

“Foreign Direct Investment (FDI) in the Polish Economy: A Comparison with Central and Eastern Europe (CEE) Countries”

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SECTION 1 | **Macroeconomic Processes and Regional Economies Management**

Foreign Direct Investment (FDI) in the Polish Economy: A Comparison with Central and Eastern Europe (CEE) Countries

Lucyna Kornecki

Abstract

Following the collapse of the communist regime, Poland began the transition toward a market economy and identified the positive effect of foreign direct investment (FDI) on the transition process. Foreign capital inflow is considered an important factor facilitating the privatization and reconstructing process of Central and Eastern European (CEE) economies.

The first section of this paper provides an overview of the basic trends of FDI in Poland, such as the size of FDI inflow, its accumulated value, structure of FDI according to the forms of investment, the country from which it's originated and the sectors of the economy.

The second section examines FDI inflow in Poland in comparison with the other CEE countries and discusses the size of FDI inflow and FDI stock as a percentage of GDP.

High foreign capital inflows and very high percentage share of Foreign Direct Investment stock in Gross Domestic Product indicate that foreign capital plays a vital role in CEE economies and becomes an important indicator of globalization processes in CEE countries.

Key words: foreign investment, CEE economies, globalization.

JEL Classifications: F02, F15, F21.

Introduction

Poland, as one of the Central and Eastern European Countries (CEEC), acknowledges foreign direct investment as an essential tool in the development and modernization of its economy. Foreign direct investment in Poland has increased in the past twenty years, to become the most common type of capital flow needed for stabilization and economic growth. Foreign capital coming into the Polish economy has fulfilled a very important role in the process of privatization and restructuring. Poland seeks to attract and promote foreign investment and to liberalize its economy to ensure free movement of capital and profits (www.usatrade.gov). Attracting foreign investment has become a key component of national strategies for many Central and Eastern European (CEE) countries. FDI is seen as an essential factor stimulating sustained economic growth, expansion of capital stock, increase in productivity, employment and innovation and technology transfer (www.poland.gov.pl/index.php?document=1638).

FDI refers to an investment made to acquire lasting interest in enterprises operating outside the economy of the investor. The investor's purpose is to gain an effective voice in the management of the enterprise. Some degree of equity ownership is almost always considered to be associated with an effective voice in the management of an enterprise and a threshold of 10 per cent of equity ownership qualifies an investor as a foreign direct investor (the Balance of Payments Manual BPM5: Fifth Edition, International Monetary Fund, 1993) (www.unctad.org/Templates/Page.asp?intItemID=3146&lang=1).

This paper reviews recent trends in FDI in Poland and CEEC and represents a preliminary investigation of FDI inflows and their contribution to Poland and the CEE economies. (www.paiz.gov.pl/?id=2056d8c1dec3d12cbce646b348d189d1).

Basic Trends of FDI in Poland

The Inflow of FDI in the Polish Economy and its Accumulated Value

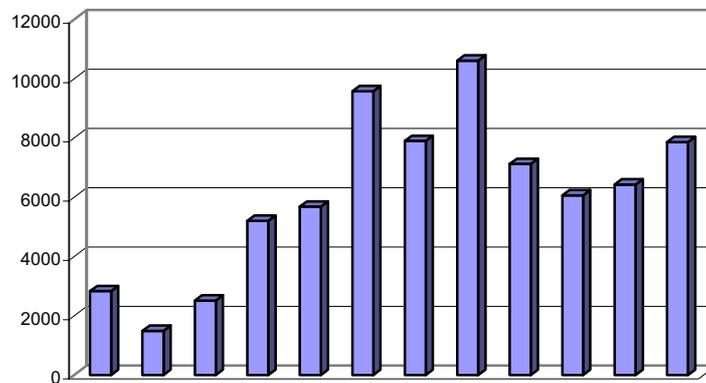
The transformation in Poland from a closed, communist economy to an open, market economy has been facilitated by the privatization of state owned enterprises and the development of the private business sector. The private sector continues to facilitate economic growth and employment in the Polish economy, constituting about 70% of GDP and generating 72% of employment in the country (Kornecki, 2005).

