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**Is Poland Emerging from the Periphery of Foreign Direct Investment Flows
to Central and Eastern Europe? An Examination of the Evidence**

By
Alicja Wielgus

**A thesis submitted to the
Faculty of Graduate Studies and Research
in partial fulfilment of
the requirements for the degree of**

**Master of Arts
The Norman Paterson School of International Affairs
Carleton University
Ottawa, Ontario
April 1995**

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Maureen Appel Molot

Maureen Appel Molot, Director
The Norman Paterson School
of International Affairs

Carl McMillan

Professor C. McMillan, Supervisor

Abstract

This study searches for reasons why Poland, despite its leading role in overcoming communism, remained in the periphery of foreign investment flows in the early years of transition. The factors that help to explain this phenomenon are both external and internal in nature.

First, this thesis provides an examination of the statistical evidence on foreign direct investments in Poland. Then, it analyses the factors that influenced foreign investors' decisions to channel private capital away from Poland. The external factors help to explain modest foreign direct investment flows to Central and Eastern Europe as a whole. The internal factors determine Poland's low attractiveness for investment relative to other locations.

Following the analysis of Poland's experience with foreign capital in the era prior to 1990 and numerous legacies of that period, the economic, political and social environment is examined. It is concluded that a slow progress of privatization, especially through direct sales greatly limited the scope for foreign acquisitions. However, an emerging "genetic" private sector that became an engine of recovery from the post-communist recession provided new opportunities for foreign investors and encouraged capital inflows.

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List of Abbreviations

AIZ--Agencja d/s Inwestycji Zagranicznych--Foreign Investment Agency
BICFC--Basic information about companies with the share of foreign capital report
CMEA--Council for Mutual Economic Assistance
CEE--Central and Eastern Europe
CFC--Company with foreign capital
CFSA--Companies with Foreign Shareholdings Act of June 14, 1991
EAE--Emerging Asian economies
ECEE--Emerging Central European economies
ELAE--Emerging Latin American economies
EU--European Union
FDI--Foreign direct investment
FSSF--Foreign small scale enterprise
GUS--Główny Urząd Statystyczny--Central Statistical Office
IMF--International Monetary Fund
JSC--Joint stock company
JV--Joint venture
LCFC--Large company with foreign capital
LLC--Limited liability company
MNE--Multinational enterprise
NAFTA--North-American Free Trade Agreement
NFI--Narodowy Fundusz Inwestycyjny--National Investment Fund
OECD--Organization for Economic Co-operation and Development
PAIZ--Państwowa Agencja Inwestycji Zagranicznych--Polish Agency for Foreign Investment
PPP--Program Powszechnej Prywatyzacji--Mass privatization program
PSEA--Privatization of State-owned Enterprises Act of July 13, 1990
PZL--Polish zloty
SOE--State-owned enterprise
UN--United Nations
USD--US dollar
WSE--Warsaw Stock Exchange

Is Poland Emerging from the Periphery of Foreign Direct Investment Flows to Central and Eastern Europe? An Examination of the Evidence

The post-socialist countries of Central and Eastern Europe have been a subject of attention among politicians, academics, journalists and business representatives around the world. Some have been excited by the proclaimed end of the Cold War. Others have explored the complexity of post-socialist transition and speculated about its outcomes. Yet, another group has focused on emerging business opportunities, short or long-term. All, regardless of a motive for this awakened interest, have been very enthusiastic about the recent change in the region.

By now, it is widely recognized that freedom from the socialist ideology and practice is only the very beginning of a long way towards attaining a quality of life achieved by some industrialized democracies in the world. At the turn of the decade, the new governing authorities in post-socialist countries claimed that within a few years of necessary reforms and adjustment, the Western model based on democracy and market could be duplicated. Although, in many cases, they underestimated the depth and length of the transition, they recognized that in order to complete the task they would require substantial assistance from developed countries.

The region's needs for foreign capital have been enormous. Domestic savings have been dissipated by inflation, the ability to earn foreign exchange has been constrained by falling output and a collapse of a major export market in the former Soviet Union, and existing domestic enterprises have been struggling to compete with imports from the West. The capital has been needed to rejuvenate falling industries and enterprises, to modernize obsolete equipment and to introduce new methods of efficient management

and manufacturing. Depending on the method of calculation, the capital needs for six post-socialist countries such as the Czech Republic, Slovakia, Hungary, Poland, Bulgaria, and Romania have been estimated at USD 23 billion to USD 226 billion annually (Zoethout, 1993, p. 38).¹ The authorities in developed countries and international agencies, at least in part aware of the magnitude of change and potential consequences of a failure, have offered expertise and some financial aid. These forms of assistance, however, have been limited in size, and both sides (with hope) have looked upon private capital flows to play a significant role in transition.

In the era prior to 1990, the governments of Central and Eastern Europe authorized only limited exposure to foreign direct investment (FDI). They tried to tap into other sources of international capital and technology flows, to finance growing consumption, and to modernize their economies. As a result of heavy borrowing they quickly incurred huge foreign debts. Since 1990, the post-socialist countries placed higher expectations upon foreign direct investment and its contributions. FDI was to ease the pain of transition and to incorporate the region into the international system.

The desired "economic" and "institutional" benefits of FDI in four areas of the transition process such as "stabilization, marketization, privatization, and economic restructuring" have been identified by McMillan (1993, pp. 97-119). FDI inflows can accelerate the transition by supplying necessary capital and technology to cushion the shock of post-communist reforms and by building the indispensable institutions of the market (both in terms of liberal, market-oriented policies and in terms of business services, business ethic and management skills). They can play a significant role in building a private sector whether through takeovers of state-owned enterprises or by "greenfield investments" and as a result can alter the structure of ownership in the region. Lastly, FDI can assist post-communist countries in modernization of economies and in restructuring of

¹ A huge range of estimates comes from various methods used to calculate capital needs in Eastern Europe. They are based on projected annual GDP and export growth necessary to bring the capital stock and standard of living in the region close to the one enjoyed on average by the OECD countries. Zoethout also suggests that this task would take up to thirty years.

enterprises according to commercial considerations, in creating an industrial structure more responsive to trends in the world economy and in enhancing the region's share in global trade and investment.

All post-socialist countries have tried to create a favorable climate to attract FDI and inject their economies with Western capital, technology and management skills. Unfortunately, after five years of attempted restructuring and building new economic and political systems, the region has recorded only modest inflows of investment. In comparison with other areas in the world, the multinational enterprises (MNEs) have apparently found the conditions too risky to incorporate these economies significantly into their global strategies. Contrary to widely publicized expectations of "FDI invasion" into the region to take advantage of newly open markets, the MNEs have been slow in establishing their presence there. The financing, provided by foreign assistance, has been only in part supplemented by private capital. According to the *World investment report 1994* (UN, 1994, p. 98) total cumulative stock of FDI transfers in the countries of Central and Eastern Europe amounted only to USD 13 billion by the end of 1993. The estimated annual requirements of capital for each of the countries thus far exceed the funds received up-to-date.

While generally limited in magnitude, the penetration by foreign investment across the region has varied considerably in intensity. Hungary and the former Czechoslovakia have experienced comparative success in attracting actual investments destined for the transforming economies. Poland's hopes for active participation of foreign capital have not been fulfilled. Nonetheless, there are some signs that this situation may be changing. In 1993, Poland experienced a substantial surge in FDI inflows. Despite this improvement, however, the country still falls well behind Hungary and the Czech Republic on the FDI inflows per capita basis.

This is surprising since Poland was the first country to break away from the Soviet system, to introduce radical market-oriented reforms, and to experience a positive

real GDP growth of 2.6% in 1992 and 3.8% in 1993 (IMF, October 1994, p. 66). Despite widely held perceptions of Poland's path breaking role in the transition and its lead in the recovery from the post-communist recession, foreign capital has entered Poland very slowly. Even the advantages of a rapidly growing private sector in Poland², with a cheap but skilled labor force, a location on major routes to the East, a large domestic market and proximity to Western markets have not attracted substantial FDI inflows. An investigation of the reasons for Poland's surprisingly poor showing will be a subject of this thesis.

The Core Hypotheses

The point of departure is a premise that FDI inflows to Poland have not been forthcoming in a size comparable to other countries or amounts necessary to aid the transition. Despite the rapid pace of the reforms carried out in the beginning of the new era, Poland has not become a location to which multinational enterprises rush to place their subsidiaries or branch offices. Foreign investors have not satisfied the pressing requirements of a capital-deficient country. The MNEs have not played a vital role in the privatization process and have not seized alleged opportunities of recent liberalization. They have not rescued (as it was expected) a substantial number of state-owned enterprises from a drop in output or virtual collapse. Although Poland has implemented legislation favorable to FDI, there have still been numerous internal factors that have deterred foreign investors. Foreign investment euphoria has not materialized and remained only on paper, be it newsprint or academic journals. Hence, the questions that still remain to be asked are:

Why did a substantial amount of FDI not flow into Poland as it was predicted and/or hoped for? What are the factors that have placed Poland in the periphery of foreign investment flows to Central and Eastern Europe? Has Poland not been

² Prior to 1990, the private sector played a marginal role in the economy. In 1994, according to the World Bank report on Poland, the private sector there accounted for "more than a third of industrial activity and half or more of all GDP and employment" (*Privatization Update*, December 1994, p. 7).

successful in creating appropriate conditions for private capital? Does the evidence indicate that Poland is emerging from the post-communist recession and that the country's FDI record is improving?

The surprisingly low initial FDI inflows to Poland and recent higher investments deserve examination. Hence, in this thesis, I undertake a search for causes of modest foreign capital inflows to Poland in the early years of transition. These causes are both external and internal in nature. In explanation of the controversies surrounding Poland's poor record of FDI inflows the following hypotheses will be examined:

- 1. Poland entered the ranks of potential host countries at a time when FDI outflows from the OECD countries were in general decline, and when the nature of multinational enterprise was changing. This created a more competitive international environment for private capital in the early 1990s.**
- 2. Poland was unable to compete successfully for these funds, because of the following internal factors:**
 - a) Poland's legacy from the period prior to 1990 was especially weak in this area. It inherited neither a policy orientation towards foreign investment nor an established system for managing capital inflows.**
 - b) Its early, radical reforms ushered in a period of political and economic instability which produced a fragmented and unpredictable policy environment for foreign investment.**
 - c) The uncertain state of ownership rights and the delays in the privatization of Polish state industry have inhibited foreign investors and restricted their opportunities.**
- 3. The factors, external and internal, cited in explanation of Poland's poor FDI record are all transitory in nature. As they diminish in force, Poland's**

FDI showing can be expected to improve. There are first signs that this improvement is now underway.

The modest size of FDI in Poland may be due to the specific characteristics of global foreign investment flows. The global system is undergoing profound changes as a result of production over capacity, recession, and an emergence of the new markets. New business practices force corporations to reorganize and arrange their operations according to new strategies. This global restructuring makes it even more difficult for Poland to be successful in its attempt at attracting FDI. In addition, Poland needs to compete with a growing number of other host countries for shrinking FDI outflows from the OECD countries.

A number of domestic factors that might have deterred foreign investors can be identified in the analysis of the FDI flows to Poland. Despite Poland's attempts to encourage private investment in the period prior to 1990, its experience in this area was very weak. Therefore, in the beginning of the transition it possessed neither an appropriate policy nor a functioning system to absorb substantial capital inflows. Next, a package of far-reaching reforms even further exacerbated economic and political instability already experienced at the formation of the new system. The "shock therapy" brought about not only a tremendous need for adjustment but also a political backlash against fast-track transition. These, in turn, led to policy instability which generated an unpredictable investment regime. At the time of frequent economic policy changes, the performance of the Polish economy worsened even further and as a result deterred private capital inflows. Also, a long-lasting debate on the issues of ownership rights and delays in the transfer of state assets into private hands have restricted participation of foreign investors in privatization and in the restructuring of failing enterprises.

An identification of the reasons for Poland's relatively poor ability to attract FDI is critical in estimating prospects for future foreign involvement and its contribution in

building a new system. Considering the potential benefits of FDI (outlined before) that have not been captured because foreign capital has not entered Poland in the amount anticipated, it is important to find the factors that have deterred investors and their funds. Once these factors are identified, the findings may be used to remove obstacles that have held back potential investments to Poland. Also, assuming these obstacles are transitory in character, we may assess whether the recent rise in FDI inflows to Poland is likely to strengthen, i. e. that it is a sign of a successful emergence from the initial shock of transition and consequently, a sign of a greater confidence on the part of the international business community. If it is the case, private capital inflows may still play a role in the country's attempt at advancement. An improvement in Poland's FDI standing that is currently underway, may indicate a beginning of an easier recovery from post-communist recession.

The set of the suggested hypotheses not only places Poland in a broader context of global FDI flows but it also identifies at least some disadvantages created by Poland's past socialist development and by the particularities of the political, economic and social transformation that the country has been undergoing since. Although the list may not be exhausted, the incorporation of various dimensions of transition emphasizes an interdisciplinary character of the above hypotheses.

Methodology

Theoretical Foundations and Sources

"Global corporations of the future will be rather like amoebas. This single-celled aquatic animal is among the most ancient life-forms on earth. It gets all its nourishment directly from its environment through its permeable outer walls. These walls define the creature as distinct from its environment, but allow much of what is inside to flow out and much of what is outside to come in. The amoeba is always changing shape, taking and giving with the surroundings, yet it always retains its integrity and identity as a unique creature."

Joel Bleeke and David Ernst, 1993

A desire to explore and expand into new areas of the world is not a novel phenomenon. What is new are the rapidly evolving forms of that expansion and the actors involved in the process. A form that is a subject of this inquiry is foreign direct investment. Private capital flows globally in an attempt to find a location where it can be used most effectively. The center stage in this search is occupied by a multinational enterprise that has become a medium of expansion into new areas world-wide. Due to its distinct way of doing business across national boundaries, its ability to influence the environment around, and its quick adaptation to arising opportunities and/or constraints, a multinational enterprise deserves special attention. It has been perceived by host countries' governments as a source of capital, technology and managerial know-how. For those with severe capital constraints and/or low technological capability, foreign investment presents a solution in their attempt at national advancement. Both home and host countries try to respond to this "unique creature" (Bleeke and Ernst, 1993, p. 269), by implementing policies that would govern relations between the respective parties. An MNE, just like "an amoeba", interacts with the surroundings by exploiting their locational advantages, by internalizing host country's market imperfections, and by affecting the local environment through its operations.

There exist various theories of FDI that try to explain MNE phenomenon. Dunning (1993, p. 81), in his "eclectic paradigm of international production" gathered the findings of many scholars in the field into one model. His framework, "an OLI paradigm" consists of three components. First, "ownership-specific advantages" explain why firms engage in activities abroad. Second, "location-specific variables" outline where multinational firms locate their activities. The third element, "internalization incentive advantages" define how MNEs enter a new country. The second component is of primary importance for it identifies factors that determine a destination of an investment. The "why" and "how", however, cast some light on motivations and strategies of foreign investors and MNEs, an understanding of which helps predict the "where".

At a given time, MNEs possess a specific configuration of "firm-specific advantages" that need to be internalized and exploited from a foreign location. The MNE's business strategy is external to a host country but the very fact that an MNE finds itself in a search for an appropriate site diminishes its bargaining power. Then, a decision has to be made as to where would be the best site for "ownership-specific advantages" to be deployed. A locality must provide a potential that the firm's advantages will be exploited with a greater success relative to other locations. Hence, the host country must provide an economic, social and political environment conducive to prosperous business operations. A major challenge for a host country is to create an environment favorable to FDI. In recent years, the competition among countries to lure foreign capital and reap the alleged benefits, has increased. Host countries strive to attract foreign capital, albeit with varying degrees of success. It is an intention of this thesis to find the reasons for modest foreign involvement in the Polish economy.

A detailed analysis of domestic conditions existing in Poland is essential. The economic environment consists of the combination of endowment in resources such as labor, capital, raw materials, market size, domestic infrastructure, and level of technological development. All of these factors create a "diamond of national competitive advantage" that according to Porter (1990, pp. 71-72) consists of "factor conditions, demand conditions, related and supporting industries, and firms strategy, structure and rivalry". All four are shaped, however, by the social and political factors prevailing in the system among which the role of a government is particularly important (Porter, 1990, p. 127). Poland's ultimate goal is to create this "diamond". Before it happens, it must successfully emerge from a post-communist recession and sustain that growth.

Apart from the economic environment, other elements of the investment climate play a significant role in creating differences in attractiveness of various locations. Dunning (1993, pp. 270-271) used the "Environment-System-Policies (ESP) paradigm" to explain differences between countries in terms of their ability to attract FDI. He suggested

that the three elements are "interlinked" and affect one another. On the same topic, Eden (1994, p. 233) stated that "the locational advantages of various countries are key in determining which will become host countries for the MNE." A model suggested by Eden (1994, pp. 233-240) organizes "country-specific advantages" into three categories such as "economic, social/cultural and political/legal". The analysis of Canada, the United States and Mexico shows relative differences between the three countries. Clearly, a country must possess a certain configuration of these elements in order to attract FDI. The crucial question for the economies in transition remains: what is a critical mass or a minimum configuration of economic, social and political factors that will make a country more attractive relative to others.

In a framework of a socialist ideology, the state assumed a role of a "manager" of a system at large and of its individual parts. The central plan embraced all state-owned enterprises into an operating whole although, as the history has proved, this system was not sustainable in the long run. By controlling their output and holding a monopoly on foreign trade, the government determined not only the level and composition of production but also the size and structure of consumption. Only a small fraction of the whole remained in the hands of private owners. Once the socialist system collapsed, this initially marginalized sector emerged as a nucleus of Western style entrepreneurship. The rest of the system became both a witness and a subject of the change that has been taking place ever since.

The change itself, advocated by Western advisors as a mere reorientation according to a set of neoclassical economic principles, soon proved to be a long, complex, and controversial process. The excitement accompanying a defeat of socialism (at least in declarations if not fully in practice) covered up the challenge of building a new system that lay ahead. The peculiar circumstances of creating a market oriented economy from the ashes of an opposite ideology have tremendous consequences.

First, the countries in transition have been pioneers in a process that does not have a comparable historical reference. Second, striving towards a democratic and market based system, they devise the paths and embark on them simultaneously and, thus, remain in a state of a continuous flux. Third, the peculiarity of the previous system and the scope of change prevent them from applying conventional, Western style solutions.

Poland, like the other emerging Central European economies (ECEs) has to face the legacies of the past while they struggle with the present and slowly build the future. These legacies are present in the social characteristics of the system (culture, historical ties, work ethics, expectant attitudes toward the state, attitudes towards foreigners) and in the political process that accompanies policy making in Poland. The old patterns of thinking and behaving have for years been internalized by the participants of the present transformation. They are reflected in their demands and displayed in their actions. The responsibility of introducing far-reaching reforms has been vested in the state. In the meantime, a private sector has grown on its own, supplying "the battle field" with new players: the domestic and foreign investors. But by no means have the state and investors been the only players. The multiplicity of actors on the microeconomic level and their interests has, over time, fragmented support for economic reforms and in some cases effectively blocked implementation of the next stages.

In the 1980s, decentralization of decision making transferred part of the authority to lower levels of government and to state-owned enterprises themselves. The workers' councils were established to carry out self-management on the enterprise level. They soon became a powerful force and added a new dimension to a two-player game between managers and labor unions. The "labor-controlled enterprise hypothesis" (Mickiewicz, 1993, p. 205) attempts to explain a slow process of restructuring in state-owned enterprises. Mickiewicz argues that the labor in some industries controls the level of employment in enterprises to maximize average earnings per worker and not the firm's profits.

"The Bermuda Triangle Syndrome" (Bienkowski, 1992, p. 751) will be used to identify the main actors and their interests at the microeconomic level.

Bienkowski's concept of an interaction of three players such as trade unions, workers' councils (called by Bienkowski employees' councils), and directors and managers helps to explain why the self-governed enterprises have been reluctant, to say the least, to embark on privatization. Instead of permitting SOEs to undergo necessary restructuring to become viable economic units, in many cases the three players have been opposed to the wave of ownership change. They have preferred preservation of the existing status quo and engaged in activities to stall the progress of privatization.

Foreign investors, contemplating entry and operations in post-socialist countries, encounter a power struggle that in many cases delays the building of a market oriented system or precludes it altogether. The state attempts to design and introduce new policies and establish market based institutions in a situation of strong legacies from the past. The clash of old and new attitudes is aggravated by multiple actors who seek to influence both the policy making and policy implementation. At the enterprise level various groups try to secure their stake in transformation. The tensions reflect a complexity of interaction between a course of change and the players involved in the process. The issue of ownership change may serve as an example. The uncertain fate of privatization inhibited by lengthy debates on property rights, restitution and methods of divestiture of the state assets poses a major obstacle to active foreign involvement in Poland.

Hence, a discussion on factors that determine whether FDI locates in Poland must include not only a presentation of static characteristics of economic, social and political system but also an analysis of policies, parties involved, and tensions that arise in the decision making and implementation of these policies. In order to explain the reasons for small capital inflows to Poland, the theory of foreign direct investment and/or multinational enterprise, as we know it, must be supplemented by a new dimension that is peculiar to the post-communist economy in transition and that takes into account multiple

players involved in the course of change. This thesis, hopefully, is an introduction to the development of a more comprehensive theory.

In the course of my research on these phenomena, I traveled twice to Poland. In an attempt to find relevant material, I met with employees of various ministries and government agencies (such as the Ministry of Privatization, the Ministry of Finance, the Ministry of Foreign Economic Relations, the Polish Foreign Investment Agency, the Central Statistical Office), and with research workers from many institutes (such as the Foreign Trade Research Institute, the Institute of Finance, Friedrich Ebert Foundation, the European Institute for Regional and Local Development at the University of Warsaw, and the World Economy Research Institute at the Warsaw School of Economics). As a result of these meetings, I gathered an extensive amount of primary and secondary information, both in Polish and in English, pertaining to political, economic and social transformation, to issues of ownership change, and to flows of foreign direct investment and foreign trade.

Especially valuable for this thesis were statistical data on the size, structure and country of origin of FDI inflows, on characteristics of companies with foreign participation operating in Poland, and on the progress of the privatization process. Books, surveys and research reports, government publications, statistical yearbooks, and newspaper articles (from *Gazeta Bankowa*, *Polityka*, *Rynki Zagraniczne*, *Rzeczpospolita*, *Tygodnik Gospodarczy*, *Wprost*, and *Zycie Gospodarcze*) were consulted in preparation of this thesis. The information, obtained in Poland, was supplemented by numerous journal and newspaper articles, conference and working papers, statistical reports from international organizations and some recently published books written in English by scholars and business representatives around the world who have been interested in the issues of transition, trade, and investment in Central and Eastern Europe in general, and in Poland in particular. As a native of Poland, I have personal memories from the communist period and observations of current changes thanks to recent, multiple visits to Poland. In

addition to the published volumes about the region, my personal experience and knowledge about Poland acquired through academic learning have been utilized in this thesis.

Organization of the Thesis

The analysis in this thesis will be arranged in accordance with the structure of the core hypotheses put forward earlier. Following this introductory chapter devoted to methodological issues and a literature review, the second chapter will offer a statistical evaluation of private capital inflows to Central and Eastern Europe in the years 1989-1993 in general, and to Poland in particular. A very detailed examination of 7,935 companies with a share of foreign capital and of 225 large investments in Poland will be conducted. The third chapter will examine global trends in FDI and their effects on the size of inflows to Poland. Poland's experience as a host for FDI in the period prior to 1990, the legacies of the communist period, and their impact on current investments will be discussed in chapter four. The fifth chapter will focus on the policy making environment in post-communist Poland. It will be argued that an unpredictable investment regime has existed in Poland due to the fragmentation of the political scene and economic recession that accompanied radical reforms and the emergence of a new system. Poland's privatization policy and its impact on foreign investors will be of primary interest in chapter six. The discussion will identify major players, their conflicting interests, and arising tensions that effectively deterred foreign investors from locating their capital in Poland. The analysis, conducted in these chapters on the global, country, and enterprise levels, will provide evidence to support the hypotheses formulated earlier. These hypotheses, accompanied by conclusions, will be revisited in the last chapter.

Literature Review

The literature that is directly pertinent to this thesis includes work on transformation, privatization, and foreign direct investment. A considerable body of literature, both in large volumes and academic journals, has appeared about the transformation processes in Central and Eastern Europe. Following the collapse of communism, early articles attempted to grasp the scope of change and predict its outcomes. Now, the transition literature is devoted to the analysis of the three pioneers of transformation, the former Czechoslovakia, Hungary and Poland. Each of them moved towards the same goal along a different path. Each of them encountered unexpected challenges and recorded numerous failures and successes, but the experience of Poland is the most relevant to this thesis.

The literature on transformation in Poland delivers analyses of the initial conditions at the outset of transition and describes the current economic, political and social environment. This literature is important for it identifies the legacies of the previous era. These legacies have shaped the policies and processes of transformation which in turn affected FDI inflows. But it only provides a background for the theme that has been placed in the center of attention: foreign direct investment.

Although the FDI phenomenon is not entirely new for the former centrally planned economies, most of the literature on FDI in the region is very recent. It seems to be emerging from a state of non-existence and, therefore, is still represented by a limited number of articles and books. First, FDI participation in these economies was restricted, data on FDI not publicized and the issue considered politically and ideologically sensitive. Second, the FDI inflows were relatively small and, consequently, their economic effect not significant, although a symbolic impact might have been enormous. The literature that dates back to 1980s was devoted to presenting the legal framework of forming joint ventures with state-owned enterprise, discussing restrictions on FDI entry and speculating on the potential inflows to the region.

In the post-communist era, FDI has been assigned to play an important role in transition. The literature published between 1990-94 attempted to identify the specific goals of Central and East European host governments in achieving the alleged benefits of FDI presence. Just a few scholars undertook the challenge of sketching out the size of FDI inflows prior to and in the early years of transition. Among them is Carl McMillan who has been exploring the issue for many years, who edited the United Nations' *World investment directory. Central and Eastern Europe* (1992) and has published a few more recent articles. McMillan (1992) explained the size and nature of FDI flows while McMillan (1993) presented the potential and actual roles of FDI in the post-communist transformation. Meyer (1994) offered a valuable overview of statistical data on FDI inflows to the region, its sectoral distribution and country of origin. Kuznetsov (1994) reviewed the tangible determinants of an investment climate critical in estimating risk for FDI entry and the appropriate macroeconomic policy for the transition.

More specifically on Eastern Europe, Dobosiewicz (1992) published a book entitled *Foreign investment in Eastern Europe* which attempts to present the expectations of potential host countries, existing regulations, motives for investing in the region and structure of investments. He drew rather optimistic conclusions on FDI inflows in the future based on an initial enthusiasm of liberalization in the region and foreign declarations of involvement in transition towards democracy and market. Two collections of articles on FDI in Central and Eastern Europe and new business relations between the East and the West were edited by Schenk, Monkiewicz, Wass v. Czege (1991) and Artisien, Rojec and Svetlicic (1993). The series of annual publications *Funkcjonowanie inwestycji zagranicznych w Polsce* (Foreign Investments in Poland) edited by Sadowska-Cieslak and published since 1990 have been the most extensive work on the size and structure of FDI in Poland, on performance of companies with foreign capital and on regulations pertaining to FDI in Poland. Last year, an article on Poland's attractiveness to FDI by Markowski and Jackson was published in *Communist Economies and Economic Transformation*.

In the context of economies in transition the most important issue is FDI and its links with privatization. The privatization in the West has been widely researched and described in the literature. However, privatization in Central and Eastern Europe and especially its links with FDI has been an area which is in the stage of development. Hunya (1992) tried to cast some light on the issue. Some literature on the progress of privatization has been supplemented by articles in academic journals such as *Communist Economies and Economic Transformation*, *Journal of Comparative Economics*, and *RFE/RL Research Report*. The recent books edited by Poznanski (1993) and Csaba (1994) offer more insight on privatization in transition. The latter book contains an article by Paul Welfens on interdependencies between privatization and FDI. But a comprehensive theory of privatization and FDI is still missing. This thesis will hopefully fill some "holes" in the existing literature.

The statistical data utilized in this thesis were collected from reports such as *International direct investment statistical yearbook* and *Balance of payments statistical yearbook* and from publications of the Central Statistical Office (GUS) and the Polish Agency for Foreign Investment (PAIZ) in Poland. A full discussion of the numerous sources of data will be provided in the next chapter.

It is an intention of this thesis to present the factors that influence foreign investors' decisions about which site will be chosen as a host country. These factors comprise locational determinants of FDI and in reality represent relative attractiveness of one location over the others. The interdisciplinary study of economic, political and social characteristics that created the investment climate in Poland is conducted in search for factors that determine a country's competitiveness for FDI. This thesis contributes to the existing literature because it is the only systematic review of the Polish investment environment.

Chapter II. An Examination of the FDI Statistical Evidence

Characteristics of Data

Sources of Data and Their Limitations

In order to conduct a comprehensive analysis of FDI flows, multiple sources of information have to be utilized. As a result, the degree of reliability between the data differs and comparability is sometimes impossible to establish. Major Western countries provide detailed statistics of their investment flows (both inflows and outflows) but even their data collection is based on different statistical methods. For many developing countries and post-socialist economies, FDI is either a relatively novel phenomenon or the reporting practices are not sufficiently developed. During the socialist era, foreign capital was looked upon with suspicion and the existence of foreign firms or capital transfers were not reported. Only limited data exist for the period prior to 1990. As the investment regimes liberalized and inflows of private foreign capital increased, more data became available. With the passage of time all countries will adopt a Western system of reporting which will make the data on FDI flows transparent, and the evaluation easier.

Meyer (1994, pp. 4-10) attempted to identify the sources and potential problems with available data for ECEs. He distinguished among four concepts of FDI based on the sources of information and type of data provided by them. The "balance of payments concept" reports data on cash flows made through the banking system. The "stock survey concept" provides statistics collected through surveys of enterprises and by tax offices. The "registration concept" supplies information based on data collected upon the official registration of projects. The "journalistic concept" reports data based on company announcements. All of these concepts have their own shortcomings. While the first two provide information on capital flows, they may underestimate actual investment by

omitting the value of in-kind contributions, especially the value of technology transfer. The "registration concept" varies across countries as some of them report cash investments only, others cash and in-kind contributions, and others cash payments, in-kind contributions, and potential commitments. The fourth concept usually overestimates the inflows by reporting investment intentions in addition to actual investments.

Having identified some of the difficulties with available data, it is necessary to present the sources, type, coverage and limitations of the data utilized in this thesis. Data pertaining to FDI flows and their interpretations in OECD countries were derived from the OECD reports such as *International direct investment statistical yearbook* (and subsequently published in *Financial Market Trends*) and from UN publications such as *World investment report* and *World investment directory*. Some data pertaining to economies in transition come from the above mentioned UN reports. All of this information originated in national statistical reports that may cause some inconsistency in cross-country comparisons as the reporting practices in various countries may differ. Macroeconomic and FDI data characterizing three emerging Central European economies (ECEE-3) such as the former Czechoslovakia, Hungary and Poland; three emerging Latin American economies (ELAE-3) such as Argentina, Chile and Mexico; and three emerging Asian economies (EAE-3) including Malaysia, South Korea and the People's Republic of China were derived from IMF's *International financial statistics yearbook* and *Balance of payments statistics yearbook*. These last two publications were especially useful in establishing the size of FDI flows to Central European economies. The direct investment data is based on actual capital transfers and presented in balance of payments statistics. The annual data is collected and reported according to recommendations for coverage, timing and classification of transactions in the balance of payments contained in the IMF's *Balance of payments manual*. It is compiled incorporating additional data, available only annually, to improve compliance with these recommendations. There may still be some discrepancies as the degree of compliance varies across countries.

More detailed data have been used to analyze the magnitude and characteristics of FDI flows to Poland. Three sources of information were identified in addition to the data provided by the international agencies.³ Depending on the source, the quality of statistics and their limitations vary.

The general information on the structure of public and private sectors in Poland, as well as the numbers of projects with foreign capital participation were derived from publications (statistical yearbooks) prepared by Główny Urząd Statystyczny (GUS), the Central Statistical Office in Poland. Data pertaining to these projects were collected at registration and as a result, include not only initiated but also potential projects. The information is useful in estimating a business interest among investors and potential inflows of investment in the future. However, it does not provide a clear picture of actual investments or currently operating enterprises and tends to overstate the involvement of foreign investors.

The second source of data is the detailed report prepared by the Central Statistical Office (GUS) on the basis of statistical information supplied by enterprises with foreign capital operating in Poland. Data from the statistical financial reports as of December 31, 1993 filed by 7,935 companies were compiled and published in October 1994 in a report entitled *Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r.* (Basic information about companies with the share of foreign capital in 1993).⁴ It represents 52.7% of all registered projects by the end of 1993. Data pertain to companies with foreign capital regardless of type or size of the enterprise or foreign equity share. Many companies are wholly foreign-owned. Therefore, attributing a term joint-venture to any enterprise with foreign capital participation, as it has been commonly used in Poland, becomes incorrect and misleading. Consequently, the term

³ The international agencies such as the IMF, OECD, UN, the World Bank prepared international statistical reports mentioned above and used in the analysis that follows.

⁴ For identification of the source and limitations of the data and for easier reference in the text, this publication will be referred to as the BICFC report.

joint-venture (JV) will be used only to indicate a clearly joint effort. The above mentioned report covers joint-stock and limited liability companies with foreign participation and foreign small scale enterprises. Since all of these types of enterprises are treated together in the report, for consistency throughout the thesis they will be referred to as companies with foreign capital (CFCs). It is important to stress that CFCs are the operating companies with foreign capital and not all registered projects.

The third source of information is the Polish Agency for Foreign Investment which on the basis of reports from the Central Statistical Office, newspaper articles and companies' announcements prepares a list of major foreign investors in Poland. The most recent list (June 1994) contains 225 large companies with foreign capital (LCFCs) that each invested or committed over USD 1 million⁵. Data provided by PAIZ have a journalistic and promotional character and tend to overstate the size of private capital entering Poland. In addition, the list ignores small and medium size investments that comprise a clear majority in terms of number of enterprises. However, after disregarding the size of commitments and focusing only on actual investments, it becomes very useful in the analysis of the largest investments carried out by multinational enterprises (MNEs) in Poland. These projects are the source of about 70% of the foreign capital invested in the country. Since MNEs are the world-wide agents of significant investment flows, the list is essential in evaluating Poland's attractiveness for investment and its position in global strategies of multinational firms.

The analyses conducted on the basis of the available data are intended to identify the general trends in global investment flows and to cast more light on the magnitude and nature of FDI inflows to Poland. Although interpretations must be made with some degree of caution and with a recognition of data limitations, conclusions

⁵ In PAIZ reports "Investments" include equity and loans while "Commitments" indicate potential capital that investor promised to invest in the future.

resulting from this exercise are an essential part of the search for reasons of modest foreign investments in Poland. The following Table II. 1 summarizes the above discussion.

Table II. 1. Characteristics of Data on Foreign Direct Investment by Source

Data	International agencies	GUS (Central Statistical Office) general reports	BICFC report (GUS)	Polish Agency for Foreign Investment (PAIZ)
Collection	National balance of payments, transaction records and surveys	Information provided at registration of projects	Statistical financial statements of enterprises as of 31.12.1993	Information published by GUS, newspaper articles and companies' announcements
Country coverage	All	Poland	Poland	Poland
Coverage of information:				
Annual Flows	Yes	No	Yes	Yes
Stock of FDI	Yes	Yes	Yes	Yes
Country of origin	Yes	No	Yes	Yes
Sectoral distribution	Yes	Some	Yes	Yes
Geographical distribution	Yes	No	Yes	Yes
Number of companies	Some	Yes	Yes	Yes
Employment size	Some	Some	Yes	Some
Type of enterprise	Some	Yes	Some	No
Foreign equity share	Some	No	Some	Some
Type of foreign contribution	Some	No	Yes	Some
Functionality of data	Coverage consistent across countries Reports actual transactions in the balance of payments statistics	Covers all registered projects	Coverage consistent across surveyed firms Covers actual investments in operating firms	Identifies MNE's and the largest investments
Reliability of data	High	High	High	Medium
Problems and limitations of data	Based on national statistics that use different statistical methods Data pertaining to emerging economies is not updated for 1993 Best coverage of OECD countries	Does not differentiate between operating and intended projects Does not update later changes Data limited to number of projects	Covers only 7,935 companies that filed financial statement Most data reported in Polish zloty	Covers only 225 firms Covers only large firms (over USD 1 million of foreign capital) Data overestimated by commitments Journalistic and promotional character
Usefulness of data	Medium	Low	High	Medium

Time Period and Geographical Coverage

The first foreign participation at the enterprise level in Poland was in the form of non-equity industrial cooperation agreements. The experience with FDI in Poland has almost twenty years of history. The first legal document pertaining to FDI was prepared in 1976. Hence, the analysis of FDI inflows in this thesis will begin from mid-1970 until the present. Due to the limited amount of data published for the period up to 1990, it will be treated primarily by examining the evolution of the laws and corresponding foreign interest in investing in Poland. Starting from 1989 until the end of 1993, a detailed analysis of quantitative data on FDI will be conducted.

Although the main subject of inquiry will be FDI flows to Poland, in order to evaluate these inflows, it is essential to present experiences of other countries. An analysis of foreign capital involvement in countries of Central Europe such as Hungary, the former Czechoslovakia and Poland will provide evidence of various successes in attracting private capital in the region. Detailed information about the size and sectoral structure of inflows, country of origin and regional distribution of FDI among various provinces in Poland will be offered.

Central and Eastern Europe and FDI

Opening up to FDI in the Region

The inflows of foreign capital to ECEEs have been taking place for several decades. Until the 1990s, however, their experience with FDI was very limited. The investment regimes permitted only narrow foreign participation, reflecting the rather tentative and even hostile character of FDI regulations at the time. The flows of foreign capital and the scope of cooperation between foreign and domestic enterprises were restricted by the autarkic character of socialist industrialization and the political climate of East-West relations.

Despite political and ideological reservations, communist governments recognized a need to tap into the latest achievements of technological and managerial innovation. By creating a highly regulated environment for FDI the authorities sought to exercise control over foreign investors. The very small inflows of private capital⁶ to Central and Eastern European countries serve as evidence of the deterrent effect of the regulations.

The approach towards FDI changed once ECEEs embarked onto a transition path at the turn of the 1990s. The needs for capital were enormous, and FDI was to assist these countries in a transition period. The ability to attract foreign investment became a critical objective and liberal investment laws were introduced.

According to the latest *World investment report 1994* (UN, 1994, pp. 98-100) cumulated FDI stock based on committed but yet not all implemented projects in the countries of Central and Eastern Europe⁷ through the end of 1993 could be estimated at over USD 19 billion in about 100,000 projects. The amount of actual FDI that entered the region by the end of 1993 amounted to USD 13 billion. Compared to the small amount of FDI that entered these countries prior to 1990⁸, the cumulative numbers just three years later seem encouraging. The excitement about the size of inflows into post-socialist economies fades away, however, when the statistics are compared with total world-wide FDI flows of USD 192 billion in 1993 or FDI inflows to other emerging economies. According to the *World investment report 1994*, (1994, p. 98) investment inflows to Central and Eastern Europe amounted to USD 2.6 billion in 1991, USD 4.6 billion in 1992 and USD 5 billion in 1993. The inflows to developing countries surged from USD 39 billion in 1991, to USD 80 billion in 1993. While the latter countries were able to attract

⁶ Recognizing that it is a simplification, FDI and "private capital" will be used interchangeably in this thesis.

⁷ The report on cumulative FDI registrations (number of projects and value) includes the following countries: Bulgaria, former Czechoslovakia, Hungary, Poland, Romania, former Soviet Union and Slovenia.

