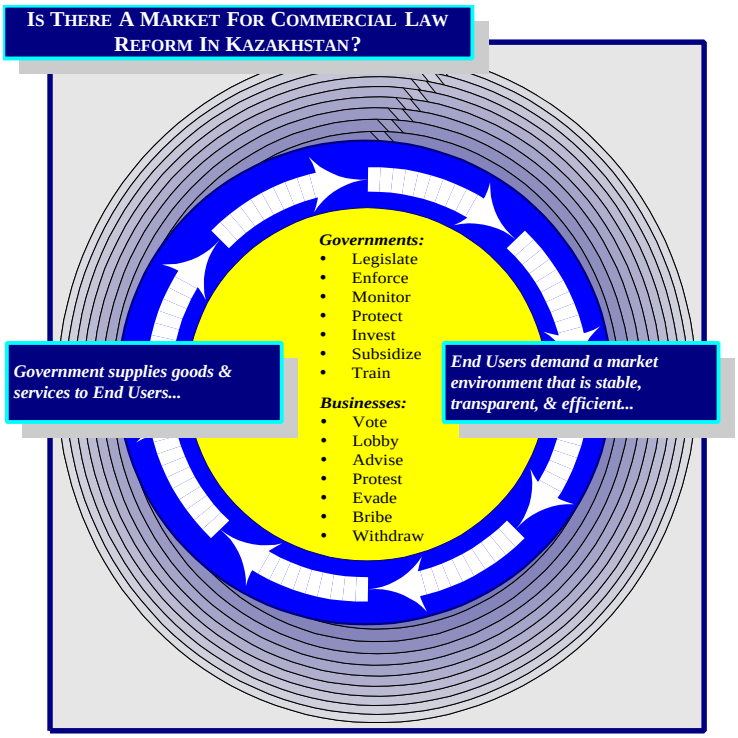
- ***Contract*** - The legal regime and institutional framework for the creation, interpretation, and enforcement of commercial obligations between one or more parties.

- ***Foreign Direct Investment*** - The laws, procedures and institutions that regulate the treatment of foreign direct investment.

- ***Trade*** - The laws, procedures, and institutions governing cross-border sale of goods and services.

Each of these substantive areas was assessed by collecting data across the four sample countries. Within each of these substantive areas, four "dimensions" of C-LIR are proposed as a conceptual framework for comparison. These include:

- *Framework Law(s)* - Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Pledge of Moveable Property);



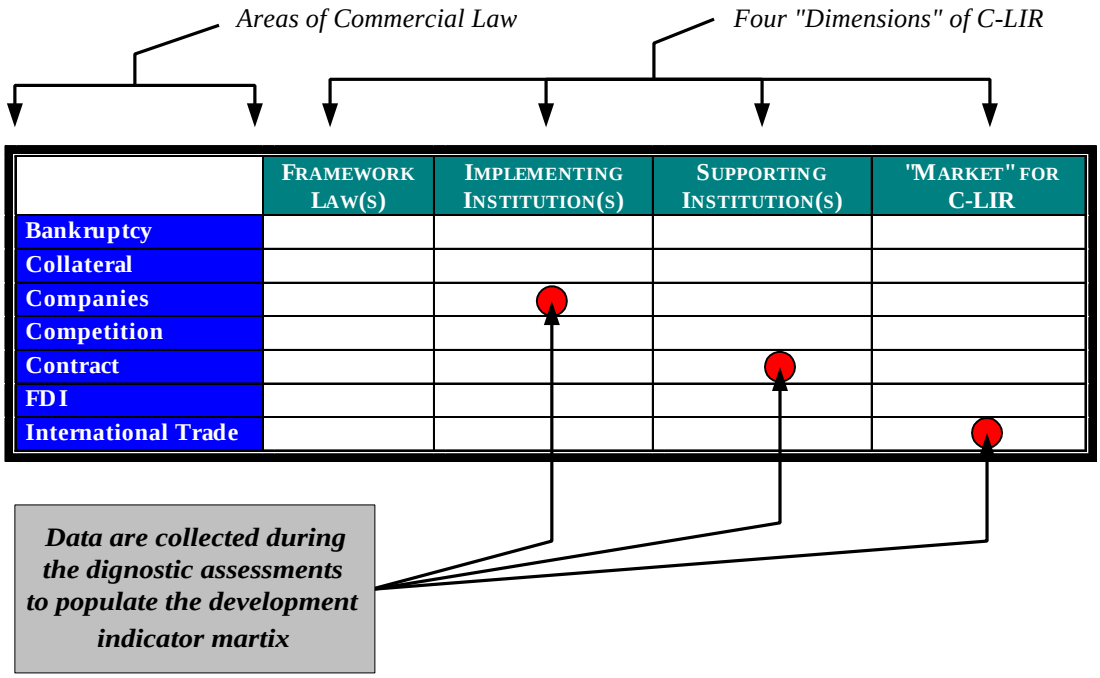
- *Implementing Institution(s)* - Governmental, quasi-governmental or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework law(s) is vested (e.g., bankruptcy court, collateral registry);

- *Supporting Institution(s)* - Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework law(s) (e.g., bankruptcy trustees, notaries); and,

- *"Market" For C-LIR* - The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

Within each substantive area, development indicators have been defined for each of the four "dimensions" of C-LIR. The figure below provides a conceptual overview of how the development indicators are organized. The twenty-eight "cells" below represent groups of development indicators (or simple propositions) that are designed to provide a "snapshot" of the current state of commercial law reform in each subject area. From a practical standpoint, the diagnostic assessment itself is performed by collecting and analyzing data through published sources, and face-to-face interviews, that are used to populate the development indicator tables.

Conceptual Overview of C-LIR Development Indicators



IV. Interpretive Notes for C-LIR Indicator Tables

Figures 1 and 2 below illustrate how the indicator tables are organized, and can be interpreted. The first example presented is a summary table of "Tier I" and Tier II" indicators for collateral law. The four "dimensions" of commercial law development around which this analysis is organized appear in the left column of table. In this case, the table summarizes the collateral law. The next column to the right ("Ref.") contains a "reference value" (i.e., benchmark) against which the countries in this study will be compared. As indicated, the total score for Country A (228) and Country D (181) in the area of collateral law are to be compared against the reference value for this analysis (400). From this example, it might be inferred that Country A's collateral law system is more advanced than Country D's.

FIG. 1 - TIER I & II INDICATORS

COLLATERAL LAW	REF.	A	B	C	D
Legal Framework	100	85	90	22	64
Implementing Institution	100	72	25	33	47
Supporting Institution	100	34	67	35	49
"Market" for C-LIR	100	37	53	66	21
TOTAL	400	228	235	156	181

4 "Dimensions" of C-LIR

Country Totals = "Tier I" Indicators

Sub-Totals = "Tier II" Indicators

The Tier I and II indicators in Fig. 1 above are derived from the raw data collected in the course of the diagnostic assessments. Tier I indicators provide the highest level of abstraction[8] and are intended to be the most useful to policy makers and those interested in broad regional comparisons of commercial law environments. Tier II indicators provide an intermediate level of detail, and are intended to be useful in program design and management where diagnosis and resource allocation are key concerns.

FIG. 2 - TIER II & III INDICATORS

B.1.	LEGAL FRAMEWORK - COLLATERAL	REF.	A	B	C	D
1	Law recognizes personal guaranties, either direct or third party, and bank guaranties	10	2	1	3	7
2	Law recognizes non-possessory pledge in tangibles.	10	4	2	5	6
3	Law creates a property interest that allows holder to execute against the security.	10	4	2	5	8
4	Law allows flexibility in the type of security interest created, and nature of the interest secured.	10	10	2	2	4
	SUB-TOTAL	40	16	7	15	27

Tier III Indicator "B.1.3"

Indicator Identifier

Tier II Indicator

Reference Value for "Legal Framework"

Tier III indicators provide the bedrock for this analysis. In Fig. 2 above, Tier III indicator values are assigned based on the findings of the diagnostic teams. The Tier III indicators are added to yield the relevant Tier II indicator characterizing the legal framework for collateral law.

As noted above, 7 areas of substantive law are being considered in this study. The three tier approach outlined above, while admittedly complex, is intended to provide both the level of detail required by a specialist; yet the degree of abstraction required by senior program managers and policy makers as they address macro-level issues.

> ***"Yet having begun, we must go forward to the rough places of the law...."***
>
> **Plato's Republic, Book V.**

[8] Tier I indicators consist of the sum of twenty-eight Tier II indicator values (i.e., four "dimensions" each for 7 substantive areas of law under consideration) for each country analyzed.

V. Narrative Summary of Diagnostic Findings

A. Bankruptcy Law

Legal Framework

Kazakhstan's bankruptcy law has undergone constant change and fine-tuning in recent years but is still far from perfect. When it was adopted in 1997, the Law on Bankruptcy[9] was praised as breakthrough legislation in Kazakhstan and the Commonwealth of Independent States (CIS). Unlike the prior law,[10] which gave few protections and rights to creditors, the new law adopted the traditional structure of bankruptcy legislation used in Western countries and laid out a relatively coherent set of procedures.

Since its enactment, the law has already been amended three times: on July 11, 1997, July 1, 1998, and July 10, 1998. Not all the amendments are considered improvements. There is widespread sentiment that the Bankruptcy Law, which governs a complex field, is more complicated than necessary, resulting in much misapplication in practice. This trend in complications seems to be continuing in the wrong direction, with one of the implementing institutions currently proposing twenty-four separate amendments.

Even so, the law has set out the ground rules for bankruptcy. Based primarily on a Western model, the law adopts the binary "liquidation or rehabilitation" options. In this approach, the courts supervise the collection of information sufficient for creditors to decide whether the company should be liquidated or rehabilitated. If the company cannot be rehabilitated within 2.5 years, it is declared bankrupt.

Filing of bankruptcy creates a moratorium on debt repayment, allowing the debtor company to attempt rehabilitation. In addition, the law permits some flexibility in negotiating by permitting extra-judicial settlements directly between the debtor and creditors, although the scope of such agreements is limited.

Creditors may initiate bankruptcy proceedings by showing that the debtor is 90 days overdue on debt of more than "150 minimum monthly salaries." Creditors may combine their claims to meet the size-of-claim requirement. Once a proceeding has been initiated, the law prohibits the debtor from disposing of or transferring its assets. This can be an important tool for a creditor who is trying to stop the debtor from selling assets in a non-competitive sale.

Despite improvements in the law, all too often debtors succeed in defrauding shareholders and frustrating creditors' rights. The typical pattern is for management of a large state company to file for bankruptcy after the company has been run into the ground. Although there is a voidable preference period of one year in Kazakhstan, fraudulent or illegal "anticipatory" transfers are infrequently stopped or voided. Thus theory and practice have not sufficiently intersected.

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9 *The Law on Bankruptcy, [Law No. O256], adopted January 21, 1997.*

10 *Decree of the President "On Bankruptcy" of April 7, 1995.*

Debtors also take advantage of an overlap between the new Bankruptcy Law and retained provisions of the Civil Code which continue to deal with bankruptcy. Before the new law took effect, owners of many companies initiated voluntary liquidation proceedings under the articles 50 and 51 of the Civil Code. They filed for liquidation, appointed themselves (or their friends) to serve on the liquidation commission, and controlled the proceedings in such a way as to favor their own interests and those of selected creditors. The end result was that most of the creditors (including the Tax Inspectorate) ended up with nothing.

This practice still exists, but it has been greatly curtailed. The law is now clear that Civil Code liquidations are intended only for debtors who can pay all their debts. When the assets of a company are insufficient to pay off the company's debts, the Civil Code recognizes that a liquidation under bankruptcy proceedings is the appropriate route.

The shift from Civil Code to Bankruptcy Law proceedings is not self-executing, however. Instead, a creditor must initiate the change. In practice, this occurs when a creditor reads in the newspaper that a debtor has initiated a liquidation under the Civil Code, and responds by commencing the proper bankruptcy petition with the court. Of course, if a creditor does not sufficiently monitor the newspapers or court proceedings to learn that a Civil Code liquidation is underway, then debts may be seriously compromised or extinguished, just as happened before the new bankruptcy law was enacted. Further changes are needed to close this loophole.

Another problem area is that the bankruptcy of "individual entrepreneurs" is governed by Article 21 of the Civil Code while the bankruptcy law only applies to legal entities. Individual bankruptcies are universally related to business dealings (non-commercial bankruptcy is not recognized), so that this situation could be handled through the Bankruptcy Law. Selection of law based on the nature of the party seems to be a holdover from the communist period.

It would eliminate much current confusion in the law if the retained bankruptcy provisions in the Civil Code were harmonized with the bankruptcy law and both laws were consolidated in a single piece of legislation. Just to highlight one obvious point: there is no reason why bankruptcy and Civil Code liquidations should not be governed by a single standard of actual notice to known creditors and constructive notice (through newspaper advertisements) to unknown creditors.

Despite its imperfections, the existing Legal Framework for bankruptcy is still far better than Ukraine's and is comparable to that found in Romania. This is apparent from the numerical scores attached to the Legal Framework indicators attached to this report.

Implementing Institutions

There are two implementing institutions for bankruptcy in Kazakhstan: the courts and the Agency for Restructuring and Liquidation of Enterprises ("Agency") within the Ministry of State Revenue. By far, the courts play the more important role.

Under the Bankruptcy Law, jurisdiction over bankruptcy cases is vested in the Commercial Law Collegium at both the Oblast and Supreme Court level. This is the successor to the *Arbitrazh* Courts under the former Soviet system. Currently, these courts only have jurisdiction over legal

entities, although consideration is being given to merging the Commercial and Civil Collegia and eliminating the practice of having the nature of the party determine the jurisdiction of the court.

Either a debtor, or a creditor, or certain third parties may initiate a bankruptcy by filing a petition with the Commercial Law Collegium in one of Kazakhstan's fourteen Oblast or two city courts. Once accepted, all claims against the debtor are consolidated within the bankruptcy proceeding.

Over the next three months, the parties submit documents that clarify to the court (a) the indebtedness of the debtor, (b) the State interest in delaying proceedings for various public policy reasons (for example, privatization, adoption by the Rehabilitation Bank, or the role of the debtor as main employer in a company town), and (c) any interest in and the likely outcome of a rehabilitation attempt. The court then holds a hearing to decide whether to liquidate the company, dismiss the case, allow rehabilitation procedures, or allow more time for considering rehabilitation. If the debtor can demonstrate that it is able to pay off its debts, the court may dismiss the case. If there are no petitions for rehabilitation or if either the secured or general creditors reject the petitions, liquidation proceedings begin. The court appoints a liquidator (usually with the consent of the creditors) who musters assets, considers claims, sells the debtor's property, and distributes proceeds. The company is then removed from the list of legal entities kept at the Ministry of Justice.

If the secured and general creditors each (by voting separately) agree to rehabilitation, then the court appoints a rehabilitation manager (approved by the creditors) who has approximately two years to put the company back on its feet. If this effort is unsuccessful, then liquidation proceedings begin.

The Agency, in contrast, is not a statutory body and has rather circumscribed functions. It represents the interests of budget creditors and initiates extra-judicial bankruptcy proceedings. In addition, the Agency maintains statistics on bankruptcy cases, arranges training for bankruptcy professionals, seeks and attracts foreign investors, and is charged with making recommendations to the Government to increase the effectiveness of bankruptcy procedures.

According to Agency statistics, 5,694 enterprises were included on the Insolvent Enterprises Register as of June 1, 1999. This compares with 4,591 enterprises at the end of 1998. Of these amounts the vast majority of companies are destined for liquidation. Examining the most recent statistics, rehabilitation procedures were applied to only 99 enterprises, while a further 37 are in the process of court examination. By contrast, 820 enterprises were already liquidated, 2,470 are pending liquidation, and 1,616 may be recognized as potential bankrupts. Another 439 of the companies were dropped from the insolvency rolls and resumed normal operations. To complete the picture, 213 were involved in court procedures.

In the case of companies being liquidated, the vast majority of liquidations are handled through judicial proceedings. This reached 85% in the most recent statistics. In recent years the percentage of liquidations handled through non-judicial proceedings has been consistently dropping. There were 26% fewer non-judicial bankruptcy proceedings from March to August 1999.

It should be recognized that many of these bankruptcy cases involve companies that have literally no assets and are only fit for liquidation. In many situations, management has stripped the companies of assets and then declared bankruptcy. As a result, many companies lack sufficient property to meet even creditors' claims of the first order of priority – namely labor "invalids" (valid Workers' Compensation claims). Agency statistics show only 40 cases of deliberate (intentional) or fictitious bankruptcy, but the real number can be assumed to be much higher.

Supporting Institutions

From an institutional point of view, the role of the courts as implementing institutions must be supplemented by a community of experts who understand the bankruptcy process and can effectively implement the bankruptcy laws. This community is a supporting institution for purposes of this diagnostic. It includes trustees, clerks, appraisers, liquidators, crisis managers, bankers, lawyers, etc. – all of whom should be willing and eager to implement the bankruptcy laws.

In Kazakhstan the law designates three types of representatives to protect the interests of the creditors once a company enters bankruptcy proceedings: an administrator, a rehabilitation manager, and a liquidator. The administrator is initially appointed by the court to watch over the company until the creditors can meet. If the creditors decide that a rehabilitation is appropriate, then they choose a rehabilitation manager. If they choose liquidation, they appoint a liquidator.

The bankruptcy law adopted in 1997 required that creditor representatives be trained and licensed. Over 1,500 liquidators, rehabilitation managers, lawyers, economists, and others were trained in two-week bankruptcy training courses offered by three training entities in different urban centers during the past few years. Over 90% of the trained liquidators were licensed as rehabilitation managers as well.

However, the licensing requirement was eliminated in the July 1998 amendments of the law. As one of its 24 proposed amendments to the law, the Agency is urging that this requirement be reinstated, arguing that this is the only way to ensure that bankruptcy professionals meet necessary standards of ethics and professionalism. Skeptics argue that the Agency's position has more to do with the monopoly power that it seeks over the selection of this lucrative class of functionaries rather than any deep-seated desire to improve the system. Kazakhstan is a heavily (over) licensed society which serves the purposes of rent-seeking bureaucrats.

Whatever position one takes on this debate, there is no doubt that liquidation and rehabilitation managers leave much to be desired on the ethics and professionalism front. They often abuse administrative costs through high salaries, inflated staff levels, kickbacks from auditors, etc. The Agency's position is that there should be statutory norms for the compensation of liquidation managers, staff levels, and operations. The Agency also argues that liquidation managers should be given performance incentives to keep costs down and maximize the return for creditors. These changes are included in the legislative proposals offered by the new director of the Agency.

The attached Development Indicators show that supporting institutions for bankruptcy in Kazakhstan are more advanced than in Ukraine though are somewhat behind Romania's. These institutions are embryonic, however, and still well below any acceptable standard.

The "Market" for Bankruptcy Reform

In a demand-driven commercial economy, successful suppliers will adapt their goods and services to meet demand. When supply does not respond to demand, the market will be less robust. This is equally true in Kazakhstan's market for legal reform. In the field of bankruptcy, the market is not thriving.

Clearly, there is demand for a system to deal with failed or failing companies. Registered insolvent enterprises have grown almost 24% in the first six months of 1999, up to 5,694 from 4,591 in late 1998. The demand, however, is coming from two separate sources. On the one hand, some government officials, often at the insistence or influence of foreign donors and lenders, are demanding a new regime to relieve the state of its historical role in paying for bailouts. One the other hand, local "consumers" – creditors and failing companies – have different demands, with a strong preference for a continuation of state bailouts.

In response to this bifurcated demand, there has been a bifurcated supply. Kazakhstan has adopted Western-style bankruptcy laws that could potentially be very effective for rehabilitation and proper liquidation of troubled enterprises. At the same time, however, the state continues to prop up and bail out some companies. Consumers thus have an option, and so far tend to prefer government funds and guarantees to the less certain results of negotiated settlements under the bankruptcy regime. As long as bailouts are available, the demand for formal bankruptcy proceedings will be diminished, and improvements to the system will be delayed, which will further lower the demand.

On the supply side, there are problems both with the substance and the process of the law. Practically everyone with whom the team visited had an unkind word to say about the existing Bankruptcy Law. Even those people who generally favored the law argued that it was unnecessarily complex, hard to understand, too much of an import from the West, and inconsistent with other laws. Frequent changes (one critic argued that essentially there have been four bankruptcy laws in the past two years) made it hard to keep up. Almost certainly, more changes are on the way, but there is no assurance that they will be changes for the better. Existing demand is for a user-friendly law, which is not currently being supplied, resulting in a low level of enthusiasm for bankruptcy as an institution.

Ideals held-over from the Soviet period also affect supply. There are still many in Kazakhstan who do not believe that a company should be allowed to go bankrupt, but should instead be bailed out by the state. This school of thought diminishes demand for a bankruptcy regime, thus impeding the development of a genuine institutional framework that regulates how under-performing and non-performing enterprises *exit* the marketplace. Banks and other creditors will not vigorously enforce their rights under bankruptcy legislation unless they are convinced that state bailouts are unavailable. Once bailouts are no longer an option, the demand for coherent bankruptcy laws will increase.

Reacting to imperfections on the supply side of the ledger, banks, and the private sector have not devoted much attention to the rehabilitation aspects of bankruptcy. Of course, liquidating defunct, asset-bare, State companies is not controversial. But bankruptcy has yet to fulfill the efficient market-clearing mechanism that it does in the West. Weaknesses in the institutional framework of bankruptcy have added to the ambivalence about it. There is a widespread feeling that the law is not understood by the legal community or properly applied in practice. In other words, the supply of bankruptcy law and services is perceived as low quality. Consequently, there is little demand for these services.

Although far from dynamic, a community of bankruptcy experts may be starting to take shape. Fifteen hundred professionals undergoing bankruptcy training is a considerable number. There have been some early signs that creditors, lawyers, and accountants are starting to organize themselves to advocate and lobby for improvements in the law. Experience in other transition economies shows that as the pace of reform quickens, new interest groups form and the policy agenda becomes more extensive. Liberalization of the business environment can be a powerful catalyst, setting off a virtuous cycle where each reform makes the next one easier.

Once the government relegates bailouts to the past, demand will have to focus on the bankruptcy regime. It is expected that creditors will then become much more serious about proper enforcement of rational laws, and the framework will be refined and improved in keeping with local needs.

B. Collateral Law

Legal Framework

Collateral law in Kazakhstan seems to be a case of arrested development. Although framework legislation has been enacted,[11] it lacks the necessary implementing regulations to make the pledge registry a reality. Such regulations have been drafted and were even considered by the Government during November 1998, but they have been left on the table. There seems to be no momentum in Kazakhstan to push collateral law forward at this moment.

The inertia is in part due to priorities (demand) and in part to perceptions of quality of the law adopted, leading to a lack of enthusiasm shared by foreign advisors and Kazakhstanis alike. On the priority side, many of those potentially affected simply feel that pledge registry is secondary to real estate registry, which does not yet exist. Few understand the role of collateral in increasing the quantity and quality of credit. Consequently, establishing the collateral registry is not a high priority.[12]

In addition to low demand, the law is considered both redundant and deficient. The team frequently heard arguments that collateral pledges were adequately dealt with by Article 308 of the Civil Code, and thus there is no need for the 23 new articles under a separate new law. These potentially supportive groups generally find insufficient benefits to justify changing to the new law.

In Western eyes, the law is deficient because it does not provide for filing adversarial liens by pledge holders in cases where the collateral is transferred to a third party. Moreover, there is no clear liability for persons who dispose of collateralized property without the consent of the pledge holder. Thus the lender's security interest is not sufficiently protected.

The collateral law does improve upon the prior regime, however. It applies equally to physical persons as well as legal entities – solving an earlier problem with the draft bill. The law clearly establishes the registration date for determining the priority order of claims. (It is a "race notice" statute.) The registration system seems simple and workable. The law limits the circumstances under which a pledge can be refused registration. And registered pledge holders have a high priority in bankruptcy court.

On the whole, the legal framework has been improved through recent reforms, but not sufficiently. It is doubtful that there will be much additional reform until there is better understanding of the benefits of a collateral lending system.

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[11] *The Law on Registration of Pledges of Moveable Property [Law No. 254-1] of June 30, 1998.*

[12] Many view a collateral registry as a matter of secondary importance. To them, the *real* pledge problem relates to *immovable* property. Currently there is no legal pledge registry mechanism for land. Under current law it is possible to give a mortgage on a building together with the underlying land, but not on land alone. Land titles will not be issued until the necessary cadastral register is prepared. Several interviewees said that once the land registration problem was solved there would be time enough to tackle collateral pledges.

Implementing Institutions

As already noted, Kazakhstan has not yet enacted the regulations necessary to establish the implementing institutions for collateral registration. The framework law simply provides that agencies for registration of pledges of moveable property are "organizations operating under the jurisdiction of the Ministry of Justice…as well as other state agencies and legal entities authorized by legislative acts to register certain types of moveable property…and pledges of such property."

This is a mouthful, and a very unclear one at that. The Ministry of Justice will undoubtedly play a key role in collateral registry, but exactly which agency under the jurisdiction of the Ministry of Justice will be charged with this responsibility is impossible to say. There are currently three agencies charged with some form of pledge registration: the Immovable Property Registry (which registers security interests in buildings and the underlying land); the Motor Vehicle Administration (GAI) (which includes registration of pledges on automobiles, but not tractors, farm equipment or other off-road vehicles); and the Share Depository at the National Securities Committee. It is quite possible that collateral registration will be handled by an entirely new agency.

Where the underlying property is *not* subject to mandatory registration, there is no existing uniform registry system. A partially effective system has evolved to fill this need: creditors sometimes register pledges with a notary. This gives the pledge holder minimal protection by placing others on notice as to the existence of this security interest, but only with that notary. Debtors can (and sometimes do) register a new pledge on the same property with a different notary and thereby frustrate the interests of the first lienholder.

To summarize, existing pledge registration functions are divided among several entities. It is unclear at the moment whether this practice will be continued (with expanded powers for one or more of the entities) or whether functions will be consolidated in a single collateral pledge registry. Until implementing regulations for Law No. 254-1 are adopted, there will be no Implementing Institutions.

Supporting Institutions

The Supporting Institutions for Collateral Law are the courts and the enforcement agents (bailiffs) who execute judgments against pledged property.

The Legal Framework and Implementing Institutions for collateral law are so imperfectly developed in Kazakhstan that the Supporting Institutions have had scarcely any opportunity to respond. The number of cases that come before the courts in the collateral law area are miniscule. The head of the Commercial Collegium in the Supreme Court reports that considerably less than one percent of the commercial cases involves pledges. Not surprisingly, enforcement agents have very little to do with pledged property.

In Collateral Law, Kazakhstan has the lowest score of the four countries studied for Supporting Institutions.

The "Market" for Collateral Law Reform

As is evident from the above discussion, the "market" for Collateral Law reforms in Kazakhstan is extremely weak.

To many Kazakhstani jurists and lawmakers, the collateral law is just another import from the West that is not really needed or relevant to Kazakhstan. Ideally, the demand for collateral law should begin with investors (whether corporate or individual) who can borrow against the value of their movable property, and lenders, who can lower their risks of loss by ensuring against default through security interests. When properly constructed, collateral law improves the quantity (more loans) and quality (better terms) of credit available.

Demand for a collateral regime is weak in Kazakhstan. This is due to several reasons. First, demand for this type of reform is often led by creditor institutions. However, there is very little pressure on Kazakhstani banks to enter this area of finance. They are currently concentrated on trade finance with its high interest rates and quick returns. This has diverted the banks from developing a system for commercial project lending.

To they extent that banks and other lenders do get involved in project lending, they have developed survival strategies outside the practice collateral use. Commercial banks require bank guarantees and personal guarantees, either direct or third party. Lenders take mortgages on commercial buildings and personal residences as security. According to officials at one bank, collateral pledges are mostly used to secure loans by individuals, whereas companies normally pledge immovable property.

From the perspective of the small business community, however, the demand profile is much different. This group is definitely seeking more credit and project finance. This group would normally serve as an engine for creating a collateral system or reforming the existing law. In Kazakhstan, however, the importance of Collateral Law as a way of achieving this objective is scarcely recognized. Hence practically no one is urging vigorous Collateral Law reform at the present time.

It is not surprising, then, that there is little interest in Collateral Law reform at the government level. In some ways, this can be seen as a positive situation: representative government should generally respond to the demands of its constituency; there is no demand for a collateral pledge system, therefore, government is utilizing its limited resources more in accordance with perceived need and not taking a paternalistic approach. Indeed, without an expressed need for such reform, it is unlikely that any law supplied will adequately address local realities and more likely that paternalism will shape the framework, requiring additional reform once demand has developed.

In short, Collateral Law reform in Kazakhstan is ahead of the game. There is virtually no demand for it, and, as a result, no supply.

C. Company Law

Legal Framework

Kazakhstan has undertaken substantial reforms and improvements in its Company Law framework. In 1998, the government adopted the new Law "On Limited and Additional Liability Companies" dated 22 April 1998 and the Law "On Joint Stock Companies" dated 10 July 1998.

Today, Kazakhstani law recognizes the following types of legal entities:

- General partnerships;
- Limited partnerships;
- Limited liability companies;
- Additional liability companies; and
- Joint stock companies.

These entities are generally established pursuant to a foundation agreement (for more than one participant or shareholder) and a charter. The foundation agreement governs the rights and obligations of the founders prior to incorporation or establishment. Once incorporated or established, the charter generally governs the rights of participants and shareholders. The foundation agreement only governs disputes between the founders.

The limited liability company ("LLC") is the most frequently used business vehicle in Kazakhstan. An LLC is a company established by one or more physical or legal persons, not to exceed fifty. The foundation agreement sets forth the participation interests that the members must contribute toward the charter capital. Participant liability for LLC obligations is limited to each participant's charter capital obligation, allowing participants to define their level of risk at the outset.

The joint stock company ("JSC") is expected to become an increasingly popular organizational form for many legal entities doing business in Kazakhstan as a result of the new Law on Joint Stock Companies. The law creates a framework for private sector companies that is familiar to western businessmen and lawyers. The law contains protective clauses for investments in circumstances that have the greatest potential for abuse, such as:

- additional share issues;
- maintenance of charter capital and restrictions on payment of dividends;
- re-purchase by companies of their own shares; debt to equity conversions;
- conflicts of interest for company officers;
- proxy votes;
- independent audits; and
- determination of asset value during sales of company property.

A JSC is a legal entity that issues shares in order to raise capital for its activities. Shareholders of a JSC are not liable for the obligations of the JSC and bear the risk of loss only to the extent

of the amount the shareholder agrees to subscribe for shares. At the time a JSC is formed, the founders must elect whether it will be open or closed. The number of shareholders in a closed JSC may not exceed 100. Shareholders in a closed JSC have a preemptive right to acquire the shares of other shareholders.

An open JSC may have an unlimited number of shareholders who have the right to dispose of their shares without the consent of other shareholders. If an open JSC meets the following three tests, it will be a "public" open JSC: (i) its shares are quoted on an organized securities market, such as the Kazakhstan Stock Exchange; (ii) its assets are worth at least 200,000 times the monthly calculation index (MCI) or approximately $1,250,000; and (iii) it has at least 500 shareholders.

These laws also set forth important provisions in the areas of fiduciary duty and minority-shareholder rights. Among other items, the law gives shareholders a legal right to sue to stop or seek redress for actions that constitute a violation of law or the company charter. Some of the more common abuses are:

- Diversion of business to another company in which the majority shareholder holds a greater interest.
- A majority shareholder awarding himself excessive financial benefits.
- The asset-stripping of controlled or related companies by the majority.
- A share issue offered on a pro rata basis at a manipulative price in the knowledge that the minority shareholder will be unable to buy.

The right of redress for such abuses is limited to situations in which there is a breach of law or the company charter. There is no concept of "unfair behavior" for which a court might intervene on the basis of equitable principles. Thus, a Kazakhstani minority shareholder cannot intervene simply because a majority shareholder obtains excessive rewards -- which is not illegal -- unless the charter forbids such actions. Likewise, dilution of minority shareholding (which is not always illegal even in protective Western jurisdictions) and asset stripping are not illegal per se, leaving minority shareholders exposed to risks that should be more explicitly covered by law.

The existing laws are decidedly steps in the right direction and are better than the laws that they replaced. In addition to the weaknesses in protecting minority shareholders, however, there there are provisions of both laws that have businessmen and lawyers concerned. Clearly the most serious of these provisions is the notorious Chapter 5 of the Law on JSCs entitled "Additional Shares Issued Pursuant to a Court Decision." This chapter is intended to give the State a creative way to collect back taxes from delinquent JSCs without forcing them into bankruptcy proceedings. Briefly, it allows the State, with court consent, to force a JSC to issue new shares to new shareholders, the proceeds of which are applied to satisfy back taxes and other overdue payments to the budget.

There is a strong fear in the foreign business community that the State, by asserting an arbitrary, excessive tax claim, could use this legal authority to, in effect, reverse a prior privatization should the company prove profitable and the government want it back. (This fear is magnified by an anomaly in the tax code, requiring payment of taxes on payables without any offset for

uncollected payables. In other words, the tax code requires tax on amounts invoiced, *whether or not* the invoices are ever collected.) This law reflects a serious lack of understanding by the Kazakhstani authorities of what a JSC is and how it should operate in relation to shareholders, creditors, etc.

Another controversial provision of the JSC Act is Article 22(4), which allows the founders of a company to be granted a "golden share" giving the holder "the right to veto resolutions of the company's bodies on the issues defined in the company charter." Although the "golden share" does not participate in the formation of charter capital or receipt of dividends, this right of veto over an ongoing company's operations has raised alarm bells with investors both foreign and domestic. It is used frequently in privatized companies, allowing ongoing -- though limited -- government control even after privatization.

Lastly, Article 27 of the Law on LLCs requires notification of all creditors when there is a reduction of charter capital and then gives creditors the right to accelerate their debts. Although this provision seems strange in the U.S. context, it is a quite common feature of the European approach to company law which regards the minimum stated capital as the special preserve of creditors. In keeping with this approach to company law, it is not illogical to allow the creditors to accelerate their loans whenever the company's capital falls below their comfort level.

Although not strictly part of the Company Law legal framework, licensing legislation in Kazakhstan establishes an extensive list of investment activities requiring licenses and permits. By law a license is granted without discrimination to any entity that satisfies the requirements for that specific license. Thus, foreign investors may obtain licenses on the same conditions and in accordance with the same procedures as Kazakhstani nationals. Despite this equality, foreign investors fear that they may be the targets of legal and extra-legal harassment – particularly if they find themselves in a minority position in a company.

The Legal Framework for Company Law in Kazakhstan has made important steps forward in recent years. Kazakhstan is considerably ahead of Ukraine and not far behind Romania in the Development Indicators in this category.

Implementing Institutions

Company registration is under the oversight of the Ministry of Justice, which has established territorial bodies throughout Kazakhstan for this purpose. These registering authorities are considered the Implementing Institutions for purposes of this report.

Until recently, a major problem in the overall Company Law framework was the complexity, cost, and corruption involved in registering a new business in Kazakhstan. The simple act of officially registering a business grew into a complicated multi-stage procedure requiring extensive time, money, and influence. This situation created a difficult barrier for small entrepreneurs struggling to find a place in the marketplace, as well as unnecessarily raising the costs of incorporation for wealthier, better connected investors. Fortunately, these problems have been mostly corrected.

After years of mounting complaints from domestic and international business groups, combined with pressure from the World Bank, the Government simplified the business registration procedures. Under Edict 2198[13] of 1995, new procedures came into force. In essence they mandate that the state registration of "a legal entity should be made no later than 15 days, and for small business no later than three working days from the date of submission of an application." The documents required to support an application are clearly stated in the Edict. Should the authorities refuse registration, the reasons for the refusal must be stated in writing, thus creating a basis for appeal or protest based on law.

Under article 5 of the Edict, the Ministry of Justice carries out:

- Registration of legal entities and management of the State register of legal entities.
- Oversight of the "territorial bodies" that handle company registrations.
- Preparation of a quarterly report on new registrations of legal entities and of those that ceased activity during the quarter.
- Consideration of and acting on complaints leveled against the territorial bodies.

Thus, each LLC, JSC, and other legal entities must be registered with a territorial body of the Ministry of Justice. These offices are located throughout the country. Information including the name, address, charter capital, names of the founders, and members of the executive bodies are recorded in the State register of legal entities. The fee for State registration of an LLC or JSC is equivalent to twenty times the MCI as of the date of submission of the documents for State registration, or approximately $125.