The importance of FDI to the stabilization and growth of the Polish economy particularly cannot be underestimated. Foreign direct investment (FDI) has increased in the past twenty years to become the most common type of capital flow into the Polish economy during transition period. The most important economic reason for attracting FDI at the beginning of the transformation process was to facilitate the privatization and restructuring of the economy (Heimann, 2003). At present as the privatization and reconstructing process in Poland comes to an end, the main reason to pursue FDI is to enhance productivity, encourage employment, stimulate innovation and technology transfer as well as enhance sustained economic growth.

Poland has recognized the positive effects of FDI on the transformation process of the economy and remains one of the most advanced transition economies among other Central and Eastern European Countries (CEEC). Poland, Hungary and Czech Republic have become leaders in the attraction of FDI. The governments of those countries have officially encouraged FDI and have provided substantial incentives for foreign companies, such as 5-10 years tax abatements, infrastructure improvements, tariff exemptions, outright subsidies and other favorable treatment (Gabor, 2000).

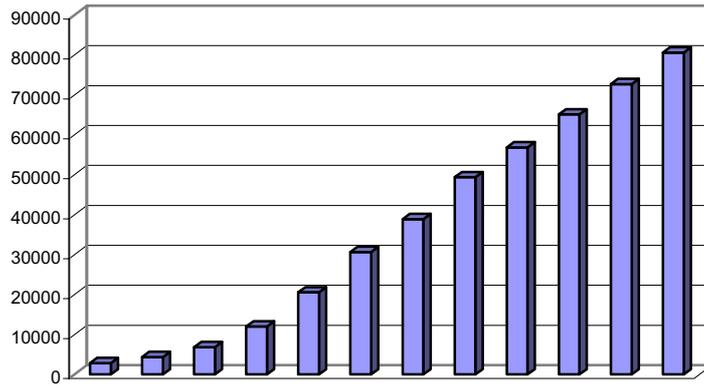
The majority of foreign investment in Poland comes in the form of FDI (Figure 1). In the year 2004, USD 7.9 billion was allocated in Poland in the form of FDI. This marks an increase of 23% in comparison to the year 2003 and the highest inflow over the last four years, what can be attributed to the accession to the European Union.

The accumulated value of foreign capital in Poland between 1993-2004 amounted to USD 80 billion (Figure 2). Poland receives about a third of all FDI inflows to Central and Eastern Europe and its size has been increasing continuously by 44% per year on average over 1991-2004 and reached the highest level of all CEE countries (www.poland.gov.pl/index.php?document=1638).



Source: Polish Information & Foreign Investment Agency, www.paiz.gov.pl/index

Fig. 1. FDI, Poland, USD million, 1993-2004

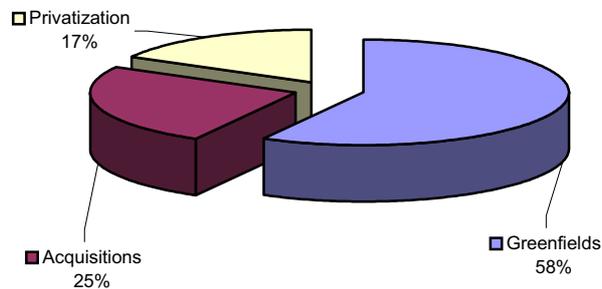


Source: Polish Information & Foreign Investment Agency. www.paiiz.gov.pl/index

Fig. 2. Accumulated value of foreign capital, USD million, 1993-2004

The structure of FDI in Poland: The Greenfield Investment

There are two fundamentally different types of FDI, sometimes called “modes of entry”. Foreign investors can either buy an existing company, or create a new company. The latter is often referred to as “build” (vs. buy), or as a Greenfield investment. Recently, the majority of foreign investment to Poland has taken the form of Greenfield investment (www.poland.gov.pl/index.php?document=1638). The Greenfield investment constitutes 58% of total FDI inflow in 2004 (Figure 3). Greenfield investments create additional productive capacity in a country, but they may also create new competition for existing local companies.



Source: Polish Information & Foreign Investment Agency. www.paiiz.gov.pl/index

Fig. 3. Forms of investment in the inflow of foreign direct investment to Poland in 2004

FDI related to privatization and acquisition also have a significant share in the structure of foreign inflow. FDI connected with privatization constitutes 17% and acquisition 25% of total FDI. In Poland, privatization is no longer a major source of FDI inflows as Greenfield projects comprise the majority of FDI inflows (www.usatrade.gov). Poland and other CEE countries have become a major source of skill-intensive assets, as they combine advanced education with competitive pro-

duction costs, relatively low wages, low corporate taxes and the use of subsidies (www.usatrade.gov).