⁸ Hungary and the former Czechoslovakia were the most successful while FDI inflows to Poland were almost negligible.

41.7% of global flows in 1993, the former attracted only 6.8%. The available detailed data pertaining to three Central European countries--the former Czechoslovakia, Hungary and Poland--are displayed in Table II. 2 presents the information on the value of FDI transfers between 1989 and 1993. These three countries attracted almost all the FDI destined for the region while the Russian Federation and Slovenia enjoyed a majority of the remaining inflows.

In 1994, according to *PlanEcon Report* (21 March 1995, p. 29), FDI inflows to Hungary dropped to USD 1.6 billion while to the Czech Republic increased to USD 862 million in comparison to the previous year. FDI inflows to Poland also decreased from its 1993 level to USD 1.3 billion (*Business Eastern Europe*, 20 February 1995, p. 3). The data for 1994 should be treated as preliminary since the size of inflows has yet not been available in statistical publications used for the earlier period⁹. Also, it needs to be noted that the annual FDI inflows can be easily influenced by a single large investment. A longer reporting period is essential for extrapolating a dominant trend in FDI inflows to ECEE-3. The available data are illustrated in Figure II. 1.

⁹ According to the *National Bank of Hungary: Monthly report* (December 1994, p. 97) FDI inflows to Hungary between January and September amounted to USD 1,307 million.

Table II. 2. Foreign Direct Investment in ECEE-3: Inflows 1989-1993

	1989	1990	1991	1992	1993
FDI Inflows in USD million					
Former Czechoslovakia	257	207	600	1,103	480 ^a
Hungary	215	354	1,462	1,479	2,339 ^b
Poland	11	89	291	678	1,697 ^c
Total	483	650	2,353	3,260	4,636
FDI Inflows as % of GDP					
Former Czechoslovakia	0.5	0.5	1.8	3.1	1.5
Hungary	0.7	1.1	4.7	4.2	6.5
Poland	0.0	0.1	0.4	0.8	2.0
FDI Inflows per Capita in USD					
Former Czechoslovakia	16.43	13.21	38.51	70.12	46.56
Hungary	20.67	34.17	141.26	143.31	227.31
Poland	0.29	2.33	7.61	17.67	44.12

Source: *Balance of payments statistics yearbook*, Part 2, IMF, 1993, p. 67.

^a Data from Meyer, 1994, p. 41, Table. A1 on Czech Republic only

^b Data from *International financial statistics yearbook*, IMF, 1994, p. 411.

^c Data from *International financial statistics*, IMF, December 1994, p. 454.

Figure II. 1.

Source: Prepared on the basis of data in Table II. 2.

1994 data: for the Czech Republic and Hungary from *PlanEcon Report*, 21 March 1995, p. 29 and for Poland from *Business Eastern Europe*, February 20 1995, p. 3.

The ability of the ECEE-3 to attract FDI varies considerably. Hungary has been a leader with 51.9% of all inflows to the three countries. Next, the former Czechoslovakia, that for a period 1991-1992 outperformed Poland (third on the list) by a large margin, recently lost its advantage¹⁰. The gap between the former Czechoslovakia and Poland disappeared after the latter experienced significant surge in FDI inflows in 1993. Nevertheless, both Hungary and the former Czechoslovakia with cumulative populations amounting only to 2/3 of population of Poland, attracted 3/4 (75.4%) of all inflows to the ECEE-3 region while Poland attracted 24.6%. Since the turn of the 1990s, FDI inflows to Poland have been on a rise but the rate of growth can be deceiving, as a negligible amount of investment prior to 1989 would be used as a base for calculations.

¹⁰ Starting from 1993, data pertains to the Czech Republic only.

Hungary Becomes a Leader in Attracting Foreign Capital

Hungary enjoyed the highest actual inflows of FDI in the region annually which totaled over USD 2.3 billion in 1993 and cumulative inflows which amounted to over USD 5.8 billion by the end of 1993. It also became a leader in terms of a number of registered projects at 21,468 (UN, 1994, p. 100). Foreign capital flows to Hungary as percentage of GDP have placed the country way ahead of other post-socialist economies in FDI inflows. In 1991 the share reached 4.7%, decreased slightly in 1992 to 4.2% and rose again in 1993 to 6.5%. Also, in per capita analysis (Figure II. 2), Hungary experiences the highest inflows of USD 227.31 which represents a five-fold advantage over both Poland and the former Czechoslovakia.

Gradually introduced reforms (initiated much earlier) created a stable environment conducive to foreign investment. The country's image in the West, propagated by the best economic conditions and greatest political stability in the region, was very positive and reflected itself in a preference exhibited by foreign investors for Hungarian locations. Very quickly, private capital was pouring into the country taking advantage of the recent opening up, potential opportunities on the domestic market and the government's invitation to participate in the privatization process¹¹.

In the first wave of privatization and sale, investors managed to take over or establish cooperation with Hungarian enterprises in the best conditions¹². It raises the suspicion that the success of Hungary in attracting FDI may not be sustainable as the country's supply of companies with good economic performance dries up. Once the best investment opportunities are gone and the country is struggling under the highest per capita

¹¹ Foreign capital accounted for 85% of revenues from privatization of state enterprises in 1991 and totaled USD 770 million (Conner, 1993, pp. 121-122).

¹² The analysis of type of 334 transactions suggests that acquisitions accounted for 36% of all projects and 35% of value of foreign capital committed in Hungary, joint ventures accounted for almost the same share both in number and value of projects (36% and 36% respectively), and "greenfield investments" (investments that establish new economic units) for 28% of projects and 29% of total value (UN, 1994, p. 101).

debt in the region which totaled USD 22.5 billion in 1992 (Conner, 1993, p. 58), the prospect for more FDI become gloomy. The decrease in FDI inflows in 1994 in comparison to 1993 may be a beginning of the downward trend.

Inflows of FDI to the Former Czechoslovakia.

The second place where foreign investors focused their attention and invested their money was the former Czechoslovakia. The country experienced a surge in FDI in 1992. However, it was followed by a drop of the same size a year later which brought inflows to the 1991 level. It is a host to 9,350 projects¹³ (UN, 1994, p. 100). After the split between the Czech and Slovak Republics, the former is considered (along with Poland) as the most competitive country in Central and Eastern Europe according to the World Link-Ernst & Young survey published in May 1994. In this report the Czech Republic receives high scores for political and economic stability but is condemned for the expensive price of blue collar workers, extensive bureaucracy and "red tape" (*Privatization Update*, 1994, p. 4).

In 1994 FDI inflows to the Czech Republic recovered from the drop a year before. The privatization process has been much more advanced there than in Poland, and many enterprises have already been sold, decreasing the number of attractive assets. There may not be any more opportunities for takeovers, however, foreign investors can now enter the market through portfolio investments on equity markets or "greenfield investments" by supplying new capital.

¹³ In more detailed analysis of 181 projects in the Czech Republic, acquisitions represented the highest receipts in terms of value (63% of total investment in projects) followed by JVs and "greenfield investments" while number of projects was distributed equally for each category (UN, 1994, p. 101).

Improvement in Poland's FDI Record

The detailed analysis of the FDI inflows to Poland will be conducted in the next sections. In order to complete the discussion on the FDI flows to ECEE-3 some data will be presented here.

Between 1990 and 1992 Poland occupied third place (behind Hungary and the former Czechoslovakia) in its ability to attract foreign investment despite its much larger population among ECEE-3, its location on major routes from Western Europe to the East, its natural resource and skilled labor force endowments, its accumulated experience with private sector and trade outside the CMEA scheme, and a large Polish expatriate community in the West. Before 1993, the inflows were negligible in terms of per capita inflows and as a percentage of GDP. In 1993 actual FDI increased significantly to USD 1,697 million allowing Poland to catch up with the former Czechoslovakia in cumulative FDI inflows statistics. However, FDI on a per capita basis and as a share of GDP are still very low at USD 44.12 and 2.0% respectively, placing the country far below Hungary. In terms of value, FDI to Poland in 1994 still exceeded capital inflows to the Czech Republic and was close to FDI transfers to Hungary, which experienced a substantial drop.

Figure II. 2.

Source: Prepared on the basis of data in Table II. 2 and Table A1 in Appendix A.

Magnitude of FDI Flows to Poland in the 1990s

Rise in the Registration of Projects with Foreign Capital Participation

The number of registered projects increased significantly in the period 1990-1993. Compared to a very small number of registrations by the end of the 1980s, foreign investors displayed a surge of interest in entering the Polish market. The data collected by GUS (Table A7 in Appendix A and Figure II. 3) indicates that 13,408 new projects were registered between the end of 1990 and the end of 1993. The largest number of projects registered was in 1992 (5,335), falling in 1993 to 4,922. It does not mean, however, that all of them started operations and fulfilled their investment promises. The number of active companies is much smaller, as will be discussed later. In addition, their size vary considerably. Due to the fact that a majority of project are small investments, the cumulative inflows of FDI are modest despite an impressive number of registrations.

Figure II. 3.

Source: Prepared on the basis of data in Table A7 in Appendix A.

Based on data registrations from various statistical reports it was possible to construct Table A7 in Appendix A presenting distribution of projects with foreign capital by sectors. Figure II. 4 suggests that although projects in industry dominated the scene in the first two years, the registrations in trade outnumbered any other sector and in 1993 reached a cumulative figure of 5,958. Next were industry with 4,638 projects, construction with 1,147, and transport with 534. Only in one sector, namely the communication sector, did the number of projects decline reflecting a decision of Northern Telecom to withdraw from Poland. Other sectors experienced a steady growth tendency with industry and trade in the lead.

Figure II. 4.

Source: Prepared on the basis of data in Table A7 in Appendix A.

The majority of foreign investment prior to 1990s was made in the form of foreign small scale enterprises (FSSEs) which were called "Polish firms"¹⁴. The scope of activities performed by them was determined in the law of 1982 which governed FSSEs that were established before the end of 1988. New permits based on this law have not been

¹⁴ They will be discussed in more detail in chapter IV.

issued since January 1989. The existing FSSEs could continue operations until their permit expires, or transform themselves into companies with foreign capital as prescribed in the law of December 23, 1988 which replaced both the law on conducting economic activity by small scale enterprises and the law of 1986. It was inevitable, therefore, that the number of FSSEs would decline, as FSSEs terminate operations or became either a joint stock company or a limited liability company. The number of registered FSSEs by the end of 1993 decreased to 647 from 862 in the end of 1990 (Table A5 in Appendix A) providing proof to that assumption.

Figure II. 5.

Source: Prepared on the basis of data in Table A5 in Appendix A.

The highest number of registrations of FSSE was in industry, with construction and trade far behind the leader. The tendency persisted throughout the period 1990-1992 with only a few undertakings in other sectors. Table A7 in Appendix A presents the sectoral distribution in more detail.

Analysis of Companies with Foreign Capital Operating in Poland

The preceding overview of registered projects gives only a very general picture of the phenomenon in question. Due to the fact that not all registered projects are carried out in reality, the data tend to overstate actual foreign involvement in Poland. Therefore, the analysis should focus on enterprises that have begun operations, on their experience and impact on the economy. Data collected by GUS from financial statements of active companies with foreign capital participation serves that purpose. In 1992 GUS published a report on the economic activity of enterprises with foreign participation¹⁵. The report mentioned 1,645 registered projects in 1990 and 4,796 in 1991. But in more detail, it examined operating JVs and FSSEs and was prepared on the basis of surveys filled out by these enterprises and sent back to GUS¹⁶. This publication was the first comprehensive study of FDI in Poland.

Next, Sadowska-Cieslak, in her studies published annually from 1990 and entitled *Inwestycje zagraniczne w Polsce* (Foreign investments in Poland) attempted to utilize data collected by GUS and to present the size, sectoral and regional distribution, and geographical origin of FDI along with its effects on employment, sales and exports. The latest report entitled *Inwestycje zagraniczne w Polsce* (Foreign investments in Poland) published in 1994 offers a detailed analysis of 5,740 companies with foreign capital participation active in 1992 (56.7% projects out of cumulative 10,131 registered by the end of that year) that submitted statistical reports to GUS.

The attempt of this section is to conduct an analysis of 7,935 companies with foreign capital (CFCs) which represent 52.7% of all 15,053 projects with foreign participation registered by the end of 1993 in Poland. It is based on the latest statistical report from GUS entitled *Podstawowe informacje o podmiotach z udziałem kapitału*

¹⁵ The report entitled *Podmioty gospodarcze z udziałem kapitału zagranicznego w latach 1990 i 1991* (Economic units with the share of foreign capital in 1990 and 1991), GUS, 1992 became a main source of information on FDI in the first three years of transition.

¹⁶ The analysis pertained to operating 1,078 JVs in 1990 while in 1991 to 2,207 JVs and 442 FSSEs.

zagranicznego w 1993 r. (BICFC) published in October 1994. The report is based on the statistical financial statements F-02 prepared as of December 1993 and sent to GUS. The information includes data on the economic activity of companies. The data pertain to active CFCs regardless of the size of employment, and cover joint stock companies (JSCs), limited liability companies (LLCs) and FSSEs. Therefore, the term "company with foreign capital" may entail any of the above three unless stated otherwise. In order to preserve commercial secrets data pertaining to three or less enterprises are not published.

Number of CFCs

According to data from BICFC (GUS, 1994, pp. 50-51) and presented in Table II. 3 and Figure II. 6, the highest number of CFCs began operations in 1993, when a total of 2,743 companies started economic activity. This number exceeded the 2,462 new CFCs in the year before. Poland had experienced growth in the number of CFCs since 1987, although in 1993 the growth rate was the lowest at 11.4% . In 1989 the growth rate in the number of CFCs was over five-fold, and both the year before and after, three-fold. This can be explained by the very low starting base number of CFCs operating in Poland in 1987. As the number of new CFCs grew in consecutive years, the ability to sustain the rate of growth diminished. In 1991 the number of CFCs crossed the four-digit barrier and reached 1,335. Although the rate of growth has slowed down, it is still positive and, providing that the improvement of conditions in Poland will attract new investors, a rising number of CFCs may be expected.

Table II. 3. Companies with the Share of Foreign Capital by the Year of Commencement of Operations (by Sectors)

	Total	1985	1986	1987	1988	1989	1990	1991	1992	1993
Total of which:	7,935 ^a	246	13	15	47	265	809	1,335	2,462	2,743
Industry	2,877	154	13	9	38	159	430	540	759	775
Construct.	512	23	-	2	1	11	49	82	154	190
Agriculture	83	-	-	-	-	5	10	16	20	32
Forestry	13	-	-	-	-	1	2	2	1	7
Transport	330	11	-	-	-	13	45	69	69	123
Communication	16	2	-	-	-	-	4	1	5	4
Trade	2,844	40	-	1	3	41	165	357	1,025	1,212
Other branches of material production	406	5	-	3	3	17	52	119	129	78
Community services	43	1	-	-	-	-	3	3	13	23
Housing and non-material community services	11	-	-	-	-	-	-	1	5	5
Science and R&D	8	-	-	-	-	1	-	2	1	4
Education	32	-	-	-	-	-	-	9	10	13
Culture and arts	39	1	-	-	-	3	5	5	18	7
Health care and social welfare	43	-	-	-	-	2	1	4	18	18
Physical education tourism and recreation	134	3	-	-	-	4	9	32	40	46
Other branches of non-material services	470	6	-	-	2	7	32	74	184	195
Finance and insurance	43	-	-	-	-	-	2	19	11	11

Source: *Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r.* (BICFC), GUS, 1994, pp. 50-51.

^a Data below may not add up to "Total" as some branches may not be listed

Figure II. 6.

Source: Prepared on the basis of data in Table II. 3.

Initial and Committed Capital of CFCs

In the 7,935 CFCs under consideration, the share of foreign initial capital amounted to PZl 35,473,571 million (approx. USD 1,773 million¹⁷) and represented 73.1% of total initial capital of CFCs (Table B2 in Appendix B and Figure II. 7). Foreign partners were the dominant contributors to the initial capital of both foreign small scale enterprises and joint stock companies. The dominance is also true in the case of limited liability companies, but to a lesser degree.

Detailed analysis of the committed foreign capital presented in Table B1 in Appendix B indicates that foreign investors promised upon registration to invest over USD 3,070 million in Poland. Almost USD 2 billion were directed to limited liabilities companies, where 33.6% is represented by non-cash commitments. In joint stock companies and FSSEs, on the other hand, committed cash contributions were around 95%. As we can see (Figure II. 8) foreign investment in CFCs as a whole came in the form of

¹⁷ For approximate calculations, the exchange rate of PZl 20,000/USD (as of the end of 1993) can be used.

cash commitments and not directly in the form of capitalized transfer of technology through equipment, management skills and product and/or process technologies. Even the largest companies considered in the JSCs category do not show a high propensity to provide in-kind contributions.

Figure II. 7.

Source: Prepared on the basis of Table B2 in Appendix B

Figure II. 8.

Source: Prepared on the basis of Table B1 in Appendix B.

Polish authorities advocated the granting of financial incentives to attract large investors capable of channeling large capital inflows. Unfortunately, the highest number of CFCs was established with an initial capital of less than PZl 150 million (approx. USD 7,500). They composed 3,109 (39.2% of all) CFCs. Figures II. 9 and II. 10 prepared on the basis of data in Table B4 in Appendix B illustrate the structure of CFCs by value of initial capital. Foreign capital in these companies amounted to PZl 121,666 million and constituted only 0.3% of total foreign initial capital. Next, 1,511 companies were created with an initial capital between PZl 1.5 billion and 1,360 with PZl 0.5-1 billion. In summary, 7,187 CFCs (90.6%) were established with an initial capital less than PZl 5 billion (approx. USD 200,000). These companies invested only PZl 3,442,293 million (9.6% of foreign initial capital invested in CFCs). There were only 315 CFCs (4%) with an initial capital of over PZl 20 billion. However, they invested 81.6% of

foreign initial capital which amounted to PZl 28,931,367 million (approx. USD 1,446 million).

As we can see, the impact of even few large investments in terms of capital inflows can potentially be very significant. Conversely, even a large number of small investments is not able to supply an amount of capital with a comparable impact. The effect of a huge number of small investments on capital formation and, subsequently, employment and output, is significantly different. Unfortunately, the evidence suggests that investments in Poland have been very small. Therefore, a substantial amount of foreign funds have not entered Poland through the operations of CFCs as it was expected. Based on the data in Table B4 in Appendix B, average foreign investment in Poland amounted to PZl 4.47 billion while average foreign investment in the category up to PZl 150 million amounted only to PZl 39.1 million.

Figure II. 9.

Source: Prepared on the basis of data in Table B4 in appendix B

Figure II. 10.

Source: Prepared on the basis of Table B4 in Appendix B.

Foreign Equity Share in CFCs

Among all companies with foreign capital, 3,216 (40.5% illustrated in Figure II. 11) were wholly foreign-owned.¹⁸ By doing so they freed themselves from potential conflicts with partners, from the legacies of the socialist style management and from the dissipation of a decision-making power. A majority foreign share was invested in 5,479 (69%) of all CFCs. Table B5 in Appendix B provides data on CFCs by the size of foreign equity share. It is obvious that foreign investors preferred to enter Poland via enterprises controlled in this way.

¹⁸ The category of CFCs with 99.5% to 100% foreign equity share will be referred to as wholly-owned.

Figure II. 11.

Source: Prepared on the basis of data in Table B5 in Appendix B.

In companies with a majority foreign equity share, foreign investors invested 86.5% of all foreign initial capital. Also, these CFCs captured 70.6% of income from total sales and 82.4% of income from export sales. The companies with a majority foreign equity share emerged as a very strong group among CFCs capable of outperforming in basic comparisons the CFCs where domestic partners had a majority share. As Figure II. 12 illustrates, wholly-owned CFCs (40.5 % of all companies) invested 41.7% of initial foreign capital and reported 32.9% of income from sales and 25.6% of income from export sales. CFCs with a foreign equity share between 70.5% and 99.4% captured the highest percentage of income from export sales equal to 40.6%.

Figure II. 12.

Source: Prepared on the basis of data in Table B5 in Appendix B

Sectoral Distribution of CFCs

By number of CFCs two sectors, industry and trade, emerge as the most successful in attracting foreign investment. The sectoral distribution of the number of CFCs (see Table II. 3 and Figure II. 14) clearly shows that these two sectors attracted 2,877 and 2,844 companies respectively or 72.1% of all CFCs. CFCs in industry have been growing at a slower rate and with the strong expansion in trade, the former may soon lose its leading position. Enterprises in construction constituted 6.5% of CFCs and in

transport 4.2% (in absolute numbers 512 and 300 companies respectively). Next, on the list were physical education, tourism and recreation with 134 companies, and agriculture with 83. Community services sector, health care and social welfare sector and finance and insurance sector enjoyed 43 companies each. A rapid growth in the trade sector reflects the growing import-export activity of small, family-run companies. They are interested in supplying the domestic market with consumer goods and contributed greatly to a surge in imports from the West, especially from Germany.

The discussion on sectoral distribution of CFCs should include an analysis of the value of FDI invested in various sectors of the economy. Regarding CFCs operating in Poland, only data on committed foreign capital were available. The following Table II. 4 indicates that on average committed foreign capital in all CFCs amounted to USD 387 thousand. Only foreign capital committed in the communication and industry sectors exceeded this average. From the perspective of the Polish authorities, FDI inflows in the industrial sector were to play a crucial role in transition. They were expected to revitalize state-owned enterprises and enhance the productive capacity of the economy. Table B3 in Appendix B and Figure II. 13 show that the value of committed capital in industry was almost three times higher than in trade (although the number of projects was about the same). However, the low average value suggests that foreign investors (on average) did not channel large amounts of capital into the industrial sector (or any other sector). Only few large SOEs received substantial investments while the rest recorded modest inflows.

Table II. 4. Average Value of Committed Foreign Capital in Selected Sectors of the Polish Economy.

Sector	Average value in USD thousand
Total of which:	387.0
Industry	649.4
Construction	257.7
Agriculture	63.0
Transport	186.1
Communication	947.4
Trade	237.5
Physical education, tourism and recreation	234.9
Finance and insurance	192.7

Source: Prepared on the basis of data in Table II. 3 and Table B3 in Appendix B.

Figure II. 13.

Source: Prepared on the basis of data in Table B3 in Appendix B.

Figure II. 14.

Source: Prepared on the basis of data in Table II. 3.

Table II. 5. Value of Committed and Initial Foreign Capital by Branches of Industry (as of 31.12.1993)

Branches of Industry	Committed capital ^a		Initial capital in PZI million ^{a,b}	
	in PZI million	in USD thousand	Total	Foreign
Total Industry	15,083,905	1,868,381	36,802,074	26,745,726
of which:				
Coal	4,236	5,593	83,013	82,022
Fuel	24,066	2,333	40,026	34,809
Iron and steel	22,229	4,593	1,235,892	714,977
Non-ferrous metallurgy	8,255	1,423	33,276	19,772
Metal products	520,349	76,634	2,514,812	2,136,131
Engineering	1,067,912	100,141	815,455	502,063
Precision instruments and apparatus	221,896	26,959	574,351	386,766
Transport equipment	475,743	35,176	6,521,134	5,679,660
Electrical engineering and electronics	1,869,561	156,346	3,363,414	2,045,810
Chemical	1,802,419	181,648	3,718,645	2,940,868
Building materials	1,070,743	125,077	2,117,138	1,052,833
Glass products	373,256	20,328	497,703	370,392
Pottery, china and earthenware	17,806	2,275	176,199	17,698
Wood	445,647	222,594	1,296,018	1,019,234
Paper	1,250,462	108,947	1,394,445	1,287,636
Textile	164,266	25,322	506,378	373,986
Wearing apparel	292,805	110,245	895,212	644,309
Leather	67,777	8,278	3,909,402	1,860,023
Food	5,111,636	628,494	6,483,677	5,082,481
Fodder and utilizing	59,353	4,961	182,218	137,007
Printing	162,063	14,828	307,003	251,198

Source: ^a Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r. (BICFC), GUS, 1994, pp. 12-13.

^b Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r., (BICFC), GUS, 1994, p. 21.

* "Committed capital" consists of cash and in-kind contributions declared at the time of registration.

** "Initial capital" consists of investment (cash and in-kind) made to begin operation of the company

The analysis of the branch structure of CFCs in industry (Table II. 5) supplies another piece of information in discovering the characteristics of FDI flows to Poland. Two branches dominate the scene in terms of the value of foreign initial capital invested in CFCs. The first place is occupied by transport equipment due to the largest investment made by Fiat, second by food (with investments from Coca-Cola and PepsiCo and third by chemicals (with Procter & Gamble, Unilever and Henkel leading the list in

personal hygiene products and detergents). These three are followed by metal products, electrical engineering and electronics. A considerable amount of FDI (USD 1,868 million) has been declared in the industrial sector but yet not invested. Among branches with high promises of future investments are food, wood, chemicals, electrical engineering and electronics and wearing apparel.

Effects of CFCs on Employment.

The level of employment in Poland in 1993 was at 8,790,000, of which the public sector employed 5,945,000 and the private sector 2,845,000 (Table B7 in Appendix B) Employment in 7,935 CFCs amounted to 310,180. Total employment in CFCs thus comprised 3.5% of total employment and 10.9% of total employment in the private sector. Details of the employment structure in CFCs by sectors are given in Figure II. 15 and Table B6 in Appendix B. Industry employed 223,810 people (72.2%), trade was second with 34,074 employees (11%) and construction third with 15,564 (5%). The employment in CFCs in industry constituted 6.7% of total employment in industry in Poland and 19.4% of employment in the private sector industry. The percentages for corresponding categories in other sectors were the following: in construction 2.3% and 3.4%; in transport 1.2% and 11.6%; in trade 4.4% and 5.4% respectively. Industry and transport recorded the largest share of CFCs employment in total private sector employment in the sector.

In terms of the size of established enterprises, small companies, with below 5 employees, constituted 46% (3,651 firms) of all surveyed firms (see Figure II. 16). In the second place (ranked by number of companies) comprising 25.9% (2,056) were CFCs employing between 10 and 50 people and in the third place companies with between 5 and 10 employees representing 14.8% (1,174) of CFCs. Only 31 (0.4%) firms employed more than 1,000 people and these were concentrated in industry (28 enterprises). In sum, 7,351 CFCs (92.6%) were small companies employing less than 100 employees.

Figure II. 15.

Figure II. 16.

Source: Both Figures prepared on the basis of data in Table B6 in Appendix B.

Regional Structure of CFCs.

There are a few provinces and urban centers that have been very successful in attracting FDI (Tables B8 and B9 in Appendix B). The highest share (in descending order) of foreign initial capital was directed into the following provinces: Warszawskie, Bielskie, Katowickie, Wroclawskie, Poznanskie, Rzeszowskie, Lodzkie and Elblaskie. In terms of number of companies, the descending order was: Warszawskie, Katowickie, Gdanskie, Poznanskie, Szczecinskie, Wroclawskie, Lodzkie and Krakowskie. Warszawskie, Bielskie, Katowickie, Poznanskie, Gdanskie, Lodzkie and Bydgoskie dominated the group of provinces in terms of the size of labor force employed in CFCs.

Table II. 6 provides a ranking of selected provinces (provinces in which the presence of FDI has been larger than in the remaining parts of the country), according to their success in attracting FDI as measured by four categories: size of committed foreign capital, size of initial foreign capital, number of companies that have located there and total employment provided by CFCs. Each province has been assigned a rank in respective categories and the smallest total score indicates the highest level of success in placing high in the ranking. The highest twelve provinces, with a total score up to 50 points, are included in Table II. 6. These are the most successful but they still differ among themselves across the four categories. All categories are treated with the same degree of significance although one could argue that placing high in the initial foreign capital category is more important than in committed foreign capital. This type of debate is omitted here because the purpose is only to present quantitative and not qualitative differences between voivodships. The success among these 12 voivodships is considered high if the score is below 20 points, medium if is between 20 and 40 and low if is over 40 points. Warszawskie emerged as the most successful, ranking first in all four categories. Katowickie scored third three times and second once. Bielskie ranked second twice and fourth once, while Poznanskie twice fourth and once fifth. Also, Gdanskie performed well: once second, once third and once fifth.

The data suggest a strong regional dimension of FDI flows to Poland.

Central voivodship with its capital city Warsaw was the most attractive for foreign investors. 23% of total committed foreign capital and 29% of total foreign initial capital was invested in the Warszawskie province. This province by far outnumbered others in terms of a number of CFCs and the employment provided by them. The former amounted to 2,522 (31.7%) of CFCs and the latter to 72,963 employees (23.5%). A victorious cluster of voivodships could also be found in the south-western part of Poland with cities of Katowice, Bielsko-Biala and Krakow. Central-western voivodships of Poznan, Wroclaw and Opole also represented a booming region. The coastal voivodships with major cities of Gdansk and Szczecin (two biggest harbors in Poland) and Elblag (with well-developed engineering) constituted another successful region. Central-western voivodships of Lodz and Bydgoszcz received international attention and capital inflows.

In summary, twelve territorial units attracted 84% of CFCs' initial foreign capital, 76.7% (6,088 firms) of total CFCs, and 70% (217,139 jobs) of all CFCs' employment. The inevitable polarization between these winning provinces and the rest of the country in terms of FDI inflows took place. The group of losers, mainly the rural provinces, was also differentiated. In the western border voivodships such as Gorzowskie, Zielonogorskie and Walbrzyskie and in the eastern part of Poland (Rzeszowskie, Przemyskie and Radomskie) small FDI inflows were recorded while the rest was almost neglected by investors.

Table II. 6. Ranking of Selected Provinces in Poland

Province	Committed foreign capital	Initial foreign capital	Number of companies	Total employment	Total score	Relative success in attracting FDI
Warszawskie	1	1	1	1	4	High
Bielskie	4	2	11	2	19	High
Bydgoskie	12	9	11	8	40	Medium
Elblaskie	5	8	27	10	50	Low
Gdanskie	2	13	3	5	23	Medium
Katowickie	3	3	2	3	11	High
Krakowskie	7	11	8	12	38	Medium
Lodzkie	11	7	7	7	32	Medium
Opolskie	6	10	9	11	36	Medium
Poznanskie	10	5	4	4	23	Medium
Szczecinskie	13	12	5	6	36	Medium
Wroclawskie	16	4	6	9	35	Medium

Country of Origin of CFCs.

Data on foreign investors' country of origin was not published until the BICFC report (GUS, October 1994). As a matter of fact this type of information wasn't even collected and, therefore, is impossible to obtain (Sadowska-Cieslak, 1994, p. 41). It may be due to sensitivity of the public to foreign involvement in the economy. Statistics on the origin of the largest investments in Poland collected by PAIZ in the 1990s was the only source of data. The list of 225 largest projects in Poland will be analyzed later in this chapter.

On the basis of data on CFCs supplied by GUS, PZI 35,473,571 million was invested in Poland as initial foreign investment. In terms of the share of capital in total initial foreign investment (Table B12 in Appendix B) Germany emerged as a leader with 22.9% of capital (see Figure II. 17). The second largest share of capital was invested by Italy 19.3%, which was followed by the United States at 16.4%. Each of the rest of the countries invested less than 10% of total initial foreign capital. The group was led by Netherlands (8.3%), France (5.2%) and Austria (5%). Investors from Sweden, Great Britain, Norway and Switzerland each invested over 2%. Canada placed 13th on the list with 1%.

Figure II. 17.

Source: Prepared on the basis of data in Table B10 in Appendix B.

However, in terms of the number of firms with capital from a particular country, Germany was even more dominant with 2,943 CFC's which constituted 37.1% of the total (see Figures II. 18 and II. 19). It was followed by the United States with 532 firms (6.7%), Austria with 475 (6%), France with 425 (5.4%) and Sweden with 404 (5.1%). Italy and Netherlands were involved in 387 and 388 firms respectively (4.9% each) while Great Britain in 319 (4%). Canada placed 13th with 104 enterprises that constituted 1.3% of all CFCs.

It is not surprising that the German and Austrian investors decided to invest in Poland. The proximity of markets and historical trade relations allowed for a faster penetration of the Polish market. Their first response was to satisfy a huge demand for various consumer goods. The surge in imports from Germany suggests that investors were interested in establishing distribution networks for goods produced in the West before

moving to Poland to manufacture for local needs or export. An average German investment in CFCs amounted only to PZl 2,762 million (approx. USD 138,000). An average American investment amounted to PZl 10,961 million (approx. USD 548,000). Even Austrian investments on average were higher than German and amounted to PZl 3,744 million (approx. USD 187,000). As we can see, although German investors dominated the scene, each of them did not risk large outlays of capital by investing in Poland. They did not invest in industrial production but limited operations to trade. The family ties between the citizens on both sides of the border permitted development of a large number of "import-export CFCs". Germany's leading position in the amount of initial foreign capital is due to a huge number of small firms. If their strategy were to explore the investment environment in Poland for potential larger projects in the future, one can expect that once the conditions improve, the amount of capital will increase.

Figure II. 18.

Source: Prepared on the basis of data in Table B10 in Appendix B.

Figure II. 19.

Source: Prepared on the basis of data in Table b10 in Appendix B.

Major Foreign Investments in Poland

Investments by Multinational Enterprises

Another way of analyzing participation of foreign capital in Poland is by examining the largest investments announced by the end of June 1994 and recorded by the Polish Agency for Foreign Investment. The data was compiled into a list of 225 major investors of which 219 invested at least USD 1 million. The FDI inflows recorded by PAIZ exceed the data provided by the balance of payments statistics and the report published by GUS and analyzed in the previous part of the chapter. Due to the fact that the information is based on companies' announcements it may be overstated. "Investments"

mean that the actual transfers took place while "Commitments" represent additional amount of capital that investor promised to invest in the future.

The well-known multinational enterprises can be found on the list¹⁹. (see Appendix C) They responded to the opportunities of recent opening up. However, not until the year 1992 were the biggest deals signed. Some MNEs participated in a direct sale of the best Polish companies and purchased the assets by negotiations with the authorities from the Ministry of Privatization. Most companies on the list entered the Polish market by this acquisition route or by forming joint ventures with the existing companies. Out of 225 major investments 39 projects (17.3%) do not have a domestic partner. Among ten largest foreign investors presented in Table II. 7 only Curtis International was identified as not having a domestic partner. The equity share of the MNEs is difficult to present because many of them are involved in few companies in which the equity split varies²⁰. For example, the share of Fiat in joint venture with the Polish small car manufacturer FSM amounted to 90%, of International Paper Company in ZCP Kwidzyn 80%, and of Unilever in Pollena Bydgoszcz also 80%.

The large investments presented in Table C5 in Appendix C (of which only ten appear in Table II. 7) are the most important to the Polish economy in terms of value. Once the MNEs pick a perfect location for their operations, they are capable of transferring the latest technology and/or substantial amounts of capital to the host country. Since most MNEs take advantage of economies of scale, their impact on employment and output is significant. It was expected that the MNEs would participate in the restructuring and modernization of Polish state-owned enterprises and would strengthen the private sector in Poland.

¹⁹ Due to the fact that many foreign investors on the list are considered multinational enterprises as defined in the FDI theory, for the purpose of this thesis all investments of at least USD 1 million will be considered as made by MNE.

²⁰ For example Asca Brown - every invested in 10 companies by the end of 1993. ABB's share varies from 30% in ABB-ZWUS Signal, to majority share in a few companies and to 100% in ABB-Flakt Industry and ABB Poland (Sadowska-Cieslak, Biskup and Burzynski, 1994, pp. 86-87).

Table II. 7. Ten Largest Foreign Investors in Poland

Investor	Investments in USD million	Commitments in USD million	Country of origin	Branch of the economy
FIAT	260	1581	Italy	manufacturing of passenger cars
Coca-Cola	235	50	USA	soft drinks
EBRD	213	0	International	banking, capital participation in enterprises
International Paper Company	193	125	USA	paper products
Polish American Enterprise Fund	180	63	USA	capital participation in private sector
Thomson Consumer Electronics	147	37	France	TV tubes and sets
International Finance Corporation	123.4	0	International	investments in private sector projects
ABB	100	20	International (Sweden-Switzerland)	power supply systems, turbines, electric engines
Curtis International	100	0	USA	electronics, construction
Unilever	97.7	0	International (Netherlands-Great Britain)	washing powder, food processing

Source: Data on the basis of the list of major foreign investors in Poland prepared by PAIZ.

Foreign MNEs explored the Polish market; many representatives visited Poland but they exercised caution in locating there. After two years of observing Poland's success with economic and political transition, the largest amounts of private capital finally entered the country in 1992 and 1993. By the end of June 1994, actual investments amounted to USD 3,741.4 million and further commitments to USD 4,760 (see Table C1 in Appendix C). If all promises are carried out foreign investors would invest a total USD 8.5 billion through LCFCs. It represents 70% of all foreign capital invested in Poland in the last 5 years, which based on that information is estimated at USD 5,344.86 million. At the end of 1992, the value of FDI was USD 1,409 million. In 1993, Poland attracted USD 1,632 million and until June 1994 another USD 700.4 million.

Country of Origin of LCFCs

The American MNEs have been the leading group of large investors in Poland. This is not surprising, since the United States has been the largest investor in the world, with outflows of FDI far exceeding those from other countries. Table C1 in Appendix C and Figure II. 20 provide details on major foreign investors in Poland. In terms of the share of foreign capital invested, the US MNEs account for 1/3 of the total. Their investments of USD 1.27 billion are followed by the international (multi-party) investments of USD 605.6 million, Italy with USD 365.8 million and Germany with 313.8 million. Also, the US leads with its 48 investments in terms of number of such firms active in Poland, but is closely followed by Germany with 41 investments (see Table C4 in Appendix C and Figures II. 21 and II. 22). The German firms, however, did not bring in a comparable amount of capital. Although there were only seven more American firms than German, the former invested over USD 900 million more than the latter.

The ranking of countries changes once again when the category of FDI commitments is considered. The highest commitment of USD 1,581 million was undertaken in 1992 by Fiat of Italy. The firm assumed the debts of the Polish car manufacturer equal to over USD 1 billion. Italy leads the "Commitments" category with USD 1,731 million, the US is second with USD 1,545.8 million and Germany third with USD 290.39 million. Despite Fiat's huge commitment, the American investors are leading the list of total investments and commitments with over USD 2.8 billion. Italy is second, international capital third, Germany fourth and France fifth.

Figure II. 20.

Figure II. 21.

Source: Both Figures prepared on the basis of data in Table C1 in Appendix C.

Figure II. 22.

Source: Prepared on the basis of data in Table C1 in Appendix C.

Sectoral Distribution of Major Investments

A detailed sectoral information about the MNEs' investments in Poland was provided with a list of 217 major investors prepared by the end of March 1994 (Table C3 in Appendix C). The largest amount of capital was invested by MNEs in electro-mechanical industry, finance and the food processing industry. FDI commitments were highest in the electro-mechanical industry (which includes automotive), food processing, finance, telecommunications, wood and paper, and construction. Over 72% of the foreign capital was invested and committed in the industrial sector. Out of 217 investments 131 (60.4%) were undertaken in various industries with the food processing branch leading with 42 firms and followed by the electro-mechanical industry with 30 firms. In other sectors, the number of investments was the highest in trade and then in finance and construction.

Comparison of Findings

The attempt of this section is to present the main findings based on the evidence presented earlier in the chapter. Tables II. 8 and II. 9 below supply summaries of data. The two main sources of information, namely GUS and PAIZ, provided statistics on the operations of CFCs and the largest investments in Poland respectively. The former reported all active companies with foreign capital regardless of the size of investment while the latter focused only on the largest 225 capital transfers from abroad.