In order to establish a legal entity, the following documents must be submitted to the registering authorities of the Ministry of Justice:

- Application,
- Charter,
- A document confirming payment of the State registration fee,
- If one of the founders of the JSC or participants in an LLC is a foreign legal entity, a certificate of registration/good standing from its place of registration.

After registration is completed, the legal entity must complete additional post-registration requirements, including requirements to obtain a tax registration number and register with various social funds.

According to numerous lawyers, bankers, businesspeople, and business-related NGOs that the team interviewed, the earlier problems associated with company registrations have largely been corrected. Practically every person interviewed said that creating a legal entity in Kazakhstan was not a particular problem. The numerical scoring that Kazakhstan receives in this area reflects this improved situation.

Supporting Institutions:

[13] *Edict of the President With Force of Law No. 2198 ("On State Registration of Legal Entities") of April 17, 1995, as modified on August 31, 1995, July 15, 1996 and June 19, 1997.*

In the West, business associations, lawyers' associations, universities, foundations, and even think tanks are key participants in the public policy dialogue that leads to improved corporate governance and protection of shareholder rights. This support structure for Company Law is at a very early stage of development in Kazakhstan.

One consistent advocate for change in the area of Company Law is the Foreign Investment Council - jointly composed of representatives of the Kazakhstani authorities and foreign investors. As further described in the section on Foreign Investment, the Council has proven itself an important voice in how laws are structured and enforced. The comparable body on the domestic side is the Forum of Entrepreneurs of Kazakhstan. With over 2,000 members mostly drawn from the private sector, the Forum is starting to play a more active role. By and large, though, Kazakhstani entrepreneurs are more reconciled to the status quo than their foreign counterparts, having developed their own individual survival strategies in various business settings. The Council and Forum together offer influential support for and input to the legal reform process.

The judiciary also constitutes a Supporting Institution for Company Law in Kazakhstan through its role in interpreting the law through decision-making. The new JSC Law – and to a lesser extent the LLC Law - establish strong standards of corporate governance and protection of shareholder rights. For example, Article 14 of the JSC Law gives shareholders the right to contest company decisions and board of directors resolutions in court and to seek relief from cognizant state agencies. These provisions are designed to curb self-dealing and other abuses of corporate governance.

It is still far too early to say whether the courts will intervene in a creative way in cases of this kind to rule against some of the more egregious machinations found in the corporate governance area. Some critics are skeptical that the courts will be able to play this role and that judges will understand the complex legal issues under consideration. Others see the courts, which already take an interventionist role in many other legal areas, as a positive force for strengthening corporate law.

Some of the persons interviewed by the team studiously avoided the courts and favored local arbitration and mediation, both of which become supporting institutions. Others were generally pleased with their judicial treatment. One respondent reported that frequent use of the courts for contract, labor and debt collection cases resulted in overall satisfaction with the quality of justice dispensed. In addition to general competence in decision making, the courts are reported to be much more efficient than those in other former Soviet Union (FSU) countries: cases are decided expeditiously (often within 30 days of filing the complaint), with adequate appellate recourse to the Supreme Court, permitting redress for unjust results in the lower courts.

Supporting Institutions, in summary, are still nascent but growing. The Council and Forum are expected to develop their roles increasingly over time, and while the courts seem well positioned to fulfill their supporting role. Other institutions are still needed – lawyers' associations, among others. Kazakhstan's scores on the Development Indicators reflect these developments.

The "Market" for Company Law Reform

There is no doubt that the Market for Company Law reform has greatly improved in recent years. Demand has grown from several directions. As noted above, the Foreign Investment Council brings foreign investors together with government representatives, creating an institutionalized channel for investors to voice their needs for law better attuned to the realities of market economics. Likewise, the Forum of Entrepreneurs of Kazakhstan serves a similar function for domestic investors. Together, the two groups represent an important source of demand for ongoing change in the legal framework of corporations.

Not all Kazakhstani business people are demanding reform. Many are quite content with the status quo, having adapted sufficiently through their own survival mechanisms. With changes being compelled by other sectors of the reform market, however, the status quo will change, inevitably affecting the nature of their own demands. The new laws have sparked a vigorous discussion in corporate boardrooms and among shareholders which may lead to intra-company reform, and this reform may well augment the demand for the new systems currently being instituted.

Lawmakers are regularly improving the supply of laws in the Company Law market. A few years ago there was practically a total absence of protection in the corporate governance area – namely the duties and responsibilities of directors and the protections and rights afforded to shareholders. Now legal standards exist and the issue has shifted to whether these rights may be effectively enforced in court.

In addition to the Company Law legislation described above, new laws on the securities markets and the registration of securities transactions were enacted in 1997. Securities are not fully defined under the law; therefore the decision whether a given instrument will be deemed a security rests with the National Securities Commission. Better definition is likely to develop with practice, possibly through regulations, as the Commission exercises its functions. The supply of laws in this area has improved greatly in recent years, and gaps such as the definition of securities can be expected to close over time.

In terms of the responsibility and predictability of the legislative process, Kazakhstan can do much to improve the situation. The business community still feels largely cut off from the legislative process. There is no established system for vetting draft legislation with business groups nor a generalized feeling that the business community has a meaningful role to play in shaping policy reform in the Company Law area. Now that a beginning has been made, Kazakhstan could do more to make its laws accessible, transparent, and user-friendly.

D. Competition Law

Legal Framework

The major enabling legislation in the regulation of competition includes the Anti-Monopoly Activities;[14] the Law on Natural Monopolies; [15] and the Law on Unfair Competition.[16] These three laws establish an effective foundation for restricting monopolies and reducing anti-competitive practices. The common goals of these mutually dependent laws are to stimulate free competition, encourage entrepreneurship, insure consumer protection, and designate natural monopoly markets and their respective operating rules.

The principal implementing institution for the initial legislation was originally the Anti-Monopoly Committee, now known as the Agency on the Regulation of Natural Monopolies and the Protection of Competition (Competition Agency).[17] It is a stand alone agency, not part of any ministry.

Kazakhstan, like other former Soviet republics, inherited a highly concentrated industrial structure with a completely monopolized distribution sector. Kazakhstan had no experience in promoting competitive practices prior to 1991. Existing state structures typically were in charge of setting socially acceptable prices with a sub-goal of preventing speculative transactions.

Kazakhstan has made significant progress in both developing antimonopoly legislation and implementing these laws. The country's legislation, developed with substantial international assistance, provides the basis for vigorous enforcement of sound competitive principles.

The following summarizes the principal legislation. Shortcomings in these laws are discussed after this overview.

1. The Anti-Monopoly Law (AML)

This foundation law is modeled on the competition laws of several Western countries. Its broad goals are to support free-enterprise ("entrepreneurship"), promote market competition, and prevent restrictive trade practices and unfair competition. This legislation is clearly drafted and provides broad but not detailed coverage of basic anti-trust concepts. The AML establishes an administrative body with regulatory authority that includes investigation and enforcement of anti-competitive actions. The Competition Agency is empowered to impose fines, confiscate property, and to initiate court proceedings to enforce its proposed sanctions. This regulatory body appears to combine many of the functions found in both the U.S. Federal Trade Commission (FTC) and the Anti-Trust Division of the U.S. Department of Justice.

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14 *Law of the Republic of Kazakhstan Concerning Development of Competition and Restriction of Monopoly Activities* of June 11, 1991.

15 *Law of the Republic of Kazakhstan on Natural Monopolies* of July 9, 1998.

16 *Law of the Republic of Kazakhstan on Unfair Competition* of June 9, 1998.

17 The Competition Agency was formally known as the State Committee of the Republic of Kazakhstan on Pricing and Anti-Monopoly.

2. Law on Natural Monopolies (LONM)

The legislation was enacted to free "natural monopolies" from restraints and sanctions established in the foundation statute, the AML. The LONM defines natural monopolies as the "state of a commodity, works and service market, where the creation of competitive conditions for satisfying demand for a particular type of [service] is impossible or economically inexpedient due to the technical peculiarities of producing and providing of this type of services…" (Article 3(3).) The LONM establishes a list of applicable activities that are covered by the statutory definition, e.g., transmission/distribution of electric power. The legislation does not discriminate between private and public enterprises in these spheres of activities of natural monopoly entities (Article 4). The legislation includes enabling language for the authority and operation of a natural monopoly regulatory body as well as sanctions for violating the LONM.

Consumer protection principles are more thoroughly dealt with in the LONM than in the original AML. Sections appear on consumer rights (Article 11) and delivery standards for suppliers. This part of the LONM is followed by a section that establishes the buyer's (consumer's) obligation to pay for services rendered by the natural monopoly. (Electric utility payment receipt problems are believed to be the genesis of this language.)

3. The Law on Unfair Competition (LUC)

The LUC moves beyond the general language found in the AML foundation legislation by providing a serious statutory basis for dealing with unfair competition. Specific coverage encompasses:

a) definitions of actions considered as unfair competition;
b) mechanisms for preventing and eliminating unfair competition; and,
c) liabilities associated with anti-competitive behavior including specific sanctions.

The LUC prohibits government agencies and self-regulatory bodies from enacting any regulations that would be discriminatory and therefore favorable to a particular party. Prohibitions include violation of trademarks, service marks, trade names, creation of appearances that will make it difficult to differentiate products, releasing misinformation for competitive gain, predatory contractual terms used in quasi-monopoly situations, collusion between competitors, predatory pricing, misappropriation of trade secrets, etc. It does not, however, handle institutional conflicts of interest with sufficient specificity, nor does it prevent the government from delegating the regulation of their private competitors to state-owned commercial enterprises, as with Kazakhtelecom and Kazakhoil.

Principal shortcomings with the above legislation includes the following:

1. The AML contains an automatic presumption that there is no monopoly so long as the enterprise in question does not control more than 35 percent of any one market. On the one hand, this presumption is not necessarily appropriate in the service and manufacturing industries, where less than 35 percent control may still lead to a non-competitive business environment that discourages new entrepreneurs. On the other

hand, experience in other countries suggests that a lower percentage might create unnecessary interference by the Competition Agency in vetting routine business transactions. The Competition Agency, as the principal regulatory and investigative body, needs to be authorized to establish regulations and guidelines that can effectively deal with different industrial sectors and dynamic economic conditions. While price controls may be imposed by the Competition Agency to companies with 35-65 percent market share, this does not necessarily rectify the dominance that already exists. Changes may, therefore, be needed.

2. The Competition Agency is not politically independent. The need for independence in investigations and administrative proceedings against violators is important in terms of assuring objective and transparent enforcement.

3. Sanctions are set by the enabling legislation rather than the regulatory body. This has direct impact on the effectiveness of both the law and the enforcing agency, the Competition Agency. For example, under the AML, fines are *de minimus*. Moreover, fines and other sanctions may be difficult to enforce through the courts, which are still relatively weak at this stage in their development.

4. The existing legislation does not require the collection, analysis, and free dissemination of anti-competition information. Current quantitative information is not easily accessible.

5. The AML and the subsequent supporting legislation is national in scope but it does not impose sanctions on local *Oblast* officials who participate in discriminatory actions that have an anti-competitive impact.

Implementing institutions

The Competition Agency of Kazakhstan is the principal government agency empowered to enforce the anti-competition laws. The President appoints the head of the Competition Agency, and the Competition Agency has a direct reporting relationship to the Cabinet. The Head of the Competition Agency is a member of the government. The Competition Agency performs functions similar to the U.S. Federal Trade Commission (FTC), the Antitrust Division of the U.S. Department of Justice (DOJ) and other federal regulatory commissions in the U.S. It was created under the AML.

The Competition Agency has seen its role expand due to subsequent legislative initiatives and Presidential decrees. For example, it has expanded its responsibilities to take over the role of the Pricing Committee originally found in the Ministry of Economy. The Competition Agency's principal functions now are de-monopolization, pricing and natural monopoly regulation, registration approval, market supervision and monitoring, investigations, prosecution, and consumer protection.

Since its formation in 1991 and as a result of USAID and other donor agency assistance, the Competition Agency has made dramatic progress in:

- expanding its staff's capabilities;
- assisting in developing a competitive private sector;
- building support for freer markets at both the Cabinet of Ministers and the legal community level; and
- reducing national government regulation of the market; and improving its own regulation of natural monopolies.

These achievements have come about because of major support at the highest levels of government. President Nazarbayev's commitment to a market economy continues with a vision of an economy dominated by the private sector and a shrinking government that intervenes less and less. This is illustrated in part by the Presidential Decree on Insurance, signed on October 3, 1995, which undid the protectionist provisions of the 1992 law (prohibiting foreign participation in local insurance) and re-opened the insurance market to foreign investors.

The Competition Agency suffers, however, from a number of problems that are common to many other government agencies. These include: a high turnover of staff; inability to get qualified staff; inadequate operating and training facilities; limited allocation of budgetary resources; local, *oblast* cooperation problems; and dependence for enforcement on a court system that often lacks the training to appreciate the legislative intent and applicability.

The LUC allows the Competition Agency to counter anti-competitive actions taken by individual state agencies or government officials. Prospectively, this may enable the Competition Agency to prohibit anti-competitive actions taken at the local level and directed at foreign investors. These actions range from the never-ending barrage of local decrees and unique legislative interpretations and enforcement standards that are used as the basis for taking action against foreign investors and local entrepreneurs. One recurring example is the high incidence of frequent tax inspections. These are costly and time consuming, and are occasionally used to undermine the competitive position of the targeted enterprise. The LUC may be used to empower the Competition Agency to address discriminatory practices in the Government of Kazakhstan procurement process that permit domestic suppliers to exceed foreign quotas by up to 20 percent. Whether the Competition Agency will be able to enforce such provisions effectively against the government remains to be seen.

Supporting Institutions

As is the case in Ukraine, it is difficult to assess the role of supporting institutions in the enforcement of the antimonopoly legislation in Kazakhstan. There are questions about the reliability and completeness of the data available from the courts with respect to anti-monopoly cases.

Aside from the courts, various other agencies have come into existence that complement the Competition Agency by promoting an anti-monopoly environment. For example, the Agency for the Support of Small Businesses, established by Presidential Decree in 1998, is intended to promote small business development, analyze small enterprises' competitive position, and interface with agencies such as the Competition Agency to assure a "level" playing field. Its level of activity and effectiveness is difficult to judge at this time. Another example is the Gosstrakhnadzor, created under Articles 40-52 of the new reinsurance law. This statute creates a

supervisory insurance body that has as its genesis the First Presidential Decree on Insurance No. 1658 (April 16, 1994). It is a regulatory body with investigative powers intended to help end a monopoly position for certain types of investment reinsurance.

Unfortunately, there are no data about any meaningful cooperation between the Gosstrakhnadzor and the Competition Agency nor is there any reliable data on the effectiveness of the former institution with respect to improving the competitive environment. Finally, there do not appear to be any NGOs that have become effective adjuncts to the Competition Agency.

In summary, several supporting institutions have been created for the purpose of engendering greater competition. The data currently available, however, do not permit an assessment of their effectiveness.

The "Market" for Competition Law Reform

Kazakhstan's Competition Agency has been effective both as a regulatory body and as a catalyst for changing the government's pro-monopoly orientation that carried over from the Soviet period. It has greatly increased demand for reform by sensitizing both government officials and the business community to the advantages of a free-market economy with healthy competition. The Competition Agency has achieved these results through a variety of training programs and education programs at both the state and *oblast* level.

Advocacy for change in this area is also driven by the domestic private sectors, the foreign investor, and international treaties. While U.S.-style lobbying continues to be frowned upon, groups such as local chambers of commerce and the American Chamber of Commerce, nevertheless, make anti-competitive legislation and enforcement a principal topic of discussion at their regular meetings. They are somewhat effective in communicating their concerns to both Parliamentarians and the President. The President, in fact, appears to consider anti-monopoly enforcement one of the cornerstones of his current economic development regime as is evidenced by both recent decrees and his recently convened foreign investor advisory board. Finally, it is noted that some court cases have resulted in favorable, pro-competition judgements for foreign plaintiffs.

Local government interference with the private sector, especially foreign investors, continues to be a major problem in Kazakhstan. This behavior is often seen as motivated by local officials wanting to offer competitive advantages to favored (local) enterprises. This problem has been a major catalyst for local entrepreneurs and foreign investors calling for enforcement of the anti-monopoly laws and regulation of local government officials who frequently take actions that counter existing legislation. Because it is evident that some of the *oblast*-level interference with private sector enterprise is a direct result of poor training, local government revenue shortfalls, low wage rates, corruption or a combination of all of the preceding, foreign donors are encouraging the Government of Kazakhstan to take corrective measures. In keeping with this, the Competition Agency has undertaken a number of training programs at the local level to overcome anti-competitive actions.

In summary, demand for competition law reform and enforcement is noted among both the domestic and the foreign investor. Budding local entrepreneurs in sectors such as insurance,

banking, and food distribution are keenly aware of the potential and actual negative impact on their businesses of anti-competitive practices. They remain sanguine, nevertheless, about an improving environment. Our investigation found several instances of Kazakhstan citizens who, after living abroad, returned to the country to become investor-entrepreneurs because the "free-enterprise" climate has improved.

E. Contract Law

Legal Framework

The Constitution of Kazakhstan recognizes the equality between public and private property and the protection of private property rights (Article 6 – 1). Although it reserves certain assets or objects for ownership by the state, even those can be included in contractual obligations to which the state is a party. The Constitution also specifies that restrictions on private property may be imposed in order to protect public interest. Separate laws may specify any such restriction. Land is owned by the state, but can also be held as private property under the terms and conditions specified in the law.

The Constitution does not provide directly for freedom of contracts, but has a general guarantee for entrepreneurial freedom (Article 26, (4)) which implies freedom of contract as well.[18] However, freedom of contract is guaranteed explicitly by Article 14 of the Civil Code as one of the basic rights of Kazakhstani citizens.

Kazakhstan's contract law is contained in the Civil Code, but the Second (Special) part of the Code had not yet been adopted during the assessment (however, it was subsequently on July 1, 1999. As a result, the framework law for contracts was not yet fully in place at the time of the assessment. Parliament previously rejected the bill containing the Second (Special) part of the Civil Code because of several contradictions to the Constitution. The rejected draft was based on the Model Civil Code, prepared for the CIS countries, and adopted with some changes in Russia and several other republics. The General part of the Civil Code in Kazakhstan is based on the same model. There were no policy arguments over the Code, but in the opinion of the Constitutional Council the draft needed to be brought in line with the Constitution. Evidently, these needs were met by version adopted by the Parliament in July.

The basic contract law of Kazakhstan is the Civil Code of 1995.[19] The Code contains 405 Articles and covers all basic transactions and the formal requirements for their validity. The Kazakhstani law provides for some separation of business and non-business transactions. This separation is based on the nature of the legal entities or the activities of the individuals involved. Individuals and family units may act as entrepreneurs, in which case different rules or standards of care may apply to some transactions. Legal entities are classified as either commercial or non-profit organizations, and each classification has tax[20] and other consequences.

The law does not recognize any formal difference between commercial and non–commercial contracts. Developing legal theory, however, has begun to delineate the most the most important features of business relationship, such as:

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18 The text, at least in the Russian translation, states that "every legal entrepreneurial activity is permitted" instead of the common principle, that "every activity, not specifically prohibited by the law, is permitted." As a result, different interpretations of what is legal may be offered. Such wording gives rise to the arguments restricting activities not expressly permitted by law.

19 Adopted on December 27, 1994, in force as of March 1, 1995.

20 In practice, however, all organizations are currently treated the same for tax purposes.

- the nature of parties (legal entities or individuals, registered with the State and involved in business activities);
- the special business relations, regulated by the contract (primarily property-related activities, except property transfers related to consumer transactions between individuals);
- any special form, required for the conclusion of contracts;
- any special liability of the parties, including product liability.

The law in Kazakhstan requires the registration of all business entities and most individuals involved in commercial activity. (See Civil Code Art. 19.4 for individuals and Art. 42 for legal entities.) Individuals and businesses cannot, however, use the lack of such registration as a defense in cases when they have been parties to business contracts.

The legal framework for contracts has no significant gaps or weaknesses, at least theoretically. Problems exist at implementation level and are related primarily to the capacity of the judiciary to handle complex commercial cases. Commercial arbitration in Kazakhstan is in nascent stage, but there are no legal obstacles for the parties to commercial contracts to agree on arbitration clauses in their contracts

Implementing Institutions

Dispute resolution on contractual matters in Kazakhstan is carried by the Economic Sections (Collegia) of the district and regional courts. In 1998, they handled approximately 18,000 new cases, a reduction of about 10% from 1997. Almost two-thirds of the cases (65%) are generally resolved within one year and within the time limits established by the law.

Kazakhstan's court system functions reasonably well compared with other countries in transition. The Supreme Court regularly publishes case summaries, including a special section on economic disputes. Lower courts do not yet publish summaries, and there is no classified summary available separating cases according to Code Section or type of dispute. The courts could benefit strongly from improved judicial training, better administrative practices and better dissemination of information. For three years, these issues had been addressed by USAID projects; recently activities in this area have been transferred to the World Bank who has begun implementing a Judicial Reform Project.

Supporting Institutions

Notary services are one the most important supporting institutions for contract law. Notaries have a special role in the continental legal tradition. In Europe, notaries have historically been attorneys who had the privilege to record transactions. Often the notary prepared the documents for the transaction. The books, kept by the notary, served as important evidence of the time and place where transactions were concluded and of the parties involved. In some jurisdictions the institution developed as a parallel land recordation office. The role of the notary has grown beyond simple recordation of facts.

For a European-trained lawyer, the idea that a person without legal training can be a notary will sound outrageous. Yet most of the European laws allow some notary certification services to be provided by non–lawyers in certain circumstances, when access to attorneys is limited or impossible (e.g., on board ships, in remote areas of the country or in military units).

For the purposes of complex commercial transactions the role of the notary becomes more important, yet more limited in scope. On one hand, it is essential to formalize and establish the time of many transactions. On the other hand, those transactions require more complex legal documentation and the notaries cannot be expected to be experts in all areas of law. Yet the law often requires that the notaries review the documents not only to ensure compliance with formalities, but also with respect to their legal content. The state thus attempts to ensure legal stability by guaranteeing that all notarized documents are prepared in accordance with the law.

The situation in Kazakhstan is similar. The Kazakhstan law on notaries generally follows the European legal tradition in maintaining most of the obligations of the notaries beyond simple certification. Notaries in Kazakhstan may only be only Kazakhstani nationals with legal training and at least two years of experience. They must be properly licensed after passing special examinations. Licenses have no time limit and are valid for the entire territory of Kazakhstan. However, certain activities can only be performed by notaries within a specified notary district (i.e. where the real estate is located), and only by notaries admitted to practice in that district.

Private notary practice is allowed and private notaries have the same rights as state notaries. Notary licenses can be suspended or terminated in certain cases, strictly specified by the law (including medical reasons, which prevent the notary from carrying out his obligations, commission of a crime by the notary, gross violations of the requirements for document certification and other similar violations). The decision to suspend or terminate a notary license is subject to appeal.

Allowing private notary practices is a major feature of the new Kazakhstani system. This will improve the accessibility of notaries, increase competition and reduce transaction time. It will also allow certain specialization of the notaries in recording more complex transactions.

Yet the new law does not address some of the principle problems of the European system. It still requires the notaries to review all documents for legal content and inform the parties as to the legal consequences of execution of particular documents. While this provision has some justification in the case of non–complex, day-to-day transactions between individuals, it is unnecessary and even troublesome in complex commercial transactions between sophisticated parties. This situation permits notaries to insist on contract modifications that may not represent the interests of the parties and that may result in unreasonable delays. It may also result in varying practices in different parts of the country or in different notary offices. These legal reviews do not reduce the need for commercial attorneys in the preparation of complex transactions, but can increase the cost of counsel as the lawyers must negotiate with the notaries and renegotiate with each other based on the notary's proposed amendments.

The notaries are restricted by law from participating in any other entrepreneurial activity and from providing legal services other than those related to their notary practices. These

requirements reduce the likelihood of notaries pushing for any reduction or simplification of notary practices that would affect their income levels.

The Ministry of Justice establishes fees for state notary services. Private notaries can negotiate their own fees with the parties. In many cases notary fees are also based on the value of the transaction rather than the level of effort of the notary. Most of the fee in such cases is directly transmitted to the state budget and in fact serves as a stamp duty unrelated to the service provided by the notary. For instance, to notarize a loan agreement for $1,000,000 or $100,000 will require basically the same amount of work, yet command different fees, representing a percentage of the value of the transaction.

Notaries have several other important functions, related primarily to commercial transactions. They may serve as escrow agents and receive payment from debtors for transfer to the creditor, may certify documents for execution based on judicial decisions or other execution titles, as provided by the procedural laws. They may also accept documents for safekeeping.

Prior to the commencement of court action and upon request by the parties, notaries may take action for preliminary injunction in cases when there is serious danger that documents or other evidence may be destroyed. They may also depose witnesses and assist the parties in collection of other evidence.

Kazakhstan has made significant progress in improving the notary practices. The problems in the system are related mostly to the traditional approach to the functions of the notaries. Such fundamental changes are highly unlikely.

The "Market" for Contract Law reform

There is currently little demand for ongoing reform of contract law because the legal framework is virtually complete, and the "consumers" find it generally satisfactory, especially with the adoption of the Second (Special) Part of the Civil Code. As Contract Law is tested over time in the courts, additional need for reform may arise based on practical experience. For now, however, there is no significant recognized need for change.

Although the Civil Code seems to be addressing adequately the demand for Contract Law at this time, there does seem to be some confusion over the position of the Civil Code itself in the hierarchy of laws in Kazakhstan. In general, laws and codes are on the same level, so that in the event of a conflict, the most recently adopted prevails. Legal construction might be better served, however, if the Law on Normative Acts, which defines the hierarchy[21], were amended to

[21] The Law on Normative Acts of November 1998, ranks the laws in the following order of importance:
Constitution
Laws changing or adding to the Constitution
Constitutional Laws and Decrees of the President having the force of constitutional laws
Codes, laws and Decrees of the President having the force of law
Normative Decrees of the President
Normative Acts of Parliament
Normative Acts of Government
Normative Orders of Ministries and State Committees
Normative Decisions of Mayors

raise the status of the Civil Code so its provisions could be altered only by amendment, and not by subsequently enacted laws outside of the codes.

Recent improvements in the supply of contract law are due in part to substantial foreign assistance. Several international projects have supported the development of new legislation. The government has carried out several annual legislative programs, with assistance from international experts, resulting in systematic development of legislation. These programs helped to overcome instability in the first few years after independence resulting from frequent legislative changes.

The more important market for reform at present is for the implementing institutions. Demand exists from the commercial community and the judiciary for judicial training, improved legal education, administrative reforms of the court, and better dissemination of information. Such reform is already being supplied through the Judicial Reform Project. Time will tell how much additional work will be needed.

There is little recognizable demand for reform of the supporting institution of notaries. A more efficient system of pricing, as well as removal of employment restrictions for notaries could permit rationalization of fees and services. Such demand would have to come from the users, but has not yet surfaced in any significant amount. Currently, the supply of notaries in terms of availability and cost is considered sufficient.

F. Foreign Direct Investment (FDI) Law

Kazakhstan is very serious about attracting foreign investment, and this is reflected in the indicator scores. To date Kazakhstan has attracted over $6 billion in FDI, with $1.2 billion in 1998. The expected inflow for 1999 is over $1 billion, but will be lower than in 1998. On a per capita basis Kazakhstan ranks well above all of its neighbors, but is behind the best performing transitional economies in Central and Eastern Europe and Estonia. Yet, foreign investment has largely remained limited to the energy and oil sectors and the related service industries, with little or no effect on the rest of the economy. Being of primary importance for the country, the oil sector is regulated by separate law, but the foreign investment legislation is also applicable in certain circumstances.

Framework law

Kazakhstan has a liberal foreign investment law[22], which places few restrictions on foreign investment, and conforms to what are accepted as international standards for admission and treatment of foreign investors. The law establishes the following general principles:

- National treatment of foreign investors, except in a limited number of cases related to the national security;
- General guarantees against substantive changes in the legislation that will diminish the position of the foreign investor (which permits the investors to be grandfathered under the most favorable provisions of any abolished legislation for up to 10 years);
- Full and adequate compensation based on the market value of the investment in case of nationalization or expropriation;
- Guarantees against arbitrary expropriation;
- Guarantees of repatriation of all profits and other investment related income;
- Duty–free import of the production assets of enterprises with foreign participation;
- No restriction on the employment of foreign staff and managers[23]; and
- Flexible dispute resolution procedures, including arbitration between the state and the foreign investor in internationally recognized venues.

In general, Kazakhstan has stood by these guarantees, but there have been difficulties reported in repatriating profits in at least one case involving a terminated joint venture. Consistent implementation will be essential to ensure investor confidence.

The registration procedures for companies with foreign participation are similar to those for local companies and do not place a significant burden on potential investors. The law makes an attempt to limit any unnecessary involvement in the business activities of foreign enterprises and to protect them from the rent-seeking behavior of various local and central government

[22] *Law on Foreign Investment of December 27, 1994, N 266-XIII*, as amended. (Most recent amendment was April 22 1998, N 221-I.

[23] Since completion of this assessment, Kazakhstan has imposed non-transparent, extensive work permit requirements on all foreign employees, replacing the less intrusive regime encountered during the assessment.

institutions. This provision is more a policy statement than directly applicable norm, but it is important indication of the intentions of the government.

The framework law is on par with the good examples of similar legislation in other transition economies and with the standards set up under model international legislation. It also shares the weaknesses of similar laws elsewhere: it contains too many policy provisions and too few directly applicable norms, while referring frequently to other, unspecified laws.

Another problem is more serious, undermining confidence in the legal investment climate. Existing foreign investment laws could be improved, but are generally accepted by and acceptable to investors. Even so, they have been frequently altered and amended, with six changes during its first five years (three in 1997 alone). Although the amendments do not affect the general principles of the law, they create an impression of legal instability.

Other laws of direct importance for foreign investors are the Law for State Support of Investment Activities and the Law on Free Trade Zones.

Kazakhstan also provides a number of additional investment incentives not included in the main framework law. Those are granted to investors in priority sectors of the economy, in industrial infrastructure or in the new capital Astana pursuant to special agreements concluded between the investors and the Agency for Investment. The incentives include:

- Tax holidays of up to five years, with possible reduction of 50% of the profit tax for another five years;
- Natural grants from the state (i.e. contribution of land, buildings or other facilities to the enterprise); and
- Release from customs duties for the import of goods necessary for the implementation of investment projects. (This provision seems to replicate the provision of Article 22 of the Law on Foreign Investment, which provides very broad exemption from customs duties.)

For some investments, additional security is available by treaty. The European Energy Charter Treaty provides additional protection for investments in the energy sector. Kazakhstan was one of the original signatories to the Charter, and under its terms guarantees that treatment of foreign investment in energy will not be altered while Kazakhstan remains a party to the Charter. This lowers the risk of arbitrary or unexpected changes in the investment framework. Moreover, the Charter elevates some breaches of contracts by governments with private firms violations of the treaty itself. This further lowers the risk of arbitrary or capricious changes. Although the Charter provides no special incentives, it does increase stability for investments in the energy sphere. For European investors, there is another stabilizing influence -- the Partnership and Co-operation Agreement. This treaty provides additional protection for investors from the EU.

Implementing institutions

Kazakhstan has two implementing institutions with clearly defined functions: The Agency of the Republic of Kazakhstan on Investment (ARKI) and the Kazakhstan Investment Promotion Center (Kazinvest).

ARKI was initially established as the State Investment Committee (SIC) under the Law on State Support for Investment. As of June 1, 1999 SIC was restructured as ARKI. It is located in Astana and has the following basic responsibilities:

- Development and implementation of the investment strategy of Kazakhstan;
- Development of proposals and implementation of measures to improve the investment climate;
- Promotion of investment opportunities in Kazakhstan; and
- Protection of the rights of foreign investors.

The main functions of the Agency include the following:

- Maintenance of statistics on foreign investment in Kazakhstan;
- Preparation of legislative amendments related to foreign investment;
- Preparation and negotiation of international agreements related to foreign investment, including bilateral and multilateral investment treaties and conventions;
- Identification of the priority sectors of the economy that qualify for direct state support;
- Identification, together with other authorized state agencies, of the sites of concessions for exploitation of natural resources;
- Registration of all licenses granted with relation to investment projects; and
- Monitoring of the implementation of investment projects and fulfillment of the contractual obligations of the parties.

The Kazinvest is responsible for general promotion of Kazakhstan as an investment destination and for the preparation and presentation of particular investment projects. So far, Kazinvest has prepared a database of over 700 investment projects and organized a number of seminars.

In contrast to ARKI, Kazinvest was conceived as a more business-oriented institution, participating directly in project implementation. Overall evaluation is still premature due to their short tenures, but ARKI and Kazinvest are both showing encouraging signs for success, including:

- Both have undertaken serious studies of experiences in other transition economies, and are adopting solutions based on these investigations and policy dialogues;[24]
- Both institutions have clear mandates and are designed as investment–friendly, one–stop agencies;
- There is cooperation between private sector and government agencies (see the discussion of the supporting institutions below);
- There is a special set of incentives, including a salary scale different from that generally applicable for civil servants, for the staff of ARKI and Kazinvest, which reflects the desire of the Government to maintain high quality staff in those agencies.

[24] Some of the solutions have been controversial, such as an overcomplicated incentive system, which favors major projects over small and medium enterprises, but the institutions are expected to examine the results and make necessary adjustments in the future.

Even so, it is not clear that the Government of Kazakhstan views ARKI as a success in encouraging investment. ARKI, now under the Ministry of Foreign Affairs, has been scaled back, including a proposed amendment to the Forgeign Investment Law and the Law on State Support to Direct Investment that would restrict ARKI's ability to offer tax incentives or relief for investment in primary economic sectors.

Supporting Institutions

Several institutions, similar to those in other countries, are active in Kazakhstan, including the American Chamber of Commerce, all of the major accounting firms and several established law firms, with international reputations. In terms of the available professional services there seems to be sufficient support, especially for major investors. There is still a lack of specialized consulting services for medium and small local companies, which need assistance in attracting international partners. The capacity for project preparation at this level is still limited.

The most interesting supporting institution in Kazakhstan is the Council of Foreign Investors. Although similar councils exist in other countries, the Kazakhstani Council is a model for cooperation between the public and private sectors. The Council consists of representatives of foreign companies active in Kazakhstan and of Kazakhstani officials. It meets with the President of Kazakhstan at least twice a year. At those meetings the Council presents a proposal for the work in the following 6 months and reports on the status of previously approved tasks.

The Council is not a damage-control institution, as is common in some countries, but rather a forward-looking body of experts who prepare proposals for the improvement of the investment climate in the country. Members of the Council interviewed for this diagnostic were very positive about the response of the authorities to their proposals and the fact that Kazakhstani officials participate in the work of the Council.

Market for reform

The market for reform of foreign investment laws poignantly exposes the conflicts between "East" and "West," and suggests that they have yet to meet completely.

The primary source of demand for foreign investment reform comes, quite naturally, from the foreign investors themselves. With the Council of Foreign Investors, they have an excellent institutional platform for voicing their needs and wishes. Complementing this is a cadre of government officials who recognize the importance of foreign investment and generally understand what is required to attract foreign capital. Thus the government itself—under the vigorous leadership of the President—is demanding change.

In a parallel move, there is a growing demand for reform among actual and potential domestic investors. They have recognized the disparity between incentives for large foreign projects and those for small and medium domestic investments, and are crying out for their own benefits. This could lead easily in two directions. First, it could improve the overall investment climate by causing the government to recognize the need for all investment, not just large, foreign projects. By promoting investment generally, without foreign/domestic discrimination, the environment

and economy will improve. The Forum of Entrepreneurs represents a potential source of demand for such changes.

On the other hand, a number of regions have exhibited substantial misunderstanding over the need for foreign investment. There are numerous complaints from the investment community that foreign investors are not treated well by the local authorities, despite the efforts of the Government to improve the situation. Reasons for this ill treatment, other than the corruption and extortion problems identified as the main obstacles to investment by most foreign investors, focus on inadequate understanding by the local authorities about the need for foreign investment for the country. There appears to be little effort at this time to promote investment opportunities at the regional level. Without improved understanding, some regions may oppose future reforms while restraining current ones.

In light of the dialogue with the investment community through the Council of Foreign Investors, there is likely to be an ongoing supply of reform initiatives. The Council has the resources and motivation—while neither is a continuous guarantee—to supply policy, legal, and regulatory ideas for additional reform efforts. These efforts, however, are likely to be diluted or blocked at the regional level unless someone also supplies the necessary promotional activities to begin changing attitudes.