In the past, 90% of foreign investment in Poland – resulting from both privatization and Greenfield operations – were focused on selling products on the domestic markets (including the form of one-time investments like gas service station chains or fast-food restaurants). Recent Polish investments are now focused on export for EU markets in the manufacturing sector (Toyota, Citroen, Peugeot, Hyundai) and in the services sector in the areas of accounting, human resources management, remote customer service, back-office banking functions (Lufthansa Ticket Accounting Center in Cracow).

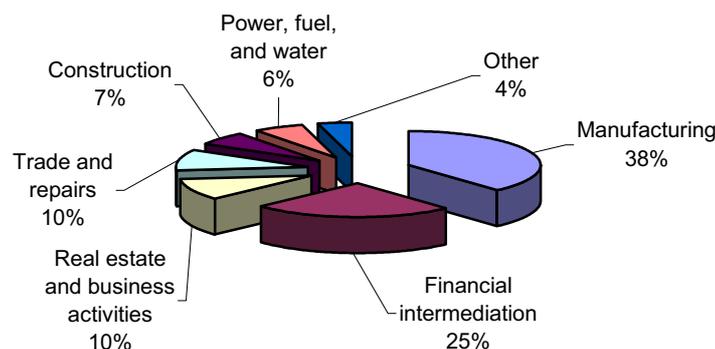
The Countries from which FDI originated

Analysis of the FDI country of origin data for Poland (2002) indicates significant contributions by France (20%), the USA (15%) and Germany (14%). Other European countries such as the Netherlands, Italy and the U.K. represent 9%, 7%, and 5% in total FDI. The remaining countries: Sweden, South Korea, Russia, Belgium, Ireland, Denmark, Cyprus, Switzerland, Austria, Norway, Japan, Greece and Portugal contributed between 1-4% to the total FDI (www.paneurasian.com/di.pdf). The largest share of investments was carried out by French and American corporations.

The Inflow of FDI to Poland with Regard to the Sectors of the Economy

Under the centrally planned economic system the service sector was neglected. Services now attract significant FDI inflows in the CEEC transition economies as investment shifts from the manufacturing sector towards the services sector. In the late 1990s, FDI inflows in the services sector became dominant in Poland, Czech Republic and Hungary. The pressure to upgrade services to the level of the old EU members has increased with the EU's last enlargement (www.UNCTAD/WIR/2003).

The analysis of the investment inflow in the Polish economy shows that FDI inflow in the service sector contributes 58% to the total foreign inflow (2004), confirming the trend of FDI growth in the service sector in transition economies. Within the services sector, the most attractive area for foreign investors was the financial sector. In 2004, investors allocated 27% of total investment outlays into the financial services. The next most popular investment areas were real estate sector (11%), trade and repairs (10.8%), construction (7.1%), and power, gas and water (6.5%). The manufacturing sector constitutes 41% of the total value of all foreign investment with 9% in the automotive branch, 6.2% in chemical and pharmaceutical branches, 6% in metal and metal products, and 5.7% in household appliances as shown in Figure 4.



Source: Polish Information & Foreign Investment Agency. www.paiz.gov.pl/index

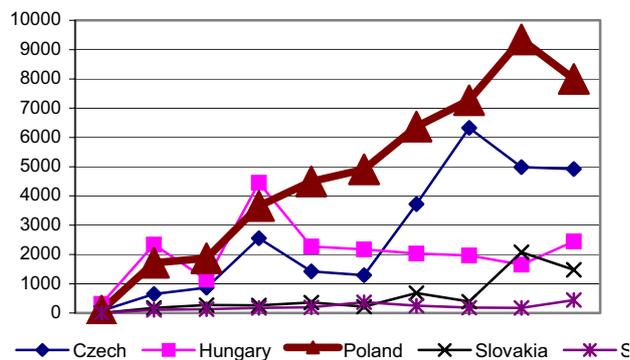
Fig. 4. The inflow of foreign investment to Poland according to the sectors of the economy, 2004