The first observation is that the amount of FDI that entered Poland does not correspond with what was expected and desired to assist the capital-deficient country and to ease the hardship of transition. The approximately USD 3 billion actually invested by the end of 1993 represents only a very small fraction of Poland's capital needs. Therefore, FDI did not play an active role in injecting an emerging market economy with foreign money. The number of companies with foreign capital is impressive, especially if one considers that prior to 1990 the exposure to FDI was very low. However, not all registered projects have started operations and not all commitments have been carried out in reality. Despite its firm efforts in the transition process, Poland's FDI showing looks poor when compared with that of Hungary or even the former Czechoslovakia.

Second, there exist differences in ranking of countries based on the size and/or the number of investments according to GUS and PAIZ. The data clearly indicates that the FDI game has been played by firms from Germany, the United States and investors representing international (multi-party) capital. The huge number of German investors allowed them to dominate the ranking. Germany is a strong leader in number of investments in Poland. One could expect this phenomenon as the proximity of markets allows for German penetration. But there are only a few large German investments in the manufacturing sector. Among them are: Continental Can Europe, Siemens and Henkel

with investments USD 47 million, 38.5 million and 36.5 million respectively. The average investment outlay is very small. The majority of ventures are targeted at establishing distribution networks in Poland and exploiting the advantages of small-size, family-run businesses in labor-intensive manufacturing (clothing, crafts). As a result, the expected impact on the economy in terms of employment and output was small and limited to the Western parts of Poland where the majority of their operations was concentrated.

Individual German investors were not willing to risk large amounts of capital in Poland. In an environment of a deeply-rooted, post-wars hostility towards Germans in Poland, it is much easier for a small company to terminate operations and withdraw if necessary.

Although many fewer in number, the American investors channeled a substantial amount of capital to Poland. According to GUS they invested 19.3 % of all foreign capital in CFCs, while on the list prepared by PAIZ, they placed first with USD 1,270.1 million in investments and USD 1,545.8 million in further commitments. The average investments were much higher and created large number of jobs in certain locations. The US firms' strategy was to establish a strong presence in Central and Eastern Europe. It might have taken them longer to make a move, since the distance and a potential risk of costly pulling out if the operations are not successful dictated greater caution. Once MNEs decided to locate there, their investments were large to take advantage of economies of scale. The size of investments suggests that they were long-term oriented and interested in taking advantage of a large and growing local market. They proved to be the vehicles of huge capital transfers and potential in-kind (technology, management skills) contributions.

The MNE participation in the transition was of critical importance to Poland, unfortunately, only a few firms had both the confidence and a strategy to invest in Poland. The leading role of the US, Italy, international investors, Germany, Netherlands and France is indisputable. Foreign investors from Asia remained uninterested in the region, and in Poland in particular.

Despite the differences in ranking provided by the data certain countries emerge as the most active on the Polish market. Investors from the following countries appear most often in both reports: Germany, USA, Italy, Netherlands, France, Austria, Great Britain, Sweden, Switzerland, and the international (multi-party) investors. They channeled the most of foreign capital through the largest number of investments.

In terms of the sectoral structure of CFCs the industry and trade are leading. The industrial sector was dominated by investments the following branches: food processing (soft drinks, fast food restaurants, breweries and tobacco processing), transport equipment, consumer electronics, metal products, chemicals, wood and paper, and personal hygiene products. Foreign investors were involved in 28 companies employing over 1,000 employees. The industrial sector's employment amounted to over 223,000 jobs. A "greenfield investment" would mean employment creation, while a simple take-over by a foreign investor in many cases results in the same employment level or even its reduction as the new owner tries to rationalize the production process. Companies with foreign capital were not able to absorb the labor force seeking employment and Poland still remains the country with the highest unemployment rate among the ECEE-3.

In the services sector, a few branches such as trade, finance and insurance, telecommunications and construction attracted the most capital. Although the number of CFCs in industry and trade was comparable (2,877 and 2,844 respectively), investment commitments in the former amounted to over USD 3 billion while in the latter only to USD 675.5 million. The industrial undertakings require much larger investment outlays while projects in trade can be undertaken with a small amount of capital. As a result, even a large number of firms in services does not provide the same employment opportunities for the unemployed in Poland²¹. The market-seeking firms had a perfect opportunity to serve the Polish market, stricken for over a decade by shortages of many consumer products. The

²¹ It needs to be noted that services are often more labor intensive but a single project in a large enterprise in the industrial sector can offer huge number of jobs.

establishment of manufacturing facilities to satisfy the demand would require not only larger investments but also a longer time. The growth of CFCs in trade suggests that the faster route for MNEs was to develop sales outlets and secure its market share immediately.

Table II. 8. Comparison of Data on Investments by Country of Origin Based on GUS and PAIZ

Data on the basis of 7,938 enterprises surveyed by GUS (Central Statistical Office)			Data on the basis of the list of major foreign investors prepared by the Polish Agency for Foreign Investment (PAIZ)		
Country	Total country's initial capital in PZl million	Country's share in total CFCs initial capital	Country	Total country's investment in USD million	Country's share in total investment recorded by PAIZ
Germany	8,130,606	22.9	USA	1,270.1	39.9
Italy	6,856,912	19.3	International	605.6	16.2
USA	5,831,318	16.4	Italy	365.8	9.8
Netherlands	2,946,039	8.3	Germany	313.8	8.4
France	1,848,243	5.2	France	263.1	7.0
Austria	1,778,421	5.0	Netherlands	201.4	5.4
Sweden	1,186,096	3.3	Austria	158	4.2
Great Britain	887,201	2.5	Switzerland	106	2.8
Norway	771,537	2.2	Great Britain	97.7	2.6
Switzerland	732,845	2.1	Sweden	70.5	1.9
Total above	30,969,218	87.2	Total above	3,452.0	98.2

Table II. 9. Comparison of Data on Number of Investments by Country of Origin Based on GUS and PAIZ

Data on the basis of 7,938 enterprises surveyed by GUS (Central Statistical Office)			Data on the basis of the list of major foreign investors in Poland prepared by the Polish Agency for Foreign Investment (PAIZ)		
Country	Number of companies	Country's share in total number of CFCs in %	Country	Number of companies	Country's share in total 219 companies in %
Germany	2,943	37.1	USA	47	21.5
USA	532	6.7	Germany	41	18.7
Austria	475	6.0	France	19	8.7
France	425	5.4	Austria	17	7.8
Sweden	404	5.1	Canada	13	5.9
Netherlands	388	4.9	Great Britain	12	5.5
Italy	387	4.9	Denmark	10	4.6
Great Britain	319	4.0	International	9	4.1
Switzerland	217	2.7	Netherlands	9	4.1
Denmark	181	2.3	Sweden	7	3.2
Total above	6,271	79.1	Total above	184	84.1

Poland experienced enormous difficulties and fell into deep recession in the first years of transition. However, already in 1992 its GDP grew by 2.6% and has remained in an upward trend since. The industrial output also started to grow and the role

of the private sector in the economy expanded. The positive evolution of the economic, political and social system has begun and Poland recorded increased FDI inflows in 1993. Although they declined slightly in 1994, FDI showing was still better than at the turn of the 1990s.

With a passage of time and with substantial improvements in the Polish infrastructure, foreign firms will gain greater confidence that the country offers the necessary conditions for a profitable business operation. The successful experience of "first-mover MNEs" will encourage other foreign firms in the same or in related industries. This will lure foreign companies that service operations of manufacturing MNEs. The successful negotiations with the Paris and London Clubs of creditors and assistance from the IMF will significantly improve Poland's creditworthiness. The inflows of FDI are expected to increase as the transformation progresses, increasing Poland's attractiveness, and as the country further integrates into the world economy. However, more complete analysis of external and internal investment environment is needed to anticipate the trends in FDI inflows.

Chapter III. The External Environment and Recent Trends in Global Foreign Direct Investment Flows

FDI Flows in Major Industrialized Countries

Changes in FDI Inflows and Outflows

After a sharp decline in FDI flows in the early 1990s, at least some industrialized countries experienced a modest increase in FDI inflows to their economies in 1993. It is still unsure whether a recovery in private capital flows will be sustained. Only the inflows to few OECD countries were on a rise. At the same time, FDI outflows from the industrialized countries were still diminishing, although at a slower rate than in the two preceding years. Tables D1 and D2 in Appendix D and Figure III. 1 present this trend.

Figure III. 1.

Source: Prepared on the basis of data in Tables D1 and D2 in Appendix D.

Since OECD countries are the leading investors abroad, a continuous decline in outflows limits the size of available private capital. Recovering inflows to OECD countries (despite an overall decrease in outflows) indicate rising attractiveness of American and West European locations for investment relative to other regions of the world. The following graphs illustrate changes in FDI inflows to and outflows from in OECD countries between 1989 and 1993. The prospect for emerging Central European economies in attracting FDI remains dim unless the trend changes and FDI outflows increase.

Figure III. 2.

Source: Prepared on the basis of data in Table D1 in Appendix D.

Figure III. 3.

Source: Prepared on the basis of data in Table D2 in Appendix D.

In the 1990s, the United States, the United Kingdom, Japan, France and Germany were the leading countries investing abroad. Following the FDI expansion in the 1980s, the growth of outflows began to slow down and experienced a decline in 1991. All investment players had been seriously hit by the recession which drastically reduced outflows of FDI abroad despite the fact that the number of companies expanding operations on a world-wide basis has grown (*Financial Market Trends*, June 1992, pp. 14-15). As the amount of capital designated for foreign investment decreased, post-socialist countries find themselves competing for whatever is available with different degrees of success. Not only do they have to offer foreign investors better prospects for profits than other locations in the world, but also it is more difficult to induce firms to expand into the region especially in times of recession and with the uncertainties associated with global restructuring. Also, the motivation for investing abroad differs among countries and firms, and it is worthwhile to look more closely at the key investment leaders' actions in order to identify further trends that help to explain this overall slowdown. This world-wide downturn has direct

implications for FDI flows to Central and Eastern Europe. A brief overview of the FDI flows for major OECD countries that may have a great importance to Poland will be presented next.

The United States and FDI

Although the outflows from the United States reached a low level in 1990, they started to increase in the following year. Recently, the American firms have been very active in investing abroad and the US became the leading investor. The slower rate of decline in OECD FDI outflows in 1993 is, without doubt, due to increased outflows from the US. It seems that the US was able to recover earlier than other countries from the world-wide recession. Canada and Mexico have become major sites for American investment. The opportunities associated with the North American Free Trade Agreement increased the attractiveness of Mexico as a low cost production site to serve the larger North American market. The potential for expanding this regional trade arrangement to countries of the Southern Hemisphere turned US investors' attention to Latin America. (*Financial Market Trends*, October 1993, p. 32).

The formation of the European Union (EU) increased American investment in Western Europe seeking to secure its market share there. Right now Poland is competing not only for capital but also for the attention and interest of those managers who make strategic decisions concerning world-wide investments. Both the NAFTA and the EU influenced American investors and it may be difficult to regain the lost interest of those who turned their attention away from Eastern Europe to other countries.²²

The decreased size of FDI flows world-wide affected inflows to the US as well. The United States began to compete for FDI with other host countries after it experienced

²² IDS Report. "Without Help We Will Lose the Battle Against Recession", (Text), Warsaw, *Zycie Warszawy* in Polish (7 April 1992, p. 2). Translation by the Foreign Broadcast Information Service. Daily Report: East Europe, 15 April 1992. (PrEx7.10: FBIS-EEU-92-073; p. 21)

economic downturn in 1989. It remains the largest host country, especially for investments in manufacturing, chemicals and high technology industries (*Financial Market Trends*, June 1992, p. 24). In 1992, the US experienced very low inflows totaling about USD 4 billion but regained its position in 1993 (see Figure III. 4). Its FDI record has a long history and together with the US stable investment regime entices new investors away from other locations.

Figure III. 4.

Source: Prepared on the basis of data in Tables D1 and D2 in Appendix D

Japanese Investment Abroad

By the end of 1980s Japan secured its position as one of the largest investors in the world. However, Japanese investment declined dramatically starting in 1991. Among the reasons for this decline, Japanese investors mentioned “the end of an attempt to built overseas systems, slowdown of the world economic growth, recession in

the US and reduction in finance available for investment abroad" (*Financial Market Trends*, June 1992, p. 21). Figure III. 5 illustrates a magnitude of a decline.

Figure III. 5.

Source: Prepared on the basis of data in Tables D1 and D2 in Appendix D.

Much of the existing Japanese investment turned to Asia to establish a regional network of foreign affiliates and to Europe to secure a share of the unified market. The trade barriers erected in the 1980s against Japanese products have been gradually reduced. If a main reason for Japanese investments were a need to internalize these barriers then once the access to the EU market improves there may be a decreasing penetration by Japanese firms.

Foreign direct investment in dynamic industries such as banking, software development and telecommunications is booming in Asia. Although low cost, labor-intensive manufacturing, mainly for export, moves from one country to another forcing the more developed Asian economies to undergo structural changes and upgrading, these industries still remain within the region. The People's Republic of China has been the largest recipient of FDI in Asia due to the size of its domestic market, low labor costs, rapid growth in the 1980s and overall progress in the reform process in the 1990s.

The prospects of business opportunities in Asia may be better than in Central and Eastern Europe. As long as the political and economic instability exists in the latter region, a possibility of undisturbed production and profits in rapidly industrializing Asian countries will prompt investors to explore and expand their operations in Asia. A reduction in transportation costs and improvements in telecommunications allow firms to serve distant markets with a high degree of reliability and help to overcome a long-time inescapable obstacle of distance. Recent reductions in trade barriers following the outcome of the Uruguay Round Multilateral Trade Negotiations will even better facilitate exports from Asia to other parts of the world. An increase in trade (especially in consumer goods) with now "opened up" Central and Eastern European countries will ensure Japanese market share in the region. Therefore, taking a risk and establishing on-site production in post-socialist markets may not be necessary. The modest record of FDI from Japan to Poland proves that Asian involvement in the country has been very limited. The same is true with investments from South Korea, Hong Kong and Singapore. In recent years, these countries became significant outward investors but their presence in Poland is negligible.

Intra-OECD Flows on a Rise

The prospect of a large, unified market in Europe has encouraged major investors to undertake intra-OECD investment. The EU was able to increase its share of global FDI inflows. The increased business opportunities in Europe have been seized by investors from the US, the United Kingdom, the Netherlands, France, the EFTA countries as well as Germany and Italy. The smaller countries of Europe such as Sweden, Norway, Netherlands and Austria experienced a rise in inflows (see Table D1 in Appendix D). Italy was able to maintain a steady increase in both inflows and outflows. FDI outflows from France have been declining since 1990 while the inflows experienced a rise in 1992 and then a subsequent drop in 1993. The US-driven recovery in the OECD outflows of FDI

was partially due to the United Kingdom as the second player in investment abroad. However, its ability to sustain inflows was seriously shaken and in 1993 the inflows reached less than 50% of the 1989 level. As the bulk of capital investments is now taking place in high technology sectors, Western Europe with well-developed infrastructure, highly skilled labor and a large market at its disposal, has become an attractive location for foreign investment. The following three Figures were constructed on the basis of data in Tables D1 and D2 in Appendix D.

Figure III. 6.

Figure III. 7. **Figure III. 8.**

One could argue that due to the fact that most of recent FDI in the EU is capital and knowledge-intensive, the labor-intensive industries should be moving to less developed countries in Europe. This assumption is made on the basis of recent trends in

Asia where low labor cost determines a location of manufacturing facilities. However, a large share of investments has been made in trade and not necessarily in the manufacturing sector where labor costs comprise a high percentage of total cost and clearly have influence on the location decisions. According to a report in the Polish press, out of 6,181 companies with foreign capital registered in mid-1992 in Poland, only 481 were actually involved in production.²³ Only recently have large multinational corporations begun to invest there by taking over existing production facilities. Labor-intensive industries will move to Poland when Western Europe completes its own restructuring, offering its labor force positions in high value-added activities and when the output produced in Poland will be of comparable quality. Poland has to compete for investments in those industries not only with other countries in Central and Eastern Europe but also with low cost locations world-wide.

Also, the uncertainty surrounding Poland's membership in the EU discourages investors from including this country in their strategic considerations. Foreign firms are not willing to take the risk of remaining outside of the regional arrangement for an unspecified period of time. As a result, they invest inside the EU rather than outside of it. In addition, they can capture market share in post-socialist economies through expansion of trade from locations within the EU. The trade liberalizations in the East facilitate this expansion.

Germany's Performance and FDI Flows

The difficulties encountered by Germany during the recent years may explain the decline of German FDI abroad. Even though the outflows were still about 10 times higher than inflows, both of them started to decrease in 1991. German reunification

²³ "Unfavorable Climate", (Text), Warsaw, *Zycie Warszawy* in Polish, (28 May 1992, pp. 1-2). Translation by the Foreign Broadcast Information Service. Daily Report: East Europe, 5 June 1992. (PrEx7.10: FBIS-EEU-92-109; p. 29)

caused enterprises to focus their attention on former East Germany. The Eastern part of the country (just like the rest of Central and Eastern Europe) needs an enormous amount of capital to carry out its privatization programs. Germany's preoccupation with the development of the Eastern part reduced the amount of capital available for investment abroad, which is reflected in the diminishing record of outward FDI presented in Figure III. 9. German investors took part in the rapid privatization of the former East Germany economy, thus the funds for potential purchases of Polish companies were limited. This may explain a modest German involvement in terms of number and capital in privatization process in Poland.

Figure III. 9.

Source: Prepared on the basis of data in Tables D1 and D2 in Appendix D.

In addition, Germany's industries are now facing strong competition from Japanese firms in sectors of great traditional importance such as automobile and engineering. German firms will have to focus on enhancing competitiveness, productivity and profits and to boost domestic investment. It may limit their ability to expand production into Central and Eastern Europe.

As Heise suggests (1993, pp. 251-258) even though Germany's competitive edge in "high-tech industries" (microelectronics, genetic engineering) might have decreased, the country still offers "functional infrastructure (roads, schools, telecommunications, energy supply)" that will attract foreign investors. In 1991 inflows of FDI increased slightly that seems to support this view. Germany's locational advantages may still mean more to potential investors than Central and Eastern Europe. It is important to mention that foreign assets in Germany experienced poor earnings and an inclusion of negative reinvested earnings in reports on capital transfers contributed to a negative level of FDI inflows in 1993 (*Financial Market Trends*, June 1994, p. 19). In addition, an evident surge in trade flows between Germany and the post-socialist countries indicates that Eastern markets can be served from German locations without taking the risk of direct investment in the continually unstable and underdeveloped environment in the East.

A Change in Sectoral Composition of FDI

In recent years, due to increased global competition and numerous breakthroughs in scientific research, firms have concentrated their core operations in a few "high technology industries". Among them are: information technology, biotechnology, chemicals, new materials, automotive and military aerospace. Strategic alliances between firms have emerged in response to rapidly rising R&D costs, shorter product life cycles (that make it much more difficult to achieve economies of scale) and technological convergence between industries (Office of Technology Assessment, 1993, pp. 116-121). While investment in high value-added industries expands, labor-intensive industries such as food processing, textiles, clothing, footwear are attracting less and less investment.

Moreover, as a result of "lean production" and automation, the labor content of the cost of production decreased. Companies are looking for production sites where the latest technology can be utilized by highly skilled labor. Therefore, MNEs are moving back to their home countries to conduct high value-added activities and ensure closeness to

final markets. The firms are concentrating FDI operations in three regions of the world: North America, Asia and the EU.

Another important feature of FDI in the 1990s is the growing share of services in overall investment. In 1991, the largest share of direct investment outflows from major OECD countries was comprised of services in finance and insurance, banking, transportation, telecommunications, and the trading sector (*Financial Market Trends*, February 1993, p. 67). The expansion of the service sector abroad has been encouraged by deregulation (primarily national airlines), global competition, technological progress in telecommunication, and the non-tradability of many services (*Financial Market Trends*, February 1993, p. 67).

The tertiary sector in Central and Eastern Europe has been undeveloped. The biggest investments and profits are to be made in the financial and telecommunication sectors. Therefore, there are huge opportunities for MNEs to enter the market and create a services sector almost from scratch. Poor infrastructure may be an opportunity for a few industries but it is often an impediment for others. Investors are discouraged by unfavorable domestic conditions. Unless the infrastructure of a host-country represents a certain minimum of compatibility with widely prevailing standards, FDI will not locate there. Poland does not offer sophisticated infrastructure capable of facilitating investments in tertiary sector which has been almost nonexistent. There is an apparent need to upgrade the domestic infrastructure before it will be able to serve external markets in global strategies of foreign firms. Although the process has already started, it will take a long time and consistent effort to enhance the base.

Increased FDI Flows to Developing Countries

General Overview

In 1993 FDI flows world-wide reached USD 192 billion. The developing countries were able to lure USD 80 billion which represents 41.7% of global flows and a two-fold increase in comparison with 1991. At the time when the OECD outward investment has been in a decline, the ability of developing countries to attract FDI is a remarkable achievement²⁴. The success of developing countries varies not only between the major regions of the world but also within them. The reported surge in FDI inflows involves a small group of countries. The People's Republic of China deserves special attention. In 1992, the country attracted over USD 11 billion in FDI.

First, increased foreign capital began to flow to South East Asia and then to Latin America. There exist some common characteristics that have played a significant role in attracting FDI. Countries that have been successful have experienced dynamic growth and were able to offer high returns on investment. They have introduced structural reforms involving trade and exchange rate liberalizations, deregulation, and decentralization. The need for capital inflows prompted developing countries to introduce investment policies conducive to FDI inflows. Most of all, they were able to stay away from a debt crisis and their economies started to grow. Thus they gained investors' confidence. A quick look at these economies will provide information on existing conditions and level of success in attracting FDI. Their experiences will serve as a background in evaluation of magnitude of FDI flows to Central Europe and Poland specifically.

²⁴ Private investment flows from OECD to developing countries amounted to USD 30.7 billion in 1990, dropped to USD 27.9 and 26.4 billion in 1991 and 1992 respectively, and then rose again to USD 28.8 billion in 1992 (*Financial Market Trends*, October 1993, p. 22).

Emerging Asian Economies and FDI Flows

There are few factors that can be considered as reasons for increased FDI flows to Asia. First, many Asian developing countries were able to avoid debt problems that caused financial difficulties among the rest of the countries involved in heavy borrowing during 1970s and 1980s. Second, they maintained macroeconomic stability which decreased the risk for potential investors. Third, fast growing economies encouraged investors to diversify their investments by capital transfers to the region. Malaysia's need for capital forced it to remove restrictions on capital movements. South Korea, despite its borrowing, pursued an export-oriented strategy that prevented balance of payments problems. In recent years many Asian countries have experienced higher wages and many manufacturing enterprises have been relocating to middle and low-income countries contributing to a rise in intra-regional investment (*Financial Market Trends*, 1994, February 1994, p. 23). The Peoples Republic of China has registered a surge in investment carried out by other Asian economies, led by Hong Kong, Singapore, Taiwan and Japan. The three countries: Malaysia, South Korea and China have been chosen to illustrate the Asian experience with FDI. The statistical information can be found in Table D3 in Appendix D.

All three economies experienced increase in GDP between 1989 and 1992. Despite China's GDP growth its GDP per capita did not improve significantly. South Korea's GDP per capita was over double that of Malaysia and almost twenty-fold that of China in 1992. Yet, China was able to attract the largest amount of FDI inflows, with Malaysia in the second place and South Korea reporting a decline in private capital inflows in 1992.

FDI inflows as a percentage of GDP were the highest in Malaysia reaching 8.6% in 1991. China's ratio was steadily growing in the beginning of the 1990s and doubled in 1992 to 2.6%. Hong Kong has been the largest foreign investor there. It is not

surprising that Hong Kong attempts to foster economic links and integrate with China prior to 1997. However, once Hong Kong becomes a part of China it will disappear from the list of foreign investors. Unless other foreign investors decide to "fill in the gap", China's FDI showing will diminish. South Korea's ability to attract FDI was steady over the years but did not exceed 0.5%. Malaysia, however, significantly outperformed the other two in FDI inflows per capita (see Figure III. 10).

Figure III. 10.

Source: Prepared on the basis of data in Table D3 in Appendix D.

Attractiveness of Latin American Countries to Private Capital

Following the improvement in the debt situation and macroeconomic environment due to extensive reforms, some Latin American countries were able to attract FDI. The economic recovery and prospects of extending the NAFTA arrangement led to an intensified interest on the part of investors to locate manufacturing facilities in the low-cost

areas in the Southern Hemisphere. Export-processing zones in Latin America started to serve as major suppliers of the large North American market. Mexico, one of the leading locations for FDI in the region, recently became the 25th member of the OECD.

Just like in the case of the three Asian economies examined earlier, the selected three Latin American countries all experienced growth in GDP between 1989 and 1992, with the highest GDP per capita in Argentina. FDI inflows in Mexico and Argentina were much higher than in Chile. In 1991 and 1992 all of them experienced an increase in private capital inflows. The confidence on the part of foreign business and attractiveness of Latin American locations found their reflection in FDI statistics (Table D4 in Appendix D). Interestingly enough, Argentina recorded the highest rise in FDI.

In the per capita analysis, however, FDI to Chile was almost at the same level as inflows to Mexico. Therefore, although quite significant in value, Mexico's success looks dim in per capita comparison. Argentina's inflows per capita were double the size of Mexico's (see Figure II. 11). In 1992, both Argentina and Chile registered higher FDI inflows as a percentage of GDP.

2

PM-1 3½"x4" PHOTOGRAPHIC MICROCOPY TARGET
NBS 1010a ANSI/ISO #2 EQUIVALENT

PRECISIONSM RESOLUTION TARGETS

Figure III. 11.

Source: Prepared on the basis of data in Table D4 in Appendix D.

Relative Position of Central and Eastern Europe

The developments in foreign investment flows analyzed in the previous sections indicate that the size, determinants and structure of international investment flows are changing. In the process of globalization of production, the MNE is searching for sites that would suit a new business strategy by serving local, regional and global markets. It makes it even more difficult for the post-communist countries to reach the target since it is changing at its own pace.

Despite a recession, the developed countries remain main players on the international stage. They are also able to lure FDI for they offer predictable investment regimes and possess the required level of development to handle investment flows in sectors in which it is available. It is anticipated that a recovery in OECD countries may

generate both increased amount of private capital investments abroad and a rise in consumer demand at home. Consequently, FDI flows would intensify in search for the best location where the funds could be deployed according to MNEs' strategy. It may be easier for ECEE-3 to compete successfully for FDI once the amount of capital available for investments expands. Also, there may be prospect for increased exports to OECD countries.

However, the fast growing East Asian economies have started to attract a rising amount of foreign investment. Some of them have even engaged in outward investment, but mainly within the region. The EAE-3 and ELAE-3 have been exposed to substantial FDI inflows for a longer period of time than the ECEE-3. They have entered the ranks of host-countries at a time when there was less competition for FDI. Thanks to an accumulated experience they have managed to adjust domestic policies and create infrastructure more attuned to FDI. Also, the advantage of a larger accumulated stock of FDI in those countries have placed them ahead of the economies in Central Europe on the list of preferred locations for MNEs. It is essential that the ECEE-3 develop a critical mass of experience over time. The FDI inflows to Hungary and Poland that increase annually suggest that the "wheel" has been put in motion and providing that their economic and political systems stabilize, one can expect growing inflows of FDI to the region.

The analysis conducted in this chapter identified external constraints on FDI inflows to Central and Eastern Europe which limited foreign participation in Poland as well. However, as it was presented earlier, Poland's FDI showing was particularly poor in the first years of transition relative to that of Hungary and the former Czechoslovakia. In order to explain this phenomenon, it is necessary to turn to internal factors that are peculiar to Poland.

Chapter IV. The Legacies of the Communist Period

It is the purpose of this chapter to present Poland's experience with FDI during the communist period and assess its impact on current private capital inflows. The inheritance from the past, whether in the area of investment regime or economic, political and social characteristics of the system, significantly shape the policies and processes of the post-communist transition. The legacies of the past, both negative and positive, set the initial conditions of the new era, especially in the formative, early years of transformation.

Hesitant Opening up to Foreign Investment

During the post-war period the attitude towards foreign direct investment in Poland gradually evolved from strong hostility prior to mid-1970s to carefully administered "cooperation" between foreign and Polish partners in the 1980s. The Polish authorities, with considerable hesitation, allowed inflows of FDI and the arrival of foreign investors was treated with a high degree of suspicion. The policies implemented in the 1970s and 1980s were designed to tap into the benefits of FDI through allowing it to come in but, at the same time, regulating it within the rigid principles of central planning.

As a result, investors' response to the restrictive legal framework²⁵ was very cautious. At the time of the Cold War, the initial opening up to the possibility of foreign capital flows to socialist economies in the 1970s attracted more international attention than actual investments (McMillan, 1992, p. 307). Only a small number of enterprises was established and the amount of invested capital was very modest. It is difficult to fully assess the quantitative significance of FDI inflows during that period as

²⁵ The chronology, titles and main characteristics of legislation pertaining to FDI prior to 1990 were adopted from various sources such as Sulejewicz (1992), Malecki (1991), Bochniarz and Jermakowicz (1993), and Sadowska-Cieslak (1991).

only limited data have been published. Therefore, the analysis here is intended to delineate the investment environment established in Poland at the time, and its implications for FDI inflows during the early years of transition after 1989.

The Emphasis on "Polonian Firms"

After a period of strong ideological hostility towards foreign investment, from the World War II until the mid-1970s, the Polish authorities decided to experiment with foreign involvement beyond non-equity forms of industrial cooperation. The first legal act allowing joint and equity ventures with foreign firms was passed in 1976. In the light of adversarial East-West relations, a penetration by foreign capital had political and ideological implications. The authorities feared the impact of enterprises that not only represented "the other (capitalist) camp" but also propagated private ownership values and Western business attitudes. The compromise of ideology in exchange for capital inflows was minimized by restrictive conditions that governed operations of joint ventures.²⁶ This initial opening up with its underlying controversy was more a matter of political declaration of liberalization and a gesture towards the Polish community abroad than a real encouragement of foreign capital participation (Sulejewicz, 1992, p. 4).

Under the Decree of the Council of Ministers of May 14, 1976 on the Granting of Permissions to Foreign Legal and Moral Persons in Respect of Certain Kinds of Economic Activity²⁷, the establishment of small, 100% foreign-owned industrial firms was permitted for a period of 10 years. Major industrial branches, such as metallurgy, railways and energy production, were excluded from the list of potential areas for investment. In forming a joint venture a Polish citizen had to be the director of the

²⁶ McMillan (1992, p. 307) suggested that the term "joint ventures" (regardless of the equity arrangement) was preferred over "foreign investment" because it eliminated direct connotations of an alien element present in the economy.

²⁷ Rozporządzenie w sprawie wydawania zagranicznym osobom prawnym i fizycznym zezwoleń na prowadzenie niektórych rodzajów działalności gospodarczej, *Dziennik Ustaw*, PRL 1976, nr 19, poz. 123.

company and had to obtain a permit for a particular type of activity. From the requirement of Polish origin for the firms' executives, they were called the "Polonian firms". The intent was to attract capital and know-how from the Polish diaspora.

The financial conditions of investing in Poland acted as a deterrent. Malecki (1991, p. 95) identified the following rules that were applied to joint ventures. The total input had to be made in convertible currency. A permit was granted upon payment of a deposit consisting of 30% of the investment commitment. The deposit was kept in a Polish bank without earning interest until half of the investment was made. It was impossible to receive credit from a Polish bank to begin operations. Foreign enterprises could transfer profits only in annual amounts up to 9% of the total investment outlay in convertible currencies and up to 50% of export surplus. The rest of earnings, in non-convertible Polish zloty and therefore incapable of expanding investor's wealth in the home-country, had to be spent within the domestic economy. However, there were limited ways in which these earnings could be designated (e.g. coverage of living expanses in Poland or travel expenses). Purchase of consumer goods was limited by customs regulations on removal of these goods abroad. The rules for foreign exchange operations were specified in the Regulation of the Minister of Finance on the Granting of Permissions to Mixed Companies to Engage in Convertible Currency Operations²⁸. The rigid rules pertaining to repatriation of hard currency profits might have induced firms to use transfer pricing manipulations which, in turn, could result in reduced tax revenue for the Polish government.

Moreover, Sadowska-Cieslak (1991, p. 16) suggested that the "Polonian firms" had to rely on centrally allocated supplies of raw and intermediate materials which often meant shortages and irregular deliveries. Foreign ventures were not permitted to use their own means of transportation in import-export freight. The latter was the sole responsibility of the state transportation monopoly Państwowa Komunikacja

²⁸ Zarządzenie Ministra Finansów w sprawie zezwoleń na dokonywanie niektórych czynności obrotu wartościami dewizowymi przez spółki o charakterze mieszanym, *Monitor Polski*, Nr 23, poz. 110.

Samochodowa (PKS). Ironically, PKS accepted only cargo exceeding 7 tones, which was rarely an output of small foreign companies that had a right of establishment in Poland. All of these rigidities effectively deterred private capital inflows and in the first six years only 76 "Polonian firms" were established.

By the end of the 1970s two other resolutions took effect pertaining to foreign investment. They were the Resolution of the Council of Ministers No 24 of July 2, 1979 on the Creation and Operation of Enterprises with Foreign Participation and the Resolution of the Council of Ministers No 112 of July 20, 1979. The status and operations of foreign firms were subject to frequent adjustments in the law, which created confusion and an unstable investment regime.

Once some of the restrictions towards foreign investment were lifted in the early 1980s, about 700 "Polonian" enterprises were established within the decade of 1976-1986. They were usually created with the capital of Polish expatriates. These were small-size enterprises operating in domestic trade, hotels and restaurants with an average investment of USD 144,000. The average employment in 80% of these firms was under 200 employees (Bochniarz and Jermakowicz, 1993, p. 123). The initial ban on mixed capital companies (partnerships between foreign firms and Polish state enterprises or cooperatives), the short period of activity allowed and various financial restrictions discouraged foreign investors. Even though the authorities extended the period of activity to 15 years and permitted mixed capital firms, it did not induce a greater interest on the part of foreign investors. As Malecki indicated (1991, p. 95) "the barriers thus removed proved not to have been the major obstacle of the flow of foreign capital".

The Investment Climate in the 1980s

The negligible capital inflows experienced in the 1970s and unwillingness of foreign governments to provide further external financing had prompted the Polish government to liberalize initial FDI restrictions to some degree. This trend, while

admirable given the systemic circumstances, still did not result in a liberal law towards foreign investment. Moreover, the rules became even more complex, especially in the area of taxation and repatriation of profits. While they provided investors with some incentives, on the one hand; they restricted their activities, on the other. In addition, following the introduction of martial law and crushing of the Solidarity movement, the world-wide condemnation of the undemocratic Polish regime did not favor development of business relations.

On July 6, 1982 the regulations pertaining to operation of foreign investors in Poland were promoted to the status of Law on the Principles of Carrying out Economic Activity by Foreign Legal and Moral Persons in the Sphere of Small Scale Production on the Territory of the PPR²⁹. In this law financial incentives to foreign investors in the form of tax relief for import substitutes and export production were introduced. Investors who reinvested at least one third of the profits made during the period were entitled to a three-year income tax holiday.

Although transfer of profits could now include up to 10% of the total investment plus part of the surplus of export earnings over import expenditures, it was still limited to maximum of 50% of the profits made during the previous year (Malecki, 1991, p. 96). To ensure the inflow of convertible currency into the economy, the investors were obliged to sell half of the export proceeds to a Polish bank at a low official exchange rate. For new investors the minimum capital outlay of USD 50,000 and the founder's deposit in the same amount acted as "a screening agency" in search for financially viable investors capable to carry out their obligations. However, a maximum employment level was set at 200 employees which effectively precluded potential expansion of foreign firms and limited their impact on the economy.

²⁹ Ustawa o zasadach prowadzenia na terytorium PRL działalności gospodarczej w zakresie drobnej wytwórczości przez zagraniczne osoby prawne i fizyczne, *Dziennik Ustaw*, PRL 1982, Nr 19, poz. 146.

In order to eliminate the inconveniences of conducting foreign trade through state foreign trade monopolies and/or depending on unreliable domestic suppliers, a few concessions were given to foreign investors. Foreign companies could obtain a license to export their own products and import essential inputs (Malecki, 1991, p. 96). However, they were still subject to frequent and unannounced controls, the signs of the prevailing suspicious attitude towards them.

The second part of the 1980s can be characterized by the growing technological and entrepreneurial backwardness of the economy. Borrowing abroad was limited by Poland's large accumulated debt and low creditworthiness. The capital needs by far exceeded funds available for investments. The regime started to recognize its imminent collapse and tried to prolong its life with foreign money by more actively encouraging FDI. With a specific set of objectives new laws on foreign investments were designed and implemented. These objectives were: an increase in capital inflows, the introduction of modern technology and management techniques, upgrading of product quality and promotion of exports (UNIDO, 1991, p. 75). Increased export sales were to provide essential foreign currency earnings to service the debt. Sadowska-Cieslak (1991, p. 13) identified another goal of early investment policy, namely protection of the natural environment.

On January 31, 1985 a document on Altering the Law on the Principles of Carrying out Economic Activity by Foreign Legal and Moral Persons in the Sphere of Small Scale Production on the Territory of the PPR³⁰ was introduced followed by a number of other amendments (on March 18, 1985 and September 9, 1985). They altered the rules of granting permission for operations and of conducting economic activity in Poland. These amendments show how the authorities continually experimented with foreign participation phenomenon and subjected it to frequent changes of the law.

³⁰ Ustawa zmieniająca ustawę o zasadach prowadzenia na terytorium PRL działalności gospodarczej w zakresie drobnej wytwórczości przez zagraniczne osoby prawne i fizyczne, *Dziennik Ustaw*, PRL 1985, Nr 3, poz. 12.

On April 23, 1986 the Parliament passed the Law on Companies with Foreign Capital Participation³¹. Instead of replacing previous legislation, the new law existed in addition to it, thus, effectively causing further confusion among foreign investors. The significant step forward in dealing with FDI lay in the fact that this piece of legislation permitted foreign investors to form joint ventures (JVs) with Polish state enterprises. It was a remarkable progress, since foreign capital was for the first time allowed to enter the public sector and was not restricted to small scale enterprises in the private sector. The share of Polish capital had to exceed the foreign share. Permission for the higher than 49% equity share of the foreign partner was given providing that it did not interfere with the security of the state. The new status of JVs improved their access to centrally allocated raw materials. Upon receiving permission, JVs were also able to open an account in a foreign bank and apply for loans.

The need to modernize the economy pushed the authorities to open most sectors of the economy to foreign investment with the exceptions of the defense industry, railways and air transport, communications, telecommunications, insurance, banking, publishing and foreign trade. It clearly indicated that investments were sought in heavy industries which had been exempted from the list of potential areas for foreign activity just a decade earlier. These industries required a capital input as well as a technological and managerial improvement that could be carried out only with foreign involvement. Hence, the restrictions on heavy industries were removed and imposed on certain services and the defense sector.

In the area of repatriation of profits, 75% of convertible currency earnings could be transferred abroad. The rest was subject to a sale to a Polish bank. 10% of profits was automatically channeled to the reserve fund. The corporate income tax was at a rate of 50% and only investment outlays were eligible for tax deductions (Bochniarz and

³¹ Ustawa o spółkach z udziałem zagranicznym, *Dziennik Ustaw* 1986, Nr 17, poz. 88. The details of this law are presented according to Sadowska-Cieslak, 1991.