There is also a weakness in the supply of some of the activities necessary to support or reform and increased investment. First, although the implementing agencies have studied the experience of other countries, they have little experience of their own, and little capacity to implement some of the best practices, particularly annual competitiveness reviews and reviews of the technical and administrative barriers to entry. No such reviews have yet been conducted, and thus an important element is missing for identifying further reform needs.

Second, project preparation skills are quite limited. Although this does not affect the legislative framework, it does lower the implementing capacity of the existing investment promotion institutions. For example, Kazinvest has identified more than 300 investment projects, but cannot perform proper presentations of these opportunities. Assistance can be provided in those areas and in the development of proposals for improvement of the investment climate. This situation limits the ability of the local sponsors to seek serious foreign investors and delays project implementation. The experience of various U.S. regional investment promotion authorities could be particularly useful at this stage in the development of Kazinvest and ARKI.

The market for legal reform thus presents a number of challenges to Kazakhstan. The Council, the Forum, Kazinvest, and ARKI together can have a tremendous impact on the shape of the investment climate, but they will somehow have to respond to and begin to reshape the less hospitable investment climate at the regional level.

G. Trade Law

The legal and institutional regimes governing international trade are broad-ranging and complex. By design, many aspects of trade regimes are responsive to changing economic and non-economic factors. Both the diagnostic indicators for trade and the following narrative summary provide a "snapshot" of current conditions without conducting a detailed analysis of the trends or nuances at play in the development of this important area of commercial law.

As summarized in the general indicator table at the beginning of this report, Kazakhstan has a population of 16.9 million and a GDP per capita of $2,880. With its land mass stretching 3,000 miles from the Caspian to China and 1,500 miles from the northern steppes to the Central Asian heartland, Kazakhstan is the ninth largest country in the world. Its five land borders have historically made it a center point in East-West trade and serve, even today, as an indicator of Kazakhstan's potential to play a pivotal role in regional trade.

As the table above shows, Kazakhstan trades predominantly with the Russian Federation and only secondarily with the European Union (EU) and the U.S.[25] Kazakhstan is party to a customs union which includes Russia, Kyrgyzstan, and Belarus. Total trade turnover in 1998 was $8.77 billion with a slight balance of trade surplus that, in turn, is assumed to have been compensated for through "suitcase trade" leaving a de facto current account deficit. A primary explanation for

[25] Source: *ANYA – Kazakhstan Annual Country Profile, 99/1 Anya Ltd.;* Almaty. 1999.

that deficit lies in the sharp fall in export revenue explained by low world minerals and oil prices and the contraction of NIS markets.[26]

Legal Framework

Trade relations between Kazakhstan and the U.S. are governed by a Bilateral Investment Treaty that entered into force on February 18, 1993. The agreement provides for Most Favored Nation status for products of both countries. It significantly improves market access, and it provides non-discriminatory treatment for U.S. goods and services in Kazakhstan and for Kazakhstani products in the U.S. The agreement also obligates both states to protect intellectual property rights and reaffirms both countries' commitment to the protection of such rights. (In practice, however, such protection has been lax, at best.) Kazakhstan is a member of the Generalized System of Preferences (GSP) which provides preferential duty-free entry to over 4,000 products from designated beneficiary countries.

Kazakhstan has, since February 1996, held observer status in the World Trade Organization (WTO)/General Agreement on Tariffs and Trade (GATT). It is currently applying for full membership in that organization and has carried out significant reforms to prepare for accession. In October 1998 Kazakhstan participated in its third Working Party meeting in Geneva where its revised offer on goods and services evoked applause – but no agreement. Kazakhstan has since opted to conduct goods negotiations on a bilateral level with WTO member countries.

During the three years since its initial application to the WTO, the Government of Kazakhstan has produced several partial tariff schedules that have been submitted to the WTO Secretariat. It has cooperated fully with the Secretariat and with member countries, responding to formal questions arising out of Working Group meetings and bi-lateral negotiations. Pending areas of concern for negotiations include the problematic issue of financial services and the substantial issues related to foreign access to the banking and insurance, telecommunications, and transport sectors.

Kazakhstan's current tax and import duty regimes are defined, to a great extent, by the Agreement for the Avoidance of Double Taxation that was signed in 1993 (in conjunction with the Bilateral Investment Treaty) and ratified in late 1998. All Kazakhstani Tax Laws must be contained within the Tax Code of April 1995 (already amended in excess of 20 times), the current form of which imposes a Value Added Tax (VAT) of 20% to all goods and services imports. No VAT applies to exports except to other NIS countries where, by agreement, the "principle of origin" dictates that exports are fully taxed and imports are not taxed.

As of March 1999, 200% tariffs were levied on selected goods, mostly foodstuffs, beverages, and tobacco without expiry dates, from Russia, the Kyrgyz Republic, and Uzbekistan. This measure was in keeping with the defensive suspension of Russian-produced goods imports that was imposed in the wake of the Ruble devaluation of late 1998. Since the end of the June Assessment, these 200% tariffs have ended.

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[26] *Commercial Overview of Kazakhstan, June 1999.* Business Information Service for the Newly Independent States. Chapter II – Economic Scenario.

Customs delays remain a concern of importers despite the 1998 amendment of existing rules. Measures intended to streamline the import entry process, including allowing the use of faxed invoices, have been implemented. However, the inefficient organizational structure of the State Customs Committee (SCC) remains an impediment to smooth customs processing.

According to the United States Trade Representative, Kazakhstan's persistent trade barriers include issues of contract sanctity, burdensome customs requirements, aggressive tax inspections, vague commercial law structures, inefficient registry administration, and intellectual property rights (IPR) failings. On IPR matters, the Kazakhstani government has adopted a Law on Copyrights and Neighboring rights, a Law on Trademarks, Service Marks and Appellations of Origin, and a Law on Patents. All these laws are largely in conformity with international IPR principles but it is noted that enforcement of such laws has been rare and arbitrary.

Implementing Institutions

For the purposes of this Assessment, Kazakhstan's implementing institution for trade is the Ministry of Energy, Industry, and Trade (MEIT). This is the principal government institution for generating state policy on international trade including proposals on customs rates subsequently implemented by the State Customs Committee; on attraction and allocation of foreign investment; and concerning settlement and credit relations in the context of international agreements. MEIT also issues import and export licenses. Consistent trade policy emerging from the Ministry seems indicative of a sound organizational capacity, and its prompt response to foreign queries, albeit supported by expatriate foreign trade consultants, demonstrates the effective commitment of the Kazakhstani government to trade policy enhancement.

Kazakhstan's adherence to the GOST regime of standards, administered by the Gosstandart agency of Kazakhstan, constitutes only a minor impediment to the entry of foreign products into the Kazakhstani market. The GOST (*Gosudarstvenyi Standart* or "State Standard") was established by the former Soviet Union, based originally on German standards of the 1930s. It has been updated on a piecemeal basis, leaving some differences between Kazakhstani standards and Western or international standards. These differences require re-certification of many imported products. In November 1996, the U.S. National Institute of Standards and Technology signed a Memorandum of Understanding with Gosstandart of Kazakhstan to bring Kazakhstani metrology methods into conformity with international rules and practices.

Supporting Institutions

The State Customs Committee (SCC), located in Astana, is the central customs body. It manages 13 customs departments, located in each oblast, and 16 customs houses, located throughout Kazakhstan, including four in Almaty oblast. It is responsible for a total of 12,012 kilometers of land borders and for ensuring that all imports are declared within 15 days of country entry. High government revenue through customs duties ($12.9 billion tenge – 6% of government revenue) ensures that the SCC receives appropriate funding for enforcement and, in fact, at present proposals exist to reinvent the SCC as a separate ministry to the MEIT.

Despite healthy funding levels, SCC performance is unpredictable. Historically, long delays in processing imports through customs have impeded smooth trade relations (while resulting in

increased warehousing revenues for the SCC). Although customs valuation rules largely conform to the GATT Valuation Agreement, and despite Kazakhstan's having patterned its tariff nomenclature after the WTO's Harmonized System, long delays at customs processing departments mean the SCC receives a lower organizational effectiveness rating than Kazakhstani legal structures might have supported.

The "Market" for Trade Liberalization

The market for trade liberalization in Kazakhstan is relatively strong. The progress Kazakhstan has made in meeting the requirements of WTO membership is demonstrative of the government's commitment to a 30-year development program recently announced by President Nazarbayev as "Independence, Prosperity, and Political Stability in Kazakhstan by the Year 2030." On the demand side of the liberalization question, the most consistent advocates of reform have been foreign trading partners and their nationals doing business in Kazakhstan. The government has shown itself to be responsive to their concerns and to the possibility of WTO accession. Unfortunately, as of yet, real progress on a legal level has been only imperfectly translated into effective implementation on an institutional level. The "gravitational pull" of prospective WTO membership holds sway in Kazakhstan to a similar extent that it does in Romania though, without the overwhelming support of the European Union, Kazakhstan has obviously not adapted at Poland's pace. Overall, it appears that Kazakhstan's commitment to trade law reform, once it is fully enforced, has the potential for a measurable positive impact on the living standard of the Kazakhstani people.

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UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

COMMERCIAL LEGAL REFORM ASSESSMENTS FOR EUROPE AND EURASIA

Final
Diagnostic Assessment Report for Ukraine

USAID Omnibus II-C: Policy/Legal/Training
Contract No. EPE-I-95-00071
Task Order No. EPE-I-09-95-00071-00
April 1999

BOOZ·ALLEN & HAMILTON
INTERNATIONAL CLIENT SERVICE TEAM

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I. Overview

The Ukraine diagnostic provides the third component in a four country study that assesses the current commercial law environment in Central and Eastern Europe and the New Independent States (CEE/NIS). Each country included in this study was selected for its unique circumstances including location, geography, size, economic base, legal traditions, and relative progress in transition toward a market-oriented economy. Ukraine was selected for study for many reasons, not least of which include its size, geo-strategic position, and the difficulties it has experienced in making the transition to an open market economy.

Ukraine's experience in transition generally, and commercial law reform specifically, help set up some of the "big" questions that this study was intended to raise. For example, what role do historical chance and culture play in the evolution of commercial life, and the laws the rules that are developed to govern it? Is Ukraine truly a "unique variant" requiring uniquely Ukrainian solutions? What root causes explain the stark differences between Ukraine and Poland's experience in commercial law reform?

Certainly, these questions are not new. More than 160 years ago, Alexis De Tocqueville asked essentially the same questions about America—then a newly emergent democracy and commercial power. In searching for an explanation for America's success, he concluded that:

> "All the causes which contribute to the maintenance of a democratic republic in the United States are reducible to three heads:
>
> 1. The peculiar and accidental situation in which Providence has placed the Americans;
> 2. The laws; and,
> 3. The manners and customs of the people.
>
> These three great causes serve, no doubt to regulate and direct American democracy; but if they were to be classed in their proper order, I should say that physical circumstances are less efficient than the laws, and the laws infinitely less so than the customs of the people. I am convinced that the most advantageous situation and the best possible laws cannot maintain a constitution in spite of the customs of a country; while the latter may turn to some advantage the most unfavorable positions and the worst laws."[1]

The diagnostic team's findings support the widely held view that Ukraine's progress toward a market economy is not proceeding rapidly. Despite the multiplication of McDonald's restaurants, and upscale shops in Kiev, the environment for private commercial activity seems little changed since early 1994. In fact, the commercial environment in outlying oblasts and cities is reported to be eroding.

[1] Democracy in America, Vol. I, Ch. XVII, Alexis de Tocqueville

Digging at the roots of Ukraine's current lethargy in reforming its economy is a difficult undertaking. For those familiar with the country, its culture, and its history, there is something familiar in the widely held belief that the way forward for Ukraine is as unique and distinct as the problems that beset it. If De Tocqueville's observation that the "customs" of the people matter, what are the implications for Ukraine?

The diagnostic assessment that serves as the basis for this study was conducted in-country between March 3 - 17, 1999. Interviews and data collection were conducted by a team of three expatriate lawyers, supported by a Ukrainian law student and an interpreter. Given time constraints, data collection was limited to the Kiev area, however, interviews were conducted with individuals familiar with current conditions in various regions of Ukraine. The diagnostic methodology employed during this assessment was mirrored that of earlier assessments conducted in Poland and Romania.

Broad Indicator	Poland	Romania	Ukraine	Kazakhstan
Population (millions)	38.7	22.5	50.5	16.3
Area (km^2)	312,683	237,500	603,700	2,717,300
1997 GDP Per Capita[2]	$6,400	$5,200	$3,170	$2,880
Ave. Δ GDP (1990 – 1996)	3.2%	0.0%	-13.6%	-10.5%
% GDP – Government	18.5	10.1	22.0	12.3
% GDP – Industry	30.7	38.7	40.1	30.4
% GDP – Agriculture	5.1	22.8	12.3	12.9
% GDP – Services	64.2	38.5	47.7	56.8
FDI (Cum. 1989 - 98 in billions)	$20	$3.4	$2.0	
FDI (Cum. per capita)	$5,170	$1,510	$40	
Corruption Index[3]	4.6	3.0	2.8	--
Credibility Index[4]	68.05	52.96	>40	48.04
EBRD Legal Transition Index[5]	4/4	3/4	2/2	2/2
Moody's Emerging Mkt. Rating	Baa3	B3	B3	Ba3

As indicated by the table of general economic indicators and perception indices above, Ukraine is lagging behind in the transition to a market economy. Per capita GDP is approximately half that

[2] International Monetary Fund, stated in constant dollars.
[3] Transparency International 1998. Scale = 1 - 10. Higher scores indicate less corruption.
[4] *Euromoney Magazine*, December 1997. Scale = 1 - 100. Higher scores indicate greater credibility of government offerings and undertakings.
[5] European Bank for Reconstruction & Development, *1998 Transition Report*. Scale = 1 - 4+, where 4+ is most advanced. 1997 and 1998 figures are included. Of those countries included in the sample, only Romania's score changed between 1997 and 1998.

of Poland, and only 10% larger than that of Kazakhstan, which in relative terms is significantly less industrialized than Ukraine. Of the sample group, Ukraine's economy has contracted substantially more than the others, and the state sector remains a significant (+20%) portion of the economy.

In general, the pace and content of economic reform in Ukraine lags behind many of the countries in the region. Privatization of small enterprises in Ukraine is complete. To date, shares in approximately 75% of the medium- and large-scale enterprises available for privatization have been transferred to private holders. Progress toward reducing the government's "negative list" of large-scale enterprises not included in the privatization program has been limited.

A significant constraint to doing business in Ukraine remains the relative lack of transparency, stability, and predictability in the legal and regulatory norms governing private sector activity. The results of the diagnostic assessment tend to support this general perception. Many of the problems encountered in Ukraine were found in both Poland and Romania. The chief differences among them in this respect seem to be largely in degree of magnitude and nuance. A more detailed comparative assessment of these findings will be provided in a Synthesis Report that will be prepared following the Kazakh diagnostic assessment.

II. Summary Indicator Results

The summary table on the next page contains the raw Tier I and Tier II indicator results. No attempt has been made to "balance" the four dimensions of this analysis, or give differential weighting to the subject matters areas. For a detailed discussion and analysis of the results, please consult the Tier III tables and associated narrative discussion for each subject matter area.

Based on the results of the in-country assessment, Ukraine ranks well behind both Poland and Romania in terms of overall development of the commercial environment. At 41% of the total possible score, Ukraine's legal and regulatory environment can be characterized as generally hostile to legitimate commercial activity. Bright spots for Ukraine in the first dimension of this analysis—the legal framework—include collateral law (76% of the total available points for scoring) and the Law on Foreign Direct Investment (89%). Ukraine's legal framework for international trade (56%) and bankruptcy (41%) were rated lowest in the assessment. Further explanation of the methodology and interpretation of these raw scores appears in subsequent sections of this report.

The institutional framework for implementation and enforcement of the laws and regulations within the seven subject matters areas was relatively weak across the spectrum for Ukraine. For implementing institutions, the areas of FDI (18%), bankruptcy (45%) and trade (34%) ranked lowest, while implementing institutions for collateral and company faired somewhat better (56% and 52% respectively). A more detailed narrative analysis of these findings can be found in the subject-specific narrative descriptions that follow.

The third dimension of this assessment found the supporting institutions to be weakest in the areas of trade (19%) and FDI (28%), and strongest in contract law (50%). Given the well known difficulties of contract enforcement in Ukraine, this result may actually overstate the relevant importance of such supporting institutions as law firms, notaries, and bailiffs.

	SUBSTANTIVE AREA	Poland	Romania	Ukraine	Kazakhstan
A.	**BANKRUPTCY**	**78%**	**54%**	**37%**	
	1. Legal Framework	80%	59%	41%	
	2. Implementing Institutions	80%	62%	45%	
	3. Supporting Institutions	76%	52%	33%	
	4. Market for Effective Bankruptcy System	78%	45%	28%	
B.	**COLLATERAL**	**77%**	**32%**	**48%**	
	1. Legal Framework	90%	44%	76%	
	2. Implementing Institutions	79%	13%	56%	
	3. Supporting Institutions	65%	35%	31%	
	4. Market for A Modern Collateral System	75%	37%	30%	
C.	**COMPANY**	**79%**	**62%**	**44%**	
	1. Legal Framework	81%	63%	47%	
	2. Implementing Institutions	76%	73%	52%	
	3. Supporting Institutions	82%	70%	42%	
	4. Market for Efficient Company Law	78%	43%	33%	
D.	**COMPETITION**	**80%**	**60%**	**41%**	
	1. Legal Framework	82%	66%	55%	
	2. Implementing Institutions	81%	62%	42%	
	3. Supporting Institutions	81%	62%	42%	
	4. Market for Open, Competitive Economy	78%	49%	28%	
E.	**CONTRACT**	**80%**	**63%**	**45%**	
	1. Legal Framework	83%	74%	50%	
	2. Implementing Institutions	83%	73%	49%	
	3. Supporting Institutions	79%	66%	50%	
	4. Market for Efficient Contract Law	75%	37%	30%	
F.	**FDI**	**77%**	**57%**	**41%**	
	1. Legal Framework	87%	96%	89%	
	2. Implementing Institutions	82%	58%	18%	
	3. Supporting Institutions	66%	38%	28%	
	4. Market for Increased FDI	75%	37%	30%	
G.	**TRADE**	**68%**	**54%**	**33%**	
	1. Legal Framework	93%	90%	56%	
	2. Implementing Institutions	71%	53%	34%	
	3. Supporting Institutions	49%	40%	19%	
	4. Market for Trade Liberalization	61%	35%	21%	
AGGREGATE TOTALS for all areas of law		**77%**	**55%**	**41%**	

The "market" for commercial law reform in Ukraine is similarly weak across the seven subject matter areas and below both Poland and Romania. The relative imbalance in the "market" can be characterized by a relative oversupply of inadequate, incomplete, and often conflicting laws, regulations, and institutional arrangements, in response to a weak, and rather diffuse level of demand from the private sector.

III. Notes on Scope & Methodology

This diagnostic assessment was designed to help achieve the following objectives:

1. To provide a factual basis for characterizing the degree of development and the level of effectiveness of the commercial law reforms initiated in Ukraine since independence in August 1991;

2. To provide a methodologically consistent foundation for drawing cross-country comparisons in an effort to identify and describe the root causes of the "implementation/enforcement" gap; and,

3. To provide analytical and planning tools and metrics that will help USAID design new approaches to sustainable, cost-effective C-LIR interventions in the region and elsewhere.

For the purposes of this effort, "commercial law" is defined to include the following substantive legal areas:

- ***Bankruptcy*** - Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets, and rehabilitation of insolvent debtors.

- ***Collateral*** - Laws, procedures, and institutions designed to facilitate commerce by promoting transparency, predictability, and simplicity in creating, identifying, and extinguishing security interests in assets.

- ***Company*** - Legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.

- ***Competition*** - Rules, policies, and supporting institutions intended to help promote and protect open, fair, and economically efficient competition in the market, and for the market.

- ***Contract*** - The legal regime and institutional framework for the creation, interpretation, and enforcement of commercial obligations between one or more parties.

- ***Foreign Direct Investment*** - The laws, procedures, and institutions that regulate the treatment of foreign direct investment.

- ***Trade*** - The laws, procedures, and institutions governing cross-border sale of goods and services.

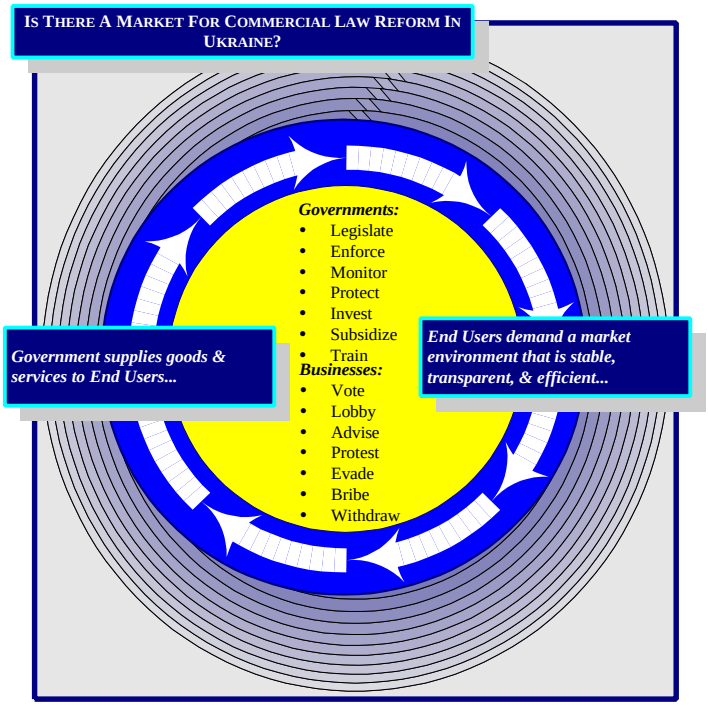
Each of these substantive areas has been assessed by collecting data across the four sample countries. Within each of these substantive areas, four "dimensions" of C-LIR are proposed as a conceptual framework for comparison. These include:

- Framework Law(s) - Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Pledge of Moveable Property);

- Implementing Institution(s) - Governmental, quasi-governmental or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework law(s) is vested (e.g., bankruptcy court, collateral registry);

- Supporting Institution(s) - Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework law(s) (e.g., bankruptcy trustees, notaries); and,

- "Market" For C-LIR - The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.



Within each substantive area, development indicators have been defined for each of the four "dimensions" of C-LIR. The figure below provides a conceptual overview of how the development indicators are organized. The twenty-eight "cells" below represent groups of development indicators (or simple propositions) that are designed to provide a "snapshot" of the

current state of commercial law reform in each subject area. From a practical standpoint, the diagnostic assessment itself is performed by collecting and analyzing data through published sources, and face-to-face interviews, that are used to populate the development indicator tables.

IV. Interpretive Notes on Interpreting C-LIR Indicator Tables

Figures 1 and 2 below illustrate how the indicator tables are organized and can be interpreted. The first example presented is a summary table of "Tier I" and Tier II" indicators for collateral law. The four "dimensions" of commercial law development around which this analysis is organized appear in the left column of table. In this case, the table summarizes the collateral law. The next column to the right ("Ref.") contains a "reference value" (i.e., benchmark) against which the countries in this study will be compared. As indicated, the total score for Country A (228) and Country D (181) in the area of collateral law are to be compared against the reference value for this analysis (400). From this example, it might be inferred that Country A's collateral law system is more advanced than Country D's.

Conceptual Overview of C-LIR Development Indicators

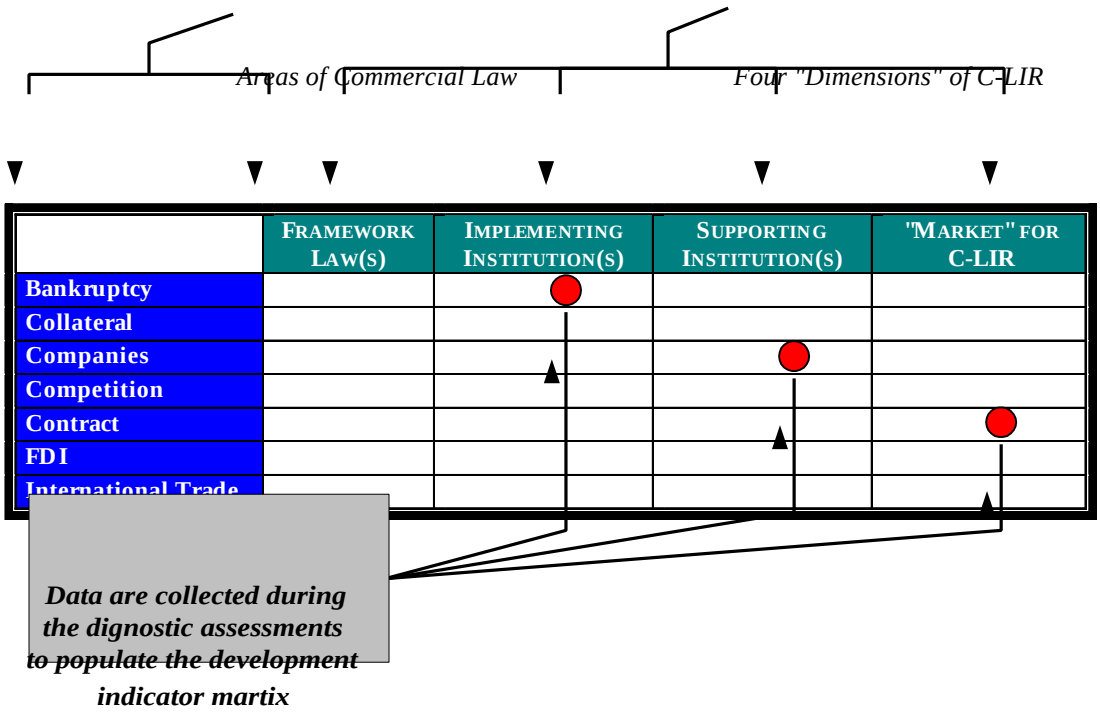


FIG. 1 - TIER I & II INDICATORS

COLLATERAL LAW	REF.	A	B	C	D
Legal Framework	100	85	90	22	64
Implementing Institution	100	72	25	33	47
Supporting Institution	100	34	67	35	49
"Market" for C-LIR	100	37	53	66	21
TOTAL	400	228	235	156	181

4 "Dimensions" of C-LIR

Country Totals = "Tier I" Indicators

Sub-Totals = "Tier II" Indicators

The Tier I and II indicators in Fig. 1 above are derived from the raw data collected in the course of the diagnostic assessments. Tier I indicators provide the highest level of abstraction[6] and are intended to be most useful to policy makers and those interested in broad regional comparisons

FIG. 2 - TIER II & III INDICATORS

B.1.	LEGAL FRAMEWORK - COLLATERAL	REF.	A	B	C	D
1	Law recognizes personal guaranties, either direct or third party, and bank guaranties	10	2	1	3	7
2	Law recognizes non-possessory pledge in tangibles.	10	4	2	5	6
3	Law creates a property interest that allows holder to execute against the security.	10	4	2	5	8
4	Law allows flexibility in the type of security interest created, and nature of the interest secured.	10	10	2	2	4
	SUB-TOTAL	40	16	7	15	27

Tier III Indicator "B.1.3"

Indicator Identifier

Tier II Indicator

Reference Value for "Legal Framework"

of commercial law environments. Tier II indicators provide an intermediate level of detail, and are intended to be useful in program design and management where diagnosis and resource allocation are key concerns.

Tier III indicators provide the bedrock for this analysis. In Fig. 2 above, Tier III indicator values are assigned based on the findings of the diagnostic teams. The Tier III indicators are summed to yield the relevant Tier II indicator characterizing the legal framework for collateral law.

> ***"Yet having begun, we must go forward to the rough places of the law...."***
>
> **Plato's Republic, Book V.**

As noted above, 7 areas of substantive law are being considered in this study. The three tier approach outlined above, while admittedly complex, is intended to provide both the level of detail required by a specialist; yet the degree of abstraction required by senior program managers and policy makers as they address macro-level issues.

[6] Tier I indicators consist of the sum of twenty-eight Tier II indicator values (i.e., four "dimensions" each for 7 substantive areas of law under consideration) for each country analyzed.

V. Narrative Summary of Diagnostic Findings

A. Bankruptcy Law

Legal Framework

Ukraine's bankruptcy law dates to the early days of the post-Communist period. The Law "On Bankruptcy" was adopted on May 14, 1992 (Law No. 2343-XII) and subsequently modified on June 17, 1993, February 25, 1994, and in March 1995. The law gives few rights and protections to creditors and does not allow for debtor-led reorganization. Also the law applies solely to legal entities, leaving untouched individual entrepreneurs and non-business bankruptcies.

In the area of creditors' rights, the law is defective by unduly restricting the circumstances under which a creditor may file a bankruptcy petition. Creditors are only permitted to file bankruptcy petitions *after* their claims have been liquidated in the civil courts and they have been unable to collect on their judgments. Article 5 of the Law on Bankruptcy states that "a creditor can file a petition commencing a bankruptcy case against a legal entity which fails to satisfy an acknowledged obligation within one month after performance is due or to satisfy a debt which is evidenced by certified documents." Since it is extremely rare for a debtor to admit the debt in writing, the creditor must first bring an ordinary debt collection action with the incumbent delay and expense related thereto. As there are costs associated with court proceedings, the creditor must pay the required 5% state duty for civil actions in advance. Once a judgment is obtained, the creditor then serves the writ of execution on the debtor's bank, and if there are insufficient funds in the account, must wait 30 days for a certificate of non-payment from the bank. Only after the certificate of non-payment is obtained may the judgment creditor file a bankruptcy petition (paying an additional 0.5% state duty).

Under the law, notice is *not* given to other creditors until 30 days after filing of the bankruptcy petition. If the debt is paid before this notice is sent, the filing creditor may discontinue the case, leaving other creditors in the position of starting the process all over again. This delayed recourse to bankruptcy protection leaves much to be desired in the protection of creditors' rights.

The second principal defect in the existing law is that it is completely devoid of any of the tools necessary to restructure an enterprise. Debtor-led reorganization does not exist because should a debtor file for bankruptcy, it would immediately lose control of the company. The main choices under the existing law are liquidation and *sanation*—which involves an effort to separate the salvageable parts of the company from those that will be liquidated. The "sanation" provision assumes that an outside "sanator" (investor) will agree to assume all the debtor's debts in exchange for an ownership position. In practice, sanation rarely takes place so it merely becomes another form of liquidation.

Other significant defects in the current law are (i) the provision that allows legal entities to serve as trustees and liquidators, resulting in a lack of accountability, and (ii) the requirement that creditor decisions be made by creditors holding two-thirds of the total debt, rather than a simple majority.

Over the past four years there has been a growing consensus among reformers and their supporters in the legislative and executive branches to abolish the law and start again. The proponents of reform have argued for a bankruptcy law that would eliminate the above defects.

Reformers have focused on six key changes in the law:

- Broad, powerful, and flexible reorganization provisions would allow the debtor, with the consent of creditors holding a majority of debt, to plan and implement its own reorganization plan.
- Amicable settlements between the debtor and creditors would be allowed.
- In the aim of generating internal capital for the company to continue operating, there would be a moratorium on debt payments upon filing.
- Explicit authority for debt forgiveness is provided, including forgiveness of all taxes more than two years old, with up to six years to pay off taxes less than two years old.
- To increase accountability and transparency, only natural persons who have been trained and licensed would serve as reorganization and liquidation managers.
- Creditor voting processes would be streamlined and calculated to produce decisions. Creditor decisions would be taken by majority vote of the debt present, and bind dissenting creditors.

The new law would make reorganization the first choice, with liquidation the last resort. The reorganization provisions provide the flexibility to do almost anything legal and necessary to reorganize successfully. It provides, for the first time, a way to deal with huge tax debts accumulated under prior confiscatory rates. Simple mechanisms would promote agreements by the parties.

On June 30, 1999 after months of debate, the new bankruptcy law—the Law of Ukraine on Restoration of the Solvency of the Debtor or Declaring it Bankrupt—received final approval by the Verkhovna Rada, Ukraine's parliament. There were substantial changes from the version of the law passed on second reading. After June 30, the law then went through final editing by the Parliament's legal and editing department, a practice not intended to change the substance of the law. The law has now been presented to the President, who can either sign it or veto it. As of August 15, 1999 the President had not yet acted.

Without having reviewed the actual, final text of the law, it is not possible to say to what extent the new law meets the objectives of the reform constituency that promoted it. We do know that last minute changes to the amicable settlement agreement provisions (Article 39) of the law, apparently intended to strengthen the debtor's hand, will probably have the opposite effect to what was intended by making it more difficult for the debtor to get creditors to agree to forgive debt. Also a new clause requires that only creditors with "indisputable claims," a defined term, can file for bankruptcy. This would appear to require creditors to go through the same kind of arbitrary, expensive, and time-consuming "action proceeding" to liquidate their claims before filing as they do now. If so, this would carry forward into the new law one of the least desirable aspects of the old law. Of course, any definitive comment must await the final text of the law.

In short, Ukraine's existing Legal Framework for bankruptcy is seriously flawed, and the extent to which the situation will be improved by a new law that is awaiting Presidential signature remained unclear as of August 1999. The numerical scores attached to the Legal Framework indicators show lower scores for Ukraine than given to Poland, Romania, and Kazakhstan.

Implementing Institutions

There are two implementing institutions for bankruptcy in Ukraine:

- The Agency for Bankruptcy is responsible for training and licensing arbitration managers and has been a strong proponent of reorganization.
- The arbitration courts actually hear and decide bankruptcy cases, and there is a hierarchy of arbitration courts headed by the Supreme Arbitration Court of Ukraine.

According to statistics compiled by the Agency for Bankruptcy, there has been a growing volume of bankruptcy cases in Ukraine. During 1996 there were 6,562 bankruptcy cases which increased to 9,645 cases in 1997. In 1998 that number increased to 12,281. Within these figures are a considerable number of unresolved cases that were carried forward from the prior year.

Most of bankruptcy cases are filed by tax authorities. Ukraine's tax law also encourages creditors to file because bad debts cannot be written off without a determination by the arbitration court that the debtor is bankrupt. Although stiff filing fees make bankruptcy an expensive proposition for large creditors, bankruptcy is used as a debt collection device by smaller creditors who can afford the filling fees. The pattern in such cases is that the creditor files a petition, is paid off by the debtor, and then withdraws the petition. Debtors almost never file for bankruptcy.

The vast majority of these cases involve liquidation and not sanation. According to Agency for Bankruptcy statistics, the number of sanations and liquidations ordered by the court were, respectively, 33 and 855 in 1996, 32 and 2320 in 1997, and 9 and 2896 in 1998.

Many of these bankruptcy cases ultimately involve corporate shells that have literally no assets and are only fit for liquidation. Bankruptcy cases may linger for years, while assets waste away. Large state-owned enterprises typically continue to operate while insolvent. When unable to continue, production is shut down without filing for bankruptcy, in the hope of a future restoration of the business. Many private sector bankruptcies occur in situations where promoters set up a private trading company, do one large transaction, and then abandon the company without paying creditors or tax.

Although the courts may invalidate fraudulent transfers of company property within specified periods before bankruptcy, they seldom do so. There are two voidable preference periods specified in Article 15 of the current law. First, the arbitration court may void any sale of the debtor's property made within three months prior to the start of insolvency proceedings if the transaction was effected to further the interests of a creditor (or another party with interests in the debtor). Second, the arbitration court may void any sale of the debtor's property made within one year prior to the start of insolvency proceedings if:

(i) the transaction has as its objective the concealment of property in order to avoid the payment of debts,
(ii) the sale price is substantially below the fair market value of the property, or
(iii) the debtor is insolvent on the date of sale or has become insolvent as a result of the sale.

As a matter of practice these preferences are rarely recovered.

Supporting Institutions

From an institutional point of view, the role of the arbitration courts and the Agency for Bankruptcy as implementing institutions must be supplemented by a community of experts who understand the bankruptcy process and can effectively implement the bankruptcy laws. This community of experts is considered the Supporting Institutions for purposes of this diagnostic. Supporting Institutions include trustees, clerks, appraisers, liquidators, crisis managers, bankers, lawyers, etc.—all of whom are willing and eager to implement the bankruptcy laws.

To date, practically none of this support structure for bankruptcy exists in Ukraine.
Given the weaknesses in the Legal Framework and Implementing Institutions for bankruptcy, it would probably be unrealistic to expect that the Supporting Institutions would be much stronger than they are. The current weakness of the sanation option in existing law and the heretofore lack of mechanisms for reorganization serve to dampen the growth prospects for Supporting Institutions.