Foreign Direct Investment: CEEC Comparison

The inflow of FDI and FDI per capita in CEEC

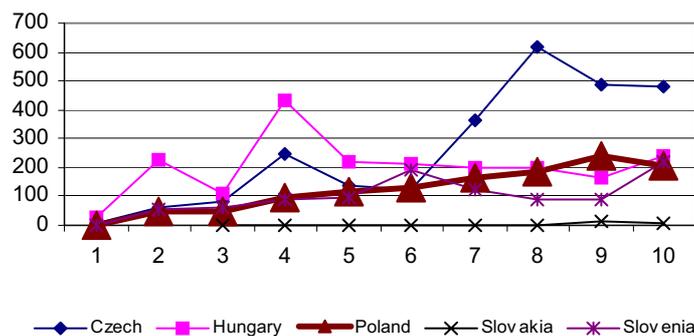
Poland is currently the leader in FDI and shows an increasing trend in FDI inflows in comparison with other CEE countries between 1990-2000 (Figure 5). FDI in Poland increased from USD 3 million in 1990 to USD 10 000 million in the year 2000. Attracting FDI has become a key component of national strategies. Incentives in Poland include exemptions from income tax offered depending on the region, the size of the investment and the number of job created, relatively low corporate income tax rates (28% in 2002, 24% in 2003, 22% in 2004, 19% in 2005), 20% tax on revenue from interest, royalties, titles to invention, and trademarks, and 15% tax on revenues from dividends and other forms of income. Foreign investors have access to various fields of the economy (seaports, airports, defense are restricted) and enjoy unrestricted right of ownership over their businesses (air transportation may not exceed 49%, radio and TV 33%). There is a 50% domestic material and labor requirement.

Considering foreign inflows per capita in CEE economies (2001) Poland is third (USD 207) after Czech Republic (USD 240) and Hungary (USD 478) as a result of relatively high population in Poland compared with other CEE countries analyzed (Figure 6).



Source: Wiener Institut für Internationale Wirtschaftsvergleiche. WIIW Annual Database Eastern Europe www.wiiv.ac.at

Fig. 5. FDI inflow, USD million 1990-2001

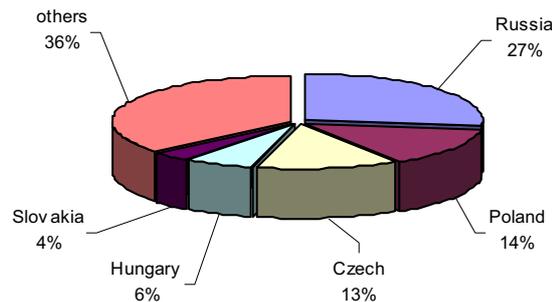


Source: Wiener Institut für Internationale Wirtschaftsvergleiche. WIIW Annual Database Eastern Europe www.wiiv.ac.at

Fig. 6. FDI inflow per capita: Poland and CEEC (1990-2001)

FDI inflows to CEE countries have been developing in parallel with improvements in political stability and progress in transformation. Recent inflows can be attributed to the positive impact of the last EU enlargement (May 2004). New EU countries, including Poland, have improved the business environment and introduced policy measures aimed at liberalizing, promoting and protecting FDI. Old EU members fear a relocation of manufacturing and services activities to the new EU members, as they offer relatively low wages, low corporate taxes and the use of subsidies. Poland and the Czech Republic were identified as the top FDI destinations in CEE. Germany and the United States are expected to be the principal investors in CEE region ([www.UNCTAD/WIR/2003](http://www.unctad.org/wir/2003)).

Figure 7 shows the projected inflow of foreign capital into the CEEC countries. Topping the list is Russia (27%), followed by Poland (14%), Czech Republic (13%), Hungary (6%), Slovakia (4%), and others (36%) (<http://samvak.tripod.com/brief-fdicee01.html>).