Jermakowicz, 1993, pp. 124-125). Foreign employees were allowed to receive up to 50% of their salaries in convertible currencies which could be repatriated abroad. Polish employees had to be paid in Polish zloty, according to the salary schedule in the public sector. This was designed to prevent joint ventures from attracting movements of labor from the state sector. It allowed the state to preserve the existing wage differentiation between various enterprises in the economy, but it discouraged payments of special rewards for effort and innovation.

Some liberalizations in the law were accompanied by many setbacks. Tax holidays could be extended only to two years and foreign partner's equity participation was limited to 49%. Now only JVs were permitted, and wholly-owned enterprises were prohibited (in the earlier period only the latter were allowed). Permission to establish an enterprise was issued for a specific period of time and type of activity and any changes had to be approved by administrative organs. This permission was subject to a consent of two ministers (the Minister of Foreign Trade and the Minister of Finance) and other parties which could be involved by virtue of other legal acts. Meanwhile, the extent of administrative discretion was not specified which invited direct interference in operations of these firms. The guarantees of assets given to a foreign partner were not automatic and were limited to the share of equity capital invested at the time of registration (Sulejewicz, 1992, p. 7). The law introduced restrictions on freedom of liquidation of an enterprise. Partner could sell shares only with the permission of other partners and if the appropriate buyer were not found, joint venture was subject to dissolution. The firms had to use Polish accounting practices which were different from the world standards.

Not surprisingly this equivocal progress in opening up to FDI had a limited effect. Foreign investors did not enter the Polish market in great numbers. Despite the fact that the law had become more liberal, there existed institutional and organizational barriers. The highly bureaucratic procedures, complex and inflexible regulations, limited freedom of operations, unreliable sources of domestic supply, and the deteriorating state of domestic

infrastructure deterred potential investors. On the basis of the law, 54 permissions for establishment of joint ventures were issued, of which 41 were active in 1991 (Sadowska-Cieslak, 1991, p. 21). At the same time, demand for capital was growing.

The need to liberalize more substantially and to accelerate the slow reform process in the bankrupt economy led to another legislative advance in 1988, when the 1986 law was amended and renamed the Law on Economic Activity with the Participation of Foreign Parties.³² It also replaced the law governing activities of small scale enterprises, the "Polonian firms". They could continue operations until the permit expired or could transform themselves into joint ventures in accordance with the new law.

The new law introduced further liberalizations. It allowed 100% foreign participation (with a minimum of 20% and USD 50,000 in value). Contributions could be made in cash or in-kind. Foreign nationals could be elected chief executives. Licenses to conduct foreign trade and the founder's deposit were abolished. It also eliminated the requirement of obtaining a permit in order to conduct economic activity. The companies were free to operate in any sector providing that they were registered. Licenses were necessary in only a few types of activities, namely, production of explosives, pharmaceuticals, alcohol and tobacco products.

Enormous decision-making rights were concentrated in the hands of the President of the Foreign Investment Agency (AIZ), established by the new law. The President of AIZ could accept or reject an investment application, and determine the conditions of the project implementation (Piontek, 1989, p. 7). This organ was designed to issue licenses and supervise the activities of joint ventures, thus, to play a role of a "screening agency". The rejection of an application could be based on the following criteria: threat to the economic interests of the state, threat to the security and defense of the state or of the state secret, and threat to the environment. In terms of serving foreign

³² Ustawa o działalności gospodarczej z udziałem podmiotów zagranicznych, *Dziennik Ustaw* 1988, Nr 41, poz. 325. It was amended first on December 23, 1988, took effect on January 1, 1989 and lasted for a year. It was then amended in December 1989 and again in July 1990 in connection with the introduction of new foreign exchange law and privatization law.

investors, the agency was created to simplify the application procedure and eliminate bureaucratic inefficiencies as well as to promote foreign investment in Poland. The least attention was, however, paid to the latter function, as the Agency concentrated its efforts on licensing and supervision of JVs' operations. The bureaucratic approach to FDI continued.

Foreign investors were made especially interested in foreign trade, since JVs were permitted to retain 85% of their export earnings. In comparison, the domestic producers could retain only between 20-50% of export earnings. Exempted from some customs duties and income tax, JVs could offer buyers competitively priced goods and outperform domestic firms. Being aware of this advantage the President of AIZ granted licenses for general foreign trade only to a limited number of JVs in which the Polish side had more than 50% equity. Permissions for exports were granted on JVs' goods and services and on import of essential raw or intermediate materials, import of pharmaceuticals and medical equipment, pesticides and herbicides and import of goods for sale in JVs' stores (providing that the firm invested significantly in construction of distribution outlets).

The new law permitted transfer of profits after reselling 15% of convertible currency profits to the state. It extended the length of tax holidays to three years, with a possibility of granting a six-year exemption if projects were carried out in preferred sectors ensuring environmental protection or implementation of advanced technology³³. The corporate income tax was reduced to 40%. Income tax of the foreign partner was set at 30% and of the Polish partner at 40%. UNIDO (1991, p. 75), expressing more the enthusiasm towards than properly evaluating the changing investment regime in Poland, named the latest regulation as "the most generous in the world."

The purpose of further alterations in 1989 and 1990 was to foster economic reforms that were taking place in the area of foreign exchange and international trade by further liberalizing foreign investment regulations. In that respect, all hard currency profits

³³ Sadowska-Cieslak (1991, p. 28) identified the following sectors: tourism, construction of hotels and recreation facilities, telecommunications, pharmaceutical and medical equipment industry, chemical industry, paper industry, construction of housing, printing.

and additional 15% of profits from sale of goods and services on domestic market were allowed for transfer abroad. The most important change, however, took place in the area of purchase of real estate. Until November 1990, foreign investors were allowed to buy land (based on the Law of March 24, 1920 on Purchase of Land by Foreign Parties) if their equity share did not exceeded 50%.³⁴ The new law still contained a provision that JVs needed to obtain the permission of the President of AIZ for a lease of real estate from the state enterprises.

Partner could sell shares in JVs upon prior notification of the President of AIZ, and the Polish partner had a right to purchase them first. If the sale was carried out in Polish zloty, transfer of funds from the sale could not take place before 10 years from the date of registration of a joint venture. The law paved a way for foreign investors to participate in the privatization process by allowing them to purchase shares in Polish joint stock companies, but an approval by the Foreign Investment Agency was required whenever a purchase exceeded 10% of capital stock. JVs were obliged to open an account in Polish banks in Polish zloty. In order to hold an account in a foreign bank, they had to obtain permission from the National Bank of Poland.

While all enterprises were subject to the tax on progressive wages called "popiwek", JVs were exempted from this tax with one exception. If the joint venture were to be liquidated within three years from the date of expiry of the tax break, it would be obliged to pay accrued "popiwek". This rule was designed to prevent creation of short term JVs interested in taking advantage of tax holidays and closing operations shortly after that. Also, the level of remuneration in JVs was to be decided by partners.

³⁴ The companies with more than 50% foreign ownership had to obtain permit from the Ministry of Internal Affairs to be able to purchase real estate (Jermakowicz and Drazek, 1993, p. 160). A permit which was granted on a case by case basis and valid for 12 months was issued within two months from the date of application.

The Results of Early Policies towards FDI in Poland

Following the initial opening up to foreign capital in 1976 a gradual, though not always consistent, liberalization of investment laws took place. As time passed and the Polish economy fell into deeper crisis, the authorities started to attribute a greater role to foreign investment. The subsequent "concessions" towards FDI indicate that the main goal was to gain access to capital by encouraging of private investment inflows. This objective remained unfulfilled. Based on estimates provided by McMillan (1992, p. 311) and presented in Table A2 in Appendix A, the total number of registered joint equity ventures in Poland (excluding "Polonian firms") by the end of October 1990 reached 1,950, with foreign investment valued only at USD 340 million. At the same time, the number of joint ventures in Hungary amounted to 5,000 and in the former Czechoslovakia to 500, with a value at USD 1,080 million and USD 340 million respectively. The four-fold higher number of joint ventures in Poland than in the former Czechoslovakia did not lead to the corresponding advantage in a value of investment. It is obvious then, that the investments in the former were on average much smaller in value than investments in the latter. As Table A3 suggests, a very limited number of companies were created throughout the 1980s until the year 1990, when a significant growth in joint ventures registration occurred as a response to political changes and reorientation towards a market-based economy. In 1987 only half of companies started operations and in 1989 only 30.7% of all granted permissions for joint ventures were active (Sulejewicz, 1992, p. 16).

In addition, those companies that were established were characterized by low initial capitalization. Table A3 in Appendix A indicates that in 1,231 out of 1,752 joint ventures (70.3% JVs operating in Poland in 1990) foreign capital input did not exceed USD 60,000. In detail, 699 were created with a minimum foreign capital outlay required by the existing law. It is easy to conclude that large multinationals did not enter the Polish market. A large number of small joint ventures was established by Polish citizens residing

abroad³⁵ whose primary motives of operation in Poland were tax holidays, exemptions of customs duties and exchange rate manipulations (especially huge profits made on the difference between the official and "black market" rate of hard currencies). In these cases, foreign partners were involved to serve as "name selling parties" and the ventures were created with a minimum initial cash contribution or second hand equipment (Sulejewicz, 1992, p. 15). Had the regulations been more favorable to FDI, the investors would not need to circumvent them in such a way.

The small firms that were attracted did not bring in the capital necessary to carry out modernization programs and played only a marginal role in the economic development of the country. These firms were not the carriers of the latest technologies to substantially increase overall efficiency and productivity. Nor did a spill-over effect take place to upgrade the domestic economy. On the contrary, Sadowska-Cieslak (1990, p. 12) suggested that a shifting of outdated process and product technologies to Poland occurred. Investors transferred obsolete equipment (e. g. machinery for processing of metal and wood) as a form of initial in-kind contribution to the company, thus, making room for modern ones at home. Some of these technologies might have been relatively new to Poland due to the country's technological backwardness. This phenomenon, explained by the product and/or process life cycle theory, has been commonly observed in transfer of technology to developing countries.

The question arises, however, whether it would be advantageous for the main foreign investors in Poland to implement outdated technologies if their output were to be exported to other countries where it could potentially face fierce competition? If the foreign firms were driven by the export-oriented strategy this type of transfer could be self-defeating in the long-run. If they, however, intended to supply the local market with products which were in shortages for many years, they could still expect demand for these

³⁵ The 1989 law granted the right to enter joint venture agreements to natural persons of Polish citizenship. This provision clearly encouraged Polish émigré population but at the same time discriminated against individuals of other nationality.

products despite the fact that they were outdated in their home-countries. Over time, however, the emerging competition among foreign investors would ameliorate this problem as each would strive to capture the higher share of the Polish consumer market by supplying more sophisticated goods. The local population, more demanding and educated in their choices of products, would also force foreign firms to supply new items produced by up-to-date technologies.

As a result of this very modest technological upgrading, the third objective of supplying the market with quality products was not reached. For the same reason, export expansion was limited, at least until a growth in competition would force the companies to offer products of quality and image comparable to ones in the West. Although joint ventures had easier access to import-intensive goods due to the fact that they were allowed to conduct foreign trade transactions, their imports were also constrained by the ability to export and earn convertible currency. Many tried to balance exports and imports and free themselves from the obligatory resale of hard currency receipts. Others exported only to enjoy the financial incentives and made up their losses through sale of imported consumer goods with minimal local processing on the domestic market. The efficiency of the exports was, therefore, very low. As Sulejewicz (1992, p. 15) suggested "the choice in the activities in the joint venture was dictated by trade logic and not by production logic."

Foreign investors who invested in Poland to take advantage of a relatively large market, were interested in serving domestic consumers and eliminating shortages of basic goods. The provision of goods and services for export was not a priority for them. Therefore, unless investors sought to earn convertible currency for easier transfer of profits abroad, they preferred to enjoy high rates of return from local sales in Polish zloty. The only drawback was that they had to reinvest profits since their repatriation was restricted. The government's goal of tapping into hard currency earnings, however, would not necessarily be feasible. First, exports did not seem to be a main goal of foreign investors.

Second, the size of exports could be set at a level preferred by the firm and not by the central authorities. Third, the product line from Poland lacked image and quality essential in competing abroad which precluded potential expansion of exports.

Any policy of environmental protection was in principal easier to implement under a strict investment law, especially when the subject of economic activities of a potential joint venture was examined by administrative authorities upon issuing a permission for a project and upon monitoring operations. Once the law became more liberal and operations of foreign investors less monitored, the implementation of environmental protection objectives became less likely.

Other Legacies from the Communist Period

In the end of the 1980s a growing dissatisfaction with the failing economic system exacerbated discontent with undemocratic, socialist regime and led to anti-government demonstrations. Facing a collapse of the system, General W. Jaruzelski, First Secretary of the Polish United Workers Union (PZPR) enforced martial law on December 13, 1981. Despite efforts to restructure and reform the system, Jaruzelski was not able to rescue the economy from falling into disarray. In 1989, he was forced to enter the "Round-table Negotiations" and to transfer power to a new government. Thus, the process of building an economic and political system in Poland began. Inevitably, the legacies inherited from the past shaped the pace of transition. Also, they created the conditions for and influenced the perceptions of business operations in Poland. These conditions played an important role in MNEs' strategic decisions about locating there.

The Attributes of the Domestic Infrastructure

Factor Endowment

Upon entry into a foreign country, a multinational enterprise follows particular strategy to exploit the host-country's specific advantages and to maximize its own firm-specific advantages. The evaluation of a foreign location begins with the exploration of its unique characteristics and endowments that may become a source of profit for the MNE. Dunning (1993, pp. 56-61) described various motivations for FDI and identified the following types of MNE's activity: "resource seekers, market seekers, efficiency seekers and strategic asset seekers". MNEs engage in a specific type of activity depending on the factors provided by the domestic conditions of the host-country.

The vast territory of Poland, unlike smaller Hungary and the former Czechoslovakia, could provide the MNEs with many natural resources (coal, sulphur, copper, wood, agricultural land). The natural resource endowment of Poland was relatively attractive to FDI but modest in comparison with the assets of its Eastern neighbor, the former Soviet Union.

Poland's location, in the heart of Europe, could serve as a platform for expansion both to the West and to the East for "market and efficiency seeking" MNEs. Its dominant trade ties with the former CMEA partners would permit foreign firms to gain access to markets of other post-communist economies. Also, in a situation of serious capital constraints for modernization, the potential of the Polish economy for international production lay in its educated and relatively cheap labor force and in an unsatisfied demand for variety of products, both intermediate and consumer goods.

Quality of Human Capital

In recent years, one of the most desirable assets that foreign investors seek prior to making a decision about investment has been a quality of human capital. Simple

calculations of the labor price differentials between countries have been supplemented by evaluations of innovativeness and creativity of a host country's labor force. Due to the implementation of cost-effective automated assembly lines, the amount of available low-skills jobs has been in a decline. Many labor-intensive industries contracted and have been replaced by the capital and technology-intensive industries. At the same time, there has developed a need for a highly-skilled labor force to be employed both in capital-intensive manufacturing industries and in a growing tertiary sector.

Thanks to educational policies of the socialist state, the percentage share of university and high school graduates in the post-war Poland increased significantly. Unfortunately, due to the lack of proper incentives for scientific and academic staff, many graduates abandoned their professional careers. Some engaged in activities of the private sector³⁶, others emigrated seasonally or permanently. As a result of the socialist industrialization, emphasis was placed on simple assembly-line type jobs provided by large state-owned enterprises in heavy industries. The evolution of these positions was precluded by their low level of technological innovation. The enterprises were more involved in providing social benefits to the workers (housing, day care centers, vacation and convalescence homes) than in modernizing their machinery and process/product technologies. Workers were encouraged to perform certain manual operations which usually entailed a minimum of their real capabilities. At the beginning of the 1990s, the "social structure in Poland was characterized by a high share of manually working people" (Gorzelak and Jalowiecki, 1993, p. 30).

Excellence and creativity were not rewarded with proper financial incentives. Upward mobility in the structure of the enterprise was based on party membership and not on professional abilities of the best employees. The wage system was designed by the state and was highly distorted. It did not reflect improvements in

³⁶ The prestige of professional life was traded for higher remuneration in the emerging private sector. There have been numerous examples of university graduates driving taxis and owning small retail stores.

productivity and output. The innovative and managerial skills, crucial in successful operations of any business venture, were not developed.

Due to the fact that "full employment policy" persisted throughout the socialist period, the Polish labor force lacked experience in adapting to changing employment conditions and job requirements. The Polish population, despite high level of literacy, does not possess flexibility, sound judgment in making decisions, and ability to apply theoretical knowledge in practice and to generate its own solutions to problems. The scarcity of managerial and organizational skills has become one of the obstacles to restructuring of the SOEs and to successful operation of foreign firms which could not rely on professionalism of the local staff.

Although the Polish labor force is capable of performing operations demanding low and middle skills, it still lacks essential training to function effectively in "high-tech industries". If a transfer of modern technologies from the West through foreign investments is anticipated, Poland must attract FDI in the first place by having at its disposal a labor force population prepared to absorb, utilize and generate new technological and managerial solutions.

Size of Domestic Demand

The high demand for consumers goods was initiated in the era of heavy foreign borrowing in the 1970s. Soon after, incapable of securing further credits to finance consumption and constrained by declining supply of domestic manufacturing, Poland entered a period of the "economy of shortages" in 1980s. The authorities attempted to control demand by raising prices that for decades were distorted and administratively determined. Thus, an inflationary machine was put in place resulting in dissipated domestic savings and reduced purchasing power of the population.

Poland's large population of approximately 38 million potential buyers could offer a sizable market for "market seeking" MNEs providing that real wages would

rise. The high inflation and a few devaluations in the early 1990s have, however, eroded savings of the population and threatened consumption. According to the logic of MNE entry, the establishment of distribution networks for imported products is a way of securing the market share and exploring the conditions of operation in the host country. These "downstream activities" are usually the precursor of larger investments in the future. The economic growth anticipated as a result of far-reaching economic reforms would ensure increase in demand and encourage MNEs to take advantage of an emerging market.

Inefficiency of State-owned Enterprises (SOEs)

Within the framework of the CMEA, enterprises specialized in production of goods according to a central plan and irrespective of the principles of comparative advantage. The fulfillment of the plan was the ultimate goal of SOEs and was pursued without consideration for economic efficiency. Based on administratively set levels of output in "downstream plants", the request for supplies of intermediate products became orders for branches of state monopolies located more "upstream in the value chain" of the socialist production³⁷. Attention was not paid to waste and inefficiency and no incentive existed to introduce energy or material-conserving solutions. As a result, SOE output was highly energy-intensive. In the situation of growing energy prices, and especially after the former Soviet Union refused to continue to subsidize oil and gas shipments following the collapse of the CMEA scheme, production in Poland became very uncompetitive. In addition, the enterprises, for years deprived of essential modernization in production and management, lacked capital to implement new technologies and organizational solutions. Their aging and obsolete equipment was not capable of keeping up-to-date with the latest breakthroughs in technological progress. The "efficiency incompatibility" (Kuznetsov,

³⁷ The terms "downstream" and "upstream" and "value chain" were introduced by M. Porter and quoted in Dunning (1993, p. 189) are often used to identify various stages of production from primary processing to marketing of the end product. It also depicts a level of integration between subsidiaries of the MNEs. The state monopolies are examples of such integration although this terminology was not used to characterize the relationship between SOEs.

1994, p. 17) with Western standards prevented Polish enterprises from becoming attractive partners in joint undertakings with foreign firms. The potential difficulties in integrating Polish SOEs into the international production networks deterred MNEs from locating in Poland. Unless the foreign investor was prepared to upgrade the existing plant, the enterprise was destined for failure in a more competitive global marketplace.

Underdeveloped Commercial Channels

Over the decades of socialist industrialization, rigid commercial channels between state-owned enterprises were developed. The existing networks of supply were established on the basis of central plans and politically-driven regional development schemes. The flows of goods took place between state monopolies in a centrally monitored manner. The enterprises were not prompted to search for the cheapest producer but relied on the distribution of products administered from above. The personal ties between managers of SOEs played a significant role in ensuring supplies of inputs and marketing of products. At the same time, the slowly emerging private sector was beyond the central distribution schemes. It had to rely on whatever was left-over from the state sector or had to develop its own sources of supply.

With the economy falling into a deeper crisis, the reliability of supply deteriorated very quickly. The ability to import necessary inputs was constrained by restrictions on foreign exchange. Some SOEs experienced interruption of production while expecting shipment of inputs but they rarely searched for other suppliers. They did not use lay-offs to avoid social discontent with the system. The problems with supplies became an accepted, almost inherent part of operation of the system.

Also, growing capital constraints of SOEs disturbed a system of payments between enterprises. At the turn of the 1990s, SOEs were involved in inter-enterprise lending. In an attempt to preserve own existence, SOEs granted temporary loans to their business partners, most often bankrupting firms. This practice was justified on the ground

of solidarity of SOEs in the tough time of economic crisis in Poland. Interestingly enough, the solidarity of workers known from the 1980s transformed itself in a solidarity of SOEs which was carried out by the management of these enterprises. It was believed that temporary difficulties could be ameliorated over time and that the state would not permit liquidation of one failing enterprise if it would force its partners to follow the same path (Hillman, 1992, p. 738). The indebtedness of SOEs increased even more when their ability to service the debt did not improve due to a drop in demand and output in the first years of transition. The financial ties, reinforced by bad loans between SOEs, posed a serious threat to the banking system and to the progress of privatization.

The highly centralized, state-owned banking system was not capable of performing its functions properly. The excessive loans of SOEs that could not be repaid because output was falling led to a situation where bad loans comprised the majority of the banks' portfolios. In many cases, only a few large SOEs were the biggest borrowers. Lack of supervision and well-functioning payment system exposed banks to numerous check scams. At the same time, undercapitalized banking system was not able to facilitate a new monetary policy and assist in building of capital markets in Poland.

Inadequate Transportation Networks

The demand for well-functioning transportation network was growing over the decades. It increased greatly when the liberalization of foreign trade took place and the domestic and foreign firms increased the volume of transported goods. Still, the main mode of transport were cars. The structure of transported goods in 1992 was the following: by car--50%, by train--39%, by ship--4.6% and by other means--4.4% (*Privatization Update*, January 1994, p. 4). It may be expected that the demand for transport services will increase as the country expands its production and distribution networks.

In order to capture the potential of Poland's central location in Europe and to facilitate constantly growing traffic, it is necessary to provide adequate routes connecting major centers of the East and the West. Due to the fact that Polish foreign trade was skewed towards shipments within the CMEA area, the existing transportation network is not compatible with the new orientation of Polish foreign trade, the majority of which is directed to Germany and other countries of Western Europe. The integration of Poland into the European transport system (both passenger and freight) requires investment in reconstruction of existing roads and railways as well as investments into new expressways.

Only 15% of all roads³⁸ in Poland are classified as good quality, while 35% are of very poor quality and 50% are not in satisfactory condition and require immediate upgrading (*Privatization Update*, January 1994, p. 4). In terms of a number of passenger cars per 1,000 people, Poland (at 160 cars) placed in 1991 behind the former Czechoslovakia (at 215) and Hungary (at 195) by a small margin and behind the developed countries (at over 400) by a much higher margin (GUS, 1993, p. 576). There were over 6 million cars in Poland in 1992 and the number is expected to double by the year 2000 (*Privatization Update*, July 1994, p. 4). Without plans for a new road construction, congestion and travel time will increase dramatically.

Another problem is an undeveloped road infrastructure. The number of gas stations, parking lots, hotels and motels close to the major roads, telephone booths, information centers, and car repair stations is low and their location is usually limited to larger cities. Also, accident rates are very high in Poland due to unacceptable traffic control, lack of visibility and poor road condition. Improvements in road conditions and infrastructure are critical for expansion of trade and investment. Well-functioning transportation networks would permit greater mobility of people and easier transfer of

³⁸ Poland has about 367,000 km of roads of which 235,100 km are paved and the rest are unpaved. Highways constitute 257 km and speedways about 700 km. There are over 4,500 bridges

goods, and would reduce gasoline consumption, car pollution, travel time, and accident risk.

Poor Telecommunication System

Despite the attempts of the state to develop telecommunications networks in Poland, the task was not completed. The state monopoly did not permit any private involvement in design, construction and provision of services in the sector. The industrialization and urbanization of Poland was not accompanied by subsequent upgrading of the obsolete and inefficient telecommunication lines and switchboards. On the contrary, investments were postponed as the sector was not a priority for the socialist regime. The lack of the latest technology and capital for improvements resulted in the high unreliability of the existing network. In addition, it was not able to satisfy the growing demand of the economy and individual users. According to *Business News from Poland* (May 1994, p. 11) 2,500 villages still have no telephone lines at all and in 40% of rural communities and small towns exchanges are manually operated. The telecommunication system in Poland is incompatible with that existing in Western Europe. This means that not even a mere modernization but building of a completely new telecommunication infrastructure is needed to ensure access to international market.

The quality of connections is very poor. There is rising pressure on the network that consists of above-ground open copper wire cable and is susceptible to interference caused by varying weather conditions. The customer service is not developed and requires extensive training. In 1990, there were 137 telephones per 1,000 people in Poland while in Hungary 167, in the former Czechoslovakia 264, in Russia 149, in Sweden 890 and in Germany 682 (GUS, 1993, p. 579). The state of Polish telecommunication sector is very poor and it is estimated that in order to triple the number of telephones by the year 2000, it would cost Poland between USD 6 and 10 billion (Kazimierski, 1994, p. 11). The frustration associated with inability to make simple phone

calls at certain time and to certain destinations, and to exchange information with subsidiaries and clients has been a serious drawback for investors. A functional and efficient telecommunication system is a *sine qua non* condition for attracting foreign business.

The underdevelopment of telecommunication network in Poland is a major obstacle for foreign investors in many industries, but it may also offer one of the biggest opportunities for foreign firms. Due to the fact that the telecommunication technology is in the embryonic stage, Poland must rely heavily on foreign investment. The well-known MNEs in telecommunications such as Alcatel, AT&T and Siemens successfully entered the market.

Level of Technological Development

The neglect of global trends and lack of proper signals from leading sectors of the economy led to backwardness and "misdevelopment of the science and technology base in Poland" (Gorzelać and Jałowicki, 1992, p. 43). The linkages between research institutes and enterprises, where new solutions could be applied, were very poor. Science, like everything else, had to rely on the centrally planned system for funds and approval of projects. With the over all slowdown of the economy in the 1980s, the demand for technological and organizational innovations had decreased. Moreover, the developed countries had restricted transfer of technologies to the socialist camp through the COCOM. Based on a study conducted in 1990 by the Polish Academy of Sciences, "70% of Polish products are outdated by at least 5 years while approximately half by more than 10 years" (Gorzelać and Jałowicki, 1993, p. 122). The technological gap between the West and all post-socialist countries reveals itself in many areas.

First, many industries were established as a result of technological race within the framework of the Cold War. Intensive research was conducted for military use and for applications in heavy, energy-intensive industries that dominated the industrial

structure of the economy. Second, capital constraints prevented Poland from directing enough funds for scientific research and innovation and for upgrading laboratory equipment. The priority of sustaining current level of production took precedence over generation of new technology. As a result, the equipment in SOEs is obsolete and not compatible with modern technologies being implemented by foreign firms or domestic investors. Therefore, transfer of technologies and management know-how will require a long process as the ability to absorb it must be created first. Third, the low level of computerization and automatization prevents Polish enterprises from achieving productivity levels comparable to the ones in the West. Fourth, product quality usually is inferior and combined with a low image of Polish goods on foreign markets it renders SOEs' output uncompetitive. The industries considered "high-tech" in Poland, are still less capital and knowledge-intensive than their counterparts in the West. Fifth, by the end of the 1980s, both the number of Polish patents filed abroad and Poland's share of publications in international databases declined (Gorzalak and Jolowiecki, 1993, p. 116). The country started to fall behind and loose contact with the latest scientific achievements abroad.

Education and "Brain Drain"

Free access to secondary and university education in Poland did not produce a core of graduates comparable to the developed countries. Moreover, many students attended vocational training schools and became blue-collar workers in state-owned enterprises. While in 1990 a level of 142 university students per 10,000 inhabitants in Poland was lower than in many OECD countries, it was still higher than indicators in Hungary or the former Czechoslovakia. The number of graduates was at 28 per 10,000 people and was lower than in many OECD countries but exceeded the other two ECEFs (GUS, 1993, p. 519). What is alarming is the fact that both indicators decreased from their 1980 levels of 166 and 42 respectively. Throughout the 1980s dissatisfaction with university education was growing. The financial resources devoted to education were

declining and reached 4.4% of GDP while at the same time in other countries they were growing.

In addition, graduates encountered difficulties in finding positions that would offer appropriate remuneration. A university degree did not secure a chance for a well paid career. In a situation of shrinking resources for research and development, scientific positions were threatened. Educational institutions were underfunded and their staff underpaid. As a result, teaching lost its prestige as a profession and started to attract not the best quality of individuals (Gorzelak and Jalowiecki, 1993, p. 134). The deterioration of the quality of knowledge delivered to students will decrease the level of education and subsequently the quality of human capital in Poland which, as mentioned earlier, has become one of the most attractive assets for foreign MNEs.

Another alarming phenomenon has been called a "brain drain". Historically, Poland experienced high levels of emigration associated with deteriorating economic and political conditions in the country. A very high number of university graduates, academics and scientists left Poland during the first few years of the socialist rule. The politically-driven migration intensified after imposition of the martial law. Also, there were very significant economic motivations to leave the country. The difficulties finding a suitable job, low wages and lack of perspectives for upward mobility in many places of employment were the main causes of the "internal brain flight" (Hryniewicz, Jalowiecki, and Mync, 1992, p. 45). They prompted professionals to move to other, better paid occupations, very often in the private sector. Based on the study conducted by Hryniewicz, Jalowiecki, and Mync (1992, p. 45)

"if there were no internal and external brain drain the employment level in science could be by some 25% higher than it actually was in 1991. ... It is worth noticing, though, that the losses of Polish science due to internal brain flight are much higher than those due to migration. The latter namely decreases the human potential of Polish science by some 10%, while the search for better paid jobs within Poland entail the outflow of some 15% of scientists."

The unfavorable political and economic environment in Poland contributed to a loss of valuable human capital. The most able, brilliant, innovative, and progressive

individuals emigrated or put their university degrees into the closet. While the state provided them with education and skills to become the driving force of the country's scientific and technological upgrading, in many cases this expected contribution was never realized. However, if they remained in the country and entered the private sector, it might have a beneficial effect. They became the precursors of the class of entrepreneurs and put the foundations for an emergence of a sizable private sector in Poland.

Financial problems

During the communist regime public expenditures were high to maintain the social benefits promised by the ideology. However, the deteriorating economic situation of enterprises contributed to a decline in government's revenue. In 1989 the budget deficit reached 7% of GDP (IMF, 1994^a, p. 1). A possibility of increased taxation to maintain government's income became a major threat to foreign investment.

Moreover, the accumulation of Poland's heavy borrowing abroad in the 1970s resulted in a total debt of USD 49 billion in 1990. According to IMF (1994^a, p. 76) the obligations to the Paris Club amounted to 67% (USD 32.8 billion) and to a group of commercial banks, the London Club, 23% (USD 11.1 billion) of the total. The need to service the debt required a transfer of foreign exchange earnings to creditors and limited the size of domestic capital formation.

The inconvertibility of the Polish zloty limited access to international money markets. Uncertainty about the future of the country prompted the population to turn domestic currency holdings into foreign currency deposits. In this situation a "hard currency black market" was thriving.

In these circumstances, foreign investors hesitant to put their money at considerable risk, employed a "watch and see" strategy before entering the Polish market. Even a renewed on June 12, 1986 membership in the IMF, did not immediately provide

Poland with a better image in the West and did not result in substantial inflows of desperately needed capital.

Socio-cultural Dimension of the Polish Society

Labor Market and the Role of Labor Unions

Under the communist regime the Polish United Worker's Party (PZPR) concentrated not only the blue collar workers but representatives of all professions. The existing labor unions were approved by the government and closely cooperated with the Party. Both were the channels for distributing not only central decisions but also privileges for political support and fulfillment of economic plans. Membership was a vehicle for upward mobility and access to special benefits such as car allowances, paid holidays, and subsidized housing.

While the first anti-government demonstrations reflected general hostility towards an undemocratic, communist regime, the next were fueled by growing privileges of the party "apparatchics" at a time when the majority of the population experienced shortages of almost everything. Frequent increases in state-set prices led to consecutive confrontations between the workers and the ruling elite.

Following the series of strikes in 1980, of which the demands of the Gdansk shipyard's employees under the leadership of Lech Walesa were especially strong, the authorities were forced to recognize Solidarity, the first independent trade union in a communist country. Within a few months about 12 millions of people joined the movement, many of them former members of the Party and government's labor unions. Although Solidarity was suppressed in 1981 by the introduction of the martial law, the voice of the labor was still powerful. The workers' councils created in the beginning of the 1980s were given considerable influence over the future of their enterprises and became

one of the most important players in transformation in the 1990s. Labor's demands for wage increases winded up the inflationary spiral.

The labor unions not only influenced the economic sphere. The representatives of the outlawed Solidarity union joined the Catholic Church representatives during the "Round-table Negotiations" with the government that led to the first post-communist government. Their priorities remained in the area of protection of social benefits which were promised and not completely delivered under communism. These were endangered by changing economic institutions and by the rationalization of production structure by new private owners, of which foreign investors were particularly feared.

Social Safety Net

The government, through state enterprises, supplied social services such as health care, education, day care, and housing. The employees of SOEs had access to additional services provided by their companies such as company trips, vacation and reconvalence homes, and housing. Although wages were low by Western standards, a satisfactory standard of living was attained through "collective consumption". Services provided free of charge substituted for individual remuneration. The paternalistic role of the state became an inherent characteristic of the system. The expectations associated with this role grew even stronger once the population began to experience the first signs of economic crisis and then various hardships of transition.

With the "Big Bang" reforms of 1990, this special role of SOEs in providing and maintaining social benefits was shaken. The principles of the new economic strategy attribute a greater role to the private sector and to minimum state involvement³⁹. As a result, enterprises are expected to eliminate expenditures in the social sphere. They are constrained not only by the rules of neoclassical economics but by their own very weak

³⁹ It must be mentioned that the role of a state in providing social benefits is highly differentiated across countries.

financial situation. A threat of a social unrest exists as the uncertainty over protection of the social safety net escalates. The perceptions of withering away of the established social system created hostility towards privatization and rendered difficult negotiations with potential investors.

Work and Business Ethics

A policy of "zero unemployment" guaranteed a position for a life-time. Change of employment was rare and pursued in a situation of ultimate necessity. The benefits granted by SOEs tied employees with the employer. Due to the fact that geographical mobility was impeded by scarce housing, individuals were very dependent on their employer. The life-time attachment to a company had an advantage of limited need for adjustment and retraining. However, it hardly provided an opportunity for innovative solutions and individual initiative. The potential of young employees was often lost behind habits and aversion to change on the part of older colleagues. The intra-enterprise networks became strong and informal institutions difficult to dismantle by new management or restructuring.

The security of employment provided by the state and distorted wage differentiation removed incentives to excel in a workplace and to upgrade one's skills. The work ethic was low. Multiple examples of late arrivals or no show-ups, repeated sick leaves, longer than prescribed breaks (often to shop during work hours), and drunkenness earned the labels of low self-discipline and unreliability for the Polish labor force. Absenteeism was particularly widespread in sectors and regions employing a high percentage of "worker-peasant group" who, during the harvest time, remained home absorbed by agricultural activities (Simatupang, 1994, p. 119). Combined with the instances of frequent strikes and labor disputes to settle wage demands, the image of low labor productivity and overpowering labor unions were spread abroad, obviously not without merit.

Employment in state-owned enterprises, based mainly on fulfilling orders to fulfill the plan, relieved workers from developing entrepreneurship skills. A majority of the population was not prepared for functioning in the private business environment. The World War II destroyed the merchant class represented mostly by Jews and after that the socialist regime effectively suppressed any entrepreneurial spirit by nationalization of property. Now, the process of learning by doing has been very common when not only first time entrepreneurs but also managers of the SOEs encounter difficulties with suppliers or marketing. Small private businesses that existed prior to 1990 became a nucleus of the emerging private sector and a propagator of new business ethics.

Attitudes towards Foreigners

Historically, Poland occupied an uneasy place in the heart of Europe. The country was subject to invasions, both from the West and from the East. The need to guard sovereignty and preserve the culture led to development of a very strong national identity. The experiences of partition of Poland in the 18th century, of two destructive World Wars and most recently of Soviet domination fueled resentment towards foreigners. Also, the nationalist attitudes reflected itself in Polish pride and a feeling of a special mission in history stemming from the period of Romanticism. The hostility towards foreigners was strong because economic success was perceived as a zero-sum game and the Poles felt that they "had limited opportunities to grow economically in their own country" (Bienkowski, 1992, p. 761).

Also, the instances of open hostility towards Germans have been widespread. President's Walesa widely quoted remark that "any foreign investment is welcome in Poland so long as it is not German" (PlanEcon, 1993, p. 12) offers another example of deeply-rooted animosity based on historical circumstances. This statement might have discouraged large German investors from entering Poland.

Yet Poland has always maintained its ties and cultural identification with the Western European tradition. Commercial channels, although altered by the CMEA arrangement, were never completely destroyed. The attempts to join the European Union express Poland's desire to expand its linkages with the West. This tendency is particularly strong in western and northern parts of Poland where family ties and market proximity with Germany foster cooperation.

Initially, the communist authorities displayed strong animosity towards foreign investors and prohibited them from economic activity in Poland. This official condemnation of foreign influence and anti-capitalist propaganda of the Cold War added to anti-foreign sentiments and caused further isolation. Over the decades, however, the socialist regime realized that foreign tourist could be a source of foreign exchange. Trips to Poland were encouraged, but foreigners were charged higher rates for accommodations and were obliged to exchange a certain amount of hard currency for an intended period of a visit. The welcoming campaign was targeted mostly at the Polish émigré communities in North America and Western Europe. The regulation permitting foreign participation in the economy encouraged FDI, but restricted it to investors of Polish descent. Once again nationalist tendencies inspired the policy.

At the turn of the 1990s, Poland was more open to foreign penetration. Individual and commercial contacts were developing. Although the need for foreign participation was recognized and approved, criticism fueled by a threat of selling the national wealth to foreigners (especially German) and potential employment cuts by new owners gathered momentum. Public opinion became divided and Poles were increasingly unwilling to exchange the Eastern political influence for Western economic domination.

According to a report prepared by Gorzelak and Jalowiecki (1993, p. 78) Polish society holds a negative attitude towards foreign capital. The first of two surveys conducted in 1992 revealed that 45% of respondents were against the sale of shares in privatized companies to foreigners, 12% approved such sales, and the rest would prescribe

definite limitations to it. In another survey, 70% of respondents were opposed to the sale of SOEs to large MNEs while only 25% perceived some advantages in such a sale.

Perceptions of Economic Reforms and Democracy

The socialist system proved unsustainable and did not supply what the communist ideology claimed to deliver. Dissatisfaction with the regime grew stronger despite its attempts at economic reforms. Even though collapse was inevitable, for many it still came as a surprise. The process of transition was initiated in a society whose socio-political attitudes were for centuries shaped by its own cultural tradition and the Roman Catholic Church. These attitudes were recently altered by communist influence and produced characteristics that were identified by Gorzelak and Jalowiecki (1993, p. 72):

"...we are dealing with catholic communities with the relatively bigger tendency to collectivism and to group uniformisation of behavior, with greater political and moral tolerance, with preference for cooperation over competition and for justice over property rights and with the need for the state interventionism."