In a market economy, the decision to reorganize or liquidate turns on which option pays the greatest dividends to creditors. But in Ukraine the mechanisms for reorganization do not exist, and the liquidation of asset-stripped enterprises does not pay enough to support Supporting Institutions.

Lastly, since no compensation to Supporting Institutions is specified in the law, there is no incentive for them to develop.

The "Market" for Bankruptcy Reform

The "Market" for bankruptcy reform in Ukraine is not robust. This should be evident from the prior sections and is reflected in the numerical scores attached to the "Market" indicators for Ukraine. These indicators point out the deficiencies both in the Supply and Demand side of the equation.

On the Supply side, there are problems both with the substance and the process of the law. Everyone knows that the existing bankruptcy law is defective and about to be replaced—hopefully with a much better product. Until there is an effective, user-friendly law in place, it will be hard to generate much enthusiasm for bankruptcy as an institution.

Reacting to imperfections on the Supply side of the ledger, banks and the private sector have not heretofore devoted much attention to bankruptcy. Creditors have developed their own debt

collection (i.e. strong arm) methods unrelated to the bankruptcy laws. Bankruptcy does not fulfill the efficient market-clearing mechanism that it does in the West. In Ukraine, no market presently exists to operate as an exit mechanism for loss-producing enterprises. Demand for the Agency for Bankruptcy's training sessions is strong, even before enactment of the law that would create paying jobs for arbitration managers. But this interest has not been translated into a generalized demand for bankruptcy law reform. Hence, as of this writing, the "Demand for Bankruptcy Law" cannot be said to be vigorous.

With a good law in place and a demonstrated serious commitment by government to see it enforced, demand should change, which is when the community of bankruptcy experts will take root. Once this happens, they will start to organize themselves to advocate and lobby for improvements in the law. As the pace of reform quickens, new interest groups form and the policy agenda becomes more extensive. Liberalization of the business environment can be a powerful catalyst, setting off a virtuous cycle where each reform makes the next one easier.

At the moment, this goal seems a long way off in Ukraine.

B. COLLATERAL LAW

Legal Framework

The Ukraine moveable property pledge registry ("Registry") became operational on March 1, 1999, which ushered in a new era for lending secured by moveable property in Ukraine. In conjunction with amendments which allow for so-called self-help seizure upon default, the creation of the Registry will take Ukraine several steps forward in the development of a fully functional secured financing system.

Creation of the Registry was designed to address the drawbacks of the prior law—i.e. the Law of Ukraine On Pledges dated October 2, 1992. Under this law, pledgors were required to keep a "Book of Pledge Entries" in which all pledges on their property were to be noted. The reliance on pledgors to provide notification of existing pledges resulted in considerable fraud. Desperate or dishonest pledgors had both the incentive and ability to create numerous pledge books in order fraudulently to obtain additional financing. While the pledgor was liable for fraudulent entries in its pledge book, the pledgor often had no resources to compensate affected lenders once the fraudulent pledge books came to light.

As a result of these and other problems with the Pledge Law, the Ukrainian parliament amended the pledge law in late 1997 to provide for the creation of the Registry for movable property. The Pledge Registry System was developed with assistance from experts familiar with the American Uniform Commercial Code Article 9 and the Canadian Personal Property Act notification systems.

The amendments called for the Cabinet of Ministers to promulgate implementing regulations and also to determine the final location of the Registry. The general language of the amendments gave significant discretion to the Cabinet of Ministers in creating the Registry to minimize potential opposition at the legislative stage.

The implementing regulations, namely "Procedures for Operating the State Moveable Property Pledge Registry," approved by Resolution of the Cabinet of Ministers No. 1185 on July 30, 1998 ("Regulations"), flesh out many of the issues left open by the general language of the 1997 Pledge Law amendments. The Regulations are relatively straightforward and contemplate the creation and operation of a user friendly Registry.

The Ministry of Justice ("MOJ")was selected as the implementing entity, with its wholly-owned entity StateInfoJust, charged with administration of the system. StateInfoJust interacts with customers directly or through its central registry and 25 regional offices. In addition, state notary offices, private notaries, and commercial banks may serve as registry offices. Parties to pledge agreements will therefore have a choice as to whether to register a pledge directly with a StateInfoJust entity or instead to go to their local bank or a local notary.

This structure varies from the original concept in one important respect. It was always contemplated that the pledge registry system would operate over the payments clearing system of

the National Bank of Ukraine ("NBU") to which all banks in Ukraine are connected, in order to give banks (initially expected to constitute 95% of pledgees) direct access to the registry. Connectivity with the NBU system is still an important goal, but it is not as automatic as it once was. Prior to any use of the collateral registry system, commercial banks must have signed an agreement with the MOJ on terms of use, liability, service, and cost. As of March 1999, 13 commercial banks were considering connectivity to the system.

Related to collateral pledges is the creation by decree of a so-called "tax pledge" during the summer of 1998. The tax administration is entitled to place the property of delinquent taxpayers under a tax pledge that, in turn, severely limits the ability of the debtor to sell the property subject to the pledge. The state tax administration is required to register any tax pledges in the Registry in order to ensure it retains its priority in the property of a delinquent taxpayer over subsequent pledge holders. This gives creditors a public mechanism whereby they may determine whether the priority of their pledge will be undermined by the existence of prior outstanding tax liabilities, avoiding the problems of secret tax liens which have plagued Central and Eastern Europe.

Implementing Institutions

The first of its kind in the former Soviet Union, the new Ukrainian Pledge Registry is a state-of-the-art system designed to reduce the type of fraud resulting from the previous pledge law's ineffective provisions governing third party notification of existing pledges or liens. The amendments also simplify the pledge law's provisions governing seizure of property subject to lien after debtor defaults.

The creation of the Registry and the corresponding public access to information about debtors are clearly critical steps in ensuring that creditors obtain real value from taking a pledge on moveable collateral (that real value to be presumably passed on to borrowers in the form of lower interest rates and/or longer loan terms).

However, the Registry is new and there is a long way to go before it can be said to be institutionalized. System hardware and software were being tested during March 1999. The first substantive task was to re-register 30,000 existing pledges. As of June 30, 1999, some 25,000 pledges had been registered in Ukraine. Also, 80,000 existing tax liens need to be registered. This is more work for the Registry but is something that the commercial bank customers want (and need) very much—so it must be treated as a priority.

The key implementing institution is the Ministry of Justice, with support from the National Bank of Ukraine. Because of the inclusion of tax pledges within the Registry, the State Tax Administration may become an implementing entity but at the moment its role is more "supporting."

The Regulations provide for registration of pledges on the application of a pledgor or pledgee with a Registrar or directly with the Registry. The registrar is to register a pledge within 2 days of receipt of a completed pledge registration application. The cost of registration and obtaining

extracts from the Registry is quite low, the equivalent of about $10 and $5, respectively, at March 1999 exchange rates.

The application process is quite simple, and the application must only contain:

1. Identifying information on the pledgor and pledgee (name, address, and for Ukrainians, either the individual's identification number or the identification code in the Centralized State Registry of Enterprises and Organizations in Ukraine; foreign entities are required to give their country of official registration), and

2. A general description of the collateral except if the collateral is in the form of moveable property subject to state registration such as vehicles, combines, ships etc. In that case, the serial number, name of the model, and year of production must be added to the general description of the collateral.

Supporting Institutions

In making the collateral law a reality, a key role has been played by a Working Group chaired by the Ministry of Justice that has distinguished itself by its stability and cohesiveness. In addition to the implementing institutions identified above, the group includes the Association of Ukrainian Banks, which represents the interests of one set of customers; the Supreme Arbitration Court, which made important suggestions in the statutory and regulatory area; and the State Tax Administration, which is particularly interested in the tax pledge provisions.

The "Market" for Collateral Law Reform

As is evident from the above discussion, the "market" for collateral law reform is much stronger than exists for bankruptcy. Although not perfect, the new collateral and pledge registry law and regulations were sufficiently attractive to the Ministry of Justice, the commercial banks, the National Bank of Ukraine (NBU), and the State Tax Administration in order to create a genuine public/private partnership. Considering that the amendments to the Pledge Law were adopted in late 1997, this reform has moved quickly.

One impressive feature is the recent positive action on the demand side. Commercial banks, the NBU, and the private sector have already started lobbying for improvements and refinements in the system. This is a good sign that shows their commitment and interest in the particular reform area. And, perhaps it signals the start of a "virtuous cycle" on collateral law where each reform makes the next one easier.

One must not be blind to the challenges ahead. In many transition countries pledges may be feasible on paper but they are stymied by pitfalls in the registration system or by cumbersome foreclosure procedures. Ukraine's registry has only just begun. Yet still, the past year's accomplishments on the registry are quite impressive for a country that in many reform areas has lagged behind its neighbors.

Of course, the bottom line is whether there are increased amounts of credit and/or better loan terms available to private entrepreneurs through commercial lending attributable to the new collateral law and registry. We have to be patient on this but still this is the result that we are seeking. It cannot be ignored indefinitely without undermining the assumption on which this assistance is based.

C. COMPANY LAW

Legal Framework

Ukraine's company law is the "Law on Business Associations" dated September 19, 1991 (Law of Ukraine No. 1577-XII) as subsequently modified. Ukraine recognizes five business organizations: the joint stock company, limited liability company, additional liability company, full liability partnership, and limited liability partnership. The first two are currently the most commonly used form of business organizations in Ukraine.

The company law was enacted at the beginning of Ukraine's independence to serve as the legal base for private business undertakings in contrast to state companies. Since then, the law has been changed little and provides few of the protections found in Western corporate law. The weakest area is corporate governance—the duties and responsibilities of directors and the protection and rights afforded to shareholders.

In 1998 a new draft Joint Stock Company law was prepared with the assistance of foreign experts which would have created a framework for private sector companies that is familiar to western businessmen and lawyers. However, the law was not enacted, and passage is not anticipated in the near term.

One of the greatest weaknesses in the existing law is the protection of shareholder rights. Shareholder rights are commonly defined as the right (i) to participate in a company's affairs through attendance at shareholder meetings and voting rights, and (ii) to participate in profits in the form of dividend payments and claims upon liquidation of the company. The fiduciary duties that in most legal systems run from directors to shareholders are totally lacking. The responsibility of general managers/directors to the shareholders is limited to gross negligence only.

The problem's in protecting shareholder rights is particularly acute for minority shareholders generally and in cases where share participation is limited by law. For example, Ukrainian legislation limits foreign participation to 49% or less in certain sectors such as publishing houses, insurance, and privatized "strategic" enterprises. In fact, even when foreign investors are majority shareholders, they may be the target of legal and extra-legal harassment. One U.S. law firm advises its clients that 76% should be the minimum investment in a Ukrainian company. Anything less is an invitation to stalemate or worse.

The complexity and cost of procedures for registering a business has been a persistent problem in Ukraine. The simple act of officially registering a business has grown into a complicated multi-stage procedure requiring extensive time and money. While this situation may have been just an annoying nuisance for rich, established firms, it created an insurmountable barrier to some entrepreneurs struggling to begin operations. Recent improvements in this area are described in the below section on Implementing Institutions.

Apart from recent improvements in legislation governing business registration, the existing legal framework for company law in Ukraine remains seriously flawed. The numerical scores attached to the Legal Framework indicators are lower for Ukraine than for Poland, Romania, and Kazakhstan.

Implementing Institutions

The registration of companies in Ukraine is handled at the district (*rayon*) level. Each district has its own registration office. The registration procedure is mainly regulated by Article 8 of the "Law on Entrepreneurship" dated 26 February 1991 and by the regulations of the Cabinet of Ministers. Many of the required documents and steps in the registration process are similar to those found in other countries. Some documents, such as the approval of the Anti Monopoly Committee and the identification code of the Statistic Committee, are additional requirements that may be time-consuming but are not generally onerous. However, local registration bodies have tended to follow their own internal instructions on registration in preference to the controlling legislation. Many have been inventive in creating "additional requirements" and finding reasons to refuse registration. The most frequent "additional requirement" is the "mandatory contribution to the social fund of the registration body" prior to the registration. Another popular "additional requirement" is the submission of the property certificate of the premises rented by the entity to be registered. Registration bodies often refuse registration with the argument that the submitted documents are not in conformity with Ukrainian law. Frequently, corporate charters and foundation agreements have to be redrafted several times. This is true even where they are within the limits of the law and strictly regulate the parties' relationship and accordingly do not affect the public interest.

After years of mounting complaints from domestic and international business groups, and to meet World Bank conditionality, the Government simplified the business registration procedures by amending Article 4 of the Law on Entrepreneurship. The reformed procedures were made operational by Cabinet of Ministers Resolution No. 740 On the Procedure for State Registration of Entrepreneurial Activities of May 25, 1998. The new procedures came into force on July 3, 1998 and in essence state that the local office must register a business within 5 working days from submission of the specified documents. Once a company is registered, the taxation authorities must register the company within 2 days from the submission.

In September 1998, the Regulatory Reform Project of IRIS and International Finance Corporation (IFC) organized a study to determine the impact of the changes in the Law on Entrepreneurship on business registration practices. Approximately 200 in-person business surveys were conducted in three regions of Ukraine—Sumy, Zhytomyr, and Lviv—with firms that had registered in the period after the new regulations had come into force.

The study found clear evidence of improvements in the business registration system. The average time required to complete the business registration application process was 3.8 days. This is well within the legal stipulated five-day period and is a significant improvement from the situation in the fall of 1997. A total of 9.0 days were required by the average respondent to assemble all the required documents, submit an application, and be formally registered. The same process took 34.7 days under the old registration system.

Also the costs of business registration were cut substantially. Costs include fees paid directly to the state and fees paid to notaries, accountants, and others to prepare the necessary documents. The average total cost of business registration was 200 hrivna—which compares favorably to the 383 hrivna that was required to register a business under the old system.

The study also found a wide divergence in the average cost and time required to complete registration in the three regions, indicating that the implementation of registration procedures was strongly affected by the behavior of local officials. For example, the researchers found evidence that sole entrepreneurs registering in Lviv had been charged 8 times more than they were charged in Zhytomyr and the process took days longer.

The business registration system has definitely been improved, but whether the new system becomes generalized countrywide is not yet clear. Similar reforms have been attempted before, and after a burst of reforming energy the situation reverts to the *status quo ante* because of the pressure on local governmental units for off-budget financing and the well established practice of rent-seeking by officials.

Supporting Institutions

This area is practically in its infancy in Ukraine. In the West, universities, foundations, think tanks, business associations, etc. are key participants in the public policy dialogue that leads to improved corporate governance and protection of shareholder rights. However, this support structure for company law does not exist in Ukraine.

Perhaps the only consistent advocacy for change in the company law area comes from foreign banks, law firms, and accounting firms. To date, their efforts are more like a crying for help in the wilderness rather than a coherent policy dialogue that is likely to change the situation. Ukrainian counterparts seem more reconciled to the status quo, having developed their own individual survival strategies.

The "Market" for Company Law Reform

To date, the demand for company law reform in Ukraine has been fairly muted. The most pressing need is corporate governance—especially the duties and responsibilities of directors and the protection and rights afforded to shareholders. However, the supply of laws in this area is poor and things do not look any better on the demand side.

The most promising area for seeing how the "market" for company law reform might develop has been in reforming business registration procedures. The IRIS/IFC study seems to show that it is possible to detect and quantify an improvement in regulatory practices produced by a change in legislation. Registration practices did improve due to the simplicity of the new procedures, and the explicit description of all procedures in the implementing regulation. These are features that should be included in the drafting of all subsequent regulations. This is a valuable Lesson Learned for the Supply side of the "market" equation.

The IRIS/IFC study also has some interesting observations for the demand side as well. The Konotop City Administration (in the Sumy region) has demonstrated the capacity of local officials to multiply the impact of reform. In Konotop, business registration has gone from being a government-sanctioned nuisance and barrier to entry to being a model of government-business cooperation. Not a single instance of refusal or delay in registration was recorded in the entire Sumy region. Local officials can be active participants in regulatory reform as long as they are convinced of its benefits. Once the ball starts rolling on the demand side, then the private sector and civil society pick it up and keep the momentum going. But will this burst of demand activity be a passing fad or a permanent change? Bursts of activity and/or progress should be monitored in the future for possible Lessons Learned for other areas of reform.

D. COMPETITION LAW

Legal Framework

Ukraine's competition law consists of the Law on Restriction of Monopoly Practices and Prevention of Unfair Competition in Economic Activity of 1992 and the Law on Prevention of Unfair Competition of 1997. The activity of the Antimonopoly Committee, which is the principal implementing agency, is regulated by the Law on the Antimonopoly Committee of Ukraine of 1993.

Ukraine, as all other former Soviet republics, inherited a highly concentrated industrial structure with a completely monopolized distribution sector. Retail trade monopolies began to break up slowly already in Soviet times, but the production and wholesale sectors remained dominated by state-owned monopolies or enterprise associations. Ukraine had no experience in promoting competitive practices. On the contrary, the existing state structures were in charge of establishing socially acceptable prices and preventing speculative transactions.

> *Manufacturing and commercial monopolies owe their origin not to a tendency imminent in a capitalist economy but to governmental interventionist policy directed against free trade and laissez faire.*
>
> *Ludwig Mises, "Socialism"*

Given this situation, the country has made remarkable efforts in developing antimonopoly legislation and practices. The legislation of Ukraine, developed with substantial international assistance, provides the base for vigorous enforcement of sound competitive principles, particularly in the area of the protection from unfair competition.

The competition law defines in detail such terms as "monopoly position," "monopoly prices and activities," and "monopoly associations." The law generally prohibits agreements between market participants that distort or prevent domestic or regional competition. The law also prohibits abuse of monopoly power, including discriminatory prices and practices for selected customers. Specific provisions prevent local or central authorities from discriminating against particular market participants in favor of other market participants. The law also provides for the compulsory break-up of the existing monopolies, and specifies the possible exceptions from this rule. The law restricts in equal manner the formation of vertical and horizontal monopolies. Finally, the law provides serious sanctions for violations.

There are several perceived deficiencies in the existing legislation. First, the law does not regulate state assistance as a form of unfair competition, thus permitting anti-competitive advantages to some firms, particularly in the production sector. Several privatized major enterprises now enjoy a favorable position not only vis-a-vis potential foreign competitors, but also with respect to the local competition. While positive discrimination is clearly prohibited by the law, the more favorite treatment of particular competitors is not. Second, the law requires burdensome pre-establishment and pre-merger reviews in all cases, without any specific threshold. This is in fact a licensing procedure for all economic activities. Although the implementing institutions maintain that such review is a formality, with permission given in all

cases, the existing procedures may be effectively used to prevent competitors from entering the market. Besides, they result in a misallocation of resources from productive activity simply to satisfy unnecessary formal requirements.

Finally, the law exhibits some of the technical weaknesses common to much post–Soviet legislation in the region. It refers to action by the Anti-Monopoly Committee (AMC) "pursuant to the applicable legislation" but does not specify the applicable legilslation. In fact, in most cases there is no corresponding legislation. This leaves wide discretion for the AMC and makes arbitrary action possible. (For example, see Section 14 on pre-formation and pre-merger control, and Sections 23-1 and 23-2 on the procedure for taking decisions in particular cases).

Section 24, regulating the procedure for appeal from AMC decisions, is particularly unclear. While it authorizes appeals before the courts of general jurisdiction or the arbitration (*arbitrazh*) courts, but does not specify the procedural rules applicable to the appeals, nor define the jurisdictional differences between the arbitration courts and the general courts. Although each court has applicable rules of procedure once a case is within the system, these rules do not expressly foresee appeal from decisions of a government agency such as the AMC, but deal with lower court decisions.

The Law on Prevention of Unfair Competition[7] is an improvement on the 1992 law, as the former is better organized and more modern. It defines in detail the cases of unfair competition in the use of trade marks, industrial samples or good will of competing companies, and of unfair business practices (e.g., discriminatory agreements, use of trade secrets, unfair use of competitors' employees, and unethical professional behavior). Implementation of the law is restricted, however, by the lack of clear procedural rules and other implementing legislation.

The Law on the Antimonopoly Committee of Ukraine[8] establishes the territorial structure and appointment of the members of the AMC. It fails to provide the procedures for making decisions, and it contains several ambiguous provisions. Particularly unclear are the intended obligations of the AMC to "address" the courts when necessary and to "coordinate" the work of the Committee with the office of the *Procuratura* (similar to an Attorney General). While "coordination" appears to be simply a role of working with institutions of equal importance, the law does not define the AMC's authority or function.

Implementing Institutions

The Antimonopoly Committee of Ukraine is a state agency, established by the Supreme Council of Ukraine and subordinate to the Government. It consists of a Head, appointed for a seven-year term by the Supreme Council, and ten State Commissioners. The Head of the Antimonopoly Committee is member of the government. The Committee maintains a network of local subdivisions, which follow the administrative division of the country, with a total staff of about 600 people.

[7] Dated June 7, 1996, most recent amendment November 11, 1997.
[8] Dated November 26, 1993.

As many other government agencies, the Antimonopoly Committee suffers from high turnover of qualified staff, inadequate facilities, and limited allocation of budgetary resources.

In 1998, the Committee identified and prosecuted 1,711 cases of violations of the antimonopoly legislation, which represented an increase of over 1.7 times compared with 1997. The cases prosecuted pursuant to complaints from affected economic entities or individuals increased more than 3.3 times (599 in 1998, compared to 184 in 1997), representing 35% of the total caseload.

In 1998, the number of cases against the (primarily local) state administration for discriminatory practices against particular economic entities increased markedly. Of the 574 cases brought, approximately 20% were related to imposition of illegal taxes and other fiscal measures that restricted the ability of new participants to enter the market; 18% were cases of forced contracts; and 30% were restrictions on the purchase of particular commodities by various economic entities. Particularly serious are the cases in which local and central authorities require private businesses to enter into contracts with unnecessary intermediaries between the state administration and the users of government services (i.e. companies "facilitating" customs processing or company registration), or to obtain mandatory insurance from a specific insurance company.

Such a caseload is indicative of the continuing, inappropriate strong state involvement in the economy, particularly at the local level, and the ability of the local authorities to influence business decisions in both formal and informal manners. For comparison, there are almost no such cases in the reforming economies of Central and Eastern Europe.

The Committee has generally concentrated its price control activities in the natural monopolies sector, assuming that natural monopolies are most likely to abuse their economic position. The increases in the cost of communal services (different utilities) and the local transport have been particularly targeted and represent over 60% of all cases of abuse with monopoly position. But the emphasis on the activities of the natural monopolies turns the Committee into a mostly regulatory agency involved in price formation, at the expense of other monopoly activities, such as anti-competitive agreements and restrictive contractual practices. Excluding the cases against the natural monopolies, in 1998 there were 32 cases against other monopolies and monopoly practices (compared with only 14 cases in 1997). Those included 14 cases of monopolistic and discriminatory price formation, 4 cases of market distribution agreements and 14 cases of practices, representing barriers to entry.

The Committee does not maintain statistics disaggregating pending cases and the total number of cases opened in one year. The available statistics represent the total number of "identified" cases.[9] There is currently no statistical information on cases completed in one year.

[9] "Identified" cases are the cases for which the Committee concluded that there is some violation of the applicable laws that merits further prosecution. The number reflects all cases, which were started pursuant to a complaint from affected private parties and pursuant to independent action by the Committee.

Supporting Institutions

It is difficult to assess the role of supporting institutions in the enforcement of the antimonopoly legislation in Ukraine. The dual court system and the unclear procedural regulations prevent the collection of data about those cases that eventually do reach the courts. The office of the Attorney General (*Procuratora*) may also play an important role, particularly in the prosecution of criminal cases related to unfair competition. In the absence of clear rules for coordination of the activities between this office and the Committee no such cases have been reported. No data exists regarding cooperation of the Committee with business associations or non-governmental organizations (NGOs) to protect the consumer rights. Such NGOs are only at the initial stage of formation in Ukraine, and so far have not submitted cases to the Committee.

The Market for Competition Law Reform

Ukraine is a country in which the functions of many government agencies are not yet clear and well established. The procedural rules for most of those agencies seem particularly underdeveloped because of the lack of tradition and of "institutional memory". The representatives of the Committee expressed particular interest in assistance in this area.

Antimonopoly legislation in Ukraine suffers less from conceptual problems than other branches of the law (i.e. property, contracts or company), but it still needs improvement. The law needs to be unified (at present there are three laws with overlapping functions and conflicting provisions). The functions of the Anti-Monopoloy Committee as a regulator of natural monopolies should be transfered to specialized regulatory agencies, as has occurred in other reforming economies in Europe. Experience in this area in Ukraine seems to be particularly inadequate.

Both supply and demand for change are adversely affected by the involvement of the state in monopolies. Legislation limiting anti-competitive behavior must be issued by the state, but the Government of Ukraine owns many of the monopolies that should be regulated by the AMC. At this time, there is insufficient political will to disengage from either monopoly ownership or monopoly practices. Any demand for change by the AMC or by outside groups is likely to meet a wall of resistance. Consequently, the AMC will be unlikely to supply the necessary regulatory measures to bring about change with state enterprises. This is a serious issue for reform.

Demand seems to be stronger for organization of implementing agencies, reduction of the workload through better identification of the cases in which the involvement of the Committee is necessary, and interaction between the Committee and other government agencies and state institutions, particularly the court and the Office of the Attorney General (*Procuratora*).

The establishment of NGOs, concerned about consumer protection, seems to be another priority. Yet the formation of such organizations is impeded by the lack of funds and traditional non-involvement of private parties in administrative matters. There are indications that this involvement is increasing, but at a very slow pace and primarily due to the interest of the directly affected economic actors, not of the public in general.

E. CONTRACT LAW

Legal Framework

The Constitution of Ukraine[10] recognizes the universal protection of private property rights, which is the basis for all business contractual obligations in a market economy. Although the Constitution exempts certain assets and objects as the exclusive property of the state, even those can be included in contractual obligations to which the state is a party.

Ukraine's contract law is contained in the Civil Code[11] and in several other laws that deal with contracts specific to certain business activities—the Law on Leasing of State and Municipal Property, the Law on Leasing of the Property of State Enterprises and Institutions, and the Law on Commodity Exchanges.

> *But the operation of the wisest laws is imperfect and precarious. They seldom inspire virtue, they cannot always restrain vice. Their power is insufficient to prohibit all that they condemn, nor can they always punish the actions which they prohibit.*
>
> *Gibbon, Decline and Fall Of The Roman Empire, Vol. 2 Page 223.*

The original text of the Code was adopted at a time when private property was not recognized as the basis of economic activity. The Code was designed to deal with a limited number of transactions between individuals and was completely inadequate for the needs of a market economy. Subsequent amendments of the Code increased the contractual freedom of the parties and the types of contracts recognized by the law. The Code also adopted the basic principle that contracts that are not contrary to law can be recognized, even if not specifically regulated by the Code. Yet the general system of contract law in Ukraine still has some inconsistencies and needs to be brought in line with the fundamental provisions of the Constitution.

Ukrainian law is only beginning to distinguish between business and non-business transactions, and to recognize involvement by individuals in business transactions. During the Soviet period, the Civil Code had only marginal importance in regulating commercial relationships. Only entities (cooperatives) could participate in commerce legally, and individuals could not.

As times have changed, the law has lagged behind. Courts are, however, coming slowly to recognize theoretical differences between business and non-business transactions and to treat

[10] Adopted by the 5th Session of the Supreme Council of Ukraine, June 28, 1996)

[11] *Civil Code of Ukraine*, adopted on July 18, 1963, amended as follows: (i) Soviet Period - Amendments and Modifications to Civil Code made according to Decrees of Presidium of Supreme Council of Ukrainian Soviet Social Republic dated: 23 November 1966; 24 June 1969; 22 July 1970; 29 March 1973; 5 June 1973; 15 October 1973; 13 September 1974; 10 April 1975; 25 April 1975; 6 December 1976; 22 December 1976; 19 August 1977; 1 March 1985; 20 May 1985; 27 June 1986; 21 August 1987; 24 December 1987; 25 October 1988; 28 January 1991; and (ii) Post-Independence - Amendments and Modifications according to Laws of Ukraine dated: 7 July 1992; 14 October 1992; 22 April 1993; 5 May 1993; 6 May 1993; 16 December 1993; 4 February 1994; 15 July 1994; 14 December 1994; 28 February 1995; 11 July 1995; 6 October 1995; 3 December 1996.

them differently. In deciding disputes, courts will look beyond the insufficient provisions of the code to determine various features of business relationship, such as:

- the nature of the parties (legal entities or individuals, registered with the State and involved in business activities);
- special business relations regulated by the contract (primarily activities related to property, other than property transfers arising from consumer transactions between individuals);
- special forms required for conclusion of contracts;
- any special liability of the parties, including product liability.

Although the law in Ukraine requires the registration of all business entities and individuals involved in commercial activity, failure to register does not necessarily affect treatment of a party. In other words, for example, an individual cannot expect to be held to a different standard of care (as a consumer rather than a professional business person) simply because he or she has not registered to do business. The courts will look beyond these formalities to determine proper practical standards for interpreting contract disputes.

The Law on Commodity Exchanges, while specialized, may serve as an important basis for development of contract law in the Ukraine, despite the decrease in commodities contracts in recent years. This law was designed to fill a gap in treatment of commercial contracts by the Civil Code. Although it is limited to a specific number of transactions (registered trades of goods at commodity exchanges) and specific participants (members of the exchange), the law recognizes and regulates a number of contracts, not recognized by the Civil Code. This provides a legal basis for the courts to enforce such contracts without the argument that they are contrary to the law.[12]

In particular, the law regulates the following contracts:

- Forward contracts – contracts which require future delivery of goods under terms established at present;
- Guarantee contracts – contracts under which a certain amount is paid in the present as a guarantee of fulfillment of certain obligations in the future;
- Credit contracts – contracts under which certain goods are purchased by the broker with credit and the obligation to be sold at the exchange in the future;
- Premium contracts – contracts pursuant to which a certain premium over the spot price at the date of sale has been agreed in advance;
- Contracts with options to change the quantity of the goods delivered; and
- Futures contracts.

[12] Section 2, Article 4 of the current Civil Code provides that "civil rights and obligations originate from contracts (agreements) provided for in the law, and also from contracts not regulated by law, but not contrary to it. " Theoretically, all contracts that are not contrary to the law can be enforced, but practice does not always follow this principle. A specific reference to a legal provision regulating a particular contract is always helpful in an attempt to enforce such a contract.

By specifying these types of contracts, the Law on Commodity Exchanges expands the number of specific contracts which are expressly recognized as not being contrary to law. Although this is helpful in court, it does not satisfy the need to modernize the overall legal framework.

The existing system of contractual law in Ukraine exhibits several major problems:

- There is no specific special treatment of business contracts. The general rules are contained in a Civil Code that was initially designed to serve civil relations much more limited in scope. It is true that the Civil Code has been amended several times and that such amendments improved the situation somewhat, but they also compromised the internal logic of the Civil Code.
- Many of the new contractual forms are contained not in the principal law (the Civil Code), but in other legislation—for instance the Law on Commodity Exchanges. This lack of unity creates double standards in the interpretation of contracts.
- Different laws often establish different standards applicable to fairly similar situations. For example, the Law on Leasing of the Property of State Enterprises and Organizations provides that if a subsequent law changes the conditions for the parties involved, the old law will be applicable for contracts already concluded. No similar provision exists for contracts regulated by other laws. Instead of adopting a general principle established in the Constitution or in the Civil Code, such a piecemeal approach further complicates the task of the courts to enforce the law equitably.
- The law does not clearly establish whether a party to a contract can be found in default without a showing of fault or culpability for the default. Without "non-culpable" default, the use of contracts to establish liability for non-performance and apportion risk is deeply undermined. The draft revised Civil Code (not yet adopted) provides for such this possibility in commercial transactions, except in cases of *force majeure*.

Implementing Institutions

Dispute resolution for contractual matters in Ukraine is carried by the court system, which at present is divided between the courts of general jurisdiction and the arbitration (a*rbitrazh*) courts, which are in charge of dispute resolution of economic cases. The arbitration courts were created by transforming the State *Arbitrazh*, which in the period of centrally-planned economy and the monopoly of state-owned enterprises was in charge of dispute resolution between all economic entities. At present, the arbitration courts are responsible for all cases in which at least one of the parties is a registered economic entity. The Code of Arbitration Procedure, however, has not been updated to correspond with the role of the arbitration courts, for it still maintains the definition of “commercial” or “economic” contracts as “planned” contracts between economic entities, which are designed to serve the “basic economic purpose” of the contracting parties. Movements to modernize the Code of Arbitration Procedure are currently unsuccessful due to high level political pressures to maintain the status quo. This unfortunate situation is very damaging to the capacity of the judiciary to decide cases equitably under the rule of law.

Ukraine faces substantial problems in the establishment of an adequate dispute resolution system. The lack of experience in dealing with economic matters in the courts of general jurisdiction was used as a basis for assigning all economic cases to the former arbitration courts (which had

experience, but the wrong type), and to postpone the establishment of a unified court system (as provided by the Constitution) for 5 years after the Constitution was adopted. This transition period is being used by the advocates of the existing system to preserve it. Until the year 2001 the Supreme Court of Ukraine will not be involved in economic cases and will not keep any statistics related to the work of the arbitration courts.

The assessment of the institutional framework in Ukraine cannot be carried out without taking into consideration the prevailing practices of barter transactions. In recent years, the Ukrainian economy has become increasingly de-monitized. Many enterprises have found themselves forced into barter by the existing macroeconomic situation and the confiscatory character of the tax legislation. This situation greatly limits the number of cases submitted to the courts, and prevents the establishment of institutionalized system of alternative dispute resolution (the real commercial arbitration). Commercial arbitration in Ukraine is in a nascent stage (with only four or five cases between domestic parties being submitted so far to the existing arbitration tribunals).[13] Moreover, the arbitration mechanisms are openly prejudiced in favor of local enterprises and are not currently perceived as developing into institutions that can be trusted by foreign investors. This lack of a competent commercial judiciary and absence of trustworthy alternative dispute resolutions will continue to plague investment and growth in Ukraine until resolved.

Market for Contract Law Reform

There is a large market for contract law reform in Ukraine. Practicing Ukrainian legal professionals and a large segment of academia recognize the need to modernize the existing contract law framework and to adopt a new, uniform, and modern contract law. There is a working group of professors and practitioners from Donetsk who have been engaged for several years in drafting a modern Civil Code, which is expected to address many of the needs of a modern system of contracts. However, drafts have not yet been made available to the general public for review or comment.

The Ukrainian legal community is divided between two proposals for the revised Civil Code:

1) adoption of a comprehensive Civil Code, which would include all provisions related to business entities and transactions, or
2) creation of a separate "Economic Code," which would regulate exclusively the business entities and transactions.

Reforming economies in Central and Eastern Europe have adopted various approaches. Some of them recognized the need for specific regulation of business entities, and adopted separate trade laws or codes (Bulgaria, the Czech Republic). Others have adopted separate company laws and left the transaction regulations in the Civil Code.[14] Russia adopted a totally new Civil Code, which also governs business transactions.

[13] As reported by the Chairman of the Association of Commercial Arbitration Tribunals in Ukraine.
[14] This has been the case in Poland for instance. While Poland has a separate Commercial Code, it regulates primarily company formation. Business transactions are regulated by the Civil Code.

Developments in Ukraine are being influenced by an influential group of old-line professors, who support strong state involvement in the economy rather than a market system. They have prepared a draft Economic Code that maintains many practices prevalent in centrally-planned economies, including the obligation of the enterprises to fulfill state orders pursuant to administrative decisions instead of contracts. Elsewhere in Europe the advocates of separate economic codes have been mostly guided by liberal ideas of limited state involvement and greater contractual freedom, but the same name is used in Ukraine for absolutely contrary purpose.

Another group of professionals, including practicing lawyers and members of the academia, advocates restricted state involvement and greater contractual freedom. This group has limited practical experience, because of their limited exposure to real commercial transactions. There is strong demand by this group, however, to apply the legislative and judicial practices of the developed market economies, and to adopt modern contract legislation in Ukraine. Comparative studies of the legislation adopted in other reforming economies in the last several years support this demand.

Despite the work being done on a draft Civil Code, Ukraine still lacks the open policy discussion needed to bring popular and professional support for market-friendly changes. If the anti-market professionals have their way, Ukraine may well adopt very conservative “economic code,” which will continue to marginalize the legal systems as the surrounding region marches on to modern times. This cannot bode well for economic growth or development of Ukraine.