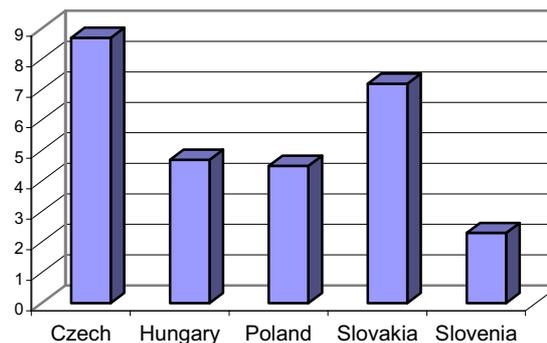


Source: Polish Information & Foreign Investment Agency www.paiz.gov.pl/index

Fig. 7. The inflow of foreign capital to the CEE countries in 2004 (projection)

The FDI as a Percentage of GDP: CEEC comparison

The size and increasing trend in FDI inflows to transitioning CEE countries are impressive. To measure the role of FDI in CEEC economies, percentage share of FDI in GDP was analyzed (Figure 8). According to this research, foreign capital inflows in analyzed countries constitute a relatively high percentage of the GDP. In 2001, FDI in Poland accounted for 4.5% of GDP in comparison with Czech Republic, Slovakia and Hungary where respective shares were: 8.7%, 6.9% and 4.7%.



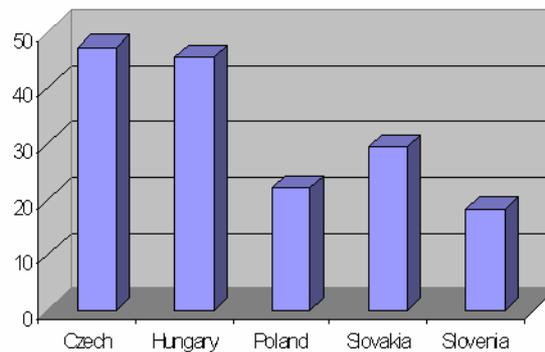
Source: Source: Wiener Institut für Internationale Wirtschaftsvergleiche. WIIW Annual Database Eastern Europe www.wiiv.ac.at

Fig. 8. FDI inflow as a percentage of GDP: Poland and CEEC, 2001

According to the matrix of the United Nations Conference on Trade and Development (UNCTAD, 2002) all CEE countries (Poland, Czech Republic, Hungary, Slovakia and Slovenia) are classified as having high FDI performance and high FDI potential.

The FDI stock as a percentage of GDP: CEEC comparison

The FDI inflow measures the amount of FDI entering a country during a one year period. The FDI stock is the total amount of productive capacity owned by foreigners in the host country. It grows over time and includes all retained earnings of foreign-owned firms held in cash and investments. The share of foreign stock as a percentage of GDP has been very high in the Czech Republic, Hungary and Slovakia, and constitutes respectively: 47%, 45%, 29% of each countries GDP. In Poland, the share of foreign stock as a percentage of GDP was much lower and amounted 22% of GDP, in comparison with the 18% share in Slovenia (Figure 9). The high percentage of foreign stock in GDP indicates that foreign capital plays a vital role in CEE economies and represents one of the most important indicators of progress of the globalization process in CEEC.

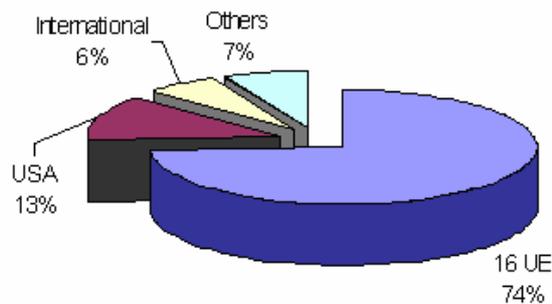


Source: Wiener Institut für Internationale Wirtschaftsvergleiche.

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Fig. 9. FDI stock as a percentage of GDP (%) 2001

The European Union Countries hold the highest share of productive capacity owned by foreigners in Poland (74%), while USA and International Corporations contribute respectively 13% and 6% to foreign stock in the Polish economy (Figure 10).