In the light of public preferences for state paternalism and egalitarianism, the transformation to a system governed by markets and competition seemed like a challenging task. The collectivist attitudes reinforced by strong family ties and egalitarian values of the Catholic religion clashed with individualistic behavior propagated by Protestant ethics in capitalist societies. A lack of proper work ethics and disapproval of (or resistance to) pro-capitalist economic reforms was attributed by Winiecki (1994, p. 715) to the Catholic values and their "...ambiguous attitude towards capitalism and individual wealth creation and disposition..." and to "...the true legacy of Solidarity."

The Poles, suppressed by undemocratic regime and dispirited by economic hardships, with some uncertainty but great enthusiasm, endorsed pro-democratic political changes and pro-capitalistic economic reforms. In the early years of transition, post-communist governments enjoyed public support for instituting profound changes.

That support started to disappear when a painful reality of building a new system clashed with high expectations for immediate improvement in the standard of living.

Two essentially different orientations emerged among the population: "individualistic-market-oriented and egalitarian-regulation-oriented" (Gorzelak and Jalowiecki, 1993, p. 76). The former, widespread among the young and successful, new entrepreneurs, highly approves recent changes in ownership and in the economy at large. The latter, expressed by workers in SOEs, reflects expectant attitudes towards the state. Based on a survey conducted among 12 companies in Cracow in the second quarter of 1992 (Drag and Indraszkiewicz, 1993, p. 63-64), two-thirds of employees believed that in comparison to 1989, the economic situation worsened and over 70% believed that it would not improve in the near future⁴⁰. These pessimistic views reflect a growing fear of what lies ahead and a dissatisfaction with the achievements of transition thus far. The differentiation of income and an emergence of wealthy elite (often associated with a former "nomenklatura") have polarized the society. The shift in public opinion has jeopardized the progress of transformation as an impatient, large part of the population has become unwilling to bear the burden any more.

Poor Legacy

The legacies of the past provided foundations for the construction of a new system in Poland that began at the turn of the decade. When the transformation from the old to the new started not much from the previous era could find its suitable place in the new circumstances. Even worse, some of the legacies have become barriers in transition and slowed down the pace of change.

As it was presented earlier, the legal framework was not only unfavorable to FDI in many ways, but also subject to frequent amendments and new laws. Its evolutionary character, by its very nature, entailed uncertainty and instability. The restrictions on repatriation of profits, lack of extensive investment incentives and

⁴⁰ 43.5% stated that it would get worse while only 25.8% that it would get better (Drag and Indraszkiewicz, 1993, p. 38)

interventionist mandate of the AIZ were the obvious drawbacks. But, on the other hand, many years of continuous "experiments" with FDI legislation provided essential knowledge about the impact of unfavorable investment regime. The failure to attract FDI prior to 1990 suggested that a more liberal approach had to be taken if the benefits of FDI were to be enjoyed.

The dissatisfaction with the communist regime led to an overwhelming political support for change. The new authorities obtained a mandate to implement radical reforms. Amidst enthusiasm and unrealistic expectations of greatly improved standard of living within a short period of time, a fast track approach was endorsed by the population. Ironically, the legacy of the communist era was the very desire to dismantle the system as fast as possible.

Also, in comparison with other Central and East European countries, the private sector in Poland was growing under communism. The examples of successful small-scale entrepreneurs were numerous. The exact contribution of the private sector is difficult to assess as much of its activities were not reported. These first enclaves of individual private business became a foundation for a market economy. Although it would appear that introduction of the market oriented principles could be easier, the multiple obstacles existing in the infrastructural and institutional spheres formed a negative legacy. These initial conditions in which the change was going to be instituted not only slowed down its pace but also shaped the policy choices and processes of transformation,

The inadequate investment regime prior to 1990 not only deterred foreign investors but also prevented Poland from reaping the benefits of foreign participation in the economy. A lack of technological and managerial upgrading contributed to the inefficiency of SOEs and the over all backwardness of the economy. The new regime inherited a deteriorating economy that required substantial infusion of capital to rescue it from further decline.

A limited exposure to FDI did not provide Poland with an infrastructure ready and able to facilitate FDI in the early years of transition. The underdeveloped transportation and telecommunication networks, ill-functioning banking sector and the technological gap posed serious constraints on the emerging system. Outdated equipment and poorly developed commercial networks in Poland did not offer sufficient prospects for success.

But, by far, the most important legacy of the past was a lack of proper institutions for democratic, capitalist system. The socio-political dimension of Polish society, whether in perceptions of political pluralism or in attitudes towards economic activity based on competition and profit did not correspond with the capitalist principles. The cultural characteristics of a collectivist society clashed with an individualist ethics of the new order. The initial unfamiliarity with new rules created resistance to abandon expectant disposition towards the state.

Under communism, labor unions and workers' councils were actually vested with more power and used it to oppose pro-market reforms. They were ill-prepared for adjustment that the new reality required. It may take generations until an inherited legacy of incompatible institutions will be substituted by a new framework which will eliminate tensions that were present at the outset of the new era.

Chapter V. Policy Environment during the Transition

Transformation of the Political System

After the collapse of communist rule in Poland, fundamental changes had to occur in order to build a democratic political system and market-oriented economy. Neither could be created overnight, but required drastic initial decisions followed by a lengthy process of evolution that still continues. Although many prescriptions were supplied by international institutions and foreign private consultants, the task proved to be not so easy as anticipated. Western "solutions" could not be simply implemented easily to produce expected results. Once they were introduced into a constantly changing environment with peculiar post-communist legacies, many took their own unexpected course.

A series of strikes in the 1988 demanding economic and political reform forced General Jaruzelski to enter negotiations on the future of Poland.⁴¹ According to a deal concluded on April 5, 1989 between representatives of the Jaruzelski government, the Catholic Church and the Solidarity movement, the transition of power entailed formation of a new Parliament. Supporters of the remnant communist bloc were assured 65% of seats in the Parliament while the other 35% of seats were captured in an open election by Solidarity candidates. Also, the latter won 99 out of 100 seats in the upper chamber, the Senate (Mason, 1993, p. 42). In exchange for the deal, Jaruzelski took over the office of the President⁴². The first post-communist, "Solidarity" government was formed in September 1989 by T. Mazowiecki. The tremendous responsibility of giving Poland a vision and direction was put upon the new authorities as the forces of political and economic change swept the country. International attention was focused on Poland, in

⁴¹ The conciliatory approach was, no doubt, encouraged by Gorbachev's reformist attempts.

⁴² Jaruzelski was elected to become the President by the Sejm and Senate but resigned a year later and the presidential elections were held (Jasiewicz 1993, p. 127).

anticipation of fast and successful transformation. Some of these expectations were unrealistic, others were overshadowed by unpredictable developments that occurred within the political and economic spheres during the early years of transition. After a defeat, the former communists formed a new forum. They admitted that Poland's path should lead to a market based system but disagreed with the rapid pace of changes and propagated social democracy. Hence, there was no major ideological difference between the traditional division on the left and the right, but rather various ways in achieving of an ultimate goal. While the majority of other political parties tilted towards conservatism, the Democratic Left Alliance (SLD) occupied the left end of a new political spectrum in Poland. With the passage of time and subsequent economic recession, the SLD's message appealed to a fearful population and brought a surprising shift in the government in 1993. The reemergence of a strong left wing on the political spectrum together with frequent changes of government, acted as a deterrent for foreign investors reluctant to invest in a high-risk and unpredictable policy environment.

The prolonged drafting of a new constitution contributed to legal instability in Poland. Numerous amendments accompanied by fierce political debates took place in the early years of transition. The issues of the balance of power between the executive, legislative and judicial branches occupied the agenda. The interim Little Constitution adopted in 1992 permitted the President to select three key ministerial posts⁴³, to propose and veto legislation, and to decide on foreign and defense policy (Howard, 1993, pp. 100-102). But the presidency was constrained by the powers granted to the Parliament, especially the Sejm. Tensions between the branches and multiple political parties have been reflected in dissolution of the Parliament, in frequent changes of government and in difficulties in forming a ruling coalition.

⁴³ The defense, foreign affairs and internal affairs posts have been a subject of controversies and political fight between the President, the coalition governments and the Parliament.

Fragmentation of the Political Scene

Competition within the Solidarity camp that resumed power in 1989 led to a creation of separate fractions. Other emerging parties underwent the same phenomenon. Between the extreme positions represented by Solidarity and the communists there was room for a number of new divisions between supporters and opponents of certain policy choices. Among the issues that started to shape the political scene were: de-communization, Balcerowicz's economic reform package, the role of the Catholic Church in public life and the role of the President (*Polityka*, 10 July 1993, p. 14).

The first full-scale, free parliamentary elections were held on October 27, 1991. In the meantime, Lech Walesa was elected as President in December 1990 and about 100 political parties emerged to compete for seats in the new Parliament⁴⁴. After decades of a one-party system, political pluralism was a positive sign. Apart from a few established political parties, however, the euphoria of freedom of association contributed to the formation of "such bizarre organizations as the Owners of Video Cassette Recorders 'V', the Polish Erotic Party and the Polish Party of Beer Lovers⁴⁵" (Michta, 1993, p. 61). The proliferation of political groups led to a fragmentation of the legislature in which 29 parties obtained seats, while none of them received more than 13% of popular vote (see Table V. 1). This seriously jeopardized the ability to achieve consensus on key issues and to maintain support for a new government. The stability of political life and policy making in Poland, vital for attracting FDI, was not established.

By the time of the next parliamentary elections, on September 19, 1993 a threshold of 5% of the vote at the national level for political parties and 8% for coalitions was adopted to bring together a very divided political environment. As a result of this election, the leftist coalition led by the Democratic Left Alliance (SLD) secured the highest

⁴⁴ The Parliament in Poland consists of two houses. Sejm is the lower house with 460 seats while Senate is the upper house with 100 seats.

⁴⁵ This movement obtained 16 seats in the first freely-elected Sejm.

number of seats (171) in the Sejm. Due to the fact that many political parties did not cross the required threshold, one-third of the electorate is not represented, while two winning parties, SLD and Polish Peasants Party (PSL) with 35.81% of the popular vote obtained 303 seats (65.7%) in the Sejm (*East European Politics and Societies*, 8,2, pp. 370-371).

Table V. 1. Results of the Parliamentary Elections to Sejm*

October 27, 1991	% of popular vote	Number of seats (460)	September 19, 1993	% of popular vote	Number of seats (460)
Voter turnout: 43.2%			Voter turnout: 52%		
Democratic Union (UD)	12.32	62	Democratic Left Alliance (SLD)	20.41	171
Democratic Left Alliance (SLD)	11.99	60	Polish Peasants Party (PSL)	15.40	132
Electoral Catholic Action (WAK)	8.74	49	Democratic Union (UD)	10.59	74
Citizen's Center Alliance (POC)	8.71	44	Union of Labor (UP)	7.28	41
Polish Peasants Party (PSL)	8.67	48	Confederation for Independent Poland KPN	5.77	
Confederation for Independent Poland (KPN)	7.50	46	Non Partisan Block for Support of the Reforms (BBWR)	5.41	16
Liberal Democratic Congress (KLD)	7.49	37	German Minority	0.7	4
People's Union (PL)	5.47	28			
NSZZ Solidarity	5.05	27			
Polish Party of Beer Lovers	3.27	16			
Christian Democracy	2.36	5			
Union of Real Politics	2.26	3			
Solidarity of Work (SP)	2.06	4			
German Minority	1.18	7			
Party of Christian Democrats	1.12	4			
Party "X"	0.47	3			
Polish Western Association	0.23	3			
Movement for Silesia's Autonomy	0.36	2			
11 other parties that obtained 1 seat each	10.75	11			

Source: 1991 electoral results from *East European Politics and Societies*, 7, 3, Fall 1993, pp. 571-572. 1993 electoral results from *East European Politics and Societies*, 8,2, Spring 1994, p. 371. * Data on 1993 electoral results includes only those parties and coalitions which crossed over the required thresholds.

Frequent Changes of the Central Government

The governing of post-communist Poland has not been easy. Fragile coalition governments could not withstand both the political struggles between multiple parties and a growing dissatisfaction with the performance of the Polish economy. Frequent changes in the Prime Minister's office, presented in Table V. 2, suggest that the competition for power and influence on policies has been fierce. Every time a deadlock occurred and a new government was formed, great uncertainty arose as to whether or not the new government would maintain a commitment to democratic and market-oriented reforms.

A message of unstable political regime was circulating within international business community. The Prime Ministers themselves represented diverse political orientations and, therefore, continuity of policy could potentially be threatened. The fundamental division between the right and the left stemmed from differences of opinions on the pace and scope of economic reforms being implemented. Prime Minister J. K. Bielecki in 1991 pointed out that the difficulty with passing the laws essential to economic transformation occurred in the Parliament which at that time still consisted of 65% deputies from the communist bloc who favored special protection of the state sector. He also said that the "investors must have confidence that their money was safe if invested in Poland".⁴⁶ Over a year later Prime Minister W. Pawlak, in the light of political fragmentation in the Parliament, stressed that "political and legal stability was the fundamental problem that needed to be overcome to encourage foreign and domestic investors".⁴⁷

46 Markus Ziener, "Warsaw Counts on Remission of Debts and Liberalization of the Investment Law", (Text), Dusseldorf, *Handelsblatt* in German, (22-23 February 1991, p. 5). Translation by the Foreign Broadcast Information Service. Daily Report: East Europe, 25 February 1991, (PrEx7.10: FBIS-EEU-91-037; pp. 44-45)

47 "Pawlak Stresses Stability for Foreign Investment", (Text), Warsaw, Third Program Radio Network in Polish, 14 June 1992, 2000 GMT. Translation by the Foreign Broadcast Information Service. Daily Report: East Europe, 15 June 1992, (PrEx7.10: FBIS-EEU-92-115; pp. 25-26)

The outcome of the September 1993 election was particularly important because it brought the left back to central government. A large number of political parties seeking seats in the Parliament dissipated the votes and permitted the SLD, whose popularity was growing among workers, students, entrepreneurs, and pensioners (*Polityka*, 2 October 1993, p. 14) to win the 20% of popular vote and the largest number of seats in the Sejm. While the Poles voted for protection from the many hardships of restructuring, the world feared that the reforms would be reversed. Although a new Prime Minister, W. Pawlak, guaranteed that the main path of change would not be abandoned, there was a suspicion that the communist coalition government would slow down pro-capitalist, radical transformation.

Table V. 2. Changes in the Office of Prime Minister in Poland

Prime Minister	Length of term	Party and its policy orientation*
Tadeusz Mazowiecki	September 1989--December 1990	Democratic Union: centrist, market-oriented, Christian ethics
Jan Krzysztof Bielecki	December 1990--December 1991	Liberal-Democratic Congress: laissez-faire, libertarian, secular
Jan Olszewski	December 1991--June 1992	Movement for the Polish Republic: "de-communization"
Waldemar Pawlak	June 1992--July 1992 (failed to form a government)	Polish Peasant Party: secular, protectionist, interventionist,
Hanna Suchocka	July 1992--October 1993	Democratic Union
Waldemar Pawlak	October 1993--March 1995	Polish Peasant Party
Józef Oleksy	March 1995	Democratic Left Alliance: interventionist, social market economy, secular

Source: Prepared on a basis of information in Staar, R., 1993 and various issues of *Rzeczpospolita*.

* Adapted from Taras 1993, pp. 30-31.

Intra-governmental Relations

There are many aspects of intra-governmental relations that contributed to instability of the domestic policy environment. First, the new regime declared radical changes of public service personnel in an attempt to develop its own bureaucratic

apparatus. Initially, all members of the previous elite were to be removed from government functions. In practice, many members of the old "nomenklatura" retained their positions or returned to the government under a new banner of pro-market ideology⁴⁸. Public opinion was divided whether a "settling of accounts"⁴⁹, carried out with the highest degree of determination under Olszewski's administration, should continue. Accusations were also made against Walesa, further aggravating already rather hostile relations between the President and the Prime Minister.

Second, there was an uncertainty surrounding the office of the President. As the Solidarity camp split and lost public support, President Walesa tried to strengthen his power vis a vis the power of government and of the legislature. Many feared that a dictatorial presidency would stall the process of democratization⁵⁰.

Third, there were frequent changes in key ministerial positions of which the nominations for the Minister of Defense or the Minister of Foreign Affairs posts swelled to a size of "political affairs" (Michta, 1993, pp. 63-67). Also, new Prime Ministers dismissed a number of voivods⁵¹. Their departure resulted in other personal changes at subordinate positions. Every change of senior personnel entailed necessary readjustments and often caused confusion. They, in turn, did not contribute to a smooth operation of various government departments but complicated implementation of new economic policies. The administrative procedures, subject to frequent changes and different rules between the government's departments, created a very unstable policy regime.

⁴⁸ Wasilewski (1992, pp. 113-127) offers an overview of leadership recruitment in Poland. His findings suggest that apart from the members of the "old nomenklatura" who managed to return to their positions, there is a "new nomenklatura". It is chosen according to the same criteria of selection such as loyalty to the party of the day or a dissident past as were employed by the communist regime.

⁴⁹ Olszewski promised to complete the "cleansing" of government ranks from former communists that began under Mazowiecki's government but was never properly carried out.

⁵⁰ For a wider discussion on relations between the President, Prime Ministers and the Parliament see Taras (1993, pp. 15-39) and Michta (1993, pp. 57-76).

⁵¹ Out of 49 voivodes in administration, Mazowiecki recalled 44, Bielecki-12, Olszewski-8, Suchnacka-10 and Pawlak-5 (*Polityka*, 15 January 1995, p. 3).

Decentralization of Power to Regional and Local Governments

The process of decentralization began in the 1980s when SOEs obtained greater economic autonomy and the voivodships greater fiscal autonomy. Not until the spring of 1990, however, were property rights transferred to regional and local governments. The central government tried to withdraw from subnational responsibilities in order to bring greater efficiency in the management of local affairs, especially with regard to the activities of an emerging private sector.

Recognizing a huge need for funds, the respective subnational governments undertook various measures to attract foreign investors: by promotions of assets available for sale, by assisting local businesses in finding partners for cooperation, and by granting incentives to investors. Unfortunately, due to capital constraints many regional and local development plans had to be halted.

Institutional and financial barriers prevented regional and local governments from establishing networks that would ensure access to a timely information on current policies and regulations. Organizational chaos and differences in application of laws between various parts of the country created confusing and unpredictable environment for investment. Although the subnational levels of administration played a critical role in small and medium-sized privatization, the sale of large SOEs was still in the realm of the Ministry of Privatization. Lengthy bureaucratic procedures and multiple parties involved in monitoring of an investment project acted as a deterrent.

Building of a Market-oriented Economy

The collapse of the communist regime cleared the way for implementation of liberal, pro-market reforms. The new government faced the tremendous task of rescuing the economy from further decline, dismantling the institutions of central planning, and building a system where state intervention would be greatly reduced. A common opinion

was that Poland had no other alternative but to move towards the market oriented regime. The debate emerged whether Poland should take a more gradual or a quick approach to systemic change. It was believed that the pain of radical change borne in the short-term would be more acceptable to the public whose support and cooperation was a key element for success. The risk of derailing from the transition path that could be caused by prolonged hardships experienced under a gradual approach prompted the authorities to act quickly. Following the prescriptions from international agencies (IMF, and the World Bank) and foreign consultants, among whom Professor Jeffrey Sachs of Harvard University was a leading figure to advise the Polish government, the Minister of Finance and Deputy Premier, L. Balcerowicz, tabled a package of radical economic reforms.

Elements of the "Shock Therapy" Approach

A comprehensive package has been labeled the "Shock Therapy" or the "Big Bang"⁵². The programs which aimed both at the macro and microeconomic spheres of the economy were implemented simultaneously. The main effort of a stabilization program was to curtail hyperinflation and decrease a budget deficit. The elimination of foreign exchange restrictions and liberalization of prices, foreign trade and investment permitted competitive pressures to end a sheltered existence of the Polish marketplace. Yet, the "backbone of systemic change" (Samonis and Hunyadi, 1993, p. 8) was a privatization program.

The economy responded by slipping further into a deep recession, with a sharp drop in output and high level of unemployment. As public support for transformation diminished with a fall in real income, demands for an adequate social safety net dominated the agenda of widespread strike actions in 1992 and again in 1994.

⁵² The key elements of the package were: reduction of budget deficit, liberalization of prices, restrictive monetary policy, wage control policy, and establishment of internal convertibility of the Polish zloty (Myant, 1993, p. 87).

Privatization was stalled by fierce debates on the national level and by the resistance of workers and managers in SOEs.

Table V. 3. Main Economic Indicators in Poland: 1989-1994.

	1989	1990	1991	1992	1993	1994 ^a
Real GDP (%)	0.2	-11.6	-7.6	2.6	3.8	4.7
Consumer price inflation (%)	251	586	70	43	35	34
Budget deficit in % of GDP	-6.1	0.7	-7.0	-6.8	-3.4	-3.0
Unemployment rate (%) ^b	..	6.3	11.8	13.6	15.7	16
Trade balance (USD billion)	0.2	2.2	0.1	0.5	-2.3	-3.9
Current account balance (USD billion)	-1.8	0.7	-2.2	-0.3	-2.3	..
Sold production of industry ^c (1990=100)	131.9	100	88.1	91.5	97.2	..

Source: *Poland: The path to a market economy* (IMF, October 1994, p. 99)

^a Data from *Rzeczpospolita* (27 January 1995, p. 12)

^b Data from *Poland: Quarterly statistics* (GUS, March 1994, p. 20)

^c Data from *Poland: Quarterly statistics* (GUS, March 1994, p. 19)

Decline in Economic Activity

The downward trend of the Polish economy throughout 1980s did not offer a strong basis for reforms. The country entered the 1990s with the highest inflation rate (586% in 1990) and among ECEE-3. In the same year it was hit by the largest decline in GDP (11.6%) (see Table V. 4). The former Czechoslovakia and Hungary experienced their highest inflation rates (59% and 34% respectively) and largest drops in real GDP (15.9% and 9.9% respectively) in 1991. None of the countries avoided the post-communist recession. Nonetheless, Poland entered it first and was very substantially

hit⁵³. However, Poland also was the first to recover in growth rate and gross industrial output in 1992 while the other two countries still recorded negative GDP growth in 1993.

Table V. 4. Economic Indicators for ECEE-3

Country	1989 ^a	1990	1991	1992	1993	1994 ^c
Real GDP (%)						
Former Czechoslovakia*	1.3	-0.4	-15.9	-8.5	-0.3	1.5
Hungary	-0.2	-3.5	-9.9	-5.1	-2.0	1.0
Poland	0.2	-11.6	-7.6	2.6	3.8	4.5
Consumer price inflation (%)						
Former Czechoslovakia*	1.4	11	59	11	21	9
Hungary	18.8	29	34	23	22	19
Poland	259.5	586	70	43	35	30
Gross industrial output^b (%)						
Former Czechoslovakia*	0.8	-3.7	-23.1	-10.6	-5.2	..
Hungary	-3.4	-9.0	-19.1	-9.8	2.5	..
Poland	-0.5	-24.0	-11.9	3.9	7.0	..

Source: Prepared on the basis of data from IMF (1994^b, p. 66)

* Starting from 1992 data pertains to the Czech Republic only.

^a Data from Winiecki (1994, p. 710 and p. 727)

^b Data from Winiecki (1994, p. 717)

^c Data for 1994 are IMF projections

From the beginning of the reforms Polish authorities insisted on "hard enterprise budget constraints"⁵⁴ and announced the elimination of subsidies. The banking system reduced lending to SOEs and domestic investment outlays were decreasing. These drastic measures forced a number of SOEs into bankruptcy as they could not maintain production without inflows of capital. Others, though in limited numbers, entered the privatization process hoping that new owners and restructuring would rescue the companies and preserve jobs.

⁵³ Based on an article in *Rzeczpospolita* (27 January 1995, p. 12) making a claim that due to the fastest systemic changes in the early years of transition, Poland experienced the largest loss of GDP may be unfounded. According to the data in the article, the GDP before 1993 decreased in Poland by 18.3%, in the former Czechoslovakia by 21.5% and in Hungary by 19.3%, thus it was not the hardest hit by recession. It may be a case that a fast recovery in growth of GDP in Poland in 1992 modified the initial deep breakdown and improved Poland's showing which was presented in the article.

⁵⁴ J. Kornai distinguished between "soft and hard enterprise budget constraints". They refer to easy and difficult terms on which SOEs obtained financing from the government.

In addition, the demand for Polish output and supply of oil and gas were suppressed by the collapse of the CMEA arrangement, economic and political crisis in the former Soviet Union (a major export market for Poland) and by recession in the developed countries combined with their protectionist measures against Polish exports. As Table V. 3 shows "sold" industrial production declined and with it also real GDP. A positive trend has been observed since 1992, when industrial output and real GDP increased (although 1989 level in output was still not attained).

Both the former Czechoslovakia and Hungary were able to keep inflation (10% and 19% in 1994) and unemployment (4% and 12% in 1994) at levels lower than in Poland (see Table V. 4). The transformation in Hungary took a more gradual course as it continued economic reforms initiated much earlier. The restructuring and adjustment already in place might have cautioned the shocks of the CMEA demise and provided more stable investment environment. But it still had to deal with the highest per capita debt and the highest budget deficit in 1993 (8% of GDP). Through tight financial policies, the Czech Republic was able to avoid high budget deficit (only 1.5% of GDP in 1993), inflation and unemployment rates. Much smaller fluctuations of economic indicators suggest that the economy was undergoing change with a lesser shock. Since the separation, the country might have again appeared more stable, thus more attractive to foreign investment. Although the recovery took place later than in Poland, on the 100-point of high investment risk, the Czech Republic scored 25, Hungary 50 and Poland 55, making the latter the most unstable for FDI (*Rzeczpospolita*, 27 January 1995, p. 12).

Reorientation of Foreign Trade

As of January 1991, all intra-CMEA transactions had to be carried out in convertible currency and in June 1991 the CMEA was dissolved. As a result, Poland lost not only a supply of subsidized fuels provided by the Soviet Union but also a huge export

market for its manufacturing output (mainly machinery and equipment). A collapsing Soviet economy forced Polish companies to look for new partners in the West. Although expansion of exports was expected to be a driving force of the post-communist recovery, even maintaining foreign exchange earnings became a challenging task.

The redirection of trade was impeded by many factors. In intra-CMEA trade Poland was an exporter of processed goods and an importer of raw materials (mainly from the former Soviet Union). In its extra-CMEA trade Poland was an exporter of raw materials and an importer of manufactured goods (consumer goods, machinery and equipment). With the necessary shift in a destination of exports, goods available for sale to the developed countries were not the type of products that Poland traditionally traded with the West⁵⁵. Poland's production structure was skewed towards producing for the Eastern market and the goods were often energy and material-intensive. Poland, therefore, had to change the structure of production and improve the quality of goods in order to be successful in penetrating Western markets. According to Rosati (1993, p. 92) the first signs of changing trade partners was seen in the late 1980s and there was no reason to preserve the CMEA, a highly distorted arrangement. Nevertheless, Polish products encountered protectionist measures imposed by the EU⁵⁶ which diminished its attractiveness as an export platform for foreign MNEs.

The paramount goal for Poland is to join the EU. In December 1991, an Association Agreement was signed that permitted gradual establishment of a free trade area within 10 years, when a decision about the membership in the EU should be made. The review deadline may serve as a "safety valve" for the EU to refuse membership if reforms in Poland suffer setback. Although Poland was granted a preferential status under the Generalized System of Preferences (GSP), there still exist a "big asymmetry in market protection" and "big asymmetry in the commodity structure of trade" (Kawecka-

⁵⁵ Brada (1991, p. 105) explains this phenomenon in full detail in relation to all East European countries.

⁵⁶ The anti-dumping cases against Poland intensified in 1992 and 1993. They are presented in Table A18 in IMF (1994^a, p. 107)

Wyrzykowska, 1993, pp. 28-29) between Poland and the EU. Kawecka-Wyrzykowska argues that EU's trade barriers in areas in which Poland has comparative advantage still prevent these goods from reaching markets in the West.

In terms of overall volume of trade Poland's exports increased significantly in 1990 (devaluations made Polish exports more attractive), leading to a sizable trade surplus of USD 2.2 billion. However, since 1991 surging imports (exports grew until 1993 but at a slower rate) decreased the trade surplus and in 1993 Poland experienced a huge trade deficit of USD 2.3 billion (IMF, 1994^a, p. 103). At the same time, comparison of the 1989 and 1992 commodity structures of trade (Table E3 in Appendix E) indicates that the highest increase was observed in metallurgy, wood and paper, light industry and agricultural products. The exports of machinery and equipment declined and, therefore, a redirection of Polish exports from Eastern to Western markets did not take place⁵⁷. The share of electrical and machinery imports in total imports remained high and those of energy and chemicals increased. It must be mentioned, though, that the share of foreign trade with the West grew significantly and with the East declined dramatically. Germany emerged as a leading trade partner while the role of Russia diminished. Tables E1 and E2 in Appendix E and Figure V. 1 illustrate a structure of Polish foreign trade by country.

⁵⁷ The similar conclusion was made in Collins and Rodrick (1991) and in Rodrick (1992).

Figure V. 1.

Source: Prepared on the basis of data in Tables E1 and E2 in Appendix E.

Although the largest FDI inflows were recorded in electrical and machinery sector, food, wood and paper, and chemical industry, the export performance of the first sector did not improve. It suggests that investments in that sector were oriented to sell in the domestic market. A declining share of electro-engineering branch in total exports did not encourage export-oriented MNEs. Once domestic demand is satisfied foreign investment in that sector may decrease. In order to encourage FDI inflows in that sector, Poland needs to enhance its ability to export. The commodity structure of Polish exports is skewed towards primary products and so is the branch structure of FDI inflows. Clearly, sectors with an export potential are able to attract FDI to locate in Poland. A desired private capital in the industrial sector has not come in through export-oriented MNEs because there was no prospect for export expansion. Poland ranked far behind the Czech Republic and Hungary on *The Economist's* list of countries with the highest share of merchandise

exports relative to GDP (*The Economist*, 26 March 1994, p. 132). However, Poland still offers the largest domestic market which may lure new investments.

Poland has been trying to foster links with developed countries and expand its export potential by concluding various trading arrangements. The most important is access to Western markets through the Association Agreement and when (if ever) Poland joins the EU. Other free trade arrangements include the Central European Free Trade Agreement (CEFTA) and the agreement with the European Free Trade Association (EFTA).

Suspension of the IMF Program

The renewed membership in the IMF allowed Poland to request financing necessary to carry out the reforms. The IMF and the World Bank addressed strict measures to be met as conditions for potential loans. The most important prescriptions were stabilization and liberalization of the economy. The funds were to strengthen Poland's balance of payments and offer technical assistance in privatization, banking sector restructuring, and modernization of infrastructure. The government committed itself to decrease the growing budget deficit and achieved a surplus of 0.7% of GDP in 1990. However, it was not sustained and in 1991 government's expenditures exceeded revenues by 7.0% of GDP and in 1992 by 6.8% (IMF, October 1994, Table. A4, pp. 93-94). The deficit violated Poland's agreements with the IMF and the World Bank which suspended financing of programs that were initially approved and worth about USD 2.5 billion (Mason, 1993, p. 47).

The suspension of funds took place at the time when the progress of transformation was constrained by lack of capital, both domestic and foreign. A number of projects were halted and as a result, the economy stagnated. Therefore, the decision not only jeopardized the transition process but also prolonged a hardship experienced by an increasingly impatient population. In addition, the IMF's decision sent a negative message

to international business and to creditors with whom Poland was conducting negotiations on debt rescheduling. Once again Poland was perceived as a high-risk location and the international financial institutions were unhappy with the progress of reforms in Poland. Scarcity of capital and postponed reforms of the banking system hit the enterprises especially hard as the restructuring plans could not be implemented without necessary financing.

The threat of derailing from the reform path prompted the international agencies to reconsider their rigid position and to assist Poland in long and costly restructuring. By the mid-1994 there have been two stand-by arrangements, one Extended Financial Facility and one Compensatory and Contingency Financing Facility under which Poland was given Special Drawing Rights of up to USD 2.4 billion (*Privatization Update*, July 1994, p. 3). Resident Representative of the World Bank in Poland, Paul Knotter, pointed out that a renewed membership in the World Bank in 1986, resulted in 22 loans totaling about USD 4 billion (*Privatization Update*, December 1994, p. 1). The rebuilt relationship with two major international financial institutions not only provides access to funds but most of all has a demonstration effect. Thanks to the confidence given by IMF and the World Bank, the perception of business risk in Poland will diminish. Thus, in turn, may lead to larger private capital inflows in the future.

Foreign Debt Burden

Once the transformation began it was expected that the economy would take a new course and emerge from the crisis. However, one of the obstacles to that expected take-off was a huge debt burden, the largest gross debt among ECEEs. Poland's access to international capital was limited by its tainted creditworthiness. An interest on foreign credits was high and a reserve of 60% was added on loans to Poland because they were considered high-risk (*Privatization Update*, April 1994, p. 3). By the end of 1989, the

country stopped servicing a part of the debt owed to the group of commercial bank creditors (IMF, October 1994, p. 77). The relations with creditors worsened and so did Poland's image abroad. Poland was caught in a dilemma. On the one hand, the authorities realized that the state was too poor to repay the obligations. On the other, improvement of relations with the creditors could potentially expand foreign financing of transformation.

In an attempt to purge the finances of an emerging state and improve foreign confidence in Polish government's commitment to reforms, a series of negotiations with the Paris Club (government lending) and the London Club (commercial banks lending) were held. It was necessary because the capital outflows to service foreign debt were putting additional pressure on very limited resources of a new state. When industrial output dropped, Poland's ability to pay its dues further decreased. In March 1991, Poland received debt-service reduction from the Paris Club. It significantly decreased annual interest payments for the first years of transition but did not lower the debt which will have to be repaid later (IMF, October 1994, p. 77). The negotiations with the London Club were concluded in spring of 1994. The creditors agreed to reduce nearly USD 13 billion debt by 45.2% and to spread over 30 years the repayments of the rest (*Privatization Update*, April 1994, p. 3). The President of the Polish Agency for Foreign Investment, M. Gorski, expressed his enthusiasm over potential annual inflows of USD 1 billion to Poland and increased investments by German banks (to whom Poland owed the most) as a result of the successful debt rescheduling schemes (*Privatization Update*, April 1994, p. 3).

It is difficult to assess whether these agreements had a greater symbolic or financial impact. Due to the fact that Poland's financial obligations were only in part eliminated and in a larger part postponed for later, agreements with major creditors might have had mostly a symbolic significance for restoring investor's confidence. It definitely decreased interest payments but until Poland takes advantage of the alleged, improved access to international capital markets and attracts funds to finance costly process of transformation, the benefits will not be visible. The "debt relief" might have halted a

growing indebtedness and reduced uncertainties associated with the country's creditworthiness but until Poland experiences actual flows of investment its result remains ambiguous. It may remain only as a declaration of creditors' good will and not a real readiness to participate in Poland's recovery from recession. In the quarterly summaries of national credit-risk ratings, published in *The Economist* in May and August of 1994, Poland placed sixth, behind five more risky countries such as Iraq, Russia, Nigeria, Venezuela, and Brazil⁵⁸.

Economic Policy Instability⁵⁹

A number of new policies had to be introduced at the outset of transformation. The political and economic system was evolving, subject to own dynamics and to signals from the policy makers. In many cases, the Polish authorities experimented with a new policy and then corrected any mistakes with subsequent regulations. The proliferation of laws and policies that were implemented in the early years of transition further contributed to an already unstable and unpredictable environment. Such an environment was not conducive to FDI inflows. The "policy risk", identified as uncertainty associated with frequently changing policies and with administrative difficulties in consistent application of new regulations, is considered as an important disincentive for private investors (Kuznetsov, 1994).

Exchange Rate Policy and Convertibility

The establishment of exchange rate regime in Poland was a condition *sine qua non* for stabilization program and development of capital market. The existence of the

⁵⁸ In both reports Hungary occupied 12th place while the Czech Republic improved its position by falling from 20th to 21st place.

⁵⁹ The discussion on exchange rate, monetary and tax policies in the sections below draws heavily on the publication entitled *Poland: The path to a market economy* (IMF, 1994).

"black foreign exchange market"⁶⁰ and non-convertibility of the Polish zloty were major obstacles to foreign investment. Poland's access to foreign capital markets was hindered by non-convertibility and so was its ability to engage in international financial operations. Restrictions on foreign exchange and repatriation of profits acted as a disincentive.

On January 1, 1990 the authorities introduced internal convertibility of the Polish zloty which permitted purchase and sale of foreign currencies and fixed the exchange rate at a level of PZl 9,500/USD in a major devaluation. The Polish zloty remained externally non-convertible rendering difficult potential international capital transactions. As a response to the appreciating Polish zloty which made the domestic market attractive for imports and led to an import surge, the authorities subsequently pegged the Polish zloty to a basket of convertible currencies⁶¹. But a "crawling peg regime" did not stop appreciation and the devaluations followed. It briefly improved Poland's export performance while in 1992 imports dramatically increased to satisfy demand of a growing economy. However, with devaluations there was a real threat of inflationary pressures which were suppressed by tight monetary and income policies. The chronology of exchange rate developments is presented in Table V. 4.

⁶⁰ Until 1993 the black market rate was always higher than the official rate suggesting that the latter was overvalued. Under communist rule, sale and purchase of hard currency was illegal but after 1990 hundreds of currency exchange shops (kantors) were opened.

⁶¹ It consisted of the US dollar, German mark, pound sterling, French franc, and Swiss franc.

Table V. 4. Exchange Rate Developments in Poland: 1990-1993

Period	Exchange rate policy	Action
Before 1990	Multiple exchange rates, adjustable peg to a basket of currencies	Frequent devaluations
January 1, 1990	Fixed exchange rate system, exchange rate PZl 9,500/USD	Unification of official and parallel market rates, Zloty pegged to the US dollar, devaluation 31.6%
May 17, 1991	Fixed exchange rate system, exchange rate PZl 11,100/USD	Shift from a US dollar peg to a basket of currencies peg, devaluation 14.4% against the basket
October 15, 1991	Preannounced crawling peg	Rate of crawl announced at 1.8% per month
February 25, 1992	Preannounced crawling peg, exchange rate PZl 13,360/USD	Rate of crawl at 1.8% per month, devaluation 10.7% against the basket
July 10, 1992	Preannounced crawling peg	Rate of crawl at 1.8% per month, technical adjustment made
August 27, 1993	Preannounced crawling peg	Rate of crawl reduced to 1.6% per month, devaluation 7.4% against the basket

Source: Table adapted from IMF, 1994^a, p. 46.

Monetary Policy

At the time of a pressing need to mobilize funds and finance both the public and the emerging private sectors, the new regime inherited a financial system that was very poorly developed. Prior to 1990, the level of household savings was low and the banks served mostly to finance SOEs and the state budget. Once Poland entered a transition period, the banking system represented a bottleneck for the process. The reform and privatization of banks placed high on a priority list as establishment of an operational system was essential to a market-based economy.

Creditworthiness of Enterprises

The financial sector lacked capital. In addition, strict limits had to be put upon credit expansion to control inflation. As a result, the growing budget deficit was financed at the expense of SOEs who were crowded out from the banks lending agenda (IMF, 1994^a, p. 25). The situation resembled a vicious circle. The banks were reluctant to lend to enterprises with bad debts. In turn, these enterprises, constrained by shortage of capital, could not maintain their operations and their bankruptcy jeopardized the existence of banks from which they borrowed funds. The banks, to prevent their own collapse, preferred lending to the government (which guaranteed its loans) while SOEs engaged in inter-enterprise lending and/or tax avoidance.