F. FOREIGN DIRECT INVESTMENT (FDI) LAW

As reflected in the summary table of Tier II indicators, Ukraine scored well below Poland and Romania in three of the four "dimensions" of the legal and institutional environment for foreign direct investment. As in other subject matter areas, Ukraine has a good framework law in place. As reflected by the indicator scores, however, the institutional framework and market for increased FDI are rather weak.

The indicator scores for Ukraine's FDI environment are generally supported by broad quantitative measures of economic performance. To date, for example, Ukraine has attracted approximately $2.2 billion of foreign direct investment, as compared to Romania and Poland, who have attracted $3.4 billion and $20 billion respectively. On a per capita basis, Ukraine ranks well behind its neighbors in FDI. On a regional basis, Ukraine has attracted approximately 10% of the FDI flows into the NIS region, and approximately 2.5% of the investment flows into the entire NIS/CEE region.[15]

Framework Law

Ukraine's leadership has frequently stated that it is eager to attract and retain significant levels of foreign direct investment. In 1996, Ukraine announced that it needed $40 billion of investment over five years in order to meet development needs. To date, Ukraine has fallen far short of that goal. Also during 1996, Ukraine adopted its Law on Foreign Investment,[16] and ratified a Bilateral Investment Treaty (BIT) with the United States.

As reflected in the Tier III indicator scores, Ukraine's FDI law substantially conforms with emerging international standards (e.g., the World Bank's "*Legal Framework for the Treatment of Foreign Investment*") for admission and treatment of FDI. Specifically, the Ukrainian law calls for open admission, national treatment (with some exceptions), repatriation of profits, and prompt and adequate compensation in the case of expropriation. Article 8 of the law contains a guarantee against substantive changes in the legislation that would diminish the guarantees extended under it. As discussed below, this guarantee is not viewed as particularly credible in light of the experience of many foreign investors. Overall, however, from the narrow perspective of the letter of the framework law, it is judged to be on par with those in force in Poland and Romania. One must remember however, that this is the fourth law on foreign investment in seven years, and it has already been amended several times.

Despite potentially positive developments in these aspects of the legal framework, registration of foreign investment has an overall negative impact. These burdensome requirements must be amended in line with more common international practices to realize Ukraine's potential for attracting outside investment.

[15] Estimate based on EBRD, IMF, and OECD figures for the period 1989 - 1997.
[16] *Law on Foreign Investment*, #93/96, 3/19/96.

Implementing and Supporting Institutions

The primary implementing institution for the purposes of this analysis is the ministry, agency, department, or quasi-governmental organization with primary responsibility for promoting foreign direct investment. In Poland, this is the Polish Development Agency (PAIZ); in Romania, the Romanian Development Agency (RDA). In Ukraine, there is no clearly identifiable entity charged with this responsibility. Instead, this type of activity is dispersed among several ministries and quasi-governmental entities. Principal among these appear to be the Ministry of Economy, Department for Foreign Credit and Investment Coordination, the Ministry for Industrial Policy, Department for Export Promotion, and various line ministries with sectoral mandates (e.g., Agriculture, Energy, Transport). Those institutions do not have clear mandates, however, and often have overlapping responsibilities; and they are not perceived by the investment public as competent and investment friendly agencies. Their development agenda is often inconsistent with sound economic practices and this results in disputes between them and the investors.

There is no major organization representing the foreign investors in general. The creation of the Foreign Investment Advisory Council (FIAC) in 1997 was viewed as positive development at the time. FIAC provides advice to the President, but this is not a permanent working body and foreign investors are cautiously optimistic as to the ability of FIAC to produce constructive results. The American Chamber of Commerce in Ukraine seems to be the focal point for discussions and development of policy proposals. It has identified several major problem areas and developed proposals for improvement, but with limited success so far. In cooperation with the Chamber several private law firms and securities companies are maintaining active promotion efforts, directed at potential foreign clients primarily in the capital markets.[17] There is an active research services sector, targeting the companies potentially interested in the securities market, but at present the activities there are restricted mostly to analytical work in the expectation of improvement of the overall investment climate. A Chamber of Independent Experts is active under the auspices of the President of Ukraine, but this institution is designed more to provide "damage control" and alternative dispute resolution capacity. The experience of the Chamber could be useful if summarized at certain intervals and used in the improvement of the applicable regulations and administrative practices, but this has not occurred to date.

Investment promotion is, at best, underdeveloped. The few agencies given the task of promoting foreign participation seem more focused on preventing foreign investors from gaining unfair advantages over their local competitors than on attracting newcomers to viable investment projects. Government agencies do little to promote or identify opportunities, concentrating their resources instead on licensing and control functions, with the emphasis on control. Even in privatization, foreign investment participation is negligible, given the size of the Ukrainian industrial sector.

Not only is there a lack of a viable promotion agency (either public or private), but in some cases the Government has postured itself as a watchdog that must protect the country from outsiders

[17] Frishberg & Partners, The Ukrainian Legal Group, Baker & Mackenzie, and Altheimer & Gray are among the firms publishing regular newsletters or analyses of the latest legal developments.

with capital. There is a perception, at least in one of the ministries in charge, that the aim of major foreign investors is to restrict the ability of local enterprises to compete in certain industrial sectors. In the opinion of the Ministry of Industrial Policy, foreigners have "targeted" the cement and iron metallurgy industries, and some of the machine producing plants. Those who are mistrustful of foreign investment do not note that most of the competing products in those sectors (excluding metallurgy), are entering Ukraine from the neighboring countries, where they have been revitalized with foreign capital and marketing expertise. Ukrainian enterprises suffer not so much from cheap competition, but from their own inability to improve their own production.

To improve the picture, the Government will need to reconsider its role. The planning committee model currently in place, whose function is to control economic activity, will need to give way to an attitude of promotion. Technical assistance could be particularly useful in several areas:

- review and reform of administrative barriers to entry,
- identification and marketing of suitable investment projects,
- cooperation with the private sector in the improvement of existing infrastructure,
- initiation of policy dialogue between the investment community and the government,
- assistance to the local private sector in the identification of potential foreign partners, and
- development of services for potential investors.

Such activities are restricted by the lack of funds and experience, but most of all by the lack of a clear vision of the proper role of government in a market economy.
The approach of the Government with respect to foreign investment reflects the fact that most of the decision makers have never had the opportunity to run a private business, and therefore have little or no experience with the problems faced by private entrepreneurs. Supporting institutions can provide assistance to decision makers, but they will have to be encouraged and permitted to function in that manner.

Market for Reform

The need for reform in Ukraine is substantial, but not all of it is within the framework law. Most importantly, foreign investment is simply not respected by the Ukrainian Government—whether in the form of contracts, incentives, or the investors themselves. Practices that would be illegal anywhere in the European Union are regularly employed in attempting to extract better terms from investors after deals have been concluded, or to reframe the income and economics of the investment based on political decisions or improper influence. Foreign investment in the Ukraine is popularly seen as a nightmare, and a number of substantial investors have pulled out because of the problems outside of the framework law. How many others have decided to forego investment is inestimable.

On the surface, things should be better. In 1996-97, the Government concentrated on measures designed to improve the investment climate and alleviate the consequences of some unpopular decisions taken earlier. During this period, however, there has been a seemingly steady drumbeat of investment disputes between Ukrainian and foreign investors. For instance, preferential

treatment of particular groups of local customers and arbitrary price formation were among the main reasons for disputes between foreign investors and the local authorities. One principal reason for disputes from those hardy investors who have stayed has been the treatment of investment incentives, provided by the government at an initial stages of investment and withdrawn at a later stage. Most recently the Government issued a decree requiring a number of enterprises with foreign participation to stop their "foreign economic activity," pending a decision by the Constitutional Court as to the constitutionality of some tax incentives given to those companies at the time of the initial investment.

Demand for change, ideally, should come from those who are losing potential foreign partners and foreign capital, government entities responsible for pursuing economic development, and the foreign investors themselves. Unfortunately, there appears to be no data collection or analysis being done by or for the Government to determine the impact of their policies and decisions. Foreign investors are not respected by the Government, so that they have very limited input into policy change. Perhaps popular sentiment will eventually create pressure for change as those who are truly losing ground—the general Ukranian population—become aware of the cost of the current situation.

A burdensome certification process may destroy successful potential ventures. After being granted a one–year temporary certificate to operate telecommunication equipment in the country, the US partner in a joint venture was dismayed to learn that the temporary certificate was revoked before the term of the certificate expired. The revocation was perceived as answer not to inferior technical standards, but to problems existing between the local partner and the US company. This misuse of regulatory authority resulted in problems that jeopardized the entire joint venture.

Foreign sovereigns may also provide some demand for change in an attempt to protect their nationals whose assets have been confiscated or investments suborned. This is certainly necessary, but not sufficient to achieve the level of change needed.

The supply of foreign investment law needs to be designed to improve the overall investment climate, not just the climate for outside capital or mega-investors. There seems to be little appreciation for the fact that foreign investors can operate successfully only if the investment climate is friendly for the local investors as well. Several major issues, particularly in the area of property regulations and stable taxation rules and procedures, should be considered as critical for the improvement of the investment climate in general.

Changes in supply should include replacing investment planning with investment promotion; adoption of clear and transparent investment regulations; and reduction of the cost and complexity of registration and licensing requirements. Predictability of all actions in an investment operation should be a priority for all investment regulations developed by the government.

Finally, the government should seek more active support from the international financial institutions and the broader business community for the development of the regulatory framework. A law, developed with international assistance, is often perceived as more stable because of the consideration given to the opinion of all interested parties.

For help on both supply and demand, the government should encourage the formation of lobby and policy formulation groups, which capture and express the opinion of the investment community on the proposed legislative measures and are in position to identify the existing problems and propose practical solutions for them. The government should be more active in obtaining the opinions of self-regulatory professional associations. They are particularly well qualified to identify technical problems in issues of direct concern to them and to foreign investors. The government does not perceive such problems as directly related to foreign investment, but investment decisions are often adversely affected by unclear technical regulations. Many countries , which were successful in attracting substantial foreign investment, conduct annual reviews of their certification procedures, in order to ensure that technical problems do not represent hidden impediments to investors. The adoption of such practices would certainly be beneficial for Ukraine.

F. TRADE

The legal and institutional regimes governing international trade are as a general matter broad, complex, and dynamic. By design, many aspects of trade regimes are responsive to changing economic, and non-economic factors. The diagnostic indicators for trade, and this narrative summary, are not intended to provide a comprehensive or authoritative description of Ukraine's current trade regime. Instead, an effort was made to develop a methodology for taking a "snapshot" of current conditions—without any detailed analysis of trends or nuances of the complex forces that are at play in the development of this important area of commercial law.

As summarized in the general indicator table at the beginning of this report, Ukraine has a population of 50.5 million, with a GDP per capita of $3,170. With a shadow economy estimated between 40% and 60% of GDP, Ukraine's economy is considerably larger than official statistics suggest. Ukraine is also blessed—or cursed—by that fact that Soviet industrial development was extensive in the western portion of the country. With a rich agricultural endowment, large territory, developed (albeit rundown) infrastructure networks, and a well-educated population, one would think Ukraine is well positioned to benefit significantly from the economic growth that comes with trade liberalization.

Ukraine's foreign trade is predominantly with NIS countries (61%), followed by the European Union (EU) (15%), and the U.S. (6%). Ukraine has signed a Free Trade Agreement with Russia and, as mentioned in the pervious section, various trade and investment treaties with the U.S. Trade turnover for 1998 was approximately $26.5 billion, with a net trade deficit of slightly less than $2 billion.

Legal Framework

Trade relations between Ukraine and the EU are governed by a Partnership and Cooperation Agreement (PCA) signed in June 1994 that replaced the earlier trade and cooperation agreement signed in 1989 between the EC and the Soviet Union. The PCA entered into force on March 1, 1998.

The PCA defines the legal parameters for trade between Ukraine and the EU, and specifies trade concessions such as most-favored-nation (MFN) status and access to the Generalized System of Preferences (GSP). Measures for phased liberalization of trade in services, FDI, capital transfers, and protection of intellectual property rights are also addressed. The PCA also creates a framework for on-going cooperation, primarily in the form of an annual Ministerial Cooperation Council, and a Parliamentary Cooperation Committee.

Trade relations between the U.S. and Ukraine are governed by the U.S.-Ukraine Trade Agreement, signed May 6, 1992, and approved by a resolution from the Cabinet of Ministers later that year. Under this agreement, the parties extend mutual Most Favored Nation (MFN)

status. In addition, mutual consultations on trade and other relevant topics occur under the Gore-Kuchma consultative mechanism.

At present, Ukraine is in the process of joining the World Trade Organization (WTO), and Ukraine's Working Party was established on December 17, 1994. Initial offers on tariffs were tabled at the third Working Party meeting held in late June 1996. To date, little progress has been made in negotiations on Ukraine's offers. The seventh and most recent Working Party meeting was held in June 1998. According to a source close to the process, Ukraine's progress in responding to numerous questions posed during these meetings has been rather disappointing. Numerous sticking points in these negotiations remain. Areas of particular concern include agriculture, the customs system, excise and value added taxes, import licensing and other non-tariff measures, industrial subsidies, national treatment, services, state trading, transparency and legal reform, and trade related intellectual property issues.

Ukraine's current tax and import duty regimes are highly complex, burdensome, and frequently discriminatory in application to foreign products. Product categories where non-tariff barriers are quite high include alcohol, tobacco, automobiles, and various luxury items. A lack of a transparent and consistently applied legal and procedural framework for government procurement is yet another area where Ukraine is well below minimum internationally accepted standards.

Ukraine's customs valuation rules substantially conform with world standards, where customs value is defined as the sum of the sales price, transportation costs, freight, insurance, storage fees, and any other costs not foreseen in the contract price. Receipts should be presented to document these costs and to allow customs officers to determine the proper customs value. In the event that receipts are not available, Ukrainian customs will assess the customs value using comparative pricing of similar goods and services in the country of origin.

One area of relative progress on this otherwise bleak landscape is in the area of intellectual property rights. While much work has to be done, framework laws protecting patent, copyright, trademarks, and other forms of intellectual property are in place. The implementation/ enforcement gap" in this area remains sizeable, and enforcement seems to be *de minimis* based on an unscientific sampling of kiosks in the pedestrian underpasses of Kiev.

Implementing Institutions

For the purpose of this assessment, Ukraine's implementing institution for trade is the Ministry of Foreign Economic Relations and Trade. The assessment of its institutional capacity is based on an admittedly narrow sample of meetings with relevant government officials, donor-funded advisors, and private sector participants. It is clear, however, based on the responses received, that Ukraine's capacity to formulate and execute a coherent trade policy in conformity with internationally accepted norms is quite low. Perhaps the best evidence of this basic lack of capacity is found in Ukraine's inability or unwillingness to provide detailed, accurate responses to WTO Working Party questions. The Ukrainian delegation's performance during the most recent meetings held in Geneva has been described by one knowledgeable observer as extremely disappointing.

Ukraine's regulatory environment for trade is Byzantine and, in application, quite protectionist. The area that has attracted the most attention—and protest—is the area of technical barriers to trade, most notably certification and licensing. Therefore Ukraine's standards body—*Derstandard*, is included in this analysis. It should be noted that *Derstandard* declined the opportunity to meet with the assessment team to clarify its position on several key issues. As a consequence, the assessment team adopted the well known standard of "*best information available*" in completing the relevant indicator tables. In this case, the anecdotal evidence of *Derstandard*'s abuses is copious. Recently, for example, a major international consumer goods company was forced to pull globally recognized brands of detergents and shampoo from the shelves of 25,000 stores across Ukraine because it refused to underwrite "inspections" by *Derstandard* officials of foreign production facilities it maintains in Europe, North America and elsewhere. Other large multinational consumer products companies have been subject to similar demands and threatened with similar sanctions. Telecommunications companies have also been subject to *Derstandard*'s attentions.

Supporting Institution

The Customs Service of Ukraine (CSU)was established in December 1991, and consists of 70 approved customs clearing points and 222 customs posts along 8,215 km of sea and land borders. The CSU is reported to have a staff training center, a canine detection unit, and a computer center, although this was not independently verified by the assessment team. The latest available data puts CSU staff levels at approximately 13,000.

Enforcement of Ukraine's customs and other applicable regulations by CSU is notoriously unpredictable. Importers are required to complete a customs freight declaration for every item imported. Frequently changing regulations and idiosyncratic interpretations of them,makes clearing even the simplest shipment through customs a potential lengthy and expensive proposition. The problem of customs enforcement has become such a problem that trade volume through Ukraine's southern ports is being diverted in significant volumes to Romanian and Russian ports.

CSU is considered to be an exceptionally difficult organization to work with, even by regional standards. As reflected in the associated indicator scores, the supporting institutional framework for trade is judged to be generally ineffective in terms of transparency and consistency in enforcing regulatory requirements. A general consensus existed among those interviewed (outside of official government circles) that, along with Derstandard, CSU was among the most unpredictable state regulatory bodies in the trade sphere.

The "Market" for Trade Liberalization

The market for trade liberalization is quite weak in Ukraine. The slow progress Ukraine has made in meeting the requirements of WTO membership is just one indication of a lack of clear policy priority. The relative oversupply of non-WTO compliant regulatory measures, the weak institutional structures, and the general lack of transparency and consistency in applying internationally recognized norm all point to a significant mismatch between word and deed in

this area. On the demand side, the strongest and most consistent advocates for reform are foreign trading partners and their nationals doing business in Ukraine. General perceptions and attitudes remain surprisingly ambivalent to the potential benefits of foreign trade and a degree of xenophobia seems to be a part of this phenomenon. Unlike Poland, and to a somewhat lesser extent in Romania, the "gravitational pull" of prospective WTO and EU membership seems diffuse by comparison in Ukraine. It therefore seems unlikely that significant trade liberalization and associated institutional strengthening can be expected. Unfortunately for most Ukrainian's this is likely to mean that the prospects of an improved living standard in the near term are also diminished.

Appendix A – Contact List

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UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

COMMERCIAL LEGAL REFORM ASSESSMENTS FOR EUROPE AND EURASIA

Final Diagnostic Assessment Report for Romania

USAID Omnibus II-C: Policy/Legal/Training
Contract No. EPE-I-95-00071
Task Order No. EPE-I-09-95-00071-00
November 5, 1999

BOOZ·ALLEN & HAMILTON INC.
INTERNATIONAL CLIENT SERVICE TEAM

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I. Overview

This report contains the preliminary findings of the second of four commercial law reform diagnostic assessments to be conducted under this project. The assessment was conducted in Romania between December 4 and December 18, 1998. The purpose of the assessment is to field test and refine a diagnostic methodology for measuring commercial law development in transition economies.

Romania's transition to a market economy has been protracted and painful. The legacy of the communist regime, extreme centralization, a high degree of bureaucracy, and no experience of partial reforms such as those undertaken in other Central European economies during the 1980s, left Romania with one of the longest paths toward a market economy.

The successive governments which ruled the country between December 1989 and November 1996 avoided serious economic reform, fearing socio-economic "shock" and its anticipated social costs, mainly the attendant mass layoffs. Although a reform agenda was developed and a large body of legislation enacted, little was done to actually implement reform.

Since 1990, Romania's policy has been to encourage foreign direct investment. To this end, a substantial body of legislation has been enacted to create a favorable investment climate. However, foreign investment in Romania has not kept pace with expectation. The new reform-minded government puts strong emphasis on the role of foreign capital, and has promised to remove the remaining structural barriers to foreign investment. Romania's private sector, which now represents 52 percent of the country's Gross Domestic Product (GDP), is growing rapidly and has become the chief engine of economic growth.

With 23 million people, Romania is the second most populous of the formerly centrally planned economies in Central and Eastern Europe. Romania's geographic position can also potentially lead it to be the one of the busiest transportation areas in Central and Southern Europe. The Romanian oil and gas industry is Eastern Europe's largest oil and gas producer. It also has the region's largest petrochemical industry. With 1.6 billion barrels of proven oil reserves, more than four times the total of other Eastern European countries combined, it has the most to gain from energy foreign investment. However, Romania's reform is one of the slowest in Eastern Europe.

Romania's ability to sustain economic reforms and promote a stable democracy faces some key constraints. The constraints, lack of access to a transparent and credible legal system, restrictions on property ownership, bureaucratic corruption and red-tape, to name a few, are similar to the constraints facing other countries in transition. U.S. assistance has been fundamental to some of the changes implemented. An assessment of Romania will provide an illustrative list of issues that must be addressed for an enforceable commercial law reform to be functional and sustainable.

In terms of legislative development Romania is the most unusual among the reforming economies of Central and Eastern Europe. The country has the largest body of pre-communist

legislation, which survived the communist takeover in the late 1940s. This long legal tradition proved to be a mixed blessing in some cases, because it encouraged the decision makers to preserve solutions which were clearly outdated and could not serve well the needs of a modern economy. On the other hand, the presence of the Commercial Code (adopted in 1887) in the body of applicable legislation provided the opportunity for the post-war generation to be acquainted with legislation completely forgotten in some other countries during the socialist period. No matter what the reason for the preservation of the Commercial Code, it fell into disuse in the years after 1945.

The Romanian legal tradition was based mostly on French models, because of the cultural similarities and the traditional adherence of the Romanian society to the Latin, rather then the Germanic school of legal thought. The Civil Code is modeled closely on the French Code Napoleon, and on the Italian Civil Code. It was adopted in Romania in 1864 and survived mostly intact until the revolution in 1989. It was not amended after World War II and the socialist concepts of property and predominance of administrative decisions over contractual obligations were never included in it. The legislative situation in Romanian contrasted strongly with the real life development - except for Albania, there was no other country in socialist Europe with such minimal opportunities for private entrepreneurial development as Romania.

Ironically, the Commercial Code was one of the first major laws which were amended and partly abolished after the revolution in 1989. It was partly replaced by the new Company Law[1] and partly by the bankruptcy legislation[2]. What remained of the Code are the basic commercial transactions, following the classic French tradition of the 19th century. But the significance of the Code for Romania is that it continues the tradition of separation between the Civil legislation (applicable for individuals and non - commercial transactions) and the Commercial law, which deals with business entities and business transactions exclusively, and is more adapted to the needs of the market. This may be the most important part of the Romanian legal tradition.

Recent legislative developments in Romania are directed towards the preparation of the country for EU membership, and the declared legislative priority is the harmonization of the legal system with that of the Union. This will give Romania the opportunity to restructure the legal system in a more organized and systematic manner and make it a useful instrument in the economic restructuring of the country.

As indicated by the table of general economic indicators and perception indices below, Romania has performed better than Ukraine and Kazakhstan on most indicators, but not quite so well as Poland. Economic growth is stagnant, and could be expected to fall after the Romanian Parliament reneged on its foreign investment incentives this past summer. This should also have a negative impact on the credibility index. Taken by themselves, Romania's indicators present a

[1] The Company law, Law #31 of 1991, as subsequently amended.

[2] Romania had several laws, dealing with bankruptcy and restructuring, the last being Law 64/1995 regarding the procedure of reorganization and judicial liquidation, published in the Romanian Official Gazette, Part I, no. 130, June 29, 1995, and amended by Emergency Ordinance 58/1997.

profile of an economy in transition, for which it is not yet possible to predict success or failure. Clearly, much work is left to be done.

Broad Indicator	*Poland*	*Romania*	*Ukraine*	*Kazakhstan*
Population (millions)[3]	*38.7*	*22.6*	*51.2*	*16.9*
Area (km2)	*312,683*	*237,500*	*603,700*	*2,717,300*
1997 GDP Per Capita[4]	*$6,400*	*$5,200*	*$3,170*	*$2,880*
Ave. D GDP (1990 – 1996)	*3.2%*	*0.0%*	*-13.6%*	*-10.5%*
% GDP - Government	*18.5*	*10.1*	*22.0*	*12.3*
% GDP - Industry	*30.7*	*38.7*	*40.1*	*30.4*
% GDP - Agriculture	*5.1*	*22.8*	*12.3*	*12.9*
% GDP - Services	*64.2*	*38.5*	*47.7*	*56.8*
Foreign Aid Per Capita	*$17*	*$9*	*$4*	*$8*
Corruption Index[5]	*4.6*	*3.0*	*2.8*	--
Credibility Index[6]	*68.05*	*52.96*	*>40*	*48.04*
Economic Freedom Index[7]	*2.95*	*3.30*	*3.80*	*4.05+*
EBRD Legal Transition Index[8]	*4/4*	*3/4*	*2/2*	*2/2*
Moody's Emerging Mkt. Rating	*Baa3*	*B3*	*B3*	*Ba3*

[3] Population Division and Statistics Division of the United Nations Secretariat, 1998 (http://www.un.org/Depts/unsd/social/poptn.htm).
[4] International Monetary Fund
[5] Transparency International 1998. Scale = 1 - 10. Higher scores indicate less corruption.
[6] Euromoney Magazine, December 1997. Scale = 1 - 100. Higher scores indicate greater credibility of government offerings and undertakings.
[7] 1999 Index of Economic Freedom Rankings, *The Heritage Foundation* (www.heritage.org). Scale: 1-1.99, free; 2-2.99, mostly free; 3-3.99, mostly not free; 4-5, repressed.
[8] European Bank for Reconstruction & Development, 1998 Transition Report. Scale = 1 - 4+, where 4+ is most advanced. 1997 and 1998 figures are included. Of those countries included in the Sample, only Romania's score changed between 1997 and 1998.

II. Summary Indicator Results

The summary table below contains the raw Tier I and Tier II indicator results. No attempt has been made to "balance" the four dimensions of this analysis, or give differential weighting to the subject matters areas. For a detailed discussion and analysis of the results, please consult the Tier III tables and associated narrative discussion for each subject matter area.

Based on the results of the in-country assessment, Romania ranks roughly equal with Kazakhstan, ahead of Ukraine, and behind Poland in most areas of legal reform. The overall level for legal framework is mediocre -- with two significant exceptions -- as is the level of implementation. The market for reform is generally quite low, so it is not surprising that there is a significant implementation/enforcement gap.

The one area of exceptional development is related to attracting foreigners. FDI and International Trade laws score 96% and 90%, respectively, suggesting a deliberate effort to attract foreigners. The effort, however, is superficial, for the rest of the investment environment is not highly conducive to investment, whether for foreign or local investors. Bankruptcy and collateral regimes are very poorly developed, and collateral implementation is marginal. Other areas score higher, but the statistical profile suggests that reform has been aimed at attracting foreign capital through incentives, in hopes, perhaps, that foreign investors would ignore the poor overall investment environment if the pot for their specific investments were sweet enough. With the collapse of that incentive scheme in July, no investment is being properly courted.

It may be useful to contrast Romania's foreign investment approach with Poland's. Romania has (or had, until July) an FDI law with very strong incentives. With a score of 96%, the law itself outpaced Poland by 9 points. The implementing and supporting institutions did not, however, measure up. The overall score for Romanian FDI was only 57%, compared to 77% for Poland. Indeed, for implementing and supporting institutions Poland's scores range from 66-82%, while Romania is far below at 38-58%. Poland has much higher foreign investment than Romania, suggesting that a few attractive laws are not nearly enough for development -- investors are looking for consistent laws, consistently implemented and supported.

Romania's very low market scores are also an area of concern. They reflect a lack of a sufficient supply of modern, market-oriented policy and legislation, as well as a lack of well reasoned demand. Much work will need to be done in developing a more informed understanding of the changes needed to support long-term economic growth.

The weakest scores are in the two areas that may have the most significant long-term impact on the availability of credit: bankruptcy and collateral. A well designed, well enforced bankruptcy regime permits lenders to assess and control their risks more effectively. Likewise, collateral law permits lower-risk, secured lending. Together, the two laws contribute to the growth and availability of lower cost credit for both business and consumers. The fact that both areas have very low scores in the market for reform suggests that there is a serious gap in understanding the function of these laws, or the benefits they can support. Romania must surmount the deficiencies in these areas to move beyond self-financed investment and create an environment for broad-

based development. Poland, which has much higher scores in both framework and implementation, also has much greater development.

	SUBSTANTIVE AREA	Poland	Romania	Ukraine	Kazakhstan
A.	**BANKRUPTCY**	**78%**	**54%**		
	1. Legal Framework	80%	59%		
	2. Implementing Institutions	80%	62%		
	3. Supporting Institutions	76%	52%		
	4. Market for Effective Bankruptcy System	78%	45%		
B.	**COLLATERAL**	**77%**	**32%**		
	1. Legal Framework	90%	44%		
	2. Implementing Institutions	79%	13%		
	3. Supporting Institutions	65%	35%		
	4. Market for A Modern Collateral System	75%	37%		
C.	**COMPANY**	**79%**	**62%**		
	1. Legal Framework	81%	63%		
	2. Implementing Institutions	76%	73%		
	3. Supporting Institutions	82%	70%		
	4. Market for Efficient Company Law	78%	43%		
D.	**COMPETITION**	**80%**	**60%**		
	1. Legal Framework	82%	66%		
	2. Implementing Institutions	81%	62%		
	3. Supporting Institutions	81%	62%		
	4. Market for Open, Competitive Economy	78%	49%		
E.	**CONTRACT**	**80%**	**63%**		
	1. Legal Framework	83%	74%		
	2. Implementing Institutions	83%	73%		
	3. Supporting Institutions	79%	66%		
	4. Market for Efficient Contract Law	75%	37%		
F.	**FDI**	**77%**	**57%**		
	1. Legal Framework	87%	96%		
	2. Implementing Institutions	82%	58%		
	3. Supporting Institutions	66%	38%		
	4. Market for Increased FDI	75%	37%		
G.	**TRADE**	**68%**	**54%**		
	1. Legal Framework	93%	90%		
	2. Implementing Institutions	71%	53%		
	3. Supporting Institutions	49%	40%		
	4. Market for Trade Liberalization	61%	35%		
AGGREGATE TOTALS for all areas of law		**77%**	**55%**		

III. Notes on Scope & Methodology

This diagnostic assessment was designed to help achieve the following objectives:

- To provide a factual basis for characterizing the degree of development and the level of effectiveness of the commercial law reforms initiated in Romania since the collapse of the Soviet Bloc in 1989 and adoption of a new constitution in 1991;

- To provide a methodologically consistent foundation for drawing cross-country comparisons in an effort to identify and describe the root causes of the "implementation/enforcement" gap; and,

- To provide analytical and planning tools and metrics that will help USAID design new approaches to sustainable, cost-effective C-LIR interventions in the region and elsewhere.

For the purposes of this effort, "commercial law" is defined to include the following substantive legal areas:

> Bankruptcy - Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets and rehabilitation of insolvent debtors.
>
> Collateral - Laws, procedures and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets.
>
> Companies - Legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.
>
> Competition - Rules, policies and supporting institutions intended to help promote and protect open, fair and economically efficient competition in the market, and for the market.
>
> Contract - The legal regime and institutional framework for the creation, interpretation and enforcement of commercial obligations between one or more parties.
>
> Foreign Direct Investment - The laws, procedures and institutions that regulate the treatment of foreign direct investment.
>
> Trade - The laws, procedures and institutions governing cross-border sale of goods and services

Each of these substantive areas has been assessed by collecting data across the four sample countries. Within each of these substantive areas, four "dimensions" of C-LIR are proposed as a conceptual framework for comparison. These include:

- Framework Law(s) - Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Pledge of Moveable Property);

- Implementing Institution(s) - Governmental, quasi-governmental or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework law(s) is vested (e.g., bankruptcy court, collateral registry);

- Supporting Institution(s) - Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework law(s) (e.g., bankruptcy trustees, notaries); and,

- "Market" For C-LIR - The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

Within each substantive area, development indicators have been defined for each of the four "Dimensions" of C-LIR. The figure below provides a conceptual overview of how the development indicators are organized. The twenty-eight "cells" below represent groups of

development indicators (or simple propositions) that are designed to provide a "snapshot" of the current state
of commercial law reform in each subject area. From a practical standpoint, the diagnostic assessment itself is performed by collecting and analyzing data through published sources, and face-to-face interviews, that are used to populate the development indicator tables.

IV. Interpretative Notes on C-LIR Indicator Tables

The Figures 1 and 2 below illustrate how the indicator tables are organized, and can be interpreted. The first example presented is a summary table of "Tier I" and Tier II" indicators for collateral law. The four "Dimensions" of commercial law development around which this analysis in organized appear in the left column of table. In this case, the table summarizes the collateral law. The next column to the right ("Ref.") contains a "reference value" (i.e., benchmark) against which the countries in this study will be compared. As indicated, the total score for Poland (185) and Romania (95) in the area of collateral law are to be compared against the reference value for this analysis (300). From this example, it might be inferred that Country A's collateral law system is more advanced than Country B's.

Conceptual Overview of C-LIR Development Indicators

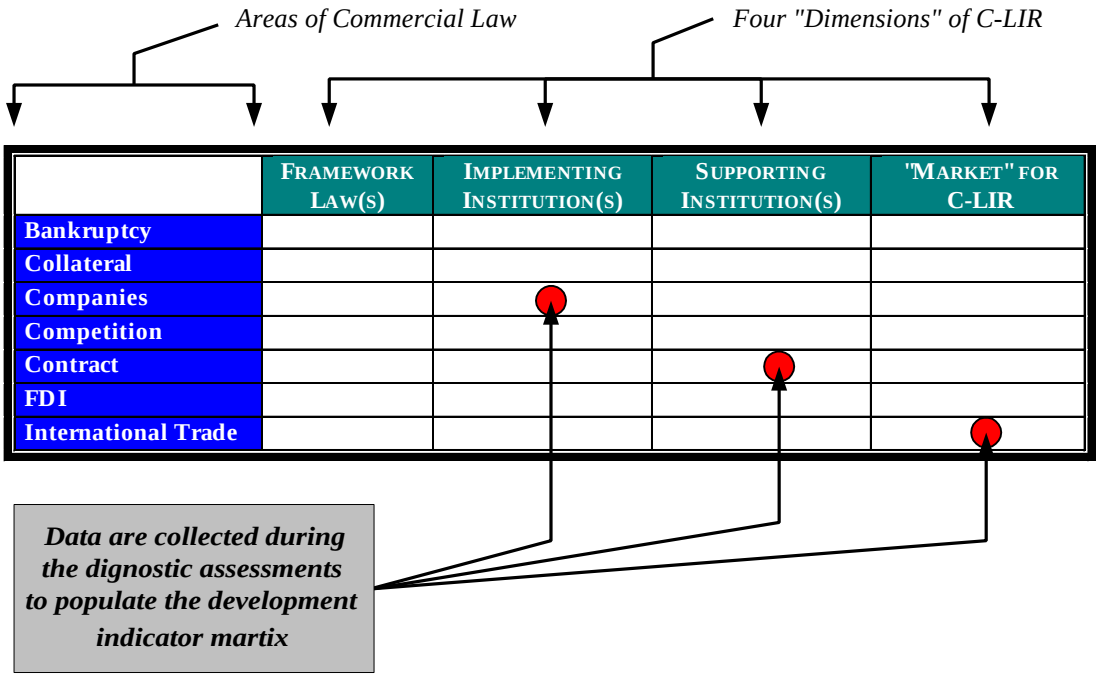

FIG. 1 - TIER I & II INDICATORS

COLLATERAL LAW	REF.	A	B	C	D
Legal Framework	100	85	90	22	64
Implementing Institution	100	72	25	33	47
Supporting Institution	100	34	67	35	49
"Market" for C-LIR	100	37	53	66	21
TOTAL	400	228	235	156	181

4 "Dimensions" of C-LIR

Country Totals = "Tier I" Indicators

Sub-Totals = "Tier II" Indicators

The Tier I and II indicators in Fig. 1 above, are derived from the raw data collected in the course of the diagnostic assessments. Tier I indicators provide the highest level of abstraction9 and are intended to be most useful to policy makers and those interested in broad regional comparisons of commercial law environments. Tier II indicators provide an intermediate level of detail, and

FIG. 2 - TIER II & III INDICATORS

B.1.	LEGAL FRAMEWORK - COLLATERAL	REF.	A	B	C	D
1	Law recognizes personal guaranties, either direct or third party, and bank guaranties	10	2	1	3	7
2	Law recognizes non-possessory pledge in tangibles.	10	4	2	5	6
3	Law creates a property interest that allows holder to execute against the security.	10	4	2	5	8
4	Law allows flexibility in the type of security interest created, and nature of the interest secured.	10	10	2	2	4
	SUB-TOTAL	40	16	7	15	27

Tier III Indicator "B.1.3"

Indicator Identifier

Tier II Indicator

are intended to be useful in program design and management where diagnosis and resource allocation are key concerns.

Tier III indicators provide the bedrock for this analysis. In Fig. 2 above, Tier III indicator values are assigned based on the findings of the diagnostic teams. The Tier III indicators are summed to yield the relevant Tier II indicator characterizing the legal framework for collateral law.