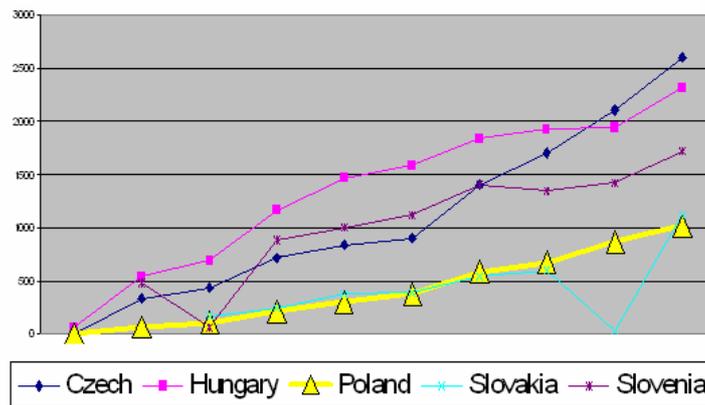


Source: Polish Information & Foreign Investment Agency www.paiz.gov.pl/index

Fig. 10. Percentage share of foreign countries in the stock of FDI in Poland 2004

Considering FDI stock per capita in CEE economies (2001), Poland remains fourth (USD 1,000) after the Czech Republic (USD 2,600), Hungary (USD 2,400), and Slovenia (USD 1,750) as a re-

sult of relatively high population numbers in Poland, as compared with other CEEC analyzed (Figure 11).



Source: Source: Wiener Institut für Internationale Wirtschaftsvergleiche.

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Fig. 11. FDI stock per capita (USD), Poland and CEEC comparison, 1990-2001

Summary

Poland has recognized the positive effects of FDI on the transformation process of the economy and remains one of the most advanced transition economies among other CEEC, in part because of its leadership in the attracting FDI. The government has officially encouraged FDI and has provided substantial incentives for foreign companies.

FDI inflows in Poland have been a vital factor facilitating the privatization process in the first stage of the transition period. At present, as the privatization and restructuring process in Poland comes to an end, the main reasons to pursue FDI are to enhance productivity, encourage employment, stimulate innovation and technology transfer as well as enhance sustained economic growth.

Research has found that the majority of FDI continues to go to the developed economies, but FDI to developing countries is increasing. Poland is the CEE leader in FDI and shows an increasing trend in FDI inflows in comparison with other CEE countries. The accumulated value of foreign investment in Poland between 1993-2004 amounted to USD 80 billion. One of the most important factors contributing to the growth of FDI in CEEC in last few years has been the EU membership.

Analysis of the structure of FDI inflow to Poland shows an increasing interest in Greenfield investment. The share of Greenfield investments constitutes 58% of total FDI inflow (2004). Privatization is no longer a major source of FDI inflows in Poland constituting only 17% of total FDI. In the past Greenfield investment focused on selling products on the domestic market. Currently, Greenfield investments in Poland are aimed at export for EU markets.

Foreign investments in Poland with regards to the countries of origin indicate significant contributions from France (20%), the USA (15%) and Germany (14%). Other European countries such as: the Netherlands, Italy and the U.K. participated respectively 9%, 7%, and 5% in total FDI. Multi-national companies accounted for 5% of the total FDI in Poland.

FDI has a positive effect on service and manufacturing sectors. FDI inflows have been shifting in recent years from the manufacturing sector towards the services sector. The services sector now constitutes 58% of FDI inflows while the manufacturing sector accounts for only 41% of the total value of foreign inflows.

Foreign investment in transitioning CEE countries shows an increase in size and constitutes a relatively high percentage of GDP. Inflows of FDI in Poland accounted for 4.5% of GDP in comparison with the Czech Republic and Hungary where foreign investment accounted respectively 8.7% and 4.7% of GDP.

Foreign stock, which represents the total amount of productive capacity owned by foreigners in the host country, has become a very important part of CEE transition economies. In the Czech Republic, Hungary and Slovakia foreign stock constitutes respectively 47.2%, 45.4%, 29.3% of GDP. In Poland and Slovenia shares of stock in GDP are 22.1% and 18.1% respectively.

This study has examined how the *closed economies* of Central and Eastern Europe have been transforming into *open economies*. High foreign capital inflows and very high percentage share of Foreign Direct Investment stock in Gross Domestic Product indicate that foreign capital plays a vital role in CEE economies and has become an important indicator of the advancing globalization processes in CEE countries.

This study reviewed the experience of Poland and other CEE economies integrating into global market and concludes that FDI facilitates the globalization process in Central and Eastern Europe. The scope of this study can be extended to show the correlation between FDI and economic growth and contribution of FDI to economies output, employment and foreign trade. This study uses FDI as a % of GDP as an indicator of advancing globalization. There is possibility to pursue further research related to indicators of globalization process.

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