Over time, the number of enterprises with no creditworthiness increased rapidly (see Table V. 5) and threatened a fragile banking system. The fastest growth occurred in 1991 when SOEs experienced difficulties with sales and adjustment to new economic conditions (Wyczanski, 1993, p. 49). The prolonged process of privatization contributed to this stagnation because the uncertainty surrounding property rights prevented SOEs from restructuring. Unless the SOEs receive a substantial injection of capital for technological and organizational upgrading, they will eventually disintegrate. The banks will lose clients and with them the unrecovered loans.

Table V. 5. Number of Enterprises with No Creditworthiness by Year

Number of enterprises	1989	1990	1991	1992
Industrial	21	247	1,077	1,671
Trading	7	138	529	908
Agricultural	40	90	965	1,236
Total	88	584	2,880	4,448

Source: Adapted from Wyczanski, 1993, p. 49.

The Banking System

The banking system underwent its own restructuring in a struggle to stay afloat. The legacy of the previous era, apart from a lack of capital, reflected itself in inefficiency of operations, outdated recording practices, undeveloped payment system and weak supervision⁶². The sector was ill-equipped to serve the expanding private sector. And the uncertainty surrounding the status of banks and the financial system at large acted as a deterrent.

The reform began with breaking the monopoly of the National Bank of Poland, which assumed the role of a central bank, and giving commercial banking functions to nine banks. The banks were divided into four groups: state-owned, state-owned specialized, private, and cooperative banks⁶³. All tried to avoid risk and preferred dealing with government-guaranteed loans. In order to ensure that at least some enterprises receive financing, banks were encouraged to participate actively in SOEs restructuring and recover losses. However, small banks have a limited capacity to engage in restructuring that very often requires large outlays of capital.

Since the viability of both the banking system and the industrial sector depends on a healthy interaction between the two, both need to recover. Once the banking infrastructure improves, the threats to the system, identified by Wyczanski (1993, pp. 60-61) as low creditworthiness of banks clients, the large share of credits (especially bad loans) in banks portfolios, and growing instances of financial offenses (bad checks, false information and forged documents), will be ameliorated. Only a well-functioning financial system capable of facilitating transactions of foreign firms located in Poland will be able to attract them in the first place.

⁶² A check scam carried out by a private company Art B was possible thanks to lack of communication and clearing system between banks. It exposed existing loopholes and further undermined already low confidence in the banking system in Poland.

⁶³ A detailed discussion of all banks is given in IMF (1994^a, pp. 35-39).

Warsaw Stock Exchange

The banking system and the stock exchange are the main sources of investment finance for enterprises. At the beginning of the 1990s, the former was undergoing reforms, while the latter had been closed in 1939. The absence of a stock exchange prohibited development of a capital market on which foreign investors could purchase controlling shares in privatized companies or could make portfolio investments.

The Warsaw Stock Exchange (WSE) was reestablished in mid-1991. In the beginning, it traded shares of only 5 companies, but by the end of 1993 shares of 22 companies were traded three times a week (The Polish Securities Commission, 1993, p. 35). After a slow start, demand began to grow and pushed up an initially low price of shares. In response to increased demand (both domestic and from abroad), a rising rate of return induced a "stock exchange fever" and the number of investment accounts grew between the end of 1992 and beginning of 1994 from 76,000 to 400,000 (IMF, 1994^a, p. 41). However, in mid-March of 1994, a huge selling trend occurred and share prices fell. The drastic fall jeopardized public support for a stock exchange, which in turn is essential to implement privatization of SOEs. It also sent a message of caution to foreign investors who were attracted by a high rate of return and an incentive of tax-free profits until 1995 and who are believed to hold 20-30% of the stock (IMF, 1994^a, p. 41).

Initially, foreigners were allowed to purchase only up to 10% of the value of stock in privatized SOEs but since 1993 there is no restrictions on their participation in the WSE. Although the recent crash revealed the volatility of the WSE, as privatization proceeds and a regular supply of shares decreases price fluctuations, one can expect more stable trading on WSE. It may encourage risk-averse investors, but on the other hand, may lose appeal to short-term profit maximizers who were attracted by high rates of return. If the latter decide to withdraw from WSE it may prolong privatization and recovery of capital-deficient enterprises. However, in the long-run, establishment of a stable capital

market will bring more benefits as long-term oriented investors gain confidence in making investments in Poland.

Fiscal Policy

In spite of central government's attempt to reduce spending, Poland experienced budget surplus only in 1990. In 1991, budget deficit amounted to 7% of the country's GDP. The process of transition required large expenditures to design and administer new policies and programs, to assist in building new institutions of the market and to preserve at least a minimum of social benefits (education, health care, unemployment insurance). The loss of traditional sources of revenue required the creation of a new tax system, the evolution of which was closely monitored by international business interested in entering the Polish market.

A number of changes were initiated in the course of reforms. Unfortunately, they were spread over four years and inevitably made the Polish tax regime very unpredictable. At over 40 points in time between January 1989 and August 1994, changes in seven different areas of taxation occurred⁶⁴. They included implementation of four major reforms: an enterprise income tax (40%), a 2% tax on gross payroll of enterprises to finance unemployment fund, a personal income tax and a value-added tax -- VAT (IMF, 1994^a, p. 7). The delays in the tax reform and frequent changes that followed, confused and deterred private investors. The introduction of the VAT brought Poland closer to a system of taxation used in the developed countries; and therefore, permitted better integration into the world economic system.

⁶⁴ A full chronology is offered in IMF (1994^a, pp. 17-22). A change of regulation or adjustment pertaining to enterprise or personal income taxes, value-added taxes, custom duties, social security taxes, wage increases taxes, and mandatory dividend paid by SOEs to the state budget were made every few months.

New Investment Policy

Aims of the Policy towards Foreign Investment

Foreign investment was expected to aid the transition from centrally planned to a market oriented economy. A new legal framework, the Companies with Foreign Shareholdings Act (CFSA) of June 14, 1991 was introduced to harmonize the instruments and the policy goals pertaining to investment. A major thrust of the policy was to encourage capital inflows with more success than the legislation in the past.

By attracting FDI Polish authorities hoped to achieve six specific goals identified by Sadowska-Cieslak (1991, p. 8). The first goal was to provide additional financial inflows to restructure the economy and induce economic growth. The second goal was to encourage transfer of technologies (process, product, management know-how and quality control) to modernize the economy. The third objective was to improve balance of trade and balance of payments. The fourth aim was to diversify the structure of production and employment and enhance qualifications of the labor force. The fifth goal was peculiar to an economy in transition. It was envisaged that FDI would increase the pace of privatization by active participation in ownership change and creation of capital markets. The sixth goal was to foster competition in the economy. The details of the current legislation regulating economic activities of companies with foreign participation demonstrate how Polish government attempted to encourage private capital inflows and fulfill its policy goals.

The Legislative Framework

Legislative changes introduced in June 1991 have given Poland a remarkably liberal nominal investment regime that approximates those in the advanced industrialized countries. Most restrictions on foreign investment have been lifted, the tax

system has been simplified and some financial incentives (although limited) have been offered. Many tax exemptions existing in the end of 1980s have been eliminated in an attempt to create a level playing field for both foreign and domestic companies. However, the law still contains some restrictions on FDI and allows for extensive bureaucratic intervention.

Modes of Conducting Activity

Foreign investments may take the form of portfolio or direct investments. Although the Polish law provides for five types of companies⁶⁵, business activity of foreign investors may be conducted only in the form of a limited liability or a joint stock company (CFSA, Art. 1, sec. 2). The operations can be wholly-owned or with a Polish partner. Economic activity pursued by foreign investors is subject to the provisions of the Commercial Code unless the law provides otherwise (CFSA, Art. 1, sec. 3). This can be viewed as an attempt to accord national treatment to foreign firms. Even though the minimum capital input of USD 50,000 has been abolished, under the Commercial Code, a minimum of PZl 40 million (approx. USD 2,000 at December 1, 1993) for a limited liability company and PZl 1 billion (approx. USD 50,000 at December 1, 1993) for a joint stock company, are required.

Obtaining a Permit

Foreign investors are free to conduct activities in all industries but a permit may be required in specific fields or types of activities. A permit is required if the scope of activity covers: management of seaports and airports, dealing in real estate and inter-mediating in real estate transactions, defense industry, wholesale trade in imported consumption goods or provision of legal services (CFSA, Art. 4, sec. 1a). It is also

⁶⁵ These five types of companies are: civil law company, registered partnership, limited partnership, limited liability company, and joint-stock company.

required if the Polish partner in a company with foreign participation is a state-owned company that would make an in-kind contribution to the initial (share) capital, in the form of real estate, an enterprise or a branch of an enterprise (CFSA, Art. 4, sec. 1b).

Other activities that require a permit are specified in Art. 6 of the Act.

Acquisitions and mergers require permission prior to the formation of a company. If a company with foreign capital intends to change the profile of its operation to the type of activity that requires prior permission (identified earlier) it is obliged to obtain such a permit. Both foreign and Polish companies must obtain a permit or concession if they plan to pursue activities in the armaments, pharmaceutical, mining, tobacco, or alcohol industries (Price Waterhouse, 1992, p. 50). The permits specified under Art. 4 and 6 are granted by the Minister of Privatization (CFSA, Art. 8) within two months from the day of application (CFSA, Art. 18).

If the formation of the company would threaten economic interests of the state, or safety and defense, or protection of the secrets of the state, the Minister can refuse to grant the permit (CFSA, Art. 17). Another way in which the Minister can intervene prior to establishment of the company is specified in Art. 16, sec. 2. Due to protection of the interests of the state, the Minister may define in the permit the conditions to be met in respect to the proportions of equity split of the company between Polish and foreign partners or to the proportions of votes at the general meeting of shareholders. This indicates that administrative interference with economic activity of private subjects can be still exercised in respect to fields and activities requiring permits.

Contributions to the Companies

There are no maximum restrictions on the amount of foreign capital that can be invested in Poland. The minimum capital requirements under the Commercial Code were discussed earlier. They are designed to differentiate between investors with various investment intentions and commercial strength. It is also meant to eliminate investors that

will not be capable of carrying out their commitments. The minimum of USD 2, 000 for a limited liability company can hardly be seen as a barrier to entry. However, a company that uses loans as the basis for the minimum capital investment cannot be created (Price Waterhouse, 1992, p. 48). The government tried to ensure an inflow of convertible currency by requiring that the capital contribution of the foreign party must be made in hard currency which would be exchanged in a foreign exchange bank. The three types of contributions are specified in Art. 10.

Transfer of Profits

The real breakthrough in the evolution of the Polish law on foreign investment is Art. 25 providing for a full repatriation of post-tax profits and dividends without obtaining a special permit. Transfer can take place upon presenting to the bank a certificate from the Minister of Finance who, prior to releasing a certificate, must review the financial statements of the company. Also, the foreign partner has the right to transfer the amounts obtained from sales or cancellation of shares in the company, as well as the amounts due in the case of liquidation of the company and amounts due as compensation for expropriation or other measures equivalent to expropriation (CFSA, Art. 26).

Income Tax

Corporations with foreign participation and their shareholders are separately taxed. Corporate income tax is applicable to all companies at a rate of 40%. Dividend income, interest income and royalties are subject to a 20% withholding tax. The tax is withheld at the source by the payer and the recipient is entitled to a credit equal to the sum withheld by the payer (Price Waterhouse, 1992, p. 128). Poland has concluded bilateral tax treaties with 23 countries for the avoidance of double taxation. These treaties have been concluded as a means of encouraging inward investment and trade. Poland's treaties that take precedence over domestic legislation give complete exemptions from withholding taxes

or reductions ranging between 5 and 15% (Price Waterhouse, 1992, pp. 162-163). Tax on royalties from intellectual property rights is withheld by the home-country of the beneficiary. Since Poland is a net importer of intellectual property it is not permitted to withhold taxes on royalties unless the bilateral treaties provide otherwise (Sadowska-Cieslak, 1991, p. 39).

Financial Incentives

The automatic 3-year tax holidays (that in some cases were extended to 6 years) were still valid for companies that were established prior to the entry into force of the new 1991 law which abolished this privilege. The current law abolished the outright 3-year exemption but specifies incentives and conditions that must be met to qualify for tax exemption⁶⁶. The Minister of Finance may grant tax exemption to investors whose initial capital contribution exceeded the equivalent of ECU 2 million (CFSA, Art. 23, sec. 1a). This tax relief can also be granted to investors who locate their companies in regions of high structural unemployment, who implement modern technologies into the national economy or whose exports amount to at least 20% of the total value of sales (CFSA, Art. 23, sec. 1b). The Minister of Finance, in the form of administrative decision, can determine the terms of tax concession or may refuse the relief for important economic reasons (CFSA, Art. 23, sec. 2). Investors may receive a tax exemption guarantee prior to the establishment of the company (which may influence their final decision about investment) but not later than two months following the date of the application for exemption (CFSA, Art. 23, sec. 4). Also, a specific undertaking such as employing a disabled person allows a small tax reduction.

Reductions in the tax rate of up to 10% can be granted on reinvested earnings, on funds set aside to buy shares in privatized Polish enterprises or on donations

⁶⁶ As of January 1994 the possibility for tax exemption granted by the Minister of Finance on the basis of value of investment has expired (Sadowska-Cieslak, 1994, p. 14).

to social projects. Expenditures on capital improvements (construction, modernization or purchase of pollution control equipment) are tax deductible. Losses can be carried forward in three equal parts over the next three years. Accelerated depreciation schedules are available for companies locating in regions of high structural unemployment or investing in new equipment (Fedorowicz, 1992, p. 48).

Import duty exemptions are a significant incentive, even though they are not connected to income tax. Customs duties exemptions are allowed on machinery, equipment, materials and intermediate products that constitute the non-cash contribution of a foreign party providing it is not transferred during the first three years of operations.

In order to encourage exports, turnover tax exemptions are available on goods and services exported from Poland. Enterprises that produce goods for export can obtain a refund on the turnover tax paid on the materials used to produce these goods. On July 5, 1993 the value-added-tax (VAT) was introduced to replace the turnover tax⁶⁷ (*Tygodnik Gospodarczy*, 1993, p. 7). Also, customs duties are not levied on imports of intermediary products that are used to produce goods for export. Other export promoting means include customs-free zones operating in Poland. The enterprises can move goods in and out of them without paying customs duties. The first customs-free zones have been established in port cities or border crossings such as Darlowo, Kolobrzeg, Szczecin, Swinoujscie, Goleniow, Gryfino, Kolbaskowo, Brody Sulechow, Wroclaw, Kedzierzyn Kozle, Gliwice, Ustka, Terespol, Poznan and Cieszyn.

Special Guarantees

An important aspect of creating a favorable climate for FDI is the security of investments and guarantees that in the event of confiscation, nationalization or expropriation the investor will receive "prompt, adequate and effective" compensation. The Polish government guarantees that the Minister of Finance will provide compensation for

⁶⁷ Turnover tax was levied on goods and services upon their sale and on goods imported or sent from abroad upon their arrival in Poland.

all losses in the amount equivalent to fair market value of the company's assets (CFSA, Art. 22).

The availability of hard currency for compensation of expropriations by the government or liquidation of a company is guaranteed under the bilateral treaties on mutual promotion and protection of investments. Poland has concluded these agreements with many countries and has been in the process of negotiating them with others. Each party agrees to create conditions on its territory for investors of the other party that are not less convenient than those created for home investors or investors from any other country. An important part of these agreements are regulations governing the repatriation of profits and other proceeds, compensation procedures in the case of expropriation or modes of arbitration in case of disputes between investors and the host country.

Poland is attempting to adapt its intellectual property laws to international standards. In the past, owners of intellectual property could register intangibles such as patents for inventions, patterns and trademarks with the Patent Office for a period of 15, 5 to 10, and 10 years, respectively. Copyrights for literary, scientific and artistic works were valid for 25 years after the authors death, however, there were widespread cases of copyrights infringement in Poland. The lack of provisions in that respect in the 1988 Law on Economic Activity resulted in pirate production and distribution. Unless this area is better regulated, foreign investors will be reluctant to enter the Polish market for fear of too fast technology diffusion and loss of revenue from royalties. According to *Economic and Legal Information from Poland* (July-August 1994, p. 2) the law has been updated and "patent protection is now extended to 20 years from the filing of the patent application and copyright protection to the life of the author, plus 50 years".

Also, following the negotiations of the investment protection agreement with the United States in 1990, a Polish-American investment treaty went into effect on August 6, 1994 (*Economic and Legal Information from Poland*, July-August 1994, p. 2). The Treaty between The Republic of Poland and The United States of America Concerning

Business and Economic Relations states the principles of treatment of American investment in Poland and Polish investment in the United States, of conducting trade, of exchange of information and transparency, and settlement of disputes between a foreign investor and a host-country. The entry into force of this treaty, with the country from which the biggest investments in value have come, has a symbolic nature and underlines Poland's commitment to create stable, predictable and fair climate for investment.

Restrictions on Foreign Investment

Although investors are welcome in all industries, some fields and types of activities require a permit. They were discussed in more detail earlier. Moreover, the registration of initial foreign capital in hard currency, technological agreements and in-kind contributions is required to be shown in the notarial deed upon a formation of a company.

In the area of ownership of real property, some restrictions exist. The 1990 law governing purchase of real estate eliminated only in theory the barrier to greater foreign investment inflows to Poland. The law permitted purchase or lease of real estate by foreigners.⁶⁸ However, a permit from the Minister of Internal Affairs upon consent of the Minister of Defense must be obtained. In addition, if the real estate has a "special importance" permission for a sale must be given by other ministers for whom the property in question has a "special importance" (such as strategic location, size, purpose). The ambiguous wording of this regulation indicates potential confusion among investors as to

⁶⁸ Sadowska-Cieslak (1994, p. 17) attempted to explain the meaning of this word. The term "foreigners" used in the September 29, 1990 Law on Purchase of Real Estate differs with the same term used in the Companies with Foreign Shareholdings Act of June 14, 1991. For the purpose of the former, foreigners are all natural persons who do not hold Polish citizenship. No Polish citizen who resides abroad and possesses citizenship of another country is considered a foreigner. At the same time, all legal persons domiciled abroad are considered foreigners even though all their shareholders are Polish. Conversely, legal persons domiciled in Poland are considered foreigners only if they are directly controlled by foreigners as understood above (i.e. at least 50% of their capital is controlled by foreigner as understood above). Also, a natural person is considered a foreigner even if that person resides in Poland on the basis of the "card of permanent residence" but does not hold Polish citizenship. In the case of the latter law, once a natural person resides in Poland and obtains a "card of permanent residence", this person is not a foreigner. A person holding Polish citizenship but residing abroad is a foreigner according to this law (although is not a foreigner on the basis of the 1990 law pertaining to real estate). Legal persons domiciled abroad or located on the territory of Poland but controlled by legal persons domiciled abroad, are considered foreign entities.

what kind of documentation and from which authorities is essential. Also, it invites administrative interference or potential blockage of the deal in its entirety if conflicting interests are involved. The permits are granted to natural and legal persons if they: conduct economic activity in Poland; possess card of permanent residence in Poland, hold Polish citizenship or have spouses of Polish citizenship. Apart from a long list of documents that need to be submitted with an application for a permit from the Minister of Internal Affairs, a number of consents from various administrative offices (e.g. pertaining to: town planning, protection of cultural artifacts, protection of natural environment national parks, construction regulation) is required. Potential investor should ensure (by checking prior to a purchase) that the particular real estate can be used for a purpose intended by the investor.

Foreign natural and legal persons may establish representative offices in the form of branches, technical information bureaus or supervisory offices and conduct economic activities according to a license issued by the Minister of Foreign economic Relations (KPMG, 1993, p. 33). They may operate in the area of foreign trade, tourism, culture and transport. It is not possible to use Poland as a base for offshore financial operations. Branch office operations are not eligible to qualify for any tax concessions (except if they qualify under the prevention of double taxation treaties). That is why Poland has not attracted multinational companies' headquarters and administrative offices. Instead, the government is committed to encourage foreign companies to locate their manufacturing activities there.

The banking and insurance sectors have been safeguarded by additional regulations in the Commercial Code and the Banking Law. Foreign banks may be represented in the form of a representative office which cannot carry out banking operations and a branch of a foreign bank that can be fully operational (KPMG, 1993, p. 34). Also, there are requirements on the minimum of investment in order to establish a foreign branch⁶⁹.

⁶⁹ The details on this subject can be found in Uchman (1991, pp. 60-61).

In the insurance sector, as identified by Sadowska-Cieslak (1994, p. 10), foreign capital is permitted (by the Minister of Finance) but a created enterprise must fulfill requirements demanded of domestic insurance firms and the share of foreign investors in initial capital must be at least 50% of the minimum guarantee capital. Branches of foreign insurance companies are not allowed to operate until the year 1999. The company will be obligated to pay all taxes if it declares liquidation before 2 years from the date when the tax exemption expired.

An Assessment of the Policy Environment

The transformation in Poland entailed a dismantling of the old institutions and the building of new ones, based on a liberal economic theory and democratic ideology. Changes were required in every area of political, economic and social life of the country. They shook foundations of the system and resulted in uncertainty and substantial readjustments. The outcome of this experiment was uncertain since Poland was leading a way on the transition path.

The large number of political parties that appeared after the collapse of communism led to a fragmentation of the political scene in Poland. Multiple parties competed for influence on policy making. The most heated debate pertained to the speed and sequence of economic reforms, of which privatization proved to be the most controversial. The radical approach to transformation, undertaken by the first post-communist government, attempted to move quickly from a centrally planned to a market based system. It meant that many new policies had to be implemented simultaneously. The number and wide coverage of new policies created confusion and difficulty in adjustment to rapidly changing environment. Not only was the investment policy unpredictable, but a whole range of other aspects of economic activity was also subject to

periodic alterations. The "policy risk" was high and the MNEs behaved with restraint by postponing entry to Poland.

The inevitable pain of transition had to be borne by the population who supported the process at its outset. However, instead of a fast improvement in standard of living, the country slipped into a recession. The political pressures threatened the direction of economic programs by demanding relief from increasingly austere domestic conditions. At the same time, the international financial institutions subjected the authorities to a rigid discipline of a structural adjustment. Political instability reflected itself in frequent changes of the government. In addition, decentralization of decision making delegated authority to regional and local governments. The differences in application of laws throughout the country combined with a high turnover of personnel at all layers of government resulted in a lack of partners to make prompt decisions on a potential project and deterred potential investors.

The investment law, although more favorable to FDI than previous regulations, still provided considerable scope for bureaucratic intervention. The possibility of administrative discretion upon registration or during operation of a company with foreign capital, vested in hands of various Ministers⁷⁰, created *de facto* a very unpredictable investment regime. It may be the case that the authorities, motivated by prevalent suspicion and public hostility towards foreign involvement, retained a power of interference that could be used if necessary. Moreover, foreign investors were subject to multiple domestic regulations which combined with the existing "red tape" contributed to higher risk for potential investment.

⁷⁰ Such as the Minister of Privatization, the Minister of Finance, the Minister of Defense or the Minister of Internal Affairs.

Chapter VI. Privatization and Its Implications for FDI

"The government will continue without dogmatism and prejudice the process of ownership changes, seeing it as an instrument to improve economic efficiency and, as a result, the living standards of citizens."

**Prime Minister Waldemar Pawlak
Speech to the Parliament on November 8, 1993**

Issues Pertaining to Privatization

From the very beginning Poland has been moving very slowly in one area of systemic change, privatization. The complexity and controversy associated with privatization did not permit a radical approach, as in the case of other dimensions of the economic transformation. The transfer of ownership became a "long-run , multidimensional process of political, economic, social, psychological and cultural change" and adjustment (Rapacki, 1992, p. 14).

The initial estimates on the part of some government officials suggested that the process could be completed rapidly. Balcerowicz's plan aimed at reducing state ownership from 80% to 50% of the country's assets in just three years (and to 15% within 5 years) and to reduce the share of the state sector in GNP to 15.5% in 1994 (Foreign Trade Research Institute, 1992, p.V\1). These expectations did not materialize. Although a variety of methods to privatize SOEs were established, a lack of consensus between parties involved led to a slow transfer of state enterprises into private hands. Numerous legacies (analyzed earlier), existing within the Polish economic, political and social environment, effectively slowed down the process.

The involvement of foreign investment in the privatization process has been very disappointing. Private capital inflows from abroad have not rescued failing state-owned enterprises. The role of FDI in the privatization of state industry has remained largely unfulfilled. It is a purpose of this chapter to demonstrate that the uncertain status of

property rights, the power struggle between multiple players of the privatization process and multiple methods of ownership change in Poland have impeded foreign involvement and diminished FDI inflows.

Definition of Privatization

Privatization as defined by Dobek (1993, p. 123) is "a program of policies designed to curtail the size and the influence of the public sector, primarily by means of disposing of public assets". It may entail various modes such as sale, lease or distribution of public property. As a result of these policies an initially public company is privatized when more than 50% of its assets are owned by a private investor. Another, very important, aspect of privatization is the emergence of a "genetic" private sector. This new private sector alters the structure of ownership, employment and output in an economy previously dominated by public sector.

The involvement of the state in the establishment of an institutional framework of ownership change can vary. In this respect, three types distinguished by Bornstein (1992, p. 287) are: privatization "from above", privatization "from below", and "external" privatization. The first type is highly centralized and the government initiates the process in the first place. In the privatization "from below", management and workers of a company become directly involved and decide whether and to whom it should be sold. In the third type, an outsider (domestic or foreign investor) initiates the process by contacting the state privatization agency or the enterprise and negotiating a deal.

During the socialist era in Poland, the ownership of industrial enterprises was skewed towards the state. At the end of 1989 private sector accounted for 10% of industrial production and 15% of industrial employment (GATT, 1993, p. 85). By contrast, about 80% of arable land was in the hands of small private farmers. In 1989 the public sector contributed to 80% of the country's GDP while it employed 52.8% of all

working people. There were 8,441 state enterprises in 1990. The potential task of privatization was, therefore, enormous. The first post-communist government considered the rapid change of industrial ownership from public to private as a condition *sine qua non* of its package of market oriented reforms. It took upon itself a task of privatizing industrial assets "from above". On July 13, the Mazowiecki's government introduced the Privatization of State-owned Enterprises Act⁷¹ which outlined the basic premises of the government's privatization programs, and its commitment to them.

Main Methods and Objectives of Privatization

Aims of Ownership Change

At the outset of the reform process, the most difficult task was to choose a way for transferring state property into private hands that would be "rapid, equitable and fiscally sound" (Lipton and Sachs, 1990, p. 293). The law provided for three methods: capital privatization (direct sales), liquidation and mass privatization. It was expected that the first form would dominate and the speed would be rapid.

A primary challenge for the process was the lack of domestic capital to finance purchase of shares under the first method. Price liberalization and inflation had eroded domestic savings. In a situation where 65% of population had no savings (Vinton, 1990, p. 30), much of the capital had to be created, or shares would have to be distributed free of charge. The entrepreneurial activity regardless of size had to be experimented in situation of serious financial constraints. That is why the extension of credit to purchase shares in privatized enterprises was proposed. Another option was to encourage foreign investment to provide necessary capital. Yet, the response of the banking sector and foreign investors did not correspond with the enormous needs to complete privatization by direct sale. The still existing suspicion towards foreign involvement in the economy,

⁷¹ Following lengthy debates, the law was enacted on July 13, 1990.

political debates on the issue, and restriction on foreign participation further stalled the process.

Social Justice

In the economy in transition, privatization serves to fulfill certain goals. First, in the sphere of social justice, it tries to rectify the wrongs of the communist regime by returning confiscated and nationalized property to its original owners (Batt, 1991, p.77). However, the authorities identified multiple difficulties in settling the restitution claims. The biggest concern was whether the capital-deficient state could compensate former owners fairly.

On the other hand, under the 1990 Act (Art. 25), the state maintained that it would redistribute part of the state property equally among all citizens through a mass privatization program. Each adult citizen would be entitled to an equal number of privatization vouchers and would participate in the distribution of national wealth. The program, just like other methods of privatization, became a subject to heated debates as various interest groups attempted to protect their stake and effect the process.

Sale to the highest bidder at auctions also gave rise to potential controversies. Considering the fact that the level of savings was very low, only a limited number of Polish citizens was able to buy shares of privatized enterprises. In the situation when market and prices were distorted for decades, a charge of undervaluation of state assets had some merit. If the foreign investors were allowed to participate, the government could be accused of selling national assets at low prices to foreigners. Despite the controversy, the authorities proceeded with privatization through direct sale of a few of the best enterprises to initiate the process of ownership change. The decision had political consequences that will be explained later.

The demands expressed by workers' councils for decision-making power in privatized companies were another issue. The workers were in favor of "employee

ownership" of state property by claiming that the previous regimes declared that the enterprises belonged to the working class. However, that would mean that citizens with non-industrial occupations would be excluded from the scheme. In addition, those who happen to work in promising enterprises would gain relatively more than those whose companies are in a poor financial situation. The question remained as to how much compensation workers should be offered when they lost property rights while being bought out.⁷²

Economic Aims

According to neoclassical economic theory, private ownership is more efficient than public because it removes politics from business decision-making and allows for the most productive use of resources. Since the fundamental institution of a market economy is the right to private ownership, the owner of a property has "the right to determine its use, to derive benefits from it or to dispose of it" (Lipton and Sachs, 1990, p. 303). The clear assignment of property rights becomes a first step in ownership transformation. It encourages individuals to engage in economic activity and to seek efficient ways of allocating resources.⁷³ In return, they enjoy material incentives arising from specific property rights.

In the context of the backward and bankrupt Polish economy, privatization is a much more complex undertaking than simply increasing efficiency. The Polish economy is in the process of creating market institutions (banks, stock market, foreign exchange market, new forms of private enterprises, mutual funds, insurance companies) essential to the achievement of efficiency. Without the whole new environment conducive to better use of the assets, the change in ownership will simply "transform the assets of the

⁷² The issues surrounding employee ownership which are mentioned in this paragraph were discussed in Vinton (1990, p. 30).

⁷³ Two types of efficiency (Bornstein, 1993, p. 284) can be achieved when enterprises are privatized. First, a "productive efficiency" takes place when the same or greater output is produced at a lower cost. Second, an "allocative efficiency" is achieved when the resources are allocated to their most productive uses. Both types are attained when competitive pressure is exerted.

state-owned enterprises from the balance sheet of the government to the balance sheet of the household sector" (Kwasniewski, 1991, p. 42). In a situation of collapsing state enterprises, privatization becomes a means to revitalize them, and to create financially sound economic units that can adapt and grow in a new environment. Many state-owned companies are unable to keep their operations without a necessary capital or new management. Therefore, a sale to a private owner provides an option by which to avoid bankruptcy and to ensure viability.

Breaking up of large state conglomerates is another objective of privatization. It creates competitive market structures by reducing the market power of state monopolies (Schmidt and Schnitzer, 1993, p. 268). Divestiture of the state assets is also a source of budget revenue. With the downsizing of the public sector and with the introduction of a new tax system (and subsequent success in curtailing widely spread tax evasion) the reliance on direct receipts from SOEs will be eliminated while the role of the tax revenue from the private sector will increase.

The long-term economic aim of privatization is to create a structure of ownership where owners have effective control over the enterprises. According to Lipton and Sachs (1990, pp. 316-318) sound "corporate governance" should be an ultimate goal⁷⁴. The issues of corporate governance emerged after the shares of the first few large enterprises were traded at the Warsaw Stock Exchange. The priority was given to small investors, but the Ministry of Privatization decided to retain a packet of shares (30%) and offer them to a large (strategic) investor at a later date⁷⁵. The government in its effort at privatization attempted to both activate citizens' property rights and to put the nation's wealth to its best economic use.

⁷⁴ The authors suggest three crucial elements of "corporate governance". First, it should be designed in such a way as to avoid fragmentation of ownership among large numbers of shareholders for it decreases effective control over management. Second, a participation of at least one non-financial investor that could hold about 20% of the share should be encouraged. This investor would constitute a "stable core" of ownership of this enterprise. And third, there is a need to strengthen the supervisory role of financial intermediaries through a new legal and institutional environment

⁷⁵ It not only ensured the state's stake in privatized companies but also offered some time to sell the package to a suitable buyer providing that one would be found.

Political Objectives

Although the reforms were based on economic objectives that were widely accepted by the Polish public, the privatization process proved to be highly politicized. The perceived trade-offs between social justice and economic aims introduced the first signs of tension. These tensions grew as the differential impact of privatization became increasingly apparent.

Due to preoccupations with the economic goals of privatization, the political dimension of privatization was initially ignored by Polish policy makers (Dobek, 1993, pp. 67-71). According to Dobek (1993, p. 77) Mazowiecki lost the 1990 presidential election due to his ignorance of the need to build political support for privatization. The Prime Minister's preference for direct sale of public property encountered strong opposition of those whose very interests were threatened by an outright sale.

His opponent in the election campaign, Lech Walesa, promised to carry out distribution of free shares and speed up the transition. Although that promise has not been carried out to this day, at least a sensitivity towards demands of the electorate paid off in the form of the presidential office for Walesa. By distribution of shares Walesa attempted to mobilize citizens in favor of market reforms in general, and privatization in particular. The idea was to introduce them to private ownership of productive assets, overcome their hesitation and make them aware of market principles and potential risks (such as unemployment and bankruptcy). The emergence of a middle class of entrepreneurs was expected to provide a core of future political support.

The question arises whether in this manner established coalition of various supporters would outnumber the opponents. As the experience of Poland indicates, the controversies around privatization were accompanied by frequent changes of government. It is wrong to assume a simple link between the two processes. Nonetheless, the fact that the privatization debate has appeared on many occasions to sharpen the political crises

suggests that, in the post-socialist reality, a multiplicity of competing actors and conflicting interests may prevent authorities from gaining critical mass of support. This can be a result of a peculiar power struggle that have emerged within the state enterprise structure and which have effectively delayed privatization attempts.

Institution-building

In the post-socialist economy the state tries to build the foundations of the market. The demand for market institutions is enormous. The achievement of a "critical mass of institutions" becomes a precondition for a successful transition period. Due to interdependence of various areas of the system undergoing transformation, the lack of institutions in one area becomes a constraint in institution-building elsewhere (Winiecki, 1992, p. 15).

Transformation requires new laws, institutions and policies in almost every aspect of the system. The institutions such as investment banks; consulting, insurance and auditing firms are needed. Also, if privatization is to proceed through distribution of shares that can be traded, the development of a stock market is necessary. In both cases the administrative side of privatization requires a whole machinery and proper sequencing. In order to proceed with privatization, for example, the state hired foreign financial and consulting firms to prepare enterprises for privatization and subsequent sale.⁷⁶

Identification of Players and Their Interests

During the era of Polish socialism the state apparatus and trade unions endorsed by the Party, formed an alliance that effectively guarded against foreign

⁷⁶ Unfortunately, this prompted criticism of the very high fees for services that foreign accounting firms charged. For example the public stock issue of the first five privatized companies cost USD 6.7 million, which constituted 13.39% of the value of enterprises in question (Dobek, 1993, p. 107). Since then the proportion of costs involved in privatization to revenue from transactions declined to 11.5% in 1992 and 6.1% in 1993 (Ministry of Privatization, 1994, pamphlet).

penetration into the economy beyond the permitted boundaries. After 1989, with the dramatically changed rules of the economic game, state enterprises could no longer count on the protection from the center. Enterprise collectives (workers' councils) soon became enemies of the new coalition emerging to foster market oriented principles: the state and potential outside investors⁷⁷. This new line up of actors and their interests had a tremendous influence on the scope, speed and modes of privatization.

Within state enterprises, the first group identified in what Bienkowski calls (1992, p. 751) "Bermuda Triangle Syndrome" consists of trade unions that historically have been representing vital interests of the workers, by promoting job security. However, union membership is fragmented among various fractions of the Solidarity movement and the unions favored by the previous governments. As the experiences of first privatized enterprises and economic rationale⁷⁸ suggest, employment levels tend to decline following changes of ownership. Driven by the short-term objective of maintaining their own ranks and preventing unemployment, trade unions emerge as strong opponents of privatization.

The second party in the triangle, worker's councils, gained legal and political legitimacy under the socialist regime. They were given formal powers for state enterprises self-management. The private ownership of companies, therefore, threatens their status and existence (Bienkowski, 1992, p. 757). In a drive for self-preservation, they oppose privatization. Just like the labor unions, this group claims their right to a "collective worker ownership" (Dobek, 1993, p. 101) of national wealth, oppose sale of assets to general public and promote employee-buyouts of state enterprises as the only acceptable alternative.

The directors and managers of state-owned enterprises also behave in their self-interest. The old management of state companies, in the past linked with the party "nomenklatura", tries to preserve the existing status quo. Although Bornstein (1992, p.

⁷⁷ With the proliferation of private property rights in Poland, domestic investors would now join foreign investors and represent interests of the business community.

⁷⁸ With a socialist policy of zero unemployment, state-owned firms were heavily over-staffed.

285) proposes that privatization can break up the old power structure which used to link state-owned enterprises with government ministries, the evidence from Poland suggests that the members of the political elite in the past have formed an economic elite in the new era. Due to the fact that top managers had access to the company's wealth, many of them obtained shares in firms under their supervision. Once they received tangible reward by becoming owners, it is possible that they will join the pro-private ownership coalition. Others who were not able to transfer the firm's assets in own portfolios, prolong the life of state enterprises by selling off remaining assets starting with the unproductive resources (Bienkowski, 1993, p. 758). Pessimistic about a potential success of the firms under private ownership, managers delay privatization. The enterprise base disappears in stages, precluding even the small possibility of restructuring by outside investors. Still another group of managers engages in inter-company lending that involves extending interest-free credit to firms with payment difficulties (Hillman, 1992, p. 738). In their view a chain of interdependent (by loans) companies has a better chance of survival, as the state will not let one of the firms fail and jeopardize the others.

From the outset of the undertaking, one should expect that there will be winners and losers. The former will be represented by the new class of businessmen, private investors and managers who obtained property rights and revitalized failing companies so they could reap the profits in the future. They will be the core supporters of the reform process. The losers in the short run will be the ordinary workers of privatized enterprises whose powerful workers' councils established in 1980s and trade unions will be jeopardized, and with them their jobs. Also, the managers, workers' councils and employees of companies that in the drive for self-preservation effectively led to self-destruction will join the group. And the public at large that has not been given material incentives to support privatization and for whom the long-term efficiency benefits of ownership transformation do not offer immediate and substantive reward will tend to oppose privatization and regret the changes.

Building the Private Sector - The Scope for Foreign Investment

Restitution

One of the biggest obstacles to the progress of privatization has been the legal status of property nationalized by the socialist regime in the post World War II period.⁷⁹ Since 1989 former land owners and industrialists have filed claims demanding return of their property confiscated through a series of acts and decrees implemented in the years 1944-1962⁸⁰. Polish authorities have attempted to resolve this issue by drafting proposals of legislative acts, albeit without great success. The issue of restitution has remained a source of numerous controversies and conflicts.

In the last few years, the representatives of former owners formed powerful pressure groups demanding return of their real estate. The form of compensation has been subject to many debates. While President Walesa supported in-kind return of nationalized property to former owners, others maintained that "one could not turn the history back" (Wellisz, 1991, p. 3). Giving the present financial difficulties of the country, compensation in such a way as to equal the value of nationalized property will not be carried out in full.⁸¹ Also, the workers have voiced their concerns about potential job losses in re-privatized firms and demanded fundamental guarantees.

⁷⁹ The decree of September 6, 1944 nationalized all agricultural land belonging to the Third Reich, Germans and individuals who collaborated with them. The same principle was a basis for nationalization of large enterprises in basic sectors of the economy (mines, petroleum refineries, distilleries utility plants and others) by a decree of January 3, 1946. Also, all companies employing more than 50 workers per shift were nationalized. In the 1950s hundreds of shops, pharmacies, mills, brickyards and housing units were confiscated. (Wellisz, 1991, p. 2)

⁸⁰ In total there were 14 various acts and/or decrees that denied property rights and nationalized the property.