> ***"Yet having begun, we must go forward to the rough places of the law...."***
>
> **Plato's Republic, Book V.**

As noted above, seven areas of substantive law are being considered in this study. The three tier approach outlined above, while admittedly complex, is intended to provide both the level of detail required by a specialist; yet the degree of abstraction required by senior program managers and policy makers as they address macro-level issues.

[9] Tier I indicators consist of the sum of twenty-eight Tier II indicator values (i.e., four "dimensions" each for 7 substantive areas of law under consideration) for each country analyzed.

V. Narrative Summary of Diagnostic Findings

A. Bankruptcy

1. Overview

The liberalization of state-controlled economies is a fundamentally messy process. State enterprises, who for decades produced what they were told to produce, find themselves suddenly faced with a bewildering state of affairs. Their inputs supply chain is disrupted, their market outlets disappear, and their products are typically viewed with indifference (or outright disdain) by consumers. Financial crisis, if not inherited from the former times, soon arrives with a thud.

The process of transition - while exceedingly complex - can be viewed narrowly (for the purposes of this Section) as a process by which new participants enter the market, and others exit it. In most cases, a reformist government need only stabilize the macroeconomic environment and eliminate state controls in order to spark a flood of new entrants. The more difficult process to manage, understandably, is how under- and non-performing enterprises *exit* the market. Properly done, a well designed bankruptcy system provides an efficient market clearing mechanism that helps assure orderly market exit and equitable liquidation of insolvent debtors obligations.

Bankruptcy legislation is for this reason one of the more contentious areas of legal reform for transition economies. Reform implies a tradeoff between short-term economic dislocation (e.g., increased unemployment, decreased micro-economic activity, etc.) and long term economic growth - the tangible benefits of which will be felt long after the next election cycle. It is not surprising, therefore, that political pragmatism frequently wins out over visionary leadership in this area of commercial law reform.

In addition to providing a mechanism to mediate conflict between and among debtors and creditors, bankruptcy laws also provide an economically and socially beneficial systems of triage for worrying - but not necessarily terminal - cases of financial dyspepsia. Thus, bankruptcy is distinguished from collateral and secured transactions law, both of which address an individual creditor's interest in property and collection remedies relating to that property. The two sets of law converge in the area of priorities, where multiple, conflicting claims may be made on the same assets.

There are several different approaches to bankruptcy that have emerged from the CEE/NIS region. These range from "straight" bankruptcy on one extreme, to insolvency proceedings geared toward rehabilitation at the other. These models also vary in the type of debtors covered. The alternative models encompass individuals and registered for profit entities. These models include a disaggregation
of the classification of covered enterprises – e.g., agricultural, financial and nonprofit entities - that may be excluded from bankruptcy. Other key differences include:

- Who may initiate a bankruptcy proceeding; and,
- How large an estate needs to be prior to allowing the creditor and/or debtor access to the bankruptcy code.

There is also considerable variation in terms of the substantive prerequisites for bankruptcy proceedings. Variations here may include the following:

- Cessation of payments;
- Inability to cover current indebtedness with current assets;
- Inability to pay all debts taking into account all prospective liabilities;
- General nonpayment of maturing debts that are not covered by legitimate disputes;
- Inability to pay on a regular basis ones' liabilities, and,
- Undertaking certain acts that clearly signal insolvency.

Among the many issues examined in these diagnostics of the current state of the region's bankruptcy law and institutions are exempt versus non-exempt assets; title to property in bankruptcy proceedings; preferences; and creditor priorities.

2. Diagnostic Findings

Legal Framework
Romania's Commercial Code of 1887 was the basis for the country's pre-communist bankruptcy procedures. Because it was never formally abrogated, the Commercial Code of 1887 became the basis for dealing with bankruptcy in the early post-communist years (1989 to 1995). The Code empowered judges to administer all bankruptcies (liquidations as well as restructurings initiated by debtors and approved by 75% of the creditors). The court also was empowered to initiate cases on its own.

The 1887 Code provided for direct judicial administration of the bankruptcy process and this tradition was carried over to the first major bankruptcy legislation (Law 64/1995). This provision was problematic as it prevented the emergence of a specialized profession of receivers and burdened the judges with obligations which were not related to their principle field of expertise. Instead of being involved in dispute resolution, the judges were in fact put in charge of an enterprise and were required to manage the day-to-day affairs of the business. The remuneration of the *syndic* judge was in no way related to the size and complexity of the case and this reduced the incentives for speedy and efficient resolution of bankruptcy cases.

Since 1989, Romania has promulgated bankruptcy laws that are favorable to the development of a market economy. Principal legislation includes Law 64/1995, Emergency Ordinance 58/1997 that modifies Law 64, and the Law on Bankruptcy Procedure for Banks, Law 129/1998. This legislation provides the basic structure for debtors and creditors to both liquidate and restructure enterprises as well as to establish some creditor priorities. Since 1995, approximately 6,000 bankruptcy cases have been filed. The passage and the implementation measures taken in support of this legislation reflects the commitment of the Government of Romania, led by the Ministry of Justice, to undertaking this reform.

Romania's bankruptcy legislation needs to be amended in order to facilitate economic development and make this market more attractive to local and overseas investors. Amendment requires resolving conflicts between existing laws (e.g., Law 64 required only a 50% affirmative vote; Emergency Ordinance 58, which was not ratified by the Parliament at the time of this assessment, changed this to 75%.); introducing new legislation that will facilitate the administration of the bankruptcy process and the development of professionals specializing in relevant support services; and assuring the timely and effective implementation of the corrected legislation.

Some of the systemic problems identified in the diagnostic are summarized in the table below:

Excessive Judicial Burden	▪ Current legislation requires judges to undertake non-judicial managerial roles in the bankruptcy process, similar to that assumed by a trustee in bankruptcy. Judges are overburdened by responsibilities including: - Taking inventory - Handling the receipt of all moneys - Due diligence of the debtor - Converting assets to cash - Managing the debtor's business - Investigating the bankruptcy causes
Judicial Training	▪ The Minister of Justice has determined that a judge must be trained in the fundamentals of bankruptcy law and procedures prior to becoming a *syndic* judge. However, *syndic* judges continue to handle non-bankruptcy cases. This lack of specialization reduces the effectiveness of this training initiative.
Judicial Empowerment Issues	▪ *Syndic* judges are limited in their ability to appoint qualified administrative receivers because creditors holding 75% of the outstanding debt must affirmatively vote by a 50% margin for the appointment of an administrator.
Funding Limitations	▪ Judges do not have adequate funding to engage qualified administrative receivers. ▪ *Syndic* judges have the same status as ordinary litigants in filings involving abrogation of fraudulent conveyances and property recovery. They are required to pay a filing fee (stamp tax) and frequently do not have the funds to further prosecute the matter. ▪ Funding limitations also hamper other administration initiatives.
Lack of Qualified Administrators	▪ Insufficient government remuneration discourages qualified administrators. ▪ Since more money can be made in the private sector, there is little incentive to participate in specialized administrator training.

Judicial Review Issues	▪ Challenges to *syndic* judges actions are brought before a tribunal in which the *syndic* judge sits with his or her fellow judges rather than in a *separate* appellate court. There is a strong likelihood that fellow judges will vote in favor of the *syndic* judge's decision.
Petty Petitions	▪ Low fees (currently 100,000 lei or U.S. $10) encourage the use of the bankruptcy system as an alternative debt collection mechanism. Ordinary commercial claims require the payment of 10% of the amount in dispute (stamp tax).
Lack of Sanctions	▪ *Syndic* judges have no effective system of sanctions that can be used to compel debtors to provide required information.
Lack of Procedures	▪ There is no "code of procedures" dealing with bankruptcy and little printed guidance on exceptions to the rule.
Standing	▪ Under Emergency Ordinance 58, only liquidators have standing to start recovery actions.
Priorities	▪ Secured creditor priorities vis-à-vis other creditors are unclear under Emergency Ordinance 58. Government claims appear to have priority over other claims, and debts arising during reorganization are not given priority. This is problematic because of the need for additional financing to cover the working capital needs of the business. ▪ Creditors need to know that their respective priority positions will be maintained, something undermined by the Emergency Ordinance 58 reference to Ordinance 11.

While the Romanian bankruptcy system does provide limited exit mechanisms for creditors, it is critically flawed in several respects. In addition to the legislative deficiencies described above, Romania lacks an effective and complementary collateral/secured transactions law. Further, the country does not have an official central registry where all bankruptcy filings may be recorded.

One flaw in the Romanian bankruptcy system is the lack of a complementary secured transactions code. Romania needs a single integrated (accommodated) body of law that establishes clear creditor rights based on secured interests and priorities and that brings together consistent rules for adjudicating bankrupt estates. Since market economies are credit dependent, there must be a system of rules that allows creditors adequately to control risk so that they are willing to lend money. Yet, in the course of this assessment, it was clear that Romanian financial institutions such as commercial banks are barely participating in commercial or consumer lending. Instead, their lending focuses principally on government treasury purchase and trading. The banks' reluctance to provide commercial, market economy type loans is the result of a legal system that does not provide an adequate foundation for hedging against the risk of an otherwise unsecured loan.

A basic secured transactions system would bring together the following:

- Concise definitions of security devices (e.g., warehouse receipts, chattel mortgages, accounts receivable financing, etc.)
- Creditor rights and priorities
- Debtor defenses
- Creditor filing requirements
- Registry requirements
- Reporting requirements
- Precise priority rights in bankruptcy proceedings vis-à-vis other creditors and government bodies
- Concise definitions of voidable interests (interests that do not meet established standards and therefore do not qualify for priority preferences)
- Bankruptcy adjudication standards

Implementing Institutions
Bankruptcy Law 64/1995 does not represent an improvement over the 1887 Code with respect to the administration of the bankruptcy process. The current law places excessive responsibilities on the *syndic* judge and restricts the ability of the court quickly to appoint specialized professionals who are capable and motivated to complete the process in a timely manner. There are 129 *syndic* judges in Romania who are typically commercial law tribunal specialists specifically appointed to handle bankruptcy cases. While they have no special qualifications to carry on this work, all of these judges have received some initial training on bankruptcy. To date, training has not been broadened to cover business management and administration.

Some specialized training has also been undertaken to facilitate the development of a pool of support specialists, including 30 liquidation specialists; 23 court clerks; and 54 receivers. Nevertheless, inadequate budgets limit remuneration rates which in turn reduces the pool of available individuals with specialist training.

While only *syndic* judges oversee bankruptcy cases, these judges continue to have other case responsibilities outside the bankruptcy area. Appointment to a large bankruptcy case that may go on for several years could represent a major time burden for *syndic* judges. Further, there are no special incentives for this additional work.

As noted in the above table identifying systemic problems, *syndic* judges may appoint an administrative receiver; however, an appointment must be approved by a high proportion of all creditors to that end (75% of the debtors as a quorum and 50% of the vote of this group of creditors). Such an additional step is extremely burdensome. Emergency Ordinance 58 fails to recognize the difficulties in gathering a large body of creditors, especially in cases with a large number of small claimants. Nor does this Ordinance does provide for compulsory formation of creditors committees in some cases, as specified in the preceding Law, or for other mechanisms prompting less interested creditors to participate in the process.

The procedures under the Commercial Code clearly gave absolute propriety to secured creditors, effectively excluding the pledged property from the bankruptcy estate. Article 104 of the current law as amended by Emergency Ordinance 58 confirms this arrangement and preserves the rights

of secured creditors but priorities remain a problem. For example, it remains to be verified how the provisions related to government budgetary claims affect the rights of secured creditors. Ordinance 58 refers to another law on public finances (Law 72/1996) and Ordinance 11/1996 as amended by Law 108/1996. Such practice allows the government to substitute the existing emergency ordinance with another one that in fact will take precedence over the provisions of Ordinance 58 with respect to the priority awarded to the budgetary claims.

The priority awarded to bank claims is somewhat unclear and seems to give disproportionate advantage to the banking sector over all other non-secured creditors. As a policy, this provision may be justified because of the importance of preserving the stability of the banking system but as practice it may eliminate the non-banking institutions as potential lenders.

By virtue of the nature of the bankruptcy procedures in Romania, there is no state institution except the courts that administer the process. The courts clearly lack the necessary capacity because of the large number of cases, inadequate training, and the initial policy on which the system is based. An estimated 6,000 cases have been filed since Law 64/1995 was promulgated. While the number of new petitions decreased between 1996 and 1997 by approximately 8%, the number of outstanding cases increased by 93% over 1996. As noted above, current legislation does not facilitate access to qualified support staff and professionals.

Current legislation requires parties to exercise a degree of sophistication that is simply not available within the existing pool of *syndic* judges, lawyers, accountants, administrators, liquidators, and restructuring consultants. Further, the passage of Emergency Ordinance 58 directly contradicts provisions of the initial enabling legislation, Law 64. Ordinance 58 is considered counterproductive by almost 80% of the *Syndic* judges and it has yet to be ratified by the Parliament. This creates great uncertainty for judges and attorneys handling bankruptcy cases.

The process of legislative drafting in Romania clouds prospects for positive legislative change. (See, Section I below). Drafting of commercial laws should be entrusted to practitioners who will undertake a process that assures dialogue with all affected interest groups. Further, drafting should be staged and the process laid out or structured so that there is relative transparency. Ultimately, the proposed laws should be acceptable to the institutions that will be administering them. For example, in discussions with the Bank of Romania, it is noted that legislation is being passed without vetting by the very institution that oversees banks and part of the bankruptcy processes. The government agency with oversight is then put in the position to establish regulations covering laws that may not be effective.

Supporting Institutions

Another flaw in Romania's bankruptcy system is the absence of an officially sanctioned Romanian Registry that would record bankruptcy filings, and there is little or no basis for secured transaction filings at such a depository. This is problematic since a collateral and bankruptcy registry is a fundamental institution and necessary adjunct in a successful market economy. It serves as a secure database holding all official records related to collateral transactions and bankruptcy. Its transaction recordation serves as a filter that can be used to filter out spurious

claims, establish interests, and determine priorities. It typically may also hold complementary information that is germane to commercial transactions. Further, it is typically designed to be easily accessible for creditors, debtors and other interested third parties.

While a bankruptcy and collateral Registry is not officially sanctioned, Romania has a *national* registry that is positioning itself to assume this depository role once adequate legislation is in place. This is the Company registry currently operated by the Chamber of Commerce and Industry. Further, if enough Romanian private lending institutions recognize the opportunities for greater profitability that may result from making traditional commercial loans, these lending institutions' collateral needs may become the driving force for this Registry to start recording commercial transactions involving secured interests. Other East European states have successfully initiated collateral registries in advance of the foundation legislation. For example, in the case of Latvia, a sophisticated collateral registry was created and has operated successfully because of demand from commercial lending institutions and leasing companies. Arguably, the existence of this registry served as a major stimulus for the Parliament's eventual passage of legislation.

B. Collateral

1. Overview

Collateral law is intended to facilitate commerce by standardizing transactions and fostering predictability and simplicity in them. More specifically, secured transactions are intended to structure the dealings of debtor and creditor so as to preserve the rights of some creditors against the rights of others. Standardization is intended to assure familiarity and thus encourage commercial transactions.

The ability to use security interests in movable property to support the extension of credit is essential for a market economy. Commerce and industry need inexpensive capital to thrive, and lending that is secured by a pledge represents one of the most economical means of procuring financing because it significantly *reduces* the creditor's risk. Secured lending goes beyond the borrower's contractual agreement to repay since it provides a second source of payment. In fact, a legal system that assures the lender that it can maintain a secured interest is just as essential as a system of contract law.

2. Diagnostic Findings

Legal Framework
Collateral interests are currently covered by the Romanian Commercial Code. Under the Code, collateral is based principally on a possessory lien: the creditor holds the collateral for the term of the loan. Two exceptions exist under Article 480 of the Commercial Code: 1) harvest on the root that can be pledged; and, (2) processed goods.

Most jurisdictions in Europe prior to World War II had similar provisions. Prompted by the needs of a market economy, the legal community managed to find creative solutions to circumvent these restrictions and, recently, to create new legislation governing collateral. Romanian lawyers are no exception and some of the European practices are common in Romania as well.

The execution title procedure appears to have been used in one recent bankruptcy case in Romania. The respondent, the principal creditor in this case, feared that "unsecured" assets would be squandered and lost before the syndic judge acted to preserve the estate. The creditor presented the "execution title" to the local police who used it as a pretext for immediately seizing assets from the bankrupt

Because such arrangements were not necessary in Romania—a socialist economy—they gradually fell into disuse and were discontinued. Yet the need for a detailed regulation covering non-possessory pledges was not foreign to Romanian lawyers immediately after World War II. Thus, in 1945, a special credit institution—the National Company for Industrial Credit (NCIC)—was established with the purpose of providing targeted credit for industrial development. At this time, the Romanian economy was still mostly private and the institution

was designed as a vehicle for furnishing credit for productive purposes. A progressive collateral law was enacted on 12 February 1945, authorizing a system of regional collateral registries for non-possessory pledges (Article 31). Indeed, such registries were limited to the credits provided by the NCIC and to goods used in the production process (equipment was not covered). Following the nationalization of industry in the late 1940s, the law was abolished and the NCIC dissolved in September 1948.

Currently, Romania has no effective collateral law system and the non-possessory pledge is not regulated by any current legislation. In fact, the non-possessory pledge is prohibited by Article 480 of the Commercial Code. Some major local and foreign commercial banks and lending institutions are advocating the creation of a non-possessory collateral law including a registry. Such legislation and a registry would increase banks' willingness to make loans and reduce the cost of loan administration.

Some local banks, however, are satisfied with the present collateral situation. Most of their revenue is derived from trading in the money market and not in making loans. When loans are made, a banking institution frequently utilizes a system of "warrants" to protect its pecuniary interests. The system works in the following way:

1) the title to the property is delivered by the debtor to the lender while the property effectively remains in the possession of the debtor,
2) the title is released only upon full repayment of the debt, and
3) the underlying contract may be registered in a court filing.

Registration expedites the procedure for obtaining an "execution title" from the court if this becomes necessary.

The problems with this system include the following: first, the status of the pledged property is not clear because there is no way of being assured that there are not other non-possessory interests in the property. Second, there is no central repository of information on the property. Third, the administration process is cumbersome and expensive. Fourth, it is not clear how the pledged property is reflected in the debtor's financial statements and therefore there is no real way to value the enterprise's property. Fifth, while the system is being used for large capital equipment, it is not effective at dealing with smaller equipment of other types of financial instruments that can be pledged (e.g., factoring).

As noted above, some banks reported no interest in changing the current collateral system because they deal with risk in alternative ways. In some instances they look to the cash-flow of the borrower, its overall financials, the revenue stream directly driven by the newly acquired equipment, and the personal relationship with the potential debtor. Further, some reported requiring the borrower to take out insurance on the capital equipment and naming the bank as the beneficiary in the event of repayment default. Such insurance is provided by specialized insurers and also covers defaults by individual borrowers who have also purchased consumer goods on credit.

The insurance scheme does not represent a viable solution to the collateral problem. It merely transfers the risk to a third party and increases the overall cost of borrowing. The insurer is then placed in the same position as a bank—at risk without knowing about secondary liens on the property.

Romania is quite far behind other CEE countries that have passed collateral laws. Clearly, Romania can benefit from a system of collateral legislation similar to those established in Bulgaria, Latvia, and Poland. Security interests in movable property would support the extension of commercial and consumer credit, both of which are essential for a market economy. Interestingly, while many CEE countries have developed a non-possessory pledge system, many have failed to carry this to the next logical step—creating a centralized registry to record secured interests. Romania has a sophisticated registry system developed to handle company registration and more recently adapted to record bankruptcies. This registry system would be an ideal complement to a Romania collateral system.

A Ministry of Justice source reported that a draft Collateral law has been prepared by a group of young Romanian attorneys but has not yet been reviewed by the Ministry. Other draft legislation being considered is based on the Model Secured Transaction Code established by the EBRD and the Collateral Law for Moveable Property that is being championed by Center for the Economic Analysis of Law (CEAL).

While some private and government attorneys believe that a collateral law is needed, those interviewed stated that there are no strong advocates for this change within the Government of Romania and that there have been no policy discussions regarding the benefits from having such law in place. Evidence that such legislation can be perfectly compatible with the Continental legal tradition is either not known or largely ignored by the competent authorities in Romania.

Despite a lack of positive movement within the government, there is reason to be sanguine about the prospects for such legal reform. First, commercial banks clearly will benefit from this initiative, as will leading members of the Chamber of Commerce and Industry. They recognize that the existence of a well-functioning market economy requires an enforceable legal system that includes property rights with a complementary systematised collateral system and registry. Such a system leads to macroeconomic stability and enhances the performance of a market economy. It is an essential building block for establishing a well-developed financial sector because it makes risk more manageable. Secondly, accession to the EU will require such an initiative. Finally, Romania is ideally positioned to initiate an effective collateral registry system. It currently has an operational company registration system that is computerized with regional wide area network (WAN) access and is national in its database coverage. This system could be expanded to cover collateral registration for business purposes. It is already being used to track enterprise bankruptcy filings, a development that has taken place without legislative authorization, or government or donor support. Incorporating a collateral registry system with this database registry will improve the ability of lending institutions to provide credit for productive purposes.

Implementing and Supporting Institutions

Romania has *neither* a central registry that records secured transaction filings nor an effective collateral law. The combination of a self-sustaining registry and appropriate legislation assure predictable and consistent results in commercial transactions involving security interests. This is essential to the creation of a sustainable market economy, instills both domestic and international confidence in the country's financial system and fosters private sector development by increasing the ability of reasonably priced credit. Although a legal and regulatory framework for collateral filings has not been established, there are a number of Romanian institutions that may be expected to support the implementation of both a registry and promote appropriate legislation.

A lead institution in this initiative is the Chamber of Commerce and Industry. The Chamber's management recognizes the importance of a nationwide data base that services businesses and that will be a building block in developing the market economy. In addition to its vision, it has shown its technical competence by designing and implementing a successful company registry that is accessible by subscription over the internet. This data base has now been expanded to post bankruptcy filings, an initiative that has neither been officially sanctioned nor supported by the government. The Chamber's management recognizes the importance of a collateral registry and is prepared to use its existing platform for this purpose pending the availability of filing data. In addition, the Chamber may be expected to be able to play a catalyst role in educating business and finance leaders, government officials and Parliamentarians about the importance of a secured transaction system.

Legislative initiatives should focus on 6 basic areas of secured financing:

1) an automatic extension of the security interest from the original collateral to property acquired by the debtor after the creation of the security agreement (e.g., inventory financing);
2) the automatic encumbrance of proceeds;
3) the need for a purchase money security interest—allowing a debtor to gain credit despite an encumbrance on the entirety of current assets;
4) the protection of ordinary course buyers;
5) the need for a fast and inexpensive enforcement system; and,
6) the need for proper notice of encumbered assets—the basis for creating a collateral registry.

There are a number of Romanian institutions that may be expected to support such a legislative initiative. These programs may include the following: the creation of *ad hoc* task forces or advisory committees to study the market economy related multiplier effect of a comprehensive collateral law; the development of education and training programs; the development of surveys; and, the creation of lobbying groups.

Among the institutions that are likely to be important to this initiative are the following:

Organization	Participation
Chamber of Commerce and Industry	• Task force • National Educational Programs • Surveys • Legislative Drafting Committee
Romanian American Chamber of Commerce	• Task Force • Surveys • Lobbying
National Council of Small & Medium-Sized Enterprises	• Members Educational Programs • Surveys • Lobbying
American Chamber of Commerce/Romania	• Surveys • Local Educational Programs
Young Lawyers Association (various)	• Educational Programs • Legislative Drafting • Training in secured transactions • Law School Initiatives • Lobbying
Law Schools	• Education programs • Design of interim collateral lending strategies within confines of existing law

Preparatory to a comprehensive secured transaction law being drafted and enacted, it behooves the law schools, lawyers' associations, financial institutions, etc., to facilitate the development of collateral lending techniques beyond possessors' interests. This may be accomplished by designing collateral programs that utilize existing legislation in creative ways. There is necessary complexity in this process and enforcement may be compromised because of limited judiciary training. Nevertheless, the creation of secured transactions will require the use of a registry and may play a catalyst role leading to the creation of a fully rationalized system. Further, enforcement may be facilitated by a Ministry of Justice initiative that extends the scope of Syndic judges into the allied field of secured transactions. Much of the Syndic judges' training is topically related in such areas as priorities. The enactment of a comprehensive collateral law will have a direct impact on existing Romanian bankruptcy law.

C. Company

1. Overview

It is well established that for-profit enterprise development (e.g., partnerships, corporations, sole proprietorships, etc.) cannot flourish in previously non-free-market economies without active governance that assures domestic and foreign investors that there is regularity, predictability, and transparency in all commercial undertakings. In the CEE/NIS, this is a critical period of private institution building that requires the dedication of internal and external financial resources to fund a process of enterprise privatization, restructuring, turn-around, revitalizing, renewal, and new business development (e.g., venture capital type start-up businesses). The government in each of the CEE/NIS countries represents part of the critical support system, which also includes NGOs.

Government regulation is essential, therefore, in terms of encouraging and facilitating the development of these enterprises, establishing standards for the internal governing of these institutions, and controlling their role in the overall economy because of potential abuses in their freedom of contract. This regulation may be part of the existing civil code, a new system of commercial codification designed to establish standards of practice in specifically defined situations ranging from commercial and secured transactions, bankruptcy, taxation, or the result of court-developed concepts such as fiduciary duty and the application of contract law. Constructive governance in this context also requires both an operating ethic that is conducive to for-profit enterprise development and that is broadly accepted by all political and bureaucratic levels. This is demonstrated by factors that go beyond code promulgation and to the very heart of the operations of the systems that result from the earlier stages of legal and regulatory reform. Examples include, among many others, increasing the size of the judiciary; educating judges about both code and regulatory reform and its importance to the overall performance of the economy; providing reasonable remuneration for the judiciary; the creation of registry bureaus that assure accurate recordation; assuring enforcement by getting buy-in by all key participants at the political, bureaucratic and business level; etc.

Company law plays a key role in market economies as it establishes guidelines for the internal organization of private companies and for corporate governance. Along with securities legislation, company law tries to protect outside investors and the public by specifying minimum requirements for capital and for the publication of information about the company. It also aims to encourage entrepreneurship by setting limits on the liability of investors.

2. Diagnostic Findings

Legal Framework
With few exceptions, transition economies have liberalized the legal regime for business organizations and provided a basic framework for different types of organizations. In Romania there are no specific investment approvals required to establish a business. In addition, there has been much recent improvement in the choice and introduction of corporate forms. By

continental standards, start-up formalities for new companies in Romania are quite expeditious. However, the protection of shareholder rights and corporate governance are more problematical.

Before the Communist takeover, Romania had a traditional continental company law, which was abrogated during the Communist era. In the first year following the 1989 revolution that displaced the Communists, the earlier traditional system was basically restored. In November 1990, the ***Companies Law*** (Law No. 31 of 1990) re-established the principal types of company organization typical of continental legal systems. These include the ***general partnership***, the ***limited partnership***, the ***limited partnership by shares***, the ***limited liability company***, and the ***joint stock company***. The latter two are the most common types of business organization in Romania.

The Romanian ***joint stock company*** resembles the French SA, the German AG, and the Anglo-American public corporation. Extensive information and procedural requirements are imposed on this form of company in order to protect large numbers of anonymous investors. The joint stock company is an important company form in all mature market economies. It was hardly used in Romania after 1989, but its use is currently increasing.

Under Romanian law, at least 5 shareholders are necessary to establish a joint stock company. They can be residents or non-residents, and legal or natural persons. The minimum prescribed capital is Lei 25 million (approximately U.S. $2,500). Paid-up capital must be at least 30% of subscribed capital (100% for contributions in kind). The capital is divided in freely transferable shares and the company may issue debentures up to a debt-equity ratio of 75%. Registered capital cannot be increased before all shares previously issued are paid in full. A prospectus is required if stock is to be offered for public sale. The Contract and the Statutes (the bylaws) for establishing the company must be approved at the first general meeting of shareholders.

With regard to ***corporate governance***, Romania's Company Law provides for a sole administrator or a board of administration to be chosen by the general meeting of shareholders. The board may delegate some of its powers to a managing committee. The president of the board of administration is required also to be the director of the managing committee.

The Romanian ***limited liability company*** follows the form used throughout continental Europe of the French SARL and the German GmbH. It combines some of the benefits of the joint stock company with the relatively simpler procedural requirements of the general partnership, and is particularly well-suited to small and medium-sized firms with only a few owners. This is by far the most common form of company in Romania.

Limited liability companies may have between one and 50 shareholders and minimum capital of Lei 2 million (approximately U.S. $200). The companies are prohibited from issuing debentures, and shares are transferable outside the company only with the agreement of shareholders holding 75 percent of capital. Because of the more personal nature of the expected relationship among owners, no prospectus is required to set up the company. All associates must have access to the books of the company at any time, and they may perform the duties of auditors if no auditors are appointed at the General Meeting. Although most decisions at the General Meeting require only

an absolute majority of the associates and of the registered shares, unanimity is required to alter the company contract or statute. A one share-one vote rule is mandated (Article 141), in contrast to the more flexible voting rules of the joint stock company.

With regard to corporate governance, a limited liability company is to be managed by one or more administrators appointed by the company contract or by the general meeting of associates. A board of directors is not required.

In the ***general partnership***, all partners have unlimited joint and several liability with regard to the partnership's obligations, and all are entitled to participate in the management of the business, unless provided otherwise in the partnership's contract. This form is most suitable for small enterprises with a few active participants.

In the sleeping partnership (***limited partnership***), in contrast, only the active partners (who serve as administrators) have unlimited liability, while the liability of the sleeping partners is limited to their capital contribution. This form is more suitable for larger undertakings where a few active participants are seeking capital from passive investors.

The ***partnership limited by shares*** or ***joint stock company limited by shares*** most closely resembles the joint stock company in its formal requirements, including minimum capital, prospectus requirements, founding and general meeting requirements, procedures for valuation of in-kind capital, auditing requirements, and record keeping. Because of this formality, this form is unlikely to be used much in practice in Romania.

Shareholder Rights - Business organizations irrespective of their size or legal form are set up by mutual agreement of the founding parties and new participants join on an equal voluntary basis. However, legislators in most countries have provided a set of mandatory provisions for certain companies, especially joint stock companies. In the case of joint stock companies the assumption is that investors require more legislative protection because the often large number of shareholders makes it difficult for them to organize as a group, and thus could be easily outmaneuvered by the company's top management. Romania (and many other transition economies) requires companies with more than 50 shareholders to be organized as a joint stock company in order to be subject to the more stringent requirements of that legal form.

Shareholder rights are commonly defined as the right (i) to participate in a company's affairs through attendance at shareholder meetings and voting rights and (ii) to participate in profits in the form of dividend payments and claims upon liquidation of the company. Yet in transition economies company laws fail to provide shareholders with the means to enforce these rights. This is particularly true with respect to former state companies that have been privatized. The new shareholders are at considerable disadvantage vis-à-vis management, and are often locked into their holdings as capital markets remain undeveloped. In spite of this, they have little scope for "voice" in the company. Romanian law does not specifically regulate shareholder derivative suits. It remains to be seen whether such an action would be tenable in the current environment in which there is no clear legislation creating shareholder rights and there is no body of judicial decisions dealing with this issue.

Even though company laws establish the "one share/one vote" principle, it may be restricted. Romania's company law provides that a company's certificate of incorporation may restrict voting rights by stipulating the highest number of votes or highest number of shares a shareholder may vote on, irrespective of the shareholder's total holdings. These provisions prevent large shareholders from making full use of their property rights, such as in recently privatized companies where management has retained de facto control over company decision-making and the new owners have no way to make their influence felt.

Corporate Governance - Corporate governance is a critical issue not only in Romania but also in all CEE countries. Many variables in an economy—including the dispersion of share ownership, the type of owner, and the tightness of other market-based constraints on managers—have an effect on corporate governance. Company laws are also important, because they provide the framework in which owners actually exert their influence in monitoring managerial behavior.

Looking at the Romanian Company Law, there is one obvious concern. In the case of joint stock companies, the president of the board of administration is required also to be the director of the managing committee. This requirement is problematic because it focuses so much power (essentially the roles of Board Chairman and CEO) in one person. This focus of power may be reasonable in some cases, but there is the obvious risk of abuse of power.

In order to give shareholders effective control rights, Western company laws often stipulate general standards of business conduct for top managers and provide detailed guidelines for transactions that involve potential conflict of interests. Defining and enforcing standards for business conduct on the part of top managers has proven particularly difficult in the economic environment of transition countries. Absent a developed business culture and faced with economic instability, most transition economies have been cautious in trying to define such standards. Perhaps more important than defining a positive standard for directors' conduct appears to be a clear definition of negative standards accompanied with an effective enforcement procedure. One cannot say that Romania is very far advanced in this area.

Relationship with Securities Legislation - These two areas of shareholder rights and corporate governance are of particular importance for public companies that are raising capital on the emerging capital market. In Romania it seems that these two areas are mostly dealt with in the framework of the securities laws, rather then being incorporated in the company legislation.

This approach may cause confusion in the law by introducing the so-called "closed" joint stock company, which in form overlaps with the limited liability company already in existence. Apparently no policy discussion took place when the decision was taken to introduce the "closed" joint stock company.

The disadvantage of this arrangement is that many general provisions of the Company Law may need to be repeated in the parallel legislation, or risk being considered not applicable to the new company form. This may be a source of legislative confusion. Most important, judging by the U.S. experience, a body of judicial decisions may emerge in several areas: valuation of the assets

of the company, fiduciary duties of directors, and protection of minority shareholders. It would be beneficial if this body of jurisprudence is based on the fundamental company law and made applicable to limited liability companies as well.

Implementing Institutions
The procedure for establishing a company was considerably simplified in 1997 and the registration time was reduced to two to three weeks (from the previous average of four to six weeks). With the exception of a single visit to the Notary's Office to certify the company's bylaws, all other contacts are with a single institution—the Trade Registry Office in the locality where the company will be active. The Trade Registry is a public institution, organized by the Romanian Chamber of Commerce and Industry (RCCI), with offices in Bucharest and each of the country's 40 counties.

There are four steps involved in setting up a company in Romania:

1. First, it is necessary to go to the Trade Registry to see if the intended company name has already been taken. One usually asks for three names and then depending on the availability, reserves the preferred name and company logo for a prescribed period of time. This process is computerized and reasonable fast.

2. Next, the company must certify the articles of incorporation (Contract) and bylaws (Statute) at a Notary. In fact, the Contract and Statute can be comprised in a single document (Constitutive Act), which must be signed by all shareholders or their representatives and notarized.

3. Incorporation papers and necessary documents are then submitted to the Trade Registry for authorization by the mandated judge ordering the incorporation of the company. The company obtains juridical personality from the date of incorporation.

4. The Trade Registry then submits the registration papers for publication in the Official Gazette.

This is a far simpler procedure than that originally adopted in 1990. The earlier procedure required seven steps including an application to the Tribunal for a judicial decision granting authorization to set up the company. This application phase was usually a lengthy process. Now the assigned judge goes to the Trade Registry every day to handle registrations. Except for the visit to the Notary, the Trade Registry has become a "one stop" shop.

The Trade Registry is regulated by Act No. 26/1990, as modified and republished in 1998. The following is a synopsis of how the system works (Article references are to the Act).

First, the Ministry of Justice, in agreement with RCCI, established the norms for operating the Registry, the required forms, and record keeping requirements (Art. 12), which were published in the Official Gazette (Art. 12). At its own expense, the RCCI then established computerized

Trade Registry Offices in Bucharest and in the country's 40 counties (Art. 9); RCCI pays for operating expenses of the Registry and for personnel costs (Art. 10).

The Ministry of Finance agreed with RCCI on the fee schedule for different types of corporate filings (Art. 11). Fees collected are divided as follows:

1. 8% to pay for the expenses of the actual registration.

2. 2% to the Ministry of Justice to pay for the judicial phase of the proceeding.

3. The balance to RCCI to compensate it for the establishment and operating expenses of the Trade Registry Office (Art. 11).

The Court makes an annual inspection of the Trade Registry Office operations as required by Article 8.

Based on a broad cross-section of the team's discussions with entrepreneurs, lawyers, bankers, non-governmental (NGOs), government officials, and ordinary citizens it is fair to conclude that Romanians are satisfied with the operations of the Trade Registry offices. The general comment was that the new procedures are a great improvement over the old way that company registrations were handled. One NGO that helps small business with business planning and corporate start-ups said that there is no need for them to get involved in the incorporation process because operations run smoothly at the Trade Registry. Indeed, the team's translator, who is establishing a private translation company, commented on the ease and efficiency of the process and the Trade Registry.