⁸¹ The Ministry of Privatization may expect about 150,000 applications for compensation valued at over PZŁ 350,000 billion. According to data from *Magazyn Informacyjny Reprywatyzacji* (Information on Re-privatization Magazine, 1994, p. 23) only three compensations were paid totaling Polish PZŁ 7,838. The Ministry postpones making a decision and counts on the adoption of the re-privatization law that will keep financial obligations of the state to USD 33 million.

1991 and 1992 witnessed a proliferation of applications filed (Table F5 in Appendix F and Figure VI. 1). At the present time, restitution claims pertaining to agricultural property (land and farm buildings) constitute 38.8% of all claims, to urban real estate 12.5%, and to forests 5.2% (see Table F6 in Appendix F). In years 1992-1993, 371 applications sent from abroad were filed for restitution of 613 properties. The highest number of applications was received from Germany, the United States, Great Britain, Canada, and Australia (Table F7 in Appendix F). The unsettled status of restitution claims prolongs the uncertainty surrounding property rights in Poland and effectively blocks privatization proceedings. A huge number of pending restitution claims--and, consequently, of properties that are "put on hold"--decreases the amount of assets available for sale to foreign investors.

Figure VI. 1.

Source: Prepared on the basis of data in Table F5 in Appendix F.

Figure VI. 2.

Source: Prepared on the basis of data in Table F6 in Appendix F.

Other Methods of Privatization

"Nomenklatura Privatization"

The managers of many companies took the opportunity to transfer state enterprises into private joint stock companies under the Economic Activity Act of 1988 which permitted state enterprises to issue and sell stock. Throughout 1989 and 1990 party-state officials acquired controlling shares of SOEs by using their "insider" positions. In this way an old political elite became a new and powerful economic elite. The disclosure of these transactions generated public outrage which gave the government another reason to initiate centrally controlled privatization programs.

It is sometimes argued that companies transferred by "nomenklatura privatization" may be put to efficient use as new owners pursue private interests (Slay, 1993, p. 53). They would use old networks to ensure supply of intermediate goods and

the distribution of output. Nevertheless, a considerable amount of suspicion and distrust was created, that increased popular hostility towards privatization generally. The assets of SOEs were set at bargain prices. The organizational chaos that accompanied the last years of the socialist regime permitted "nomenklatura" to acquire shares in the most promising enterprises. They took advantage of a loophole in the legislation that was passed to initiate reforms of the collapsing communist system. Because it was conducted by "insiders", former managers and party officials who took over the assets of companies in question, the scope for outsider (including foreign) investors was limited. Some joint-venture arrangements with foreign investors were concluded, as new owners sought capital restructuring. Unfortunately, no data has been available because of the political sensitivity surrounding this method of privatization. Although the privileges of the "old nomenklatura" (members of the communist regime) might have been curtailed, the "new nomenklatura" is believed to have preferential access to the assets in privatized SOEs. Also the "insiders" on the enterprise level (the managers and employees) acquire control of SOEs by purchase or lease while the latter dominates.

Small and Medium-sized Privatization

Small-sized privatization was designed to break up state retail monopolies (domestic trade organizations) through an immediate sale of small shops, restaurants, gas stations and other service outlets. Medium-sized privatization entailed selling firms in the services sector such as architectural and engineering firms. These enterprises could be sold to cooperatives or the employees themselves (Vinton, 1990, p. 29). Between 1989 and the end of 1993, the number of small individual businesses increased from 770,000 to about 1.8 million (Misala, 1993, p. 5). This suggests that privatization "from below" has been by far more successful and better attuned to the opportunities and constraints at the local level.

There have been some setbacks though. Local governments have preferred a lease arrangement over an outright sale of the enterprises. Moreover, bureaucratic obstacles (e.g. obtaining a variety of permits) have slowed down the process and there has been a large scope for bureaucratic intervention by local authorities.

Foreign investors have been crowded out of participation in privatization of existing small businesses as former managers and employees assumed ownership of small shops and service outlets. And there still exists uncertainty over large amount of urban properties for which restitution claims have been filed. Some of these claims have come from abroad, from Poles who emigrated after their property was nationalized. If they or their descendants still hold Polish citizenship, they are not considered foreigners for the purpose of legislation on ownership of real estate. But if they decide to invest in small companies (using the claimed or other property) they will be treated as foreign investors.

Privatization of Large SOEs by Sale

In its privatization plan, the government envisaged that some 500 large enterprises would be selected for the first round of divestiture. The most economically sound were selected to undergo capital transformation (also called "commercialization" PSEA Art. 6 and Art. 6) into joint stock company of the State Treasury. Then, the shares of restructured companies would be offered for sale by tender, through public offering or through negotiations with selected buyers. Although the highest price offered determines a potential purchaser, the lower bid may be chosen if an investor makes better commitments on employment level (KPMG, 1993, p. 18). The employees in enterprises undergoing privatization were guaranteed 20% of the shares at a preferential rate of 50% of the price charged to external buyers. In many instances, though, a difficult financial situation of the employees prevented them from buying shares in their companies. The State Treasury retained 30% of shares for an eventual strategic buyer, domestic or foreign.

There have been numerous drawbacks to this method. The valuation of assets was difficult in conditions of distorted prices, existing subsidies and a lack of capital market (Fallenbuehl, 1991, p. 12). Second, domestic investors were constrained by lack of substantial amount of capital. Third, the power struggle at the enterprise level (presented earlier) prevented many SOEs from embarking on the privatization path.

Privatization by sale has proceeded very slowly, especially in the early years of transition. By the end of 1992, out of 480 enterprises in the queue for sale, only 51 had been sold (see Table F2 in Appendix F). Half were privatized with the participation of foreign capital (Schaffer, 1993, p. 64). However, in 1993 privatization by this method accelerated and 47 sales were made. Based on the latest data from the Ministry of Privatization out of 547 SOEs destined for sale by the end of March 1994, only in the case of 101 companies was the process completed. This represents only 1.2% of all 8,441 SOEs existing at the end of 1990 and 20.2% of the 500 SOEs initially destined for privatization by sale. Unfortunately, there is no data available on how many were sold to foreign investors by the end of 1994. The success in direct sales in 1993 coincides with the over all improvement in the economy (driven by the new private sector) and especially with a growth in output.

Especially important for direct sales were the major foreign investments recorded by PAIZ. Since they were large enough to purchase the SOEs, there is a potential that at least some have done so. Based on data in Table C3 and Table F2 in Appendices there were 217 foreign investments of at least USD 1 million and 98 direct sales of SOEs by the end of 1993. No. all of the sales were acquisitions made by foreign firms. Even if they were, and assuming that a USD 1 million investment would be enough for a purchase of SOE, these 98 transactions would represent 45% of foreign investments in LCFCs. It suggests that although foreign investors had the financial capability to buy SOEs they still did not prefer this route to enter the Polish market.

In sectoral distribution the privatization process has begun in the case of 435 industrial SOEs (Table F3 in Appendix F and Figure VI. 6). This is not surprising since it was the intention to use this method to privatize large industrial SOEs and to revitalize the sector with foreign funds. Industry is also a leading sector (in number of firms and in value of FDI) in which FDI entered Poland in the form of major investments and in the form of CFCs. Figure VI. 5 indicates that almost 80% of SOEs (422) in the privatization process by this method employ over 500 workers. Among all CFCs 92 investments (1.2%) were made in companies with over 500 employees, of which 75 in industry. The highest number of SOEs was privatized in provinces such as Katowickie, Warszawskie, Gdanskie, Bielskie, Opolskie and Wroclawskie (Table F1 in Appendix F) which are also a destination for majority of FDI inflows.

After a few years of difficulties in attracting foreign direct investment to Poland, some major acquisitions were made. The biggest investment up to date took place when Fiat of Italy acquired a controlling interest (90%) of the small-size car producer, FSM in Bielsko-Biala and in Tychy. Together with FSO, a medium-size car producer, they were the only passenger car manufacturers in Poland. In the beginning of the 1990s, FSM produced about 200,000 and FSO about 100,000 cars (Morita, 1992, p. 2). It needs to be mentioned that the cooperation between Fiat and the Polish automobile industry has a long history in the form of a licensing arrangement under which Poland manufactured small and medium size "Fiat 126" and "Fiat 125p" cars. In the new deal, the Polish government invested USD 20 million (10%). Also, Fiat received guarantees of preferred access to the Polish market which substantially reduces the competition from other firms. Fiat's contribution was an initial USD 260 million and future commitments of USD 1,581 million. The firm assumed USD 1 billion in debt and other liabilities of the Polish company (*East European Investment Magazine*, 1993, p. 87). It is hoped that in the near

future other related and supporting industries will attract foreign investment to facilitate the needs of production of automobiles by Fiat and other firms.⁸²

Table VI. 1 presents the detailed information available on 25 major foreign acquisitions in 1992⁸³. It is used to give a sample of completed transactions. We can assume that all privatizations by sale made in 1992 are included. These privatization represent only 3.2% of the total number of investments in industrial CFCs in 1992. That year, for the first time, investments in trade dominated the scene but even by the end of 1993, there were only three CFCs in trade sector with employment level over 500.

In terms of value, the acquisitions of Table VI .1 represented USD 284.6 million and future commitments of USD 442.8 million. These investments made up 42% of actual FDI transfers to Poland in 1992 as presented in Chapter II in Table II. 2. As a percentage of what came in, it was a substantial success. However, the value of shares in the major 1992 acquisitions constitutes only 7.6% of all investments in LCFCs made by the end of June 1994 (which then included Fiat's USD 260 million). Also, data on CFCs Clearly, these few acquisitions in 1992 did not channel a great portion of all invested FDI to Poland. Unfortunately, there is no detailed data on major sales in 1993 or 1994 to use for complete assessment of this phenomenon.

Large Polish SOEs can be purchased only by large foreign firms ready to make substantial investments.⁸⁴ Therefore, the participation of MNEs is essential if the structure of ownership in the industrial sector is to be altered towards private ownership. As the data suggest, the American MNEs were capable and more importantly were (finally) willing to enter the market. The confidence displayed by these firms might have been in response to the Polish-American investment treaty that was negotiated and then implemented. The direct sales method based on negotiations with foreign investors appears

⁸² FSO negotiated a joint venture arrangement with General Motors in 1992.

⁸³ The publication does not specify whether or not these were the finalized deals or also the ones in the process of negotiations.

⁸⁴ Portfolio investment is another option which is not a subject of this thesis.

to be the most successful of all government privatization programs in terms of attracting FDI. Unfortunately, in comparison to the hundreds of SOEs still awaiting privatization, foreign involvement (notwithstanding the American) has been modest. However, the data on acquisitions are limited to just to one year.

Based on the *World investment report 1994* (UN, 1994, p. 100) the cumulative number of FDI projects by the end of 1993 amounted to 6,800 with an estimated value of USD 2.1 billion . Among 162 projects considered in the UN's report (1994, p. 101), acquisitions accounted for 30%, joint ventures for 28% and "greenfield investments" for 42% according to number of projects while in terms of value 56%, 31% and 13% respectively. It is very surprising that a high number of "greenfield investments", in fact, amounted only to USD 722 million. Based on this data foreign investors preferred engaging in new undertakings that has freed them from deeply rooted economic and organizational difficulties in existing state enterprises but they did not risk large outlays of capital that way. By taking over the most attractive enterprises, however, they channeled the most value of invested capital. It seems to confirm the findings on FDI in the 1992.

Table VI. 1. The Biggest Capital Privatization Transactions with Foreign Participation in 1992

Polish enterprise	Foreign investor*	Value of purchased shares (USD million)	Future commitment (USD million)
Celuloza Kwidzyn	International Paper (USA)	120	175
Wodol	PepsiCo (USA)	25	56
Telfa	AT&T (USA)	28	45
Poliam Pila	Phillips (Netherlands)	16.2	30
Polena Bydgoszcz	Unilever (Netherlands)	19.8	24
Amino	CPC Europe (USA)	8.8	17
Elta	Asea Brown Boveri (Switzerland)	10.4	13
Polena Raciborz	Henkel (Germany)	6.7	7.8
Alima	Gerber (USA)	11	11
Fampa	Beloit Corp. (USA)	7	15
Olmex	Unilever (Netherlands)	5.3	14
Miesio Opole	Penetex (Austria)	3.2	11
Polena Nowy Dwor	Benckiser (Germany)	3.2	3
Wizmet	Gillette (USA)	1.5	7.5
Pomorskie Fabryki Mebli	Karl-Heinz Klose (Germany)	1.4	2.7
Chifa	Aesculap AG (Germany)	1.6	2.4
Mefta	AEG (Germany)	2.2	4
Bydgoskie Fabryki Mebli	Schieder Trading (Germany)	1.4	2.4
Mostostal Export	K. Schroder, G. Bonn (Germany)	2.5	-
Romeo	A. Ahlers AG (Germany)	1.9	0.4
Pol-Baf	Basic American Foods (USA)	2.8	-
Malta Poznan	Kronospan (Germany)	1.2	1.2
Exbud	ITI (USA)	2.3	-
PWN	Luxembourg Cambridge Holding	1.2	0.4
Piwo Koszalin	AMS Anlagen Planung (Germany)	0.6	-

Source: Adapted from Sadowska-Cieslak, Biskup, and Burzynski (1994^a, p. 65).

* The investor's country of origin may differ with the list from PAIZ as the latter used a category "international" for multi-party investors.

Privatization of Large SOEs by Liquidation

Two legal acts govern this method of privatization. First, on the basis of Art. 19 of the Act on State-owned Enterprises of September 21, 1981 an enterprise can be liquidated and its assets can be sold to a private investor or transferred to a joint-stock company of the State Treasury. On the basis of Art. 37 of PSOE Act of July 13, 1990 an enterprise can enter the liquidation process and the assets can be sold to a private investor

or can become a part of a new company in two ways. First, the assets can be transferred to a joint-stock company of the State Treasury. Second, the employees or managers or a combination of both can transfer the assets into a new company assuming ownership of a new entity. Due to financial constraints, this new ownership is assumed predominantly through a leasing arrangement with the State Treasury. The data (that will be presented later) suggest that this method was most often used by SOEs.

Although by the end of March 1994, over 2,000 SOEs chose this method, the question remains as to whether or not it really changes structure of ownership in Poland. If the failing company is liquidated, it simply disappears from the public sector register. Unless it is sold to a private investor, it does not contribute to the private sector (but decreases the size of the public sector). Also, if a leasing arrangement is obtained, the company is *de facto* not privatized and cannot be considered a part of the private sector. Therefore, the extent of privatization is very ambiguous here. There are reasons for the issue to be pursued further and the results of this method to be presented.

First, Dobek's definition of privatization (which focuses on a policy that reduces the role of the public sector) was accepted in the beginning of this chapter. And, second because the control over SOEs is shifted away from the state, and there is a potential for fully "private ownership" in the future.

Privatization by liquidation gained momentum in 1991, continued through 1992 but started to slow down in the second half of 1993. The details of the process are presented in Table F2 in Appendix F and Figure VI. 3. In the first quarter of 1994 only 82 companies completed the process (of which 51 on the basis of Art. 37). Figure VI. 4 shows that out of 1,999 SOEs that initiated the process of liquidation, 44% (879 enterprises) completed it by the end of 1993. Privatization according to Art. 37 of the PSEA dominated in 707 cases. As Table F3 in Appendix F illustrates almost equal number of SOEs in construction and industry (624 and 602 respectively) underwent the process. However, as opposed to privatization by sale, two thirds of SOEs in privatization by

liquidation were relatively small companies with a number of employees not exceeding 200 (Figure VI. 5). Therefore, it looks impressive in terms of the number of SOEs in the privatization process but it has rather modest impact on expanding employment of the private sector

Faced with the slow progress of privatization by other means, the authorities allowed this method to predominate although it still raises questions about ownership. By doing so they have given the "insiders" (employees and managers) of these companies a preferential access to privatized companies. This option reduced opportunities for foreign participation. First, because these companies are not fully privatized. Second, the shares are divided among the "insiders" and whatever may be left may be offered to outside investors. Third, once again the power of employees, managers and labor unions was strengthened. As they hold the lease and the state is still the owner, the scope for FDI involvement is limited.

If a liquidated SOE is destined for sale (which is an option if the company is not dissolved, but offered for sale or transformed into a joint stock company of the State Treasury), there is scope for foreign investors to participate. The prevalent option in the liquidation method, however, has been employee/management ownership. In this method control is very often obtained through leasing arrangements. Out of 879 SOEs privatized by liquidation by the end of 1993 there were 250,000 people employed in "over 720 of the employee-controlled companies" (Bossak, 1994, p. 133). It is easy to infer that foreign investors' access to purchase these companies has been inhibited. The following figure present data as of the end of 1993.

Figure VI. 3.

Source: Prepared on the basis of data in Table F2 in Appendix F.

Figure VI. 4.

Source: Prepared on the basis of data in table F2 in Appendix F.

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PM-1 3½"x4" PHOTOGRAPHIC MICROCOPY TARGET
NBS 1010a ANSI/ISO #2 EQUIVALENT

Figure VI. 5.

Source: Prepared on the basis of data in table F4 in Appendix F.

Figure VI. 6.

Source: Prepared on the basis of data in table F3 in Appendix F.

Sectoral Approach and Privatization by Restructuring

In response to pressures for better harmonization of industrial policy, restructuring and privatization⁸⁵, the authorities experimented with new approaches to privatization. Sectoral privatization was proposed in July 1991. Western consulting firms were hired to prepare sectoral studies, to contact potential investors and to promote investments in specific sectors (Wojtyna, 1993, pp. 100-103). The method drew attention to sectors and SOEs with the best prospects. The chemical (personal hygiene products and detergents) sector, in which MNEs such as Unilever, Procter & Gamble and Henkel are prominent and food processing (soft drinks and beer brewing) sector, with investments by Coca-Cola and PepsiCo, serve as examples of sectoral privatization. Detailed sectoral portfolios were a good base for negotiations with potential investors and had a positive impact on both privatization and FDI inflows.

Privatization by restructuring was designed to target individual enterprises and accelerate both restructuring and ownership change. Under the business contract scheme, managers (domestic and/or foreign) competed for the right to manage an enterprise. They needed to submit a business plan for its restructuring and future development. The Ministry of Privatization decided who would be given the right to manage the firm, restructure it and then sell its stock. The managers needed to deposit 5% collateral that could be lost if the undertaking were unsuccessful. Managers were rewarded with stock in privatized firms and a share of the capital gain. Managerial contracts were similar but managers did not have to put up a collateral because the firms were not destined for immediate privatization. Both schemes seemed very promising.

The biggest impediment, however, was a lack of high-quality managers. Some perceived the risks involved as too great relative to the prospective gains. Foreign, even more than domestic, managers proved hesitant to participate in these programs (Slay,

⁸⁵ The discussions on the role of the state and industrial policy in privatization are offered in Wojtyna (1993, pp. 82-108) and van Brabant (1994, pp. 17-36).

1993, p. 55). The political uncertainty in Poland did not encourage individuals to invest their time, effort and capital in the experimental phase of a new privatization approach.

Mass Privatization Program and the Role of National Investment Funds

Following the scandals of the "nomenklatura privatization", the government attempted to speed up and increase its control over privatization by directed mass privatization program (PPP). This entailed free of charge distribution to the Polish citizens of a large proportion of state industry in a short period of time. Four hundred large enterprises that accounted for 25% of industrial output and 12% of industrial labor force were to undergo transformation into joint stock companies of the State Treasury, followed by distribution of shares (Slay, 1991, p. 14).

A political debate arose around the PPP and halted implementation of the program. The controversy, as explained by Slay (1991, pp. 15-16), was caused by a high degree of suspicion towards investment funds, their monopoly power on capital markets, and a high administrative costs required for the undertaking. The PPP did not disappear completely and reemerged again a few years later⁸⁶. A refined version was debated again, at the beginning of 1993 and finally passed by Sejm on April 30, 1993 with 215 deputies in favor, 176 against and 22 who abstained (*Rynki Zagraniczne*, 1993, p.1). In November 1994, Prime Minister Pawlak, finally accepted a list of fifteen 7-member Supervisory Boards that would control the National Investment Funds (NFIs).

The program includes 444 large and medium-sized enterprises⁸⁷ that will have the following share holding structure: 33% will be held by a main NFI; 27% will be

⁸⁶ The program was meant to fulfill three objectives: to accelerate the privatization of the state industrial sector; to bring share ownership to the majority of the population and widen the Polish capital market; and to restructure the state enterprises that participate in the program (*Rynki Zagraniczne*, 1993, p. 17).

⁸⁷ The enterprises come from the following industrial sectors: metallurgy, machine and precision engineering, chemical engineering, electrical and electronic products, pulp and paper, foodstuffs, construction and transportation equipment.

distributed equally to all other NFIs; 25% will be retained by the State Treasury; and 15% will be distributed free of charge to employees. As we can see no shares have been directly allocated to potential foreign investors who would be interested in a purchase. The distribution of share certificates to the public is expected to begin in June 1995 and the exchange of certificates for shares in NFIs in 1996. However, the process may be delayed once again because a few executive acts are still needed to implement the PPP. To assist the program, EBRD designates USD 54.4 million⁸⁸.

It is hoped that the PPP will finally bring necessary momentum to the privatization effort of the government. It seems to be the last attempt at increasing the speed of the transfer of ownership through privatization "from above". The examples of the former Czechoslovakia and Russia (both countries moved very quickly with this method) contributed to a renewed interest in this method in Poland. The emphasis is now on making sure that the enterprises have a potential to become viable economic actors through restructuring and upgrading. The government's program is expected to fulfill (at least in part) President Walesa's 1990 election campaign promise that every citizen would be USD 10,000 richer through distribution of shares and would become a co-owner of the country's capital stock (*Financial Times Survey*, 1993, p. 6).

Subsequent delays in implementation of the PPP indicate how difficult it has been to achieve consensus in the Parliament and approval of the public at large to proceed with a program. For enterprises that were designated for this method, it meant almost five years of preparations and uncertainty which in turn effected their economic well-being. For foreign investors it meant that hundreds of SOEs were not available for purchase and since the shares will be distributed among the Polish citizens, they have a preferential access to the assets in privatized companies. Once again nationalist objectives determined the course of policy and restricted foreign participation.

⁸⁸ This paragraph is based on personal communication and unpublished material obtained on December 5, 1994 from Mr. A. Kowalewski, Consul, Trade Commissioner's Office of the Republic of Poland in Canada, Montreal.

There are, though, some limited opportunities for FDI to engage in the PPP scheme. Foreign investors' participation in PPP can take a few forms. The state-designed NFIs may offer shares in privatized companies to a strategic investor who will provide equity or non-equity finance, will buy the entire company or will enter into a joint venture. Also, foreign investors may purchase shares from citizens who wish to trade them or shares in NFIs and individual companies once they are listed on the WSE. Still, the amount of shares available to foreign buyers is limited as other parties (individual citizens and investment funds, the State Treasury and employees of SOEs participating in the process) have a "first crack" at shares of SOEs privatized by this method.

Privatization of Banks

The privatization of state-owned banks began with transforming them into joint-stock companies owned by the State Treasury and recapitalizing them through restructuring of their loan portfolios, especially, dealing with the bad loans of SOEs⁸⁹. State banks were not offered for sale until 1993, when take-overs by other domestic or foreign banks were encouraged. According to *The Polish Securities Commission: Annual report* (1993, pp. 29-31), by the end of 1993 three banks were listed on WSE: Bank Inicjatyw Gospodarczych (BIG), Bank Rozwoju Exportu (BRE) and Wielkopolski Bank Kredytowy (WBK)⁹⁰. Despite the symbolic assistance of EBRD (purchased 30% of shares) in privatization of the WBK, foreign investors displayed a "wait-and-see attitude" (*Financial Times Survey*, 17 June 1993, p. 8) prior to making investments in the Polish banking system. Those who expressed interest in acquiring shares in privatized banks learned that the stock had to be purchased in Polish zloty (first they had to exchange foreign

⁸⁹ Since the banks are permitted to take over the debtor enterprises in an attempt to restructure them, SOEs prefer a deal with a domestic bank (Bossak, 1994, p. 118). The hesitant attitude of SOEs prevents foreign banks from wider involvement in privatization.

⁹⁰ A public offering of Bank Slaski took place in December 1993 (ING Bank of Netherlands acquired 25.9% of shares) and Bank-Przemysłowo-Handlowy S. A. was preparing for it in 1994

currency into PZl at an official exchange rate because PZl was externally not-convertible). Minority equity share (up to 20%) was offered to foreign investors (Uchman, 1991, p. 66) which ensured that the control over banking system remained within the national domain. Such restrictions effectively discouraged potential investors.

Faced with a modest foreign participation and a slow reform of the banking system, the Ministry of Finance encouraged banks to enter into 2.5 to 3-year "twinning contracts" with Western banks to ensure a transfer of Western banking know-how to Poland (Sikora and Miszerak, 1993, pp. 129-134). In 1992 seven contracts were signed with foreign banks for which funds were provided by the World Bank. This innovative approach endorsed by international institutions, although limited in time period, was very important in establishing credibility with Western partners. The links developed initially can continue into the future, incorporating Polish banks into the international financial system.

Since 1989 the establishment of private domestic or foreign banks was encouraged. The private banks (75 in 1990 and 85 in 1993) enjoyed neither deposit insurance nor technical assistance granted to their state-owned counterparts (IMF, 1994^a, p. 38). The low minimum capital requirement of Polish PZl 4 billion to open a bank resulted in creation of small banks which quickly encountered difficulties. To prevent loss of confidence in a reforming banking system, the National Bank of Poland assumed more supervisory responsibility and by 1993 raised the requirement to PZl 70 billion.

In a meantime, the American Bank in Poland Inc., the first bank with foreign participation, was formed in 1989 by five Polish citizens with a capital of PZl 2 billion and one foreign investor with a capital of USD 6 million (Uchman, 1991, pp. 63-67). In addition to much higher capital requirement, a foreign bank had to be formed by at least three corporate persons or ten individuals, and at least one Polish citizen was to be a member of a bank's board of directors. Among banks with foreign participation and branches of Western banks that opened in Poland are: Citibank, Bank Creditanstalt, First

Polish American Bank, ING Bank, International Bank of Poland, Raiffeisen-Centrobank, and Solidarnosc Chase DT Bank (KPMG, 1993, p. 42). Permission to open representative offices in Poland has been granted to about 20 foreign banks (Bossak, 1994, p. 116).

New Private Sector and CFCs

By far the most important development in the post-communist Polish economy is the emergence of strong, "genetic" private sector⁹¹. It developed on its own, out of the initiative of new entrepreneurs and with a substantial (more in number than in value) participation of foreign investors. The growth rate of companies with foreign partners was higher than the growth of domestic firms. The fastest growth of the latter naturally took place in the form of small and medium-sized companies. By the end of 1993 about 1.8 million individual private proprietorships were recorded. Also, a number of new joint stock companies increased rapidly. Data on the growth and structure of the private sector in Table A9 in Appendix A indicate that between the end of 1991 and 1993 a number of private companies and partnerships increased from 66,483 to 131,488.

The private sector contribution to GDP increased from 30.9% in 1990, to 47.2% in 1992 and to above 50% in 1993 while its share in employment grew to 59% in 1993 (Bossak, 1994, p. 127). More than a third of industrial output is produced by the private sector, over 44% in transport, but over 85% both in construction and trade (Misala, 1993, p. 5). As we can see industrial activity of large enterprises that employ an estimated 15-20% of labor force still remains in the public sector (*Privatization Update*, December 1994, p. 7).

In comparison, the government privatization programs in SOEs led to a decline in number of state enterprises between the end of 1990 and the end of 1993 from 8,441 to 5,924 (see Table A8 in Appendix A). Some of these companies were dissolved,

⁹¹ In the literature on transition economies, the new private sector which emerged spontaneously out of local entrepreneurship is referred to as "genetic".

therefore, did not contribute to an expansion of the private sector. In the end of 1993, there still existed a large public sector of 51,768 economic units (see Table A8 in Appendix A). Clearly, a small number of government privatizations did not explain the growth of the private sector. Therefore, the growth occurred in the "genetic" private sector. Although in terms of value of investments, government privatizations contributed considerably more because of their large investments of capital.

In 1993 there were 66,457 domestically-owned companies and 15,053 companies with the foreign capital participation (data based on registration of projects). The latter, therefore, comprised over 11% of all private companies. In 1993 alone 8,239 domestic and 4,922 projects with foreign capital were registered (see Table A9 in Appendix A). The operating CFCs (7,935) constituted 6% of private sector companies registered by the end of 1993. Small projects dominated in the trade sector, reflecting a surge in cross-border import-export transactions, mostly to supply the Polish market.

The increased activities in the "new" private sector led to various forms of cooperation between domestic and foreign partners. There are also cases where newly established Polish private companies are taken over by foreign investors. The examples are provided by Unilever, Colgate Palmolive and British ICL (Bossak, 1994, p. 151). This encouraging development may be the beginning of the larger FDI inflows to Poland as the private sector displays first signs of strength.

Summary of the Restrictions on and Obstacles to FDI in Privatization Process

Over all, out of 8,441 SOEs in Poland in the end of 1990, 46.7% of SOEs did not even initiate the process by March 31, 1994 (see Figure VI. 7). It substantially limited the amount of enterprises in which property rights have been settled and with which foreign investors could have negotiated a deal. As the economic situation of SOEs awaiting

privatization further deteriorates, they lose an appeal to potential buyers. Thus, the delays in privatization discourage FDI and prevent SOEs from essential restructuring.

Figure VI. 7.

Source: *Dynamika prywatyzacji* (Dynamics of Privatization), Ministerstwo Przekształcen Własnościowych (Ministry of Privatization), March 1994, p. 6)

Although the authorities recognized a need for foreign capital in revitalizing the state sector, major restrictions on FDI existed. Initially, foreign investors were allowed to purchase only up to 10% value of the issue of the stock in a state enterprise without obtaining a permit. This constraint on equity share prevented them from obtaining effective control of the enterprises. Its elimination, therefore, increased investors interest in privatization.

Next, the political debates on the nature and methods of ownership change slowed down the pace of privatization. Enterprises remained in a situation of uncertain

property rights status. Until these rights were clearly defined, investors refused to enter negotiations. In many cases where they did, the deal could not be finalized because disputes pertaining to ownership rights were pending. The unsettled restitution claims blocked privatization until the property rights were clearly assigned.

The tensions arising from a power struggle among stakeholders at the enterprise level stalled the progress of privatization in a number of SOEs. This struggle exacerbated the deteriorating situation in many state firms. This, in turn, effectively deterred potential investors.

The method of divestiture had the most important impact on the level of foreign participation. Foreign investors were crowded out of the small and medium-sized privatization as domestic buyers dominated the scene. Together with those SOEs that were privatized by "nomenklatura privatization", their assets were virtually out of reach for foreign investors. Due to the fact that a large number of SOEs opted for the employee/management ownership under the liquidation method, and the managers and workers acquired a controlling share of the SOE, the opportunities for FDI were substantially limited⁹². Even in the enterprises destined for a direct sale to a strategic buyer, a certain percentage of shares (varying from 10% to 20%) was reserved for the labor force in the privatized firm. Another form of privatization, namely the mass privatization program, further reduced foreign investor's chances for participation as shares in hundreds of selected SOEs will be distributed among the population and placed in the hands of state investment funds. The slow progress of the program prevented initially selected SOEs from choosing another form of privatization.

In the case of direct sales, it was anticipated that a substantial number of SOEs would be sold to a strategic investor, possibly foreign. Although this method seemed the most viable route for FDI to participate in privatization, various difficulties

⁹² This phenomenon is discussed in great detail by McMillan (1994) in his paper on the linkages between foreign investment and privatization in Russia.

appeared. The failure to proceed faster with this method, has limited the scope for foreign acquisitions. A number of obstacles existed, ranging from the complex and time-consuming negotiation process, through a rigid framework of administrative procedures and bureaucratic approach at various levels of government, to an infrastructure incapable of proper valuation of assets and handling of clients. Foreign investors are waiting for the authorities to dismantle the bureaucratic barriers and simplify the procedures. While these constraints and obstacles are present with a lesser degree in the "genetic" private sector, it has been an object of much more private investment--mostly in number but also important in value.

Chapter VII. Conclusions

A set of questions regarding Poland's FDI showing in the early years of transition inspired this thesis project. The point of departure was the fact that despite world-wide expectations of greatly intensified FDI flows to Central and Eastern Europe, actual investments have been very modest. The size of FDI flows varied across the region, with Hungary and the former Czechoslovakia enjoying majority of investments. Especially intriguing was Poland's relative failure in attracting FDI, although the country was the first to embark on the transition path and to begin recovery from the post-communist recession. The examination of factors that placed Poland in the periphery of foreign direct investment flows in the early years of transition became a central purpose of this thesis.

The core hypotheses, put forward in chapter I, delineated a structure of analysis that was followed in explaining the FDI phenomenon in Poland. Two groups of factors were identified. The first, consisted of external factors that have had an impact on the size of FDI flows to Central and Eastern Europe, as a whole, including Poland. The second group listed potential internal factors, peculiar to Poland's transition, that influenced locational decisions of foreign investors.

The statistical evidence presented in chapter II suggested that Poland's relative position among ECEE-3 was poor in the initial years of transition but it started to improve in 1993. Although it attracted a large number of German investors, the value of their investments was small. At the same time, the American investments were much fewer in number, but the value of actual FDI was the highest. The investments in industry and trade were leading in number of CFCs. Investments in the former were almost three times higher than in the latter. However, the average investments in that sector were small (except for a few major transactions), considering enormous amount of capital that is desired to privatize and restructure the Polish state industry. An encouraging trend was

observed as every year (except for 1994 for which only preliminary data were available). FDI inflows were growing and foreign investors started to overcome hesitation to invest in Poland.

Chapter III presented the changes in global FDI flows and in the nature of the MNE that had a detrimental effect on FDI flows to economies in transition. Among the most important developments were: the decreased level of outflows from the OECD countries, the growing world-wide competition for private capital, the changing composition of FDI, and the new strategies of MNEs. There is a possibility that once recession in the West is overcome, FDI outflows from OECD countries will intensify. Through development and utilizing the benefits of already present foreign investors in the economies in transition, the host countries will better attune themselves to global investment flows and will be able to successfully compete for FDI. It was concluded, however, that while the external factors influenced FDI flows to the region in question, in order to identify causes of Poland's poor showing, the characteristics of a domestic environment had to be examined.

Beginning in chapter IV, the pre-1990 experience with FDI in Poland was assessed. The evolution of the investment regime was presented. It was found that the ambivalent approach of the Polish authorities towards FDI characterized this period (1976-1989). The intention was to tap into international capital flows and to enjoy the benefits of highly regulated FDI participation in the economy, but the policy was shaped by ideological concerns and nationalist tendencies. That is why, only projects carried out by members of the Polish émigré community were welcomed. Although wholly-owned companies were initially allowed, they were limited to small "Polonian firms". They ameliorated some of the shortages of consumer goods and services but were not able to provide the failing industrial sector with necessary capital and technology. Only in 1986 were the first joint ventures between state-owned and foreign enterprises permitted. The government's focus

shifted towards bureaucratic administration of foreign investment projects and as a result FDI inflows remained very modest.

The limited exposure to foreign capital in the era prior to 1990 did not permit Poland to develop a consistent policy conducive to FDI. Throughout the socialist era, the country's economic potential deteriorated, the political scene polarized between the dissidents and the supporters of a regime, and expectant social attitudes expanded. The legacy of the socialist past in a form of inadequate physical infrastructure and market-adverse, socio-cultural institutions has persisted and shaped the policies and processes of the post-communist transformation. However, the existence of "Polonian firms" and joint ventures associated with an emerging small-sized private sector provided the foundations for a market system after 1989.

Poland's leading position in overcoming communism in 1989 should have given the country an advantage in attracting FDI. However, the political fragmentation, organizational chaos and economic recession that followed after the implementation of radical reforms in 1990, revealed the highly unstable character of the Polish system. Chapter V served to present the unpredictable and inconsistent policy environment that prevailed in the early years of transformation. The government, pursuing prescriptions of neoclassical economic theory, attempted to withdraw from the economic sphere and let the market decide. Unfortunately, the state withdrew at the time when wise intervention was essential in building a new system. Transformation took upon its own course and did not bring the expected results promised both by the advisors and the reformers. Frequent corrections of various policies created confusion while the declining economy and standard of living fueled social discontent with reforms, and especially with privatization. The social and political instability supported perceptions of Poland as a high-risk location for business and discouraged FDI inflows.

The privatization process which has been considered a core of systemic change turned out to be both complex and controversial. The tensions that arose between

main players during privatization inhibited the process and contributed to a cautious attitude among international business community. The variety of methods experimented with in Poland did not bring expected results but extended the undertaking in time. Lack of clear program and firm commitment to ownership change (in contrast to different but fast privatization schemes in Hungary, Russia and the former Czechoslovakia) prevented attainment of a necessary momentum for the process. Progress of privatization in the economy in transition is a key aspect for FDI. Chapter VI proved that the uncertain state of property rights and the delays in privatization of state enterprises reduced foreign investors opportunities to participate in changing of ownership structure in Poland. Despite multiple methods, foreign investors' participation in privatization was largely restricted to SOEs offered for sale by the Ministry of Privatization. A slow progress in this method indicates both the government's failure to move fast enough and the investors hesitation to take over the SOEs offered to them.

In a situation where government designed programs failed to move fast enough to facilitate capital entry, the emergence of the new private sector may be a key to a future success of Poland. Its strength has already been expressed in a dynamic growth in number of companies and in a large share of total employment and GDP. This sector has been the engine of Poland's recovery from the recession. This sector, also attracted most of private investment in terms of number and an important part, in terms of value. The attractiveness of the "genetic" private sector is much higher than that of the inefficient and bankrupting public sector. The new sector is governed by rules more compatible with the Western profit-making principles and business ethics. Although not free from constraints, it offers less bureaucratic environment and better opportunities for FDI. As a result of the recovery driven by the "genetic" private sector, the country has already attracted larger FDI inflows. To sustain these inflows, predictable investment climate has to be developed and then, maintained.

The examination of economic, social and political components of an investment environment in Poland, conducted in the above chapters, identified country-specific advantages and/or disadvantages that influenced the path of transition and the decisions of foreign investors. The FDI evidence on ECEE-3 suggests that in the early years of systemic change Poland was less competitive as a location for FDI'. As a domestic environment evolves, a country's attractiveness for foreign investment changes. Poland has been developing its "diamond of national competitive advantage" in Central and Eastern Europe. It needs to attain a critical mass of economic, social and political factors to create an investment environment more attractive and conducive to FDI. Therefore, timing and experience seem critical here.

The declared liberalization of the investment regime is necessary but not sufficient condition for FDI to come in. The building of a competitive domestic infrastructure and stabilization of policy environment are crucial elements in establishing favorable conditions for FDI inflows. The factors that were identified in explanation of modest foreign involvement in the Polish economy, are transitory in nature. Once they are eliminated in a course of the systemic development, the competitiveness of Poland will increase. The FDI record has shown that Poland is slowly emerging from the periphery of FDI flows but through different channels that were initially anticipated.