The favorable comments on the company registration process are not to suggest that the current system is ideal particularly from the American perspective. By U.S. standards registering a company in Romania is expensive (about $500 in fees) and slow (2-3 weeks compared with the extremely rapid process in the U.S.). A good part of the explanation is due to the fact that in the U.S. there is no judicial involvement in the company registration process whatsoever. From the U.S. perspective, the involvement of a judge contributes little of real value to the process and appears to be mainly a formality.

From the viewpoint of judicial efficiency and the sound management of scarce judicial resources, company registration creates an additional problem. Judges who are in short supply are taken away from their main duty—dispute resolution—and forced to review all business documents in order to approve a registration. This review is a purely administrative task that could be performed by an administrative arm of the court or transferred to an agency outside the court. It is difficult to see how judicial involvement protects the interests of third parties in their dealings with the new company or is otherwise beneficial in a legal sense.

On the other hand, judicial registration of companies seems to be a solidly established continental practice. Little evidence exists as to the likelihood of the practice being changed in Romania or

elsewhere in continental Europe in the near future. Given this reality, the best approach is to streamline procedures and time lines, very much like Romania has done.

Although setting up a company in Romania is expensive by U.S. standards, the expense involved does not appear to strike Romanians as unreasonable. In fact, in several of the interviews the team received the impression that people felt that something as important as setting up a company could not reasonably cost any *less*. Whether that impression is right or not, it is accurate to say that none of those interviewed criticized the expense of company registration.

The fact that a private organization like the RCCI is carrying out a critical public function such as company registrations may strike some as inappropriate, curious or even dangerous. One might imagine a risk that the Chamber use its monopoly position to pressure new companies to become Chamber members or otherwise give the Chamber some special compensation or advantage. Yet no such allegations or concerns were expressed. On the contrary, we heard accolades about the way that company registrations were being handled. Several people expressed the view that if the Government had opted to set up the Registry offices as governmental entities, the system today would be far from operational. Work would still be ongoing in setting up the offices and the computers would not be installed yet. Whether this speculation is true or not, there seems little doubt that the public/private partnership spelled out in Law No. 26 did enable the registration system to begin operations quickly.

Thus, as a private institution operating in the public good, the Trade Registry seems to be living up to its mandate. The statutory framework for the Trade Registry appears to be comprehensive and reasonable. A formula for dividing fee income as a way for financing the system seems like an excellent example of public/private cooperation. However, without having examined RCCI's costs it is not possible to evaluate whether the actual percentile distribution of fee income is appropriate. There is no doubt, however, that setting up the Registry Offices must have been expensive and the RCCI should be entitled to recover its expenses.

As a totally computerized operation the Trade Registry is able to generate extremely useful data on new company formation, liquidations, and amendments of articles of incorporation for all companies throughout the country. The Monthly Statistics on company activity are an important economic indicator.

Between December 1990 and October 1998 there were a total of 725,100 company registrations in Romania. During the same time 18,824 companies were dropped from the company registry. A further 844,228 amendments and company notifications (unrelated to company formation and liquidations) were also filed during this period. This data is available broken down by different types of business organization (joint stock companies, limited liability companies, partnerships and sole proprietorships) for all 40 counties and Bucharest. Annual comparison charts show clearly yearly fluctuations in business start ups and liquidations since 1989.

Supporting Institutions

Romania has the full range of supporting institutions described in other sections of this report. In the private sector, there are law firms, NGOs, accounting firms, banks, legal publishers, and

other economic actors that support the development of company law. New types of businesses (such as document processors and investigative services) enter on the scene to help new entrants to the marketplace. Universities, foundations, think tanks and for-profit companies sponsor seminars, conferences and workshops on different aspects of company law and company formation. Increasingly, attendees are willing to pay for business seminars—showing that companies and individuals really value the product rather than simply taking advantage of a free foreign donor-funded program. Professional associations develop in new specialties. On the state side, the courts, commercial courts, and administrative agencies become more assertive and competent in dealing with company law matters.

The path of change is not linear such as a steady march of progress in all sectors. Instead, reform in countries like Romania has proceeded in spurts—advancing, stumbling, and then surging forward again. Supporting institutions are key in fueling the demand for reforms which are sustained, tested by events, and have delivered over time.

D. Competition

1. Overview

Fair competition in the provision of goods and services is the cornerstone of the free market. Creating an environment in which such competition could flourish was one of the primary challenges facing the CEE/NIS in their programs of economic and legal reform. In the transition from the former state monopoly system, the passage of anti-monopoly laws became the focus of many legal reform efforts. In fact, foreign donors and client governments have often treated the passage of a new antimonopoly law as the chief benchmark of progress in law reform, and have commonly viewed implementation and institutional development as an afterthought. Detailed understanding of institutional constraints to implementation has been lacking. Our approach to the competition policy analysis will examine these constraints paying particular attention to supporting institutions, enforcement strategy, competition advocacy programs, and the problem of over-regulation.

Supporting institutions are critical to proper development of a regulatory and enforcement regime for competition policy. To cite just a few key linkages, skilled lawyers or consumer groups may be needed to identify and bring to the attention of antimonopoly authorities various antitrust violations; academics on law, business, and economics faculties may be helpful in advancing the state of understanding of local markets and the application of law; trained judges are needed to rule on antimonopoly cases; compulsory process is necessary to obtain business records; business records must be kept in a format consistent with modern accounting methods; and so on. While development of none of these institutions is as critical to implementation as internal development of an antimonopoly agency's capabilities, their evolution is ultimately of great significance to the establishment of the rule of law and must be tracked in some detail to present an accurate picture of the complexity of a functional enforcement regime.

A phased, targeted enforcement strategy ensures that an antimonopoly agency—especially one lacking in certain resources—does not attempt to assume more responsibilities than it can handle. It also ensures that it attacks some of the most important, yet politically attainable, problems first, thereby boosting its credibility and gaining public trust. An enforcement portfolio needs to include both critical actions against government restraints on competition as well as a handful of politically more palatable, yet less helpful, cases (e.g., antimonopoly cases, if they fall within the agency's purview). It also needs to include voluntary compliance programs and public education efforts that lay the groundwork for an enforcement program that is perceived as fair, justified, and sensitive to business community views.

A competition advocacy program is often overlooked in the midst of client government and donor preoccupation with high-profile enforcement actions. Yet this kind of education, publicity, and policy advocacy program is arguably the most critical type of activity that an antimonopoly agency can take in a transition economy. The reason is simple: most of the post-Soviet world suffers from excessive regulation and *government-directed restraints on trade that impede easy market entry (e.g., exclusive licensing arrangements).* Perhaps the highest-priority and most

effective steps that an antimonopoly agency can take are to lobby assiduously for the elimination of over-regulation generally and removal of particular restraints. Such activities will not only have a beneficial effect on competition, but will also tend to stem some of the worst *corruption* problems stemming from exclusive dealing arrangements brokered by ENI governments.

Finally, a trenchant inquiry into competition policy implementation must examine whether antimonopoly authorities are reflexively *exercising regulatory powers—e.g., industrial policies that tend to affect price and output—that are precisely contrary to the central objectives of a competition policy agency*. In many transition economies, antimonopoly agencies are often pressured by domestic business fear of foreign competition or by consumer outrage over high prices to engage in result-oriented manipulation of market structures. Often, donors are unaware of such interventions or fail to appreciate its political or cumulative economic, impact. It is therefore critical to ascertain the degree to which this is occurring in order to critically assess overall implementation of competition policy.

Antimonopoly laws encompass one part of the legal framework that is an essential element in any free market economy. Competition increases market efficiency by leading to lower prices, reduced inflation, improved technology, a broader array of product offerings, and a reasonable supply of goods. Markets remain open through a combination of open international trade, and domestic laws and international treaties that limit monopoly behavior. Domestic legislation typically includes laws that assure market information transparency, public regulation of so-called natural monopolies such as electric utilities, the deregulation of prices, and the supervision of markets by government bodies to assure competition.

2. Diagnostic Findings

Romania, along with the other Central and Eastern European (CEE) countries, inherited a highly concentrated industrial structure with state owned enterprises monopolizing or otherwise dominating markets. The continued dominant position of some entities, even post-privatization, is a major impediment to the growth of a new private sector. Because of their marketplace dominance, enterprises that are monopolies or oligopolies prevent new firms and product offerings from reaching the consumer. Further, smaller firms wishing to supply dominant companies are potentially subject to burdensome conditions.

Romania has followed a gradualist approach in developing its antimonopoly legislation. Soon after the 1989 revolution, the Government of Romania recognized the need to develop legislation in this area. It laid out *general* principles of competition in both Law 15/1990, Restructuring of State Economic Units and Law 13/1991, Unfair Competition. But these laws neither established detailed definitions of monopolistic behavior nor set out applicable sanctions.

The principal competition legislation was not passed until 1996. Competition Law 21/1996 was promulgated on 10 April 1996 and became effective on 1 February 1997. This legislation establishes the basis for competition policy in the country including the principles of market competition and price decontrol. The law generally prohibits agreements among market participants that will limit, prevent, or distort competition in Romania. Exemptions may be

granted if an applicant can show that there may be a significant improvement in production, product distribution, quality, and technology and that the improvement may strengthen the competitive positions of small and medium sized enterprises both in the Romanian domestic market and overseas. A dominant position in the market place is not, *per se*, prohibited.

Implementing Institutions
There are two principal government bodies that are responsible for implementing Competition Law 21: the Competition Council (the Council) and the Competition Office (CO). Both these organizations were established on 6 September 1996 pursuant to Law 21.

A president with the rank of Minister and three vice presidents with the rank of secretaries of state run the Council. The President of Romania, in consultation with the Parliament, appoints the Council members for a 5-year term. The Council is an adjudicative body that also has rule- and policy-making authority as well as limited internal investigative resources. The Council can and does apply sanctions to both private and government entities that violate the Competition Law. Decisions are based on investigations by either the Council or the CO. The Council's decisions are exercised independently but can be contested. Challenges are made through the Bucharest Court of Appeals with recourse to the Supreme Court of Justice. The Council also provides expert advice to other government agencies on competition policy and local public administrators prior to their restructuring of public companies.

The Competition Office's (CO) organizational and personnel structure was approved by Government Decision 775/6.1996. The CO was originally part of the pre-1989 "State Committee on Prices" within the Ministry of Finance and had responsibility for regulating prices. By 1991, as a result of the emergence of a freer-market philosophy, the CO, operating as the Department for Prices and Protection of Competition (DPPC), started to refocus its efforts on price de-regulation. By October 1996, the DPPC changed its name to the Competition Office and moved from the Ministry of Finance to an independent government agency.

The CO has several roles. First, it continues to be involved in price control monitoring and implementation focusing principally on *regies* autonomous and natural monopolies such as utilities (power), local transportation (rail, river, and municipal), communications (postal and telecom), and water and sewage. The regulatory initiative is now relatively minor as prices are now indexed each month to either the Consumer Price Index (CPI) or the exchange rate. Further, many monopoly situations are disappearing. Second, it provides surveys and economic analyses of prices in various sectors, seeking patterns that suggest restrictions on competition. This information is shared with the Council and may serve as the foundation for prospective complaints emanating from the Council. Third, the CO is the principal information conduit to both the Romanian public and international bodies with respect to quantitative and qualitative information on competition in Romania. Fourth, the CO serves as a liaison with international organizations and the EU. Fifth, it is the principal investigative authority that deals with infringements of the Competition Law (While the Council also has investigative authority, its resources are more limited.).

The CO is both reactive and proactive. It may launch an investigation based on a complaint, or initiate an investigation on its own or in conjunction with the Competition Council. All investigations are carried out in accordance with rules and procedures set out by the Competition Council and findings are submitted to the Council for its ruling.

Romania has made significant strides in developing legislation that promotes competition and in creating institutions that will support the implementation of this legislation. Systemic problems have been identified in the following areas.

Policy Issues:	▪ Debate continues about economic and political risks resulting from vigorous enforcement of antimonopoly rules and regulations. The dichotomy is manifested by the disparate and sometimes conflicting roles played by the Council and the CO. - The former is a newly created body and the champion of competition. - The CO is considered staid because of its earlier functions and the long tenure of its staff. Many of its long-term, senior staff members are unwilling to cooperate with the Council in activities as fundamental as training and are reported to be less than cooperative in some investigations.
EU Accession	▪ Romanian legislation and regulatory reform is being undertaken to meet EU accession standards. However, converting this framework to practice is proving to be problematic. This is manifested in training sessions with EU members where Romanian participants frequently come up with vastly different legal "case" conclusions than their Western European counterparts. The differences may be attributed to different economic environments, training, and a lack of experience in dealing with anti-competition regulation.
CO Staffing Problems	▪ Inability to hire and/or hold on to quality economists, accountants, and lawyers because of budgetary limitations. ▪ Significant shortfall in actual staffing levels (900 staff positions but only 450 employees). ▪ Inadequate training and budget for training of existing staff. ▪ Lack of necessary industry specialists needed to conduct inquiries.
CO and Council Information Issues	▪ Difficulty in developing and maintaining comprehensive databases on a large cross-section of industries, thus compromising investigations and follow-up analysis.
CO Process Issues	▪ Inadequate procedures for dealing with investigations including methodological problems such as how to conduct investigations, how investigators should interact with companies subject to inquiries, how to gather information, and analytical precepts. ▪ Inter-office organizational problems that compromise the effective use of CO staff in information gathering and analysis roles.
Judicial Issues	▪ Judiciary that has difficulty in effectively dealing with antimonopoly issues because of inadequate training in economics and business. ▪ Judges who are not fluent in the relevant law. ▪ Judges who do not specialize in antimonopoly matters.

Enforcement Issues	▪ Prioritization of investigations (e.g., large enterprises vs. small firms). ▪ Lack of clear standards related to pursuing investigations without stifling competition.
Council and CO Cooperation	▪ Ideological differences ▪ Unclear delineation of responsibilities ▪ Inadequate coordination and cooperation with respect to dialogue over policy issues, enforcement, and training.

The effective implementation of the Competition Law and its subsidiary regulations requires reasonable legislation, effective implementing agencies with adequate resources and staffing, a receptive society, and competent management. Romania has reasonable legislation and the management of both the Council and CO are insightful and capable. They have achieved a great deal based on recent data on the first reporting period for these organizations. Between February 1, 1997 and December 31, 1997, the first reporting period, 72 anti-competition cases were registered. Fifty-three of these were resolved during this term and 19 cases involve on-going examinations. Council-initiated complaints have been sustained in court, and significant sanctions applied to both private companies and government bodies. Ministries and the private sector now know that anti-competitive behavior is being scrutinized and that penalties will be applied. But, significant hurdles remain. Structural improvements need to be made in the CO. Technical assistance and training will not resolve fundamental problems associated with inadequate remuneration. Further, better co-ordination is needed between the Council and CO to ensure that there is effective and consistent enforcement of the Competition Law and related legislation. This requires that there be agreement between the two organisations with respect to which one will play the lead role. Cross-training and shared technical assistance programs would also reduce costs and facilitate cooperation.

Implementing and Supporting Institutions
To facilitate increased competition, Romania needs to effectively deal with product standards that are used to keep competitive products out of its marketplace. At the present time, the country has multiple regulatory bodies, standards, and compliance requirements which, cumulatively, may create a significant burden to firms trying to compete in Romania. These firms are faced with increased compliance costs and interminable bureaucratic procedures that prolong the process of getting products approved for the market.

The Competition Council and the Competition Office have not adequately addressed these issues and other government bodies have explicit authority over many of the regulations that are proving to be anti-competitive. These government bodies include the Ministry of Agriculture, the Office for Consumer Protection (established by Decree No. 21/1992), and the Romanian Institute for Standardization. Generally, goods imported into Romania need to comply with rules and regulations concerning health, safety and labeling. Many goods may qualify for the Romanian market by complying with EU designated norms (e.g., ISO 9000) and by having Romanian language labels. The application of these standards is not, however, uniform. Thus, despite being in compliance with EU requirements (e.g., Decree No. 629/1996), some classes of capital equipment are subject to separate safety testing and certification (e.g., earth moving equipment). Another example of this problem is found in food products. These are subject to

sampling, testing and analysis at the Ministry of Agriculture. Once they have met the Ministry of Agriculture's standards, the products must be granted a separate import license by the Department of Agriculture. The entire transaction time may extend out to 6 months. Interestingly, exceeding EU standards has apparently been used to exclude products from the Romanian market. Respondents reported instances in which US origin products that exceeded the EU standards were treated as non-conforming and import licenses were withheld.

In summary, the product testing and certification requirements result in pre-market clearance procedures and costs and result in significant delays in the sale of products. Company submissions are often made to several government agencies some of which have conflicting regulations. This increase in the number of pre-sale approvals increases costs, further delays market entry, and reduces competition.

The Competition Council and the Competition Office may be more effective in fostering a competitive environment in Romania if they can be made truly independent, agencies. The politicization problem is illustrated by initiatives attempted in utility deregulation. The Competition Office (CO) has been responsible for the regulation of electric utility rates. It has initiated rate deregulation. The CO has also developed a plan to have the utility industry break itself into multiple parts including power sales, power transmission, and power generation. A goal is to create competing operators/suppliers for each of the original parts of the electric utility. This plan has apparently met with resistance from the Parliament, SOEs, and newly privatized companies that continue to prefer a "closed" system and want the competitive advantages associated with subsidized energy. Unfortunately, the size of the Romanian market and the heavy cost associated with developing a new distribution infrastructure precludes the introduction of outside competitors that otherwise might drive prices down. The uncertainty here also poses problems for privatization initiatives in this sector. The net effects include the following:

- Energy costs remain too high
- New infrastructure is not developed
- Industries that are particularly price sensitive about energy costs do not come into the country
- There are fewer foreign investment opportunities for foreigners, and,
- The development of a market economy is further delayed.

E. Contract

1. Overview

No field of law is more essential to the operation of a free market than the law of contract. A consistent, predictable set of principles binding parties to the terms of their agreements underlies all of commercial law. It is, thus, an obvious and indispensable component of this analysis of commercial law reform in the CEE/NIS.

The countries examined in this assessment are at various degrees of transition from a system of state planning where contract law played only a peripheral role. Normal contract law did not exist in the planned sector of the economy. It did exist, however, in two limited areas including foreign trade relations (conducted by a limited number of state agencies) with non-communist countries, and in non-business agreements between private citizens (e.g., sale of a house with payment in installments). With these and a few other minor exceptions, it was forbidden to make all types of business agreements.

With the end of communism, laws were passed allowing contractual agreements. The starting point in our research is the nature of this basic contract legislation. Some elementary questions concerning these laws include:

- Whether the framework law embodies a market-oriented approach to contractual relations based on freedom of contract;
- Whether economically (or commercially) significant types or classes of contract, such as those for buying and selling land, prohibited or unenforceable;
- Whether imperative rules limiting the freedom of parties to set terms exist (e.g., as in Russia where some critics have claimed that the imperative rules on franchise law are so slanted toward the franchisee that they discourage the use of franchising);
- Whether parties are free to agree on customized terms relating to liquidated damages, arbitration, choice of law, and related matters; and,
- Whether adequate enforcement mechanisms are available in the event of breach (e.g. penalties, money damages, specific performance).

A major area of inquiry will concern contract enforcement. This involves four issues:

- Quality of court personnel
- Training of court personnel
- Independence of the courts from government intervention, and,
- Enforcement powers.

Given that the institutional capacity of the commercial courts cuts across most of the areas under study, it will be dealt with separately in Section I below.

2. Diagnostic Findings

Legal Framework

Romania has a long and continued tradition of development of contract legislation. The Civil Code dates from 1864 and has been amended several times (more substantially in 1913 and in 1920). It is modeled closely on the Napoleonic Code and the Italian Civil Code. It provides the basic framework for property rights and private transactions. The Civil Code was left in its original state after the communist takeover, and it was not necessary to introduce new market—oriented contract principles after the revolution in 1989.

While during the socialist period most of the relations between state-owned enterprises were regulated by administrative decisions, the application of the contract laws remained in two areas—the foreign economic relations, and the transactions between private parties. This limited application of the contract legislation was enough to keep the Civil Code from falling into complete disuse. Civil law courses were one of the cornerstones of the university curricula and the Romanian legal professionals have adequate experience in this area.

A key element of the contract law in Romania is the Commercial Code, which dates from 1887. The Commercial Code provides comprehensive regulation of the content and exercise of ownership rights, sales of goods, agency, commission and other essential business transactions. Since December 1989, many parts of the Commercial Code have been supplemented by new legislation based on current European standards. In 1991 most of the Code was replaced by Company Law 26/1990, as amended by Emergency Ordinance dated June 27, 1997. Book III of the Commercial Code, dealing with bankruptcy, and the related regulations were replaced by the Bankruptcy Law 64/1995, as subsequently amended. Secured transactions (discussed in the Collateral Law section) are one area clearly in need of improvement.

Because of the prevailing economic conditions Romania failed to develop some of the new areas of contract legislation, particularly leasing, franchising and factoring laws. Certain of those legislative gaps were filled after 1989, including the Leasing Law 90/1998 which became effective in March 1998 and amended Emergency Ordinance 51/1997 which previously regulated this particular matter. The Franchise Law was approved by the Government through Ordinance No. 52/1997 and then modified by Parliament in recently enacted Law No. 79/1998.[10]

The initial text of the Leasing Law (i.e., Emergency Ordinance 51/1997) restricted some arrangements of the Franchise Law with regard to the obligations of both the Lessor and the Lessee (Articles 4 and 5). The Leasing Law has recognized the restrictive nature of these provisions by stating that the Lessor and Lessee shall have the right to negotiate and stipulate their rights and obligations in a particular leasing contract. Further, the original text of the law introduced unclear and cumbersome administrative formalities and ambiguities with regard to the

[10] Both laws were passed in line with the existing practice – first the Government issues an Emergency Ordinance, and after several months the Ordinance is being submitted to the Parliament for approval. In the course of the approval some changes are made in the original text. In such way for a considerable period of time uncertainty exists as to the application of the new regulations. Instead of accelerating the process of application of the new law, this process is in fact delayed, because the interested parties wait to see the final text and act accordingly.

taxes and custom duties. Because of them the expected increase in leasing operations did not materialize. Ordinance 51/1997 became one more example of legislation introduced without prior review of the necessary implementation arrangements and without detailed analysis of the consequences for the affected economic agents.[11] The problems of the law are not related to the contractual framework, which is created by it, but to the inadequate tax, accounting and fiscal arrangements.

Franchise operations appeared in the former socialist countries in Europe only after the political changes in the late 1980s. Franchising as a contract was a completely new area, not regulated by the existing contractual legislation. For the first time in Romania the law defines a new contractual form, not regulated in the Civil or the Commercial code. The parties are defined by the law as "merchants", which is an important and appropriate distinction, making them subjects to the commercial legislation and not to the general civil law. This distinction has important contractual and enforcement consequences. The Law emphasizes the freedom of contract principle. In comparison to the initial Ordinance the final text has reduced the number of clauses that the franchise agreement must expressly contain. It allows the parties greater flexibility in determining the content of the agreement within the general principles of the Romania commercial legislation. The law fails to address several important issues, which are not related to the contractual freedom of the parties, but rather to their tax and customs obligations, and to the applicable accounting rules. The two most recent examples of the Romanian contractual legislation confirm the following earlier observations:

- The drafters have good theoretical understanding of the underlying problems of the economic legislation, but little or no practical experience in terms of day to day business operations;
- No models of the application of the laws have been developed prior to their enactment; and,
- Little or no consultations with practicing professionals were held prior to the preparation of the draft.

Romania recognized the importance of the existence of a comprehensive system for dispute resolution, and in particular of the arbitration as preferred way for handling of international contractual disputes. The country is signatory to the New York Convention of 1958 regarding the recognition and execution of foreign arbitration awards. Romania is also a party to the European Convention on International Commercial Arbitration concluded in Geneva in 1961 and the International Convention for the Settlement of Investment Disputes (ICSID) concluded in Washington in 1965. Arbitration awards are enforceable through the Romanian courts under regulations similar to those in the developed market economies. The problems with the application of the contract laws are more related to the enforcement, because of the inability of the system to handle efficiently the large amount of new cases, resulting from the change in the

[11] For example, the public institutions set forth in the Ordinance for the registration of leased goods were never established, and the custom duties provisions were in conflict with the new custom duties code that also came into effect in August 1997 (Law No. 141/1997).

economic conditions in the country. Enforcement problems are discussed in the section on the Judiciary.

With the exception of the secured transactions, the contract law system is established in Romania in terms of statutes and does not have substantive deficiencies. It is supported by extensive court practice (140,000 commercial cases in 1997), which has not been analyzed so far.[12] There are no restrictions of the contractual autonomy of the parties, which can enter into any form of commercial contracts. Further development efforts should concentrate more on the necessary implementation arrangements.

Implementing Institutions

Under the Communist regime, Romania had no independent judiciary. Courts were considered as specialized state offices with specific functions within the overall governmental structure. The Ministry of Justice (MOJ), under the direction of the Communist, controlled court administration and the political and ideological conformity of judges. As the all-encompassing state planning could not be challenged, only disputes between individuals concerning their personal transactions could be referred to the civil courts. The judiciary lacked secure tenure of office and many physical amenities—at times even courthouses. Thus, when the totalitarian regime of Nicolae Ceausescu fell on December 21, 1989, and the reform movement began, the judiciary had a difficult legacy to overcome.

A new Constitution, promulgated by the Constituent Assembly on November 21, 1991 was entered into force on December 8, 1991, following approval in a national referendum. The new Constitution abolished the official position of the Communist Party, established a system of democratic pluralism, and separated legislative, executive and judicial powers. Articles 123 to 133 of the Constitution describe the "Judicial Authority." Judges are independent (Art. 123), irremovable (Art. 124), and are prohibited from holding any other office except that of an academic professor (Art. 124). The Constitution also established a Constitutional Court—separate and outside the three branches of government—to rule on the constitutionality of laws.

As a means to safeguard the independence of the judiciary and also to reduce the influence of the Ministry of Justice over the courts, the Constitution established a Superior Council of the Magistracy ("SCM") with three major functions:

(1) To nominate judges and public prosecutors for appointment by the President of Romania. These proceedings are presided over by the Minister of Justice who does not have a vote.
(2) To act as a disciplinary council for judges, with the President of the Supreme Court of Justice presiding over the proceedings.
(3) To decide upon the promotion and transfer and sanctioning of judges in accordance with the law.

[12] The Ministry of Justice does not maintain statistics of the breakdown of commercial cases in the courts.

The SCM consists of magistrates elected for a term of four years by both Houses of Parliament in a joint session. As a body, the SCM is far from independent—as non-voting chairman of the SCM, the Minister of Justice still exercises an important role in the selection of judges. In general, the MOJ has a large amount of influence on the judiciary in that it continues to exercise control over court administration and the budgetary process for the courts.

The 1991 Constitution and the 1992 Law on the Reorganization of the Judiciary brought about a profound transformation of the judicial system. Romania now has a three-tiered court system, consisting of first-instance courts, intermediate appellate courts, and a Supreme Court. Leaving aside military courts (which are not dealt with here), there are four different courts, as follows:

***Judecatorii* -** The first tier in the court system is the judecatorii, which is a trial court of general jurisdiction, and only hears cases in the first instance. Romania is divided into 40 counties (judets), and there is one or more judecatorii in each county. Presently there are 167 of these courts in operation. Judecatorii judges have life tenure, subject to removal by the SCM for statutorily defined reasons. All cases in the judecatorii are heard by one or two-judge panels, depending on the type of case.

A court President, who in larger courts may be assisted by one or two court Vice Presidents, runs each judecatorii. The President, in addition to maintaining the caseload, is responsible for the court's organization and administrative affairs and makes case assignments. In larger courts there may be specialized panels for civil and criminal matters, and for commercial cases as well. Each judecatorii has its own prosecutor's office.

***Tribunals* -** Tribunals hear appeals from the judecatorii courts. The tribunal also acts as a court of first instance for more serious criminal matters (e.g. attempted murder) and in civil cases where the award sought exceeds ten million lei (around U.S. $1000). Currently, Romania has 40 tribunals corresponding to the number of judets in the country. In addition, there is a city court in Bucharest that for all intents and purposes functions as a tribunal.

Tribunals may be divided into sections depending on the caseload and the number of judges assigned to the court. The most commonly used sections are civil, criminal, commercial, and administrative law. A panel of three judges hears appeals, while a two-judge panel resolves first instance cases. The SCM appoints presidents of the tribunals who have responsibilities similar to those for the judecatorii. As with the judecatorii, each tribunal has a related prosecutor's office.

***Courts of Appeal* -** Prior to the Communist era, Romania had 12 Courts of Appeal. The 1992 Law on Reorganization of the Judiciary effectively recreated this level of court and since that time, 15 Courts of Appeal have been established. In this appellate system, a three-judge panel hears appeals from tribunals from within the panel judges' jurisdictional territory. This is the final level of appeal for cases that originate at the *judecatorii* level.

***Supreme Court of Justice* -** The Supreme Court of Justice, with a total of 60 judges, is organized into civil, criminal, commercial, administrative, and military sections. Only a relatively small

number of appeals reaches the highest level, and cases that originate at the judecatorii level cannot be appealed to the Supreme Court.

Under the Constitution the President and other Judges of the Supreme Court of Justice are appointed for a renewable six-year term of office. Before the Constitutional Court was created in June 1992, the Supreme Court of Justice used to rule on the constitutionality of legislation. Now these cases are referred to the Constitutional Court for decision.

Caseload & Backlog

Most transition economies have experienced an explosion of litigation. The most obvious cause for increased legal cases is that the move to a free market economy has resulted in the enactment of many new laws and thus new types of cases in the commercial and property area (e.g., land restitution). Non-transparent markets, high transaction costs, and uncertain and unclear laws also have added to the increase in litigation. Also, many new entrepreneurs have entered the market, and there is a lack of the long-term mutual business relationships that are an important stabilizing element in contract relations. This has added to the caseload volume. Finally, economic instability, particularly high inflation, has increased the likelihood of contractor defaults leading to more litigation.

Romania has been no exception to this phenomenon of increased litigation. In the three years following the 1989 Revolution the judicial caseload doubled from 600,000 to 1,200,000 cases. This increasing trend has continued but at a lesser rate. For 1997, according to MOJ statistics, the courts dealt with a total of 1.8 million cases, consisting of 1.4 million civil cases and 400,000 criminal cases (the MOJ treats a matter as a separate case each time it reaches a different level of court).

Of the 1.4 million civil cases, 114,000 were commercial cases. Of the commercial cases, 45,000 were in the judecatorii, 40,000 in the tribunals, and 29,000 in the Courts of Appeal. The Ministry of Justice does not maintain statistics on the breakdown of commercial law cases among the various categories of commercial law.

Many of the countries in Eastern Europe adopted a review process for judges who served under the Communist regime. For example, in neighboring Bulgaria judges who had compromised themselves during the Communist years were subject to removal during the 90 days following the entry into force of Bulgaria's 1991 Constitution. However, in Romania no such "cleansing" of the judiciary was carried out although many judges did resign to pursue a more lucrative career in private law practice. The resignations opened up the way for many newly appointed judges. In keeping with the Civil Law tradition, Romania draws most of its judges from the ranks of recent law school graduates and young lawyers.

In the first few years of the transition from the Communist regime, the size of judiciary did not keep pace with the increasing caseload. From 1989-92 while the caseload doubled, the number of judges only grew from 1,350 to 1,600 – a rather modest increase. However, the last few years have witnessed a considerable increase in the number of judges.

Currently, there are 3,696 judges in Romania, divided among the four levels of court as follows:

Court	Number of Judges
Supreme Court	60
Courts of Appeals	424
Tribunals	933
Judecatorii	2,279
Total	**3,696**

Sixty percent of the total number of judges is new since 1989, and most new judges are entry-level magistrates.

At the judecatorii level each judge handles on average 800 cases per year. The comparable numbers for the tribunal and court of appeal are 435 and 244, respectively.

According to the latest European Commission (EC) Report on Romania's Progress towards EU Accession, "judicial proceedings can take from 6 months to several years, particularly in commercial matters. This period needs to be reduced." It is difficult to gain precise information on case disposition time. There are no statistics available which indicate the exact time taken to adjudicate a case. The EC reports also highlight cases that are concluded by the end of the fiscal year, which coincides with the calendar year.

Although there are statistics which show the percentage of criminal cases outstanding by calendar quarter and the number of civil cases not completed by year-end, they were not made available to the team.

There are many reasons for delays in the adjudication of cases and many changes that could be pursued which would shorten the time for case disposition. An excellent American Bar Association/Central and Eastern European Legal Initiative (ABA/CEELI) Report on Court Administration in Romania offers recommendations that focus on ways to increase court efficiency. While the report has been provided to the government, including the MOJ, none of its recommendations have been implemented. Among some of the key recommendations are the following:

- Eliminate the complicated summonsing process which parties use to avoid being served;
- Increase authority of judges to help speed progress of cases;
- Reduce administrative responsibilities of court presidents and vice presidents;
- Centralize responsibility for supervision of auxiliary staff;
- Provide public access to information about pending cases by telephone;
- Modernize court filing system;
- Utilize for-pay copy machines for the public; and,
- Adopt specified measures making it easier for judges to prepare for hearings;

Institutional Constraints

Limited Resources - The recent injection of new judges into the system has been beneficial, as it has reduced the influence of the old *nomenklatura* judges. However, as many new judges are drawn from the ranks of recent law school graduates and new lawyers, then the skills that they acquire in law school are of utmost importance, and this is the source of one major concern. Many individuals interviewed expressed the view that there are not enough practical, case method, problem-solving courses in the law school curriculum. Also the explosion of start-up law schools after 1989 has made it difficult for the authorities to enforce high standards of legal education. Some of the new law schools are matriculating excellent lawyers and judicial candidates; unfortunately too many of these schools are not, was a view expressed by many interviewees.

An added factor is that many of the new judges who have recently entered the system do not look upon judging as a career. Rather they see court duty as a relevant period, during which they are making financial sacrifices, while garnering substantial experience that will be beneficial in a future lucrative private practice. To the extent they take good attitudes, knowledge and skills with them, the entire country gains; but, to the extent that their replacements receive training in a relatively short period, the system suffers.

A related point is that the careers of those judges who remain in the system tend not interested self-improvement. Incentives for change are few, and there seems to be no corresponding linkage between training and promotion, training and retention, or training and compensation contemplated in legislation.

In addition, working conditions for judges are poor and not conducive to effective performance. Court buildings are old and overcrowded (with three judges to an office, in some cases) and lacking in the necessary security equipment. Many courts lack qualified support staff and do not have adequate office equipment. In most courts case files are still opened in the age-old way of sewing the complaint and accompanying documents to a file folder with needle and thread. Most judges do not have secretaries, research assistants, or computers. They often type their own decisions on mechanical typewriters, do their own research, and are personally responsible for tracing all the information (factual and legal) they need to reach a decision. Judges also lack access to necessary source materials—in one court 20 judges had to share a single copy of the Official Gazette.

The salary levels for judges are not conducive for attracting and keeping the best candidates on the bench. Even with recent salary increases, a junior judge makes on average only U.S. $230-250 a month, which is far below what a lawyer can make in the private sector. Many judges move to the private sector after only a few years on the bench because they say they cannot "afford" to stay.

Some countries have attempted to legislate a pre-specified amount of the national budget for the judiciary as a method for increasing judicial resources. This percentage is usually in the range of two to four percent.

Corruption - Corruption is a serious problem for transitioning Central and Eastern Europe countries. It creates conditions that destabilize governments and the reform process. Unfortunately, Romania has not been spared from the negative effects of corruption.

There is a strong school of thought in Romania that views corruption as a part of the national mentality and value system. The state's redistributionist philosophy (the more we control the more we distribute) during the 45 years of Communist rule and again during the recent socialist government meant that over a long period of Romania's history the state worked against rather than in defense of the interests of the individual. Within the structure of national values, the notion of the public good has been vague and depersonalized. Owing to these historic or cultural roots and to the delays in market reforms, of Romanian citizens are tempted to use public office for private gain, in other words are prepared to corrupt or be corrupted.

Although it is hard to quantify the extent of corruption in the judicial system, there is no doubt that the potential for corruption exists at many stages of the judicial process. During the diagnostic, the team learned that summons clerks are sometimes paid not to deliver a summons. Some lawyers even pay court staff for preferential treatment such as expediting certain actions like providing copies. Files can also be lost or found for a price. One hears of businesses hiring a "special purpose" lawyer for a certain case that they cannot afford to lose—the lawyer's expertise is knowing which judge to get on the case and how to make it happen. In such a case the mere assignment of a particular judge on the case may be enough to predetermine the outcome. In many cases money does not change hands. A favor is done with the expectation that it will be returned when needed. Besides judicial corruption, bribery at the prosecutorial level is an added problem in criminal cases, where the prosecutor has broad discretion to decide whether or not a case should be brought to trial.

One way to combat corruption is through a public administration reform program, aimed at restructuring public services to increase their efficiency, transparency and reliability. One of a country's most important institutions is a professional and motivated civil service, with selection and promotion based on merit rather than patronage. A well-performing civil service may be a potent force for resisting corruption. In Romania, the Law on Public Administration (Law 69/1991) replaced the Communist legislation. To date there has been no reform of the Romanian Civil Service Code, although the Law of the Public Servant was on the Parliament's reform list in the last legislature. Experience in other countries has shown that civil service reform may be an important tool to counter corruption by court staff who, as gatekeepers to the adjudication system, are well positioned to extract bribes.

Measures to strengthen the courts and make them more efficient also have an anti-corruption effect as well. A broad cross section of NGOs, members of Parliament, state and municipal officials, and judges is needed to build an anti-corruption coalition. Cooperation with the media is a key part of a successful anti-corruption campaign.

More openness and transparency in court cases, together with less discretion on the part of officials and more automatic functions, will speed up justice and also discourage corrupt practices. Among the key judicial reform/anti-corruption reforms are:

- Changes in existing law to provide for serious sanctions against lawyers who abuse procedural rights by intentionally delaying court proceedings;
- Development of a system for summoning witnesses in order to preclude the possibility for intentional delays of court hearings;
- Creating institutions for alternative dispute settlement;
- Implementing filing systems that guarantee speed and reliability in the processing of case files and secure swift and easy access of citizens to the information they need;
- Developing a system for distribution of cases among various magistrates based on objective criteria, precluding the possibility for selecting a specific magistrate to work on a particular case; and,
- Implementing the principle of rotation of magistrates and staff working in sectors with a high risk of corruption.

The goal of a serious judicial reform program should be to build a truly independent, impartial, high quality judiciary that commands respect both domestically and internationally. The task is monumental, but far from impossible.

One factor that should not be overlooked in the ways to achieve this goal is the European Union (EU) accession process. Romania clearly wishes to join the EU as quickly as it can, and performance of the judiciary is an important benchmark on the path to EU membership. In the most recent report on Romania's progress towards accession, the European Commission highlighted these recent measures that were taken to strengthen the judiciary:

- The Law on the Organization of the Judiciary was amended in the Spring of 1998 to define judge panels at all levels of jurisdiction. This measure has accelerated procedures;
- The National Institute of Magistrates (NIM) has been created and is training judges and prosecutors;
- Unsuitable judges have been removed. In June 1998, seventeen judges of the Constitutional Court were not reconfirmed because of their repeated infringements of existing legislation on property; and,
- The ombudsman function created in the Romanian Constitution (the "People's Advocate") is now operational.

The Romanian push toward the EU combined with an aggressive Minister of Justice (MOJ) who has articulated a wide-ranging reform agenda has created a favorable climate for serious judicial reform. The recently issued 170 page Ministry of Justice White Paper, covering the period December 1996-December 1998, gives the reader a good idea of the extent of these reforms. Among the most impressive measures to elevate the status of the magistracy—including both judges and prosecutors—are the following:

- A 300% increase in magistrates' salaries;

- Allowing revenues generated by judicial stamp taxes to be retained in the MOJ and to be used to finance the reforms;
- Re-activating the National Institute of Magistrates (NIM) which had been established in 1991 but had been allowed to become moribund;
- Instituting a training year at the NIM as a pre-condition to being named a judge; and,
- Establishing public competitions for all appointments of magistrates.

As salary gains take hold, judicial vacancies will be more readily filled and judges will be retained in service in greater numbers. Better-trained judges and improved court management practices should lead to enhanced public respect for the judiciary. This will encourage judges to trade earnings for prestige as occurs in other countries including the United States. The usual pattern in Romania and other Eastern European countries today is for women to fill the less prestigious office of judge while men opt for careers as a prosecutor. It is also logical to assume that as salaries become more attractive and prestige builds in the job, more males will apply for judgeships.

In recent MOJ-sponsored competitions for judicial vacancies, these factors seem to have been in play. During the past two years there were over five separate competitions in which more than 5,000 law graduates and lawyers competed for judicial and prosecutorial vacancies. Eventually 663 candidates were selected. This is a far cry from several years ago when it was hard to interest young lawyers (particularly male) to serve on the Bench.

Judicial Training - Currently over 200 trainee judges are studying at the NIM – a considerable accomplishment considering that the NIM was all but inactive several years ago. Although recent governmental support for the NIM is laudable, only a viable Government of Romania (GOR) investment over the long run will maintain it. The GOR will want to finance the NIM only if it is seen to be productive, useful, and essential. Therefore, the NIM will need to demonstrate in a very convincing way that it is living up to the expectations of changing judicial attitudes, behavior, knowledge and skills. To achieve that end, there will have to be "quality checks" of how its "products" judges-function. Simply giving tests at the end of courses would not be an appropriate evaluation of the quality of the product, nor would be comments by judges at the end of the course about content and presentations. The only valid evaluation is to check in the courts to see that judges and other trained personnel are putting into practice what they learned. A number of evaluation devices can be set up, but the basic point is that training must be seen to be making an important difference in the judiciary if the NIM is to be financed over the long haul by the Government of Romania.

Although training alone will not solve cases of judicial corruption, enhanced salaries will attract better candidates. More transparency in case assignment will help, as described in the section above. Also a strong government anti-corruption campaign will cause those inclined to "return favors" to think twice before committing themselves.

As the above indicates, although there are many constraints facing the Romanian judiciary, the mechanism for overcoming these constraints is clear and Romania seems to be on the right path. It is also a path that coincides with EU Accession. The reform program that the Minister of

Justice has carried out over the past two years will produce positive results if continued with resolve. The converse is likewise true. These constraints can only be removed by Romania itself. Therefore if the political will is found to be wanting in Romania, there is little that a foreign donor can do about it.

Legal Education - Romania follows the continental Europe model of legal education. Law is a four-year undergraduate course of study, followed by a two-year apprenticeship. At the end of their studies law graduates may choose from among several careers in the legal profession, including a judge, a public prosecutor, a government lawyer, an advocate, or a notary. For each specialty there is an examination which law graduates must pass before being accepted as a professional in that field. There is a second "examination of capacity" after the two-year apprenticeship.

The basic principles of contract law (as found in the Civil Code) have always been taught in Romanian law schools, and market-oriented commercial transactions have generally been taught in the context of international trade. Apart from these traditional courses, Romanian law school curricula have undergone a wholesale revision. There are new required courses geared to the needs of a market economy and civil society. For example, courses such as Administrative Law, Commercial Law, Constitutional Law, Banking, Tax, Finance, Insurance, Property, and the Law of the European Union either were not offered before or were altered beyond recognition.

The Romanian Bar has also undergone a major revision since 1989. Until recently, private lawyers had been required to belong to the *nomenklatura* Lawyers Union. Clients paid legal fees directly to the Lawyers Union (pursuant to a preset schedule) which withheld its fees and taxes and then paid the remainder to the lawyer working on the case. Law No. 51/1995 on the organization and practice of the legal profession changed how the Bar could operate. Law No. 51 covers access to the profession, the rights and duties of lawyers, and the organization of the profession in general. The Bar now operates as a professional association similar to that found in many countries, and Bar membership is compulsory for any practicing attorney.

F. Foreign Direct Investment (FDI) Law

1. Overview

Our analysis is based on the premise that the more an FDI regime resembles internationally accepted norms, the more attractive it will be to potential investors. As in the other substantive legal areas, our FDI indicators are intended to inquire beyond the formal legal guarantees. This includes an examination of whether government agencies and the courts afford equal treatment to foreign corporations in practice. Our Team will also meet with private business executives both local and foreign to obtain their insight into the investment climate. It will be important to distinguish between those bureaucratic hurdles that restrict investment generally and those that are aimed at foreign investors. A regulation that is investor neutral on its face, if selectively enforced, may become a de facto restriction on foreign investment. We will also investigate whether there are unwritten agreements to exclude foreign corporations from certain markets, or whether the "cost of doing business" is significantly higher for those companies. Finally, we will compare the results of FDI research with the results of our analyses of trade laws and company law.

The challenge of developing meaningful comparative indicators for FDI lies in the diversity, breadth and complexity of the subject area. The indicators developed for this purpose place heavy emphasis on compliance with international obligations and norms, rather than the details of specific national legislation. This emphasis reflects the broad trend toward international harmonization of law and practice governing cross-border direct investment. It is also based on the assumption that a correlation exists—all other things being equal—between the degree that a country's FDI regime reflects international standards and its ability to compete for and retain FDI.

The emphasis placed on international obligations, rather than on a detailed analysis of national legislation is useful for several important practical reasons. First, the data required can be obtained relatively easily and cost-effectively via widely published sources. This reduces the cost of assessment significantly and makes monitoring development and updating the analysis simpler. Second, for comparative purposes, the quality of the data is relatively uniform since in many cases a single source (e.g., WTO Secretariat; MIGA, OECD) can be used. Third, focusing on consistency with international norms provides a useful means of limiting the subjectivity inherent in comparative analysis of national legislation. This approach therefore creates an opportunity to emphasize the quantitative element to the analysis by distilling development indicators into performance measures that can be stated in relatively simple yes/no propositions for comparative purposes.

The expediency of focusing on adoption of international conventions and norms as a basis for drawing cross-country comparisons has significant limitations, however. First, a gulf generally exists between formal accession to treaty obligations and compliance with those obligations. In a practical sense, therefore, it is misleading to consider treaty accession without explicit reference to treaty compliance. In developing these indicators, an effort has been made to control for this shortcoming in two ways: 1) by attempting to capture the extent to which obligations have been

limited or reserved by the acceding country during negotiations (e.g., the number of conditions placed on right to national treatment); and, 2) by focusing on regulatory barriers to entry as a basis for characterizing the climate for foreign investment.

A second difficulty arises in the selection of international norms to be included in the analysis. Poland has made full membership in the EU a central foreign policy objective. EU membership is likely to have a significant impact in terms of Poland's future FDI flows.[13] Nevertheless, including EU membership as an indicator of commercial law development is problematic from the standpoint of cross-regional comparisons given that access to membership is not universal.

Eliminating EU (and OECD) accession from the analysis, however, poses the risk that an artificially narrow and potentially distorted view of commercial law development in Poland will be presented.[14] There is no doubt that Poland's accession to both the OECD and the EU offer significant benefits in terms of credibility, consistency, predictability and durability of the reforms.[15] Because membership in these organizations is conditioned upon meeting certain legal and administrative conditions precedent (i.e., "reforms"), membership confirms, rather than necessarily determines, Poland's emergence from "transitional" to "developed" status in terms of its legal regime for FDI.

2. Diagnostic Findings

Legal Framework

At a time when investment from the government budget is minimal, the state is not able to finance any large infrastructure projects, and domestic capital is virtually nonexistent, foreign investment remains the only serious source of capital flows for the economy. Romania has failed to realize the potential for attracting large foreign investment in the years after 1998. Total foreign direct investment is estimated at about U.S. $3.8 billion, compared to $12.2 billion in Poland. Neighboring Bulgaria, which also has not met its expectations, has received more than U.S. $2 billion, yet the figure *per capita* in Romania is the lowest among the former socialist countries of Central and Eastern Europe.

The large potential of the country to attract and absorb foreign investment has yet to be realized even though a number of multinationals are present in the Romania and operate successfully. Such commitments are due mainly to the determination of the companies' managers and their internal policies of maintaining a long-term presence in a potentially large market. Procter & Gamble, Coca Cola, Dae Woo and ING Bank are the best examples of major foreign investors; but, given the size and potential of the Romanian market, their presence is only a fraction of what

[13] To date, EU countries have invested $12.2b in Poland, representing 54.1% of total FDI in Poland as of June 1998. By comparison, U.S. investments—currently the largest in terms of volume—comprise 20.8% ($4.7b) of the total FDI in Poland; and Asian investments, led by South Korea, stand at $1.5b, or 6.6.% of the total. Polish Market Review, No. 5 (21), October 1998, Polish Agency for Foreign Investment.

[14] Put differently, the level of abstraction required to developing cross-regional comparative measures for FDI that permit "apples with apples" comparisons may yield insights of limited analytical value (e.g., "apples are fruit").

[15] Institutional Investor Credibility Index.

it should be. The Government of Romania has done little to attract small and medium size enterprises, and completely failed to bring in greenfield investment that would replace the inefficient socialist enterprises and provide new employment opportunities for the qualified and well trained Romanian labor force. For the most part, government investment incentives have not worked. On the other hand, existing foreign investment laws do not seem to be a negative factor; in fact, major foreign investors reported having no serious problems with Romania's legal system.

The legal framework for foreign investment in Romania is provided by the following laws:

- Foreign Investment Law (Emergency Ordinance 92/1997, as approved by the Parliament with Law dated November 24, 1998, and published in Monitorul Oficial (MO), #483, on December 16, 1998);
- Law on Foreign Investment in Exploration and Production of Oil and Gas (MO No. 66/1992);
- Free Trade Zones Law (MO No. 84/1992);
- Law on Stimulating Foreign Investment in Industry(MO No. 71/1994);
- Commercial Register Law (MO No. 26/1990);
- Company Law (MO No. 31/1990);
- All accounting and taxation laws and regulations, applicable to resident entities and natural persons.

The investment legislation, including the latest amendments to Ordinance 92/1997, published in ***Monitorul Oficial*** on December 16, 1998, has several positive features:

- the Romanian foreign investment regime is open;
- foreign investors are granted national treatment, except for the purpose of land ownership;
- foreign investors can participate in all transactions, which are not specifically forbidden by the law, including in the privatization program;
- there are no restrictions in the percentages of foreign participation in commercial companies;
- 100 % of the after tax profits can be converted and repatriated;
- all formal legal guarantees against arbitrary and discriminatory nationalization and expropriation are in place; and,
- there are adequate legal provisions for prompt and effective compensation in case of nationalization for public needs.

Despite the evidence of a legal framework the *inadequacies* of it are part of the reason why foreign investment in Romania remains at unnecessarily low levels. Several attempts were made to implement legislation providing various incentives for foreign investors, but the legislation passed was over-complicated, difficult to administer, unclear, and finally failed to produce the desired results. The government adopted a piecemeal approach to the problem, passing laws which in the eye of the public were designed for a particular company (e.g., Law No. 71/1994 on

Stimulating Foreign Investment in Industry is known as the "Daewoo law"), or to replace some of the existing regulations only days after having been issued.[16]

Judging by the hectic activity of consecutive Romanian governments to improve the investment environment it seems that there is general policy agreement that foreign investment is necessary and indeed beneficial for the country. At the same time, there seems to be no genuine policy discussion on how to improve the situation, and most of the advice of potential foreign investors and international experts and institutions has been ignored. The lack of consultation with the private sector and investors is a chief obstacle to developing investment legislation adequate to support economic growth and increased foreign investment. This situation seems to be changing slowly, but to the government still needs to correct the mistakes of the past and to regain its lost credibility and confidence. In general, large investors are standing on the side line and waiting for the situation to improve.

Further, the latest amendments to Ordinance 92 create some uncertainty about the rights of foreign investors to own land. This right is restricted by the Constitution,[17] but the Supreme Court ruled that foreign-owned companies, registered in Romania, should be considered Romanian entities and should have the right to own land. The text of Article 6 of Ordinance 92 states that residents and non-resident commercial companies may acquire real rights over immovable property to the extent necessary for their activities, but does not clearly state that such entities can own the land. This text is open to judicial interpretation. It is certainly less clear than the abolished Article 24 of Ordinance 31/1997, which permitted foreign companies to own land for productive purposes.

In general the existing legal framework does not help small and medium size investors, and as a result very few of those are present in Romania. Big firms, able to devote large resources to business development, have been successful in establishing themselves in the market and building profitable local operations (Procter & Gamble, Coca Cola, McDonald's, Timken, several manufacturers of automotive equipment and companies involved in energy generation).

Romania recognized the importance of arbitration in the settlement of commercial disputes when it became a signatory to the New York Convention of 1958 regarding the recognition and execution of foreign arbitration awards. Romania is also a party to the European Convention on International Commercial Arbitration concluded in Geneva in 1961 and the ICSID Convention concluded in Washington in 1965.

Romania became a member of the Multilateral Investment Guarantee Agency (MIGA), part of the World Bank group, in 1992 and has a well developed system of international investment treaties (there are more than 70 concluded so far, including all countries which are major sources of capital inflows).

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[16] The *Implementing Regulations for Emergency Ordinance 31/1997* were published on December 29, 1997. The next day Emergency Ordinance 92/1997 was published, and it replaced most of the provisions of Ordinance 31, leaving only Articles 11-15 in force. No provisions were made for the validity of the Implementing Regulations, which of course were making references to the abolished articles of Ordinance 31/1997.

[17] Art. 41.2 of the Romanian Constitution prohibits the ownership of land by foreigners.

Major foreign investors are given substantial tax incentives –as shown in the table below.

Amount of the initial investment –USD Million	Profit tax reduction - %	Years of reduction
0,5	10%	2
1	15%	3
5	25%	4
20	50%	5
35	75%	7
50	100%	10

Annex to Decree 92/1997, as approved by the Parliament with Law dated November 25, 1998, and published in Monitorul Oficial on December 16, 1998

Such incentives are difficult to administer, they distort the market and create unfavorable conditions for smaller competitors in the same field of activity. There is no evidence that such incentives were ever a decisive factor in attracting investors, unless when they are tailored to the needs of particular producer. Tax incentives should always be considered within the framework of the international obligations of Romania under treaties for avoidance of double taxation. Finally, in the long term they may prove a disincentive for the local investors.

Implementing Institutions

Two things seem most striking in Romania in the last several years—hectic and uncoordinated development, and the desire to achieve miracles overnight. The first is manifested by the number of laws passed—four in 8 years, (see the attached table of the principal laws and regulations applicable to foreign investment). This is more than any other restructuring economy (by comparison, the Czech Republic never had specific foreign investment legislation or incentives, Poland and Hungary abolished the relevant laws after several years of application and granted foreign investors unconditional national treatment). The second is reflected in the number of "emergency" ordinances, which by definition should be issued in extraordinary situations with the expectation of immediate consequences.

As in other legislative areas, part of the problem seems to be that by virtue of the conditions prevailing in a centralized economy—many Romanian decision-makers and officials in the implementing institutions are not familiar with the way in which private enterprises operate. They have never had the opportunity to work in the private sector, and consequently have little or no understanding of the problems faced by a private business. Any successful assistance program or lobbying effort should start with the review of such problems, a step, which in most cases, is overlooked. Instead, an avalanche of suggestions is being presented, and often ignored, because the officials in charge lack the time or the necessary qualifications to understand the suggestions. This does not mean that they are not capable of understanding, but rather that

nobody took the effort to explain. Instead of having a dialogue, one of the sides turns defensive and does not produce the expected results, even if a genuine willingness to change is in place. [18]

The Romanian Development Agency (RDA) is currently the main body in charge of investment coordination and promotion. Originally the RDA was established as screening institution in charge of registration and approval of every foreign investment. It was independent or part of various ministries (Privatization, Industry) at particular points in time, but after several years of existence the RDA has become an unnecessary obstacle to foreign investors. It was particularly unsuitable for an emerging capital market.

To improve the picture and ostensibly the environment for foreign investors, the government decided to restructure the former licensing authority and reestablish it as a promotion and assistance institution. The management of the new RDA seems to understand the need for change, and is looking for a new identity. RDA could use assistance in several areas: identification of suitable investment projects, promotion of investment opportunities, cooperation between the private sector and the government in improvement of the existing infrastructure, initiation of policy dialogue between the government and the investors, developing of services which can be offered to potential foreign investors. The RDA can certainly benefit from the knowledge and experience of similar local investment promotion institutions in the United States. The activities of the RDA are impeded by the lack of funds to establish a viable presence in major investment centers (London, Frankfurt, Paris and New York) and on the Internet, and by the lack of experienced and motivated staff able to undertake this task. It is only now that the management of the RDA realizes the need to compete for investors with a large group of countries at similar stages of development as Romania, and actively to promote the country and its resources, instead of waiting for interested investors to come see for themselves. However, currently the role of the RDA still is not very clearly identified.

Supporting Institutions
Romanian foreign investors are organized in the Foreign Investors Council that meets regularly and is active in identifying the problems of the investment community and in looking for solutions. In May 1997 the Council issued proposals for improvement of the investment climate in Romania. So far the government has done little to take their findings into consideration.

Foreign investors operate in Romania in a very unstable macroeconomic environment that calls for adjustment of many accounting, taxation and profit repatriation rules. In particular, the following are the most important proposals made by the Council:

[18] For instance, only one of the Proposals for improvement of the Foreign Investment Climate in Romania, presented in May 1997 by the Foreign Investors Council, were taken into account. None of the reasonable suggestions published by the monthly magazine of Herzfeld & Rubin in a Letter to the Prime Minister in December 1997 were ever discussed with the authors.

• Clarification of the accounting rules, including the inventory valuation and the treatment of foreign exchange gains and loses. (12 substantive differences were identified between the Romanian Accounting Standards and the Internationally Accepted Accounting standards in 1998).	• Improvement of the definition of taxable base. The problem in Romania seems to be that seemingly low tax rates are applied on a taxable base, which prevents business entities from claiming a number of deductions, and effectively increases the tax burden.
• Introduction of loss carried forward fiscal clause (such were introduced in 1998).	• Reducing the risk factor resulting from the unexpected introduction of conflicting legislation, which was not taken into account by the business entities at the time their annual or long - term plans for Romania were prepared.

The Council produced a detailed report, including the suggested changes. The report is a valuable and highly technical, well-prepared document, but it fails to take into account that its chief audience consists of people who have never run a private business. It does not explain to the government why the changes are necessary and fails to make one important point, which is valid for all branches of the Romanian economic legislation—that there is little or no policy discussion prior to the adoption of particular laws, and there is no study of the impact of particular legislation on the business entities, affected by it. Those two elements are essential for the success of any law.

G. Trade Law

1. Overview

The sweeping political changes that began in 1989 were to have a profound impact on virtually every aspect of commercial life throughout the CEE and NIS regions. In particular, 1991 was a year of profound change throughout the region. By early 1991, market prices, hard currency payments, and international commercial practices began to replace Soviet-era mechanisms of trade throughout most of the region. In July, the Council for Mutual Economic Assistance (CMEA) was formally dissolved. In late August, Ukraine declared itself a sovereign state. Three months later, Romania adopted a new constitution. Finally, Kazakhstan declared itself an independent nation in early December 1991.

The sweeping impacts were particularly marked in the foreign trade sector, which was both highly centralized and tightly controlled by specialized state trading organizations. With the collapse of the Soviet Union, individual firms found themselves cut off at both ends - input supply on one hand, and marketing outlets on another. Further, due to the segmentation and specialization common under the state trading system, firms were faced with a debilitating lack of information or experience upon which to draw in establishing their own foreign trade relations. Added to this, many state trading monopolies seized the opportunity spontaneously privatize under *perestroika*, and utilize special hard currency and commodity trading licenses to perpetuate their monopolistic position in the sector.

It is widely stated that a country's openness to foreign trade and investment is a major determinant in its overall rate of economic growth and the stability and vitality of its markets. Empirical evidence tends to support this view,[19] however, the recent Asia Crisis has caused some to challenge this orthodoxy.[20] Despite this, a central organizing assumption upon which this analysis proceeds is that a legal regime consistent with international norms and practices is a fundamental requirement for a modern, market oriented economy.

Trade law and the institutional framework for its implementation is an extremely broad and complex subject. As a result, it has been necessary to define the parameters of this analysis somewhat narrowly. One principal theme, however, will be the extent to which the country has embarked upon the process of accession to the World Trade Organization (WTO). The progress which a country has made in negotiating and enacting implementing legislation to accede to WTO agreements is a good preliminary indicator of the overall development of a country's international trade law. Among the many areas addressed by these agreements are market access, subsidies, health standards, trade in services, intellectual property, and government procurement. We will also focus extensively on each country's customs laws and procedures, especially the

[19] See, e.g., *Trade Liberalization in IMF-Supported Programs*, Sharer, R. et al., International Monetary Fund World Economic & Financial Surveys, Washington 1998; *Open Markets Matter - The Benefits of Trade & Investment Liberalization*, OECD, Paris, France 1998.
[20] *Saving Asia*, Krugman, P., Fortune Magazine. 9/7/98, www.pathfinder.com/fortune/investor/.

tariff levels, classification system, and whether Most Favored Nation (MFN) status is afforded to its trading partners.

It is important to note the impact of many ancillary laws on the overall trade environment. Among those which could represent substantial non-tariff barriers are tax laws, currency convertibility restrictions, and immigration and banking laws. Obviously, a detailed investigation of each of these areas is well beyond the scope of this project. It should, however, be possible to include specific examples of discriminatory treatment in an overall analysis of the country's receptivity to foreign trade.

From an institutional perspective, we will focus on the major trade regulatory bodies from the Ministry level to the customs point of entry examining staffing, budgets, information management resources, and liaison with other agencies. We will assess the degree of detail, consistency and transparency in agency procedures and compare statistics regarding enforcement. We will also attempt to gauge the degree of political support for open trade policies as expressed in public statements by government spokesmen, opposition leaders, legal academics and the popular media. Finally, we will attempt to assess the degree of satisfaction Among those most affected by the trade laws including, e.g., shipping firms and foreign chambers of commerce.

2. Diagnostic Findings

Legal Framework
Since 1989, Romania has paid particular attention to bringing its trade policy into line with the principles, rules, and regulations of the international trading system. One of Romania's main objectives is its full integration into European regional and sub-regional arrangements. It already is a member of the World Trade Organization (WTO), and had been a member of the General Agreement on Tariffs and Trade (GATT).

The state's monopoly on foreign trade as well as the central planning system—both the major non-tariff obstacles during the previous region—has been eliminated. Import and export regulations were permanently liberalized by Government Decision No. 215/1992 on import and export licenses, which stipulates that the export and import of commodities to and from Romania have been liberalized, no export or import licenses being required. In addition, a new Customs Tariff was enacted as Romania's major instrument of trade policy.

World Trade Organization (WTO) Accession - Romania did not have to go through a tortuous WTO Accession process as many transition economies are today. It had been a contracting party to the General Agreement on Tariffs and Trade (GATT) since 1971. The GATT and most Tokyo Round Agreements were an integral part of Romania's domestic legislation, and Romania fully participated in the multilateral negotiations carried out under the Uruguay Round.

By Law No. 133/1994 the Romanian Parliament ratified the Marrakech Protocol establishing the WTO, and Romania thus became an original member of the WTO. Romania is a party to all multilateral agreements within WTO, and is a party to the following plurilateral agreements:

- Agreement on Trade in Civil Aircraft;
- International Dairy Agreement; and,
- International Bovine Agreement.

As noted, the Imports Customs Tariff is the main trade policy instrument used in Romania. The present Import Customs Tariff, as well as the trade policy mechanisms and instruments, are based on the Uruguay Round results.

Romania's customs duty system already complies with European Union standards (Brussels Harmonized System). In addition, as of July 1, 1995, customs duties are applied according to the rates stipulated in the WTO Marrakech Protocol, ratified by Law No. 133/1994.

H. The "Market" for Commercial Law Reform

Creating a Virtuous Cycle of Reform - Liberalization of the business environment can be a powerful catalyst, setting off a virtuous cycle where each reform makes the next one easier. Businesses organize themselves to advocate and lobby for changes in the status quo and for new commercial laws and regulations. As the pace of reform quickens, new interest groups form and the policy agenda becomes more extensive.

The challenge is how to put this virtuous cycle into motion. At the outset of the reform process, those who prosper under the pre-existing dysfunctional system will have much to lose, while the reform-minded private sector are unlikely to have reached the critical mass needed to lobby for their own interests.

This intersection of demand for commercial law reform from the private sector, together with the supply of policy responses from the government, may be appropriately viewed as the "market" for commercial law reform. This "market" will vary from country to country, and indeed from sector to sector, depending on many factors ranging from history and culture to even how key reformers interact with government officials on a personal level.

The Current Romanian Context - At first blush, it may appear that a vigorous market for commercial law reform exists in Romania. Over the past eight years changes in legislation have affected practically every area of law. Rights of private property and the predominance of the rule of law over discretionary administrative action are recognized. Romania has established a fairly comprehensive commercial law system which has received high marks from the EBRD in its annual legal survey. Many public interest groups with strong pro-market leanings are now in existence.

Yet, as is clear from other sections of this Report, this impression would be misleading. The market for commercial law reform in Romania is imperfectly developed. The *supply* of commercial laws has often exceeded the *demand* for them. A frequent criticism of private sector companies and associations is that laws are changed too frequently. Poorly- conceived laws and regulations appear with no advance warning. This theme was echoed by Romanian business leaders, NGOs, lawyers, judges, government officials and ordinary citizens.

Practically everyone agreed that it would be better for the government to concentrate on a fewer number of essential laws which are well prepared than to enact hastily prepared drafts that only have to be corrected in the next legislative session. This would also allow the authorities more time to get the necessary implementing regulations into place. Currently an overly ambitious legislative program, combined with hastily drafted and adopted Emergency Orders, leaves very little time to make the necessary implementation arrangements and to prepare the institutions involved in the implementation of the law for their new tasks, or to establish new institutions.

The heart of the problem is inadequate consultation with concerned groups and the public by the government prior to enactment of these laws. Bills do not circulate to the public in advance of

passage and in the case of implementing regulations, there is no such thing as a notice and comment period. Professional associations that might be able to offer suggestions that would improve a piece of legislation are not consulted.

The reasons for lack of consultation are several. First, most government experts and members of the Parliament never had the opportunity to work for a private business, and consequently, know little about the problems of private entrepreneurs. It may be hard for them to understand private sector concerns. Second, government officials also are probably suspicious about the motivations of the people making the suggestions. After all, not everything which is good for the private sector is good for Romania.

To have a vigorous, successful dialogue between the public and private sectors does not mean that one side wins and the other side loses. But in the "market" for commercial law reform, there must be an exchange – or a "buying" and "selling" of ideas. At the moment there is little give and take between the public and private sectors on commercial laws.

This is unfortunate. This exchange can be a "win/win" game. The private sector and pressure groups can present reasonable points which if considered (though not necessarily adopted wholesale) will result in a much better piece of legislation. It is a shame to avoid that input which can be constructive. On the other hand, the private sector's arguments may be highly technical and possibly incomprehensible to government officials with limited experience in the particular subject matter. The officials may simply decide to avoid that embarrassment by avoiding the contact.

Toward A More Rational Market for Commercial Law Reform In Romania

To arrive at a more constructive relationship between government and the private sector, each side must show more understanding of the other's position and an awareness of the constraints that each side operates under.

Is it possible that Romania is on the edge of a virtuous cycle of reform? This may well be true. The situation in Romania is far from static. There has been so much criticism directed to recent governments because of hastily-adopted legislation that there is some indication that the authorities are becoming more sensitive to this problem. Several associations mentioned that they had been recently consulted by the government relating to pending legislation.

Also there has been an explosion of non-governmental organizations in Romania in recent years. Many new interest groups with strong pro-market leanings are being created. An interaction with government officials and Parliamentary commissions is starting to take place. This may create a genuine public/private partnership that will give a new burst of energy to the reform process.

Fueling this demand for market-friendly models of legislation is a strong commitment to international integration. Romania's push to join the European Union has motivated it to adopt laws that meet EU requirements in such areas as taxation, trade and competition policy. Its

membership in the World Trade Organization has also stimulated the government to make the supply of laws more responsive to the demands of international free trade.

Romania today presents the classic glass "half full/half empty" syndrome. Although the negative is quite often emphasized about Romania, the ingredients are also there for a new strong burst of reform that would take it into the top ranks of reforming countries.

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UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

COMMERCIAL LEGAL REFORM ASSESSMENTS FOR EUROPE AND EURASIA

Development Indicators

USAID Omnibus II-C: Policy/Legal/Training
Contract No. EPE-I-95-00071
Task Order No. EPE-I-09-95-00071-00
August 1999

BOOZ·ALLEN & HAMILTON INC.
INTERNATIONAL CLIENT SERVICE TEAM

USAID/EE/PER

Commercial Law Reform Assessment for Europe and Eurasia

Development Indicators

SUBSTANTIVE AREA	REF.	POL		ROM		UKR		KAZ	
A. BANKRUPTCY			**78%**		**54%**		**37%**		**50%**
1. Legal Framework	**280**	224	**80%**	166	**59%**	114	**41%**	168	**60%**
2. Implementing Institutions	**170**	136	**80%**	105	**62%**	76	**45%**	87	**51%**
3. Supporting Institutions	**200**	151	**76%**	104	**52%**	66	**33%**	97	**49%**
4. Market for Effective Bankruptcy System	**290**	225	**78%**	130	**45%**	81	**28%**	119	**41%**
B. COLLATERAL			**77%**		**32%**		**48%**		**35%**
1. Legal Framework	**140**	126	**90%**	62	**44%**	107	**76%**	79	**56%**
2. Implementing Institutions	**210**	165	**79%**	27	**13%**	118	**56%**	49	**23%**
3. Supporting Institutions	**190**	123	**65%**	66	**35%**	59	**31%**	58	**31%**
4. Market for Modern Collateral System	**310**	234	**75%**	114	**37%**	92	**30%**	87	**28%**
C. COMPANY			**79%**		**62%**		**44%**		**59%**
1. Legal Framework	**190**	153	**81%**	119	**63%**	90	**47%**	118	**62%**
2. Implementing Institutions	**270**	205	**76%**	198	**73%**	140	**52%**	182	**67%**
3. Supporting Institutions	**100**	82	**82%**	70	**70%**	42	**42%**	58	**58%**
4. Market for Efficient Company Law	**270**	211	**78%**	117	**43%**	89	**33%**	130	**48%**
D. COMPETITION			**79%**		**57%**		**40%**		**58%**
1. Legal Framework	**210**	172	**82%**	138	**66%**	115	**55%**	135	**64%**
2. Implementing Institutions	**220**	178	**81%**	136	**62%**	92	**42%**	141	**64%**
3. Supporting Institutions	**160**	122	**76%**	82	**51%**	59	**37%**	74	**46%**
4. Market for Open, Competitive Economy	**290**	226	**78%**	142	**49%**	80	**28%**	162	**56%**
E. CONTRACT			**80%**		**63%**		**45%**		**64%**
1. Legal Framework	**90**	75	**83%**	67	**74%**	45	**50%**	66	**73%**
2. Implementing Institutions	**180**	150	**83%**	132	**73%**	89	**49%**	119	**66%**
3. Supporting Institutions	**70**	55	**79%**	46	**66%**	35	**50%**	38	**54%**
4. Market for Efficient Contract Law	**310**	234	**75%**	114	**37%**	92	**30%**	192	**62%**
F. FDI			**77%**		**57%**		**41%**		**66%**
1. Legal Framework	**290**	253	**87%**	278	**96%**	259	**89%**	240	**83%**
2. Implementing Institutions	**190**	155	**82%**	110	**58%**	35	**18%**	129	**68%**
3. Supporting Institutions	**200**	131	**66%**	76	**38%**	56	**28%**	100	**50%**
4. Market for Increased FDI	**310**	234	**75%**	114	**37%**	92	**30%**	201	**65%**
G. TRADE			**68%**		**54%**		**33%**		**52%**
1. Legal Framework	**280**	260	**93%**	252	**90%**	158	**56%**	221	**79%**
2. Implementing Institutions	**180**	128	**71%**	96	**53%**	61	**34%**	109	**61%**
3. Supporting Institutions	**180**	88	**49%**	72	**40%**	35	**19%**	58	**32%**
4. Market for Trade Liberalization	**310**	188	**61%**	107	**35%**	66	**21%**	111	**36%**
AGGREGATE TOTALS			**77%**		**54%**		**41%**		**55%**
1. Legal Framework	**1480**	1263	**85%**	1082	**70%**	888	**59%**	1027	**68%**
2. Implementing Institutions	**1420**	1117	**79%**	804	**56%**	611	**42%**	816	**57%**
3. Supporting Institutions	**1100**	752	**70%**	516	**50%**	352	**34%**	483	**46%**
4. Market for Reform	**2090**	1552	**74%**	838	**40%**	592	**28%**	1002	**48%**