Appendices

Descriptions of symbols:

Dash (-)	nil occurrence of the phenomenon
Zero (0)	the phenomenon occurs in quantities less than 0.5
(0.0)	the phenomenon occurs in quantities less than 0.05
Dot (.)	lack of information
"Of which"	indicates that all elements of the total are not listed

Appendix A

Table A1. Characteristics of ECEE-3: Former Czechoslovakia, Hungary and Poland

	1989	1990	1991	1992	1993
GDP in USD billion^a					
Former Czechoslovakia	50.41	45.20	33.17	36.10 ^a	31.66 ^b
Hungary	28.96	32.90	30.89	35.51	36.11
Poland	82.22	62.27	77.94	83.55	85.90
Population in million					
Former Czechoslovakia	15.64	15.66	15.58	15.73	10.31 ^b
Hungary	10.40	10.36	10.35	10.32	10.29
Poland	37.96	38.12	38.24	38.36	38.46
GDP per capita in USD					
Former Czechoslovakia	3,223	2,886	2,129	2,295	3,070
Hungary	2,785	3,176	2,985	3,441	3,509
Poland	2,166	1,634	2,038	2,178	2,233

Source: *International financial statistics yearbook*, IMF, 1994.

* Data calculated on the basis of national statistics in national currencies converted into USD at the exchange rate at period averages.

^a Data for the Czech Republic USD 26.1 billion and Slovakia USD 10.0 billion was added and presented for former Czechoslovakia. Data from *Poland: Quarterly statistics*, GUS, 1994, p. 37.

^b Data for the Czech Republic only from *International financial statistics*, December 1994, p. 194.

Table A2. Evolution of Joint Equity Ventures in Poland*

	Number of registered joint ventures	Value of foreign investment in registered joint ventures (in USD million)
End 1970s	-	..
1984	-	..
1 January 1988	13	4
1 January 1989	55	8
1 June 1989	190	88 ^a
1 January 1990	918	..
1 March 1990	1,000	110
1 July 1990	1,550	186
1 October 1990	1,950	340
31 December 1990	approx. 2,400	..

Source: McMillan, C. H. (1992). Foreign investment flows to the Soviet Union and Eastern Europe: Nature, magnitude and international implications. *Journal of Development Planning*, 23, p. 311.

* Cumulative estimates which exclude "Polonian firms".

^a Data for October 15, 1989

Table A3. Joint Ventures Operating in Poland: Structure of Joint Ventures by Value of Foreign Capital in 1990

Value of capital (in USD thousand)	Number of joint ventures
Below 50	32
50	699
50.1--60	500
60.1--100	279
100.1--200	129
200.1--500	66
500.1--1,000	25
1,000.1--3,000	16
More than 3,000	6
Total	1,752

Source: Gwiazda, A. (1992). The new conditions and environment for direct foreign investment in Poland, *Russian & East European Finance and Trade*, 28, p. 74.

Table A4. Composition of Inflows of FDI to Poland 1985-1992
(in USD million)

	1985	1986	1987	1988	1989	1990	1991	1992
Direct investment	15	16	12	15	11	89	291	678
Equity capital	15	16	12	15	11	69	216	433
In convertible currencies	2	3	7	1	4	68	216	433
In non-convertible currencies	13	13	5	14	7	1	-	-
Reinvestment of earnings	-	-	-	-	-	20	50	154
Other long-term capital	-	-	-	-	-	-	25	91
Short-term capital	-	-	-	-	-	-	-	-

Source: *Balance of payments statistics yearbook*, IMF, Part 1, 1993, p. 563.
Information was taken from transactions data on capital account.

Table A5. Foreign Small-Scale Enterprises in Poland in 1990-1993
Total and Industry

Periods	Total	Industry
31.12.1990*	862	739
31.12.1991	787	656
30.06.1992	714	602
31.12.1992	686	582
31.03.1993	703	591
30.06.1993	682	577
30.09.1993	661	555
31.12.1993	647	542

Source: *Biuletyn statystyczny (Statistical bulletin)*, GUS, 1994, p. 99.

* data from *Podmioty gospodarcze z udziałem kapitału zagranicznego w latach 1990 i 1991*, (Economic units with the share of foreign capital in 1990 and 1991) GUS, 1992, p. 5.

Table A6. Growth in Number of Economic Units with the Share of Foreign Capital: 1990-1993

Periods	Number of economic units	Industry	Construction
31.12.1990*	1,645	853	71
31.12.1991	4,796	2,099	319
30.06.1992	8,860	3,152	661
31.12.1992	10,131	3,463	757
31.03.1993	11,473	3,757	873
30.06.1993	12,804	4,070	981
30.09.1993	13,801	4,313	1,047
31.12.1993	15,053	4,638	1,147

Source: *Biuletyn statystyczny (Statistical bulletin)*, GUS, 1994, p. 99

* data from *Podmioty gospodarcze z udziałem kapitału zagranicznego w latach 1990 i 1991* (Economic units with the share of foreign capital in 1990 and 1991), GUS, 1992, p. 5.

Table A7. Structure of Economic Units with Foreign Participation in Poland 1990-1993 (by Sectors)

	Economic units with the share of foreign capital				Foreign small scale enterprises			
	1990 ^a	1991 ^a	1992 ^b	1993 ^b	1990 ^a	1991 ^a	1992 ^c	1993 ^d
Industry	853	2,099	3,463	4,638	739	656	582	542
Construction	71	319	757	1,147	77	79	64	
Agriculture	48	64	113	178	2	1	1	
Forestry	4	6	13 ^e	..	-	-	-	
Transport	67	207	345	534	2	2	2	
Communication	5	14	25	24	-	1	1	
Trade	198	1,158	3,605	5,958	15	30	24	
Other branches of material production	258	413	616	670	18	11	7	
Community services	6	14	41	65	2	1	1	
Housing and non-material community services	1	2	9	18	-	-	-	
Science and R&D	8	6	..	..	-	-		
Education	1	13	36	63	-	-	-	
Culture and arts	15	27	62 ^e	..	2	1		
Health care and social welfare	6	18	53	79	1	2	-	
Finance and insurance	8	64	130 ^e		-	-	..	
Physical education, tourism and recreation	33	105	199 ^e	..	-	-		
Other branches of non-material services	61	262	639	1,089	4	3	3	
Total**	1,645	4,796	10,131	15,053	862	787	686	647

Source: ^a For 1990 and 1991 data: *Podmioty gospodarcze z udziałem kapitału zagranicznego w latach 1990 i 1991* (Economic units with a share of foreign capital in 1990 and 1991), GUS, 1992, p. 5.

^b For 1992 and 1993 data: *Poland: Quarterly statistics*, GUS, 1994, p. 7.

^c Data from *Rocznik statystyczny 1993* (Statistical yearbook 1993), GUS, 1993, pp. LXII-LXIII and pp. 598-600.

^d Data from *Biuletyn statystyczny* (Statistical bulletin), GUS, 1994, p. 99.

^e Data from *Rocznik statystyczny 1993*, (Statistical yearbook 1993), GUS, 1993, p. LXIV.

* Data as of 31.12 each year

** Branches listed above may not add up for "Total" as not all items may be listed

**Table A8. Structure of the Public Sector in Poland 1991-1993*
(by Sectors)**

a: 31.12.1991 b: 31.12.1992 c: 31.12.1993	Total	State enterprises	Communal enterprises	Economic unit with the share of State Treasury	Economic unit with the share of state legal persons
Total a	54,864	8,228	741	376	909
b	53,554	7,245	542	764	794
c	51,768	5,924	647	958	830
Industry b	3,853	2,739	46	430	250
c	3,716	2,495	76	515	275
Construction b	1,860	1,164	119	85	123
c	1,698	1,016	136	96	118
Agriculture b	2,917	1,516	22	9	20
c	1,596	806	47	41	26
Transport b	804	3	3	24	28
c	790	7	7	27	29
Communicat. b	36	2	-	3	2
c	31	2	-	4	1
Trade b	984	561	19	97	138
c	958	518	21	114	152
Other branches of material production b	549	89	5	21	100
c	490	80	4	27	90
Community services b	1,647	269	273	5	11
c	1,719	138	293	5	14
Housing and non-material community services b	835	70	42	3	5
c	632	64	57	1	5
Education b	26,800	1	-	1	-
c	26,221	1	-	2	-
Health care and social welfare b	3,782	32	-	-	2
c	3,969	34	-	13	2
Other branches of non-material services b	306	10	1	37	59
c	332	11	2	57	51

Source: Poland;; *Quarterly statistics*, GUS, 1994, p. 7.

* The number of economic units registered in the REGON Business Register (without plants belonging to natural persons and civil law companies). Data refer to legal persons and independent units without legal status.

**Table A9. Structure of the Private Sector in Poland 1991-1993*
(by Sectors)**

a. 31.12.1991 b. 31.12.1992 c. 31.12.1993	Total	Cooperatives	Commercial law partnerships with the share of private domestic partnerships	Commercial law partnerships with the share of foreign capital
Total**				
a	66,483	18,949	73,699	4,796
b	102,327	19,372	58,218	10,131
c	131,488	19,746	66,457	15,053
Industry				
b	17,526	2,578	11,172	3,463
c	20,473	2,587	12,914	4,638
Construction				
b	12,751	994	11,098	757
c	14,494	1,018	12,413	1,147
Agriculture				
b	6,216	4,180	553	113
c	6,970	4,167	1,062	178
Transport				
b	1,735	286	1,102	345
c	2,195	288	1,364	534
Communicat.				
b	156	7	133	25
c	122	6	98	24
Trade				
b	28,560	3,789	20,359	3,605
c	34,156	3,784	23,155	5,958
Other branches of material production				
b	7,167	340	6,339	616
c	7,256	333	6,368	670
Community services				
b	597	76	554	41
c	716	77	761	65
Housing and non-material community services				
b	5,072	4,875	179	9
c	5,400	5,174	222	18
Education				
b	922	39	323	36
c	1,254	38	376	63
Health care and social welfare				
b	1,067	75	277	53
c	1,408	74	328	79
Other branches of non-material services				
b	5,075	336	4,056	639
c	6,387	360	4,844	1,089

Source: *Poland: Quarterly statistics*, GUS, 1994, p. 7.

* The number of economic units registered in the REGON Business Register (without plants belonging to natural persons and civil law companies). Data refer to legal persons and independent units without legal status.

** Sum of the items below may not add up to the "Total" as some items may not be listed

Appendix B

Figure B1.

Table B1. Value of Committed Foreign Capital (Cash and In-kind Contributions) at the Time of Registration

	Value in USD thousands of which			Value in PZl millions of which		
	Total committed capital	Cash contributions	In-kind contributions	Total committed capital	Cash contributions	In-kind contributions
Total of which	3,070,508	2,364,569	705,939	28,580,682	20,673,976	7,906,706
Joint stock companies	495,613	470,204	25,409	5,634,367	5,327,561	306,806
Limited liability companies	1,935,997	1,285,236	650,761	22,498,966	1,4944,115	7,554,851
Foreign small-scale enterprises	638,898	609,129	29,769	447,349	402,300	45,049

Source: *Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r.*, (BICFC), GUS, 1994, p. 10.

Table B2. Value of Initial Capital Invested at the Beginning of Operation of Companies with the Share of Foreign Capital

	Initial capital in PZl million		
	Total	Domestic	Foreign
Total	48,545,033	13,071,462	35,473,571
Joint stock companies	13,903,407	2,730,561	11,172,846
Limited liability companies	33,535,286	10,187,123	23,348,163
Foreign small-scale enterprises	1,106,340	153,778	952,562

Source: *Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r.*, (BICFC), GUS, 1994, p. 20.

Table B3. Value of Committed Foreign Capital (Cash and In-Kind Contributions) at a Time of Registration by Sectors

	Value in USD thousands of which			Value in PZl millions of which		
	Total committed capital	Cash contributions	In-kind contributions	Total committed capital	Cash contributions	In-kind contributions
Total of which	3,070,508	2,364,569	705,939	28,580,682	20,673,976	7,906,706
Industry	1,868,381	1,411,435	456,946	15,083,905	10,266,670	4,817,235
Construction	131,958	71,348	60,610	1,426,758	302,625	1,124,133
Agriculture	5,227	4,697	530	58,914	54,423	4,491
Forestry	1,076	639	437	9,001	5,645	3,356
Transport	61,439	26,421	35,018	650,507	167,439	483,068
Communicat	15,158	13,321	1,837	149,615	128,394	21,221
Trade	675,515	604,884	70,631	7,916,037	7,318,636	597,401
Other branches of material production	182,354	163,091	19,263	1794597	1,575,074	219,523
Community services	33,215	9,615	23,600	435,512	142,625	292,887
Housing and non-material community services	1,229	1,229	-	16,739	16,739	-
Science and R&D	295	106	189	2,605	962	1,643
Education	4,375	3,665	710	67,639	60,437	7,202
Culture and arts	3,158	1,741	1,417	3,6711	18,157	18,554
Health care and social welfare	1,249	606	643	14,186	7,896	6,290
Physical education, tourism and recreation	31,476	28,643	2,833	343,352	313,431	29,921
Other branches of non-material services	46,040	14,960	31,080	449,725	172,916	276,809
Finance and Insurance	8,286	8,091	195	124,835	121,863	2,972

Source: *Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r., (BICFC), GUS, 1994, pp. 10-11.*

Table B4. Structure of Companies with the Share of Foreign Capital by Value of Initial Capital

Value of capital	Number of companies	Initial capital in PZl million		
		Total	Domestic	Foreign
Total companies	7,935	48,545,033	13,071,462	35,473,571
More than Zl 20 billion	315	39,328,144	10,396,777	28,931,367
Zl 10-20 billion	186	2,612,681	761,734	1,850,947
Zl 5-10 billion	247	1,785,414	536,450	1,248,909
Zl 1-5 billion	1,511	3,233,889	1,024,080	2,209,809
Zl 0.5-1 billion	1,360	1,017,888	230,271	787,617
Zl 250-500 million	790	319,427	61,125	258,302
Zl 150-250 million	417	86,182	21,283	64,899
Up to Zl 150 million	3,109	161,408	39,742	121,666

Source: *Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r.*, (BICFC), GUS, 1994, p.24.

Table B5. Structure of Companies with the Share of Foreign Capital by Size of Foreign Equity Share

Foreign equity share	Number of companies	Initial capital in Zl million			Income from sales in PZl million	Income from export sales in PZl million
		Total	Domestic	Foreign		
Total companies	7,935	48,545,033	13,071,462	35,473,571	275,463,090	41,189,472
of which						
99.5%-100%	3,216	14,793,076	2,479	14,790,597	90,601,436	10,540,534
70.5%-99.4%	1,302	12,857,338	1,289,784	11,567,554	62,273,092	16,710,037
50.5%-70.4%	961	7,643,666	3,305,308	4,338,358	41,485,083	6,672,295
49.5%-50.4%	716	2,079,251	1,037,869	1,041,382	15,193,367	1,687,512
30.5%-49.4%	892	7,043,940	3,945,662	3,098,278	22,532,619	2,509,292
9.5%-30.4%	408	2,610,517	2,012,646	597,871	23,945,933	2,032,346
Up to 9.4%	440	1,517,225	1,477,714	39,531	19,431,520	1,037,453

Source: *Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r.*, (BICFC), GUS, 1994, p.30.

Table B6. Number of Companies with the Share of Foreign Capital by Size of Employment by Sectors (as of 31.12.1993)

	Number of companies	Employment in all companies	Number of companies in which employment size is:							
			Below 5	5-10	10-50	50-100	100-250	250-500	500-1,000	Over 1,000
Total companies	7,933	310,180	3,631	1,174	2,036	470	361	131	61	31
Industry	2,877	223,810	817	371	974	294	230	107	47	28
Construction	312	15,564	263	64	122	31	19	5	5	1
Agriculture	83	1,796	42	14	16	6	5	-	-	-
Forestry	13	294	7	1	4	-	1	-	-	-
Transport	330	8,115	130	73	91	23	9	-	1	1
Communication	16	1,132	4	2	6	-	2	2	-	-
Trade	2,844	34,074	1,723	458	531	72	30	6	4	-
Other branches of material production	406	11,108	134	71	128	24	23	5	1	-
Community services	43	3,123	16	7	11	4	1	2	2	-
Housing and non-material community service	11	108	7	1	2	1	-	-	-	-
Science and R&D	8	160	3	1	3	-	1	-	-	-
Education	32	343	20	3	7	1	1	-	-	-
Culture and arts	39	1,123	20	2	16	-	-	-	1	-
Health care and social welfare	43	391	24	2	15	1	1	-	-	-
Physical education, tourism and recreation	134	3,008	77	19	30	1	5	1	-	1
Other branches of non-material services	500	5,207	322	76	87	8	4	3	-	-
Finance and insurance	43	621	19	7	13	4	-	-	-	-

Source: *Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r.*, (BICFC), GUS, 1994, pp. 44-45.

Table B7. Employment in Selected Sectors of the Polish Economy in 1993

Sectors of the economy	Total employment in thousand	Employment in the public sector in thousand	Employment in the private sector in thousand	Employment in CFCs*
Total of which:	8,790	5,945	2,845	310,180
Industry	3,318	2,162	1,156	223,810
Construction	666	203	463	15,564
Transport	675	604	70	8,115
Trade	768	136	632	34,074

Source: *Biuletyn statystyczny (Statistical bulletin)*, GUS, June 1994, pp. 26-27.

* Data from *Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r.*, (BICFC), GUS, 1994, pp. 44-45.

Figure B2.

Figure B3.

Table B8. Characteristics of Companies with the Share of Foreign Capital by Province (as of 31.12.1993)

Province	Committed foreign capital in 22 million 1,000	in USD	Initial capital in 22 million Total	Foreign	Number of companies	Total employment
Total companies of which in	28,380,682	3,070,308	48,545,033	35,473,571	7,935	310,180
Warszawskie	7,143,798	711,017	13,733,932	10,421,621	2,322	72,963
Białostockie	63,895	5,219	110,695	79,895	15	1,318
Białockie	93,975	7,995	182,020	133,453	30	2,156
Białskie	365,601	203,462	6,234,306	5,744,057	160	24,627
Bydgoskie	970,537	85,756	1,130,064	995,747	160	9,586
Chełmskie	8,441	472	21,102	10,713	10	229
Ciechanowskie	53,864	4,442	86,147	52,017	39	1,458
Castochowskie	166,323	12,634	114,892	81,924	66	1,699
Elblskie	1,372,367	176,273	1,172,314	1,087,496	31	8,846
Gdńskie	4,318,515	397,902	1,029,061	889,334	482	13,811
Gorzowskie	356,813	22,167	474,246	430,904	131	5,488
Jeleniogorskie	235,231	23,508	273,392	233,567	96	2,890
Kaliskie	113,967	9,357	309,930	184,258	77	2,030
Katowickie	2,946,141	256,167	5,855,084	3,137,874	556	21,953
Kielckie	217,432	16,476	372,299	267,531	66	3,590
Koninckie	23,426	1,848	40,992	32,098	38	1,488
Kozalickie	65,366	8,219	149,365	104,896	95	3,869
Krakowskie	2,372,196	161,668	1,158,933	819,279	302	7,793
Krońskie	41,105	3,139	39,925	22,973	22	646
Legnickie	112,306	158,284	401,010	324,093	44	2,628
Leszczńskie	35,715	6,884	138,659	93,886	58	1,800
Lubelskie	81,036	10,546	221,010	128,077	78	3,175
Lwowskie	4,895	419	12,529	7,901	14	356
Łódzkie	965,737	86,127	1,734,331	1,288,039	313	11,753
Nowosądeckie	37,004	7,444	80,471	59,346	38	2,273
Olzyskie	115,027	11,414	416,383	246,732	93	7,394
Opolskie	2,327,912	166,667	1,812,960	933,070	198	7,989
Ostroleckie	101,781	10,744	263,966	144,060	20	4,367
Pilskie	202,077	19,451	331,029	275,991	28	4,731
Piotrkowskie	11,951	1,028	64,348	42,709	28	1,903
Plockie	33,009	3,232	70,655	49,749	24	1,685
Poznańskie	1,082,740	94,248	2,714,955	1,596,108	479	17,070
Przemyskie	328,496	39,811	406,747	309,222	13	1,586
Radomskie	286,436	96,954	400,106	367,816	44	3,579
Rzeszowskie	233,335	17,764	1,515,514	1,425,269	51	2,799
Siedleckie	85,733	40,036	92,864	69,739	38	1,255
Sieradzkie	19,692	12,502	35,703	25,924	26	821
Skiermiewickie	25,533	17,006	88,986	63,853	39	2,380
Slupskie	28,213	6,072	124,094	81,571	64	1,983
Swałskie	20,477	2,117	38,281	24,079	23	1,039
Szczecińskie	428,453	63,634	1,164,622	723,829	455	11,775
Tarnobrzeskie	44,584	17,631	28,495	17,370	9	458
Tarnowskie	99,478	8,936	266,384	102,171	29	2,075
Torńskie	66,391	8,656	393,485	314,126	59	3,277
Wałbrzyskie	112,057	11,985	577,089	125,372	96	5,403
Wicławskie	11,955	1,093	94,009	83,576	25	2,125
Wrocławskie	268,255	25,719	1,920,866	1,603,891	430	8,972
Zamojskie	2,879	254	5,345	2,418	9	254
Zielonogorskie	228,532	16,129	599,216	393,947	192	6,834

Source: Data on "Committed capital" from: *Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r.*, (BICFC), GUS, 1994, 1994, pp. 14-17.

Data on "Initial capital" from: *Ibid.*, pp. 22-23.

Data on "Number of companies and "Total employment" from : *Ibid.*, pp. 46-49

Table B9. Number of Companies with the Share of Foreign Capital by Size of Employment by Province (as of 31.12.1993)

Province	Number of companies in which size of employment is:								Number of companies	Total employment
	Below 5	5-10	10-50	50-100	100-250	250-500	500-1,000	Over 1,000		
Total companies of which in:	3,651	1,174	2,056	470	361	131	61	31	7,938	310,180
Warszawskie	1,249	422	627	101	75	28	13	7	2,522	72,963
Białkopodlaskie	4	1	4	2	1	3	-	-	15	1,318
Białostockie	26	4	14	2	-	3	1	-	50	2,156
Białskie	72	18	38	12	12	3	3	2	160	24,627
Bydgoskie	54	20	41	24	12	5	3	1	160	9,366
Chełmskie	6	-	2	2	-	-	-	-	10	229
Ciechanowskie	16	3	12	4	3	1	-	-	39	1,438
Człochowski	30	11	17	3	4	1	-	-	66	1,699
Elbląskie	10	3	8	3	2	2	1	2	31	8,446
Gdańskie	237	75	106	23	32	6	3	-	482	13,811
Gorzowskie	59	20	36	6	7	1	1	1	131	5,488
Jeleniogórskie	41	22	20	6	4	2	1	-	96	2,890
Kaliskie	34	13	21	3	5	1	-	-	77	2,030
Kalowskie	233	86	162	32	24	10	7	2	556	21,953
Kielockie	24	8	18	10	4	1	-	1	66	1,990
Końskie	20	2	9	2	3	2	-	-	38	1,488
Kozaliskie	44	8	23	11	5	3	1	-	95	3,869
Krakowskie	159	33	82	14	9	4	-	1	302	7,794
Krośńskie	9	2	6	4	1	-	-	-	22	646
Legnickie	15	8	13	2	2	3	1	-	44	2,628
Leszczyńskie	23	12	15	5	1	2	-	-	58	1,880
Lubelskie	36	10	21	6	3	-	2	-	78	3,175
Łomżyńskie	5	2	4	1	2	-	-	-	14	356
Łódzkie	134	42	85	24	19	7	1	1	313	11,753
Nowosądeckie	14	6	10	3	1	3	1	-	38	2,273
Olśztyńskie	43	11	20	5	10	1	1	2	93	7,394
Opolskie	111	25	36	11	9	1	3	2	198	7,980
Ostrołockie	9	2	3	2	2	-	-	2	20	4,367
Pilskie	5	3	9	5	4	1	-	1	28	4,731
Piotrkowskie	4	4	13	4	1	1	1	-	28	1,903
Płockie	7	2	9	1	3	1	1	-	24	1,685
Poznańskie	191	82	134	34	27	4	7	-	479	17,070
Przemyskie	6	1	4	1	-	-	-	1	13	1,506
Radomskie	8	7	10	8	6	5	-	-	44	3,579
Rzeszowskie	25	11	7	2	4	1	-	1	51	2,799
Siedleckie	12	7	13	3	1	2	-	-	38	1,255
Sieradzkie	8	3	8	6	1	-	-	-	26	821
Skiernewickie	8	8	14	4	2	2	1	-	39	2,380
Śląskie	31	5	18	3	5	2	-	-	64	1,983
Swałskie	7	4	5	3	4	-	-	-	23	1,039
Szczecińskie	210	57	143	20	15	8	2	-	455	11,775
Tarnobrzęskie	3	1	2	1	2	-	-	-	9	458
Tarnowskie	7	3	9	5	3	1	1	-	29	2,075
Torunskie	19	5	18	6	8	2	1	-	59	1,277
Wałbrzyskie	43	20	22	4	4	1	-	2	96	5,403
Wrocławskie	14	3	4	1	2	-	-	1	25	2,125
Wrocławskie	247	55	88	24	10	4	2	-	430	8,972
Zamojskie	3	-	4	2	-	-	-	-	9	254
Zielonogórskie	76	24	69	10	7	3	2	1	192	6,834

Source: Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r., (BICFC), GUS, 1994, pp. 46-49.

**Table B10. Initial Foreign Capital Invested in Poland by Country of Origin
(as of 31.12.1993)**

Countries	Number of companies from a country	Share of a country in total number of companies with foreign capital participation (in %)	Initial foreign capital from a country in Zł million	Share of a country in total initial foreign capital (in %)
Total companies* of which:	7,935	100	35,473,571	100
Germany	2,943	37.1	8,130,606	22.9
Italy	387	4.9	6,856,912	19.3
United States	532	6.7	5,831,318	16.4
Netherlands	388	4.9	2,946,039	8.3
France	425	5.4	1,848,243	5.2
Austria	475	6.0	1,778,421	5.0
Sweden	404	5.1	1,186,096	3.3
Great Britain	319	4.0	887,201	2.5
Norway	73	0.9	771,537	2.2
Switzerland	217	2.7	732,845	2.1
Denmark	181	2.3	593,967	1.7
Belgium	169	2.1	525,063	1.5
Canada	104	1.3	339,112	1.0
Luxembourg	33	0.4	331,243	0.9
Hong Kong	9	0.1	326,465	0.9
Finland	57	0.7	281,744	0.8
Spain	57	0.7	237,997	0.7
Australia	77	1.0	223,287	0.6
Liechtenstein	49	0.6	147,702	0.4
Israel	28	0.4	135,705	0.4
Saudi Arabia	7	0.1	129,807	0.4
Russia	144	1.8	114,148	0.3
Singapore	22	0.3	101,155	0.3
Ireland	17	0.2	72,482	0.2
Japan	25	0.3	64,614	0.2
Slovenia	5	0.1	53,082	0.2
Turkey	47	0.6	33,017	0.1
Greece	41	0.5	26,835	0.1
Panama	10	0.1	25,896	0.1
China	64	0.8	25,413	0.1
Former Yugoslavia	13	0.2	18,290	0.1
Gibraltar	7	0.1	17,272	0.1
Ukraine	61	0.8	15,621	0.0
Bulgaria	25	0.3	13,826	0.0
Indonesia	4	0.1	11,266	0.0
Czech Republic	37	0.5	8,727	0.0
South Korea	7	0.1	8,005	0.0
India	19	0.2	7,394	0.0
Vietnam	73	0.9	7,310	0.0
New Zealand	4	0.1	6,242	0.0
Belarus	31	0.4	5,814	0.0

Portugal	8	0.1	4,804	0.0
Lebanon	5	0.1	4,490	0.0
Latvia	13	0.2	3,256	0.0
Hungary	32	0.4	3,142	0.0
Cyprus	7	0.1	3,005	0.0
United Arab Emirates	6	0.1	2,966	0.0
Syria	6	0.1	2,916	0.0
Thailand	7	0.1	2,402	0.0
Dominica	12	0.2	2,386	0.0
Argentina	9	0.1	2,049	0.0
Taiwan	8	0.1	1,806	0.0
Slovak Republic	6	0.1	1,229	0.0
Libya	4	0.1	788	0.0

Source: *Podstawowe informacje o podmiotach z udziałem kapitału zagranicznego w 1993 r.*, (BICFC), GUS, 1994 pp. 46-49.

* Number of companies by country may not add up to "Total" because a very small share of capital was invested by other countries in 222 companies which were not listed here. Listed companies amounted to 7,713 (97.3% of total number of companies) and represent 98.3 % of total initial foreign capital

Appendix C

Table C1. Major Foreign Investors in Poland by Country of Origin (in USD million) (as of June 1994)

Country of origin	Investments (I)	%	Commitments (C)	%	Total (I + C)	%	# of projects
USA	1,270.1	33.9	1,545.8	32.5	2,815.9	33	48
Internat.	605.6	16.2	184.2	3.9	789.8	9.3	9
Italy	365.8	9.8	1,731	36.4	2,096.8	24.7	6
Germany	313.8	8.4	290.39	6.1	604.19	7.1	41
France	263.1	7.0	143	3.0	406.1	4.8	19
Netherlands	201.4	5.4	164.7	3.5	366.1	4.3	9
Austria	158	4.2	9.3	0.2	167.3	2.0	17
Switzerland	106	2.8	18	0.4	124	1.6	7
Great Britain	97.7	2.6	285.1	6.0	382.8	4.5	14
Sweden	70.5	1.9	103.5	2.2	174	2.0	8
Denmark	60.2	1.6	4.5	0.1	64.7	0.8	10
Canada	49.3	1.3	5	0.1	54.3	0.6	13
Norway	43.7	1.2	29	0.6	72.7	0.9	3
Spain	42.7	1.1	85	1.8	127.7	1.5	1
Russia	20	0.5	0	-	20	0.2	1
Finland	17.6	0.5	8.9	0.2	26.5	0.3	4
Japan	13.8	0.4	53.2	1.1	67	0.8	7
Singapore	13	0.3	60	1.3	73	0.9	1
Ireland	7	0.2	0	-	7	0.1	1
Australia	6.3	0.2	13	0.3	19.3	0.2	1
S. Korea	5	0.1	20	0.4	25	0.3	1
S. Africa	3.4	0.1	5.5	0.1	8.9	0.1	1
Former Yugoslavia	3	0.1	1	0.0	4	0.0	1
Luxembourg	2.3	0.1	0	-	2.3	0.0	1
Greece	2.1	0.1	0	-	2.1	0.0	1
TOTAL	3,741.4	100	4,760.09	100	8,501.49	100	225

Source: Data on the basis of the list of 225 major foreign investors in Poland prepared by the Polish Agency for Foreign Investment (PAIZ).

Table C2. Structure of Foreign Capital by Industry (in USD million)

Sectors	Total: Investments and Commitments	Investments: Equity and Loans	Commitments
Industry	6,253	2,281	3,972
Electro-mechanical	2,616	735	1,882
Food processing	1,460	611	849
Fuel and energy	430	117	313
Telecommunications	650	237	413
Financial sector	750	677	73

Source: Data based on calculations made by PAIZ as of June 1994

Table C3. Structure of Foreign Capital by Sectors (as of March 1994)

Sectors	Investments	%	Commitments	%	Total	%	Number of firms	%
Industry of which:	2,166	61.5	3,506	81.9	5,672	72.7	131	60.4
Electro-mechanical	725	20.6	2,024	47.3	2,749	35.2	30	13.8
Food processing	532	15.1	326	7.6	859	11.0	42	19.4
Wood and paper	279	7.9	255	5.9	534	6.8	12	5.5
Chemical	236	6.7	40	0.9	276	3.5	15	6.9
Fuel and energy	117	3.3	313	7.3	430	5.5	9	4.1
Mineral	117	3.3	196	4.6	313	4.0	7	3.2
Light	103	2.9	199	4.6	302	3.9	8	3.7
Metal	40	1.1	150	3.5	190	2.4	4	1.8
Other industries	16	0.4	3	0.1	19	0.2	4	1.8
Finance	580	16.5	73	1.7	653	8.4	19	8.8
Construction	357	10.1	172	4.0	529	6.8	17	7.8
Telecommunicat	237	6.7	413	9.7	650	8.3	11	5.1
Trade	155	4.4	116	2.7	270	3.5	31	14.3
Transport	15	0.4	0	0.0	15	0.2	5	2.3
Agriculture	8	0.2	0	0.0	8	0.1	2	0.9
Insurance	4	0.1	0	0.0	4	0.1	1	0.5
Total	3,521.7	100.0	4,279.7	100.0	7,801.4	100.0	217	100.0

Source: Data based on a list of 217 major investments in Poland prepared by PAIZ.

Table C4. Number of Investments by Country of Origin Based on the List of Major Foreign Investors in Poland (as of June 1994)

Country of origin	Number of companies	Number of companies without a Polish partner	Country's share in the total 219 companies
USA	47	10	21.5
Germany	41	5	18.7
France	19	2	8.7
Austria	17	2	7.8
Canada	13	2	5.9
Great Britain	12	1	5.5
Denmark	10	1	4.6
International	9	1	4.1
Netherlands	9	1	4.1
Sweden	7	-	3.2
Switzerland	6	1	2.7
Japan	6	4	2.7
Italy	6	-	2.7
Finland	4	1	1.8
Norway	3	2	1.4
Spain	1	-	0
Russia	1	-	0
Singapore	1	1	0
Ireland	1	-	0
Australia	1	-	0
S. Korea	1	1	0
S. Africa	1	-	0
Former Yugoslavia	1	-	0
Luxembourg	1	-	0
Greece	1	1	0
TOTAL	219	36	100.0

Source: Data based on the list of major foreign investors (those who invested at least USD 1 million) in Poland prepared by PAIZ

*0 means less than 0.5.

Table C5. Foreign Investors by Country of Origin

(Based on the list of 225 major foreign investors in Poland prepared by PAIZ as of June 1994)

USA

Investor	Investments: Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Coca-Cola	235	50	soft drinks
International Paper Company	193	125	paper products
Polish-American Enterprise Fund	180	63	capital participation in private sector
Curtis*	100	0	electronics, construction
Epstein	90	110	construction development (design), food (meat) processing
Procter & Gamble	78	190	personal hygiene products
Pepsico	55	500	sweets, soft drinks, chips manufacturing, Pizza Hut, KFC and Taco Bell's restaurants
Ameritech	45	100	telecommunications
RJ Reynolds	40	50	tobacco processing and sales
Levi Strauss*	22	50	clothing
Liquid Carbonic	20	70	technical gas output
Gerber	18.5	13.1	food processing
Owens-Illinois Inc.	17.2	25	glass plant
Colgate-Palmolive*	15	12	cosmetics, toiletries
Amerbank*	11	0	banking
D. Chase	10	10	banking, mass media
Citibank*	10	0	banking
CPC Int.	8.8	17	food concentrates
Air Products and Chemicals Inc.	8.7	0	oxygen production
Beloit Corp.	8.3	15	machinery for paper industry
Amoco*	8	22	coalbed methane exploration
Mc Donald's*	8	9	catering
International Fast Food	7.5	0	catering
VF Corporation	7	17	clothing
Greenbrier	7	0	clothing
Unisys Corporation	6	0	computer science technologies
I Komercyjny Bank w Lublinie*	6	0	banking

Pol-Amer Bank Hipoteczny*	6	0	banking
General Motors	5.6	15	automotive industry
Marriot	5	0	hotel
Nynex International Publishing Co	5	0	telecommunications, publishing of phone books
Can Pack	3.6	0	metallurgical packing
Cargill	3.2	2.7	processing of animal feed
Basic American Foods	2.8	0	food processing
Chicago Europe Partners	2.7	0	food processing
Radisson	2.6	0	hotel and office building complex
Leaf Group	2.5	0	chewing gum manufacturing
Esso*	2.4	0	distribution of oil products
Edward Mazur	2	0	food processing
DHL International*	2	0	air freight, courier
Indian Food Company	1.7	0	food processing (margarine)
Polish Cheese	1.5	10	food processing (cheese)
Gillette	1.5	7.5	shaving products
American Retail Systems	1.5	0.5	catering
Corey Durling	1.5	0	dairy products
Du Pont Conoco	1	12	sale of chemicals and petroleum products
Superior Die Set Corp.	1	0	metal industry
Ford Motor Company*	0	50	production of automotive upholstery
Total number of firms: 48	Total Investments: 1270.1	Total Commitments: 1545.8	Total Investments & Commitments: 2815.9

*denotes firms that do not have a Polish partner: 11

INTERNATIONAL

Investor	Investments: Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
EBRD	213	0	banking, capital participation in enterprises
International Finance Corporation	123.4	0	investment in private sector projects across all industry sectors
ABB	100	20	power supply systems, turbines, electric engines
Unilever	97.7	0	washing powder, food processing
Cimenteries CBR	54	33	cement industry
Kraft Jacobs Suchard AG	8	62	food processing
AGA	6	53.8	technical gas output
Hewlett Packard*	2.5	15	distribution of printers, computers and typewriters
Cambridge Holding S.A.	1	0.4	publishing
Total number of firms: 9	Total Investments: 608.6	Total Commitments: 184.2	Total Investments & Commitments: 799.8

* denotes firms without a Polish partner: 1

ITALY

Investor	Investments: Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
IAT	260	1581	manufacturing of passenger cars
Fortrade Financing	55	0	office and industry building
Lucchini Group	34.8	150	metallurgy
Simest	9.7	0	motor industry
Banca Commerciale Italiana	3.6	0	banking
Istituto Mobiliare Italiano	2.7	0	banking
Total number of firms: 6	Total Investments: 366.8	Total Commitments: 1731	Total Investments & Commitments: 2096.8

GERMANY

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Continental Can Europe	47	20	beverage packaging
Siemens	38.5	57	telecommunications
Henkel KGaA	36.5	0	washing powders, cosmetics, construction materials
Tchibo	24	25	food processing
Linde AG	23	32.2	technical gas output
Schoeller	17.6	17.4	food processing
Bahlisen	11.8	16	food processing
BTS*	10.5	0	Brick factory
Henckiser	8	8.7	cosmetics
Dr Oetker	7.9	1.5	production of food concentrates
MM Beteiligungen	7.2	7.9	furniture production
Rethmann*	6.9	5	waste utilization
Volkswagen	6.2	0	medium-size vehicle assembly
Herlitz SA	6	0	office supply
Polen Zement Beteiligungsge- sellshaft GmbH	5.9	17.6	cement industry
Karl-Heinz Klose	4.5	10.09	furniture
Mercedes-Benz	4	0	assembly and distribution of vehicles
Schroeder Bonn	4	0	industrial construction
Miebach Project GmbH	3.6	18	cement industry
Ahlers Goldress	3.6	0	clothing
Pfanni-Werke*	3.3	0	processing of agricultural products
Franke Holding Deutschland GmbH	3.3	0	commercial kitchen equipment
Furhamp*	3	0	brick factory
Aesculap	2.8	3.7	medical equipment
Herman Heye-Carl August Heinz Glass GmbH	2.7	13	glass industry
Schieder	2.4	13	furniture
Deutsche Investitions und Entwicklung GmbH	2.3	0	banking
ALXAG	1.8	0	electronics
Lisner	1.5	2.5	food processing
Baunternehmung und Betonwerke Lorenz Kesting	1.5	1.8	production of concrete
Jurgen Marquard	1.5	0	press, publishing
Brau und Brunnen	1.5	0	beer brewing
Grack-Telca	1.3	0	electrotechnics and electronics output

Vorwerk*	1.2	0	rubber products
Volkswagen Bordnetze*	1	20	cables and wires for automotive production
AMS Anlagen	1	0	breweries
Bianca Modern	1	0	clothing
Steffen Pionki	1	0	wood industry and furniture
Adolf Ahlers AG	1	0	clothing
Dieter Hafemeister	1	0	land recultivation
Horst Mosolf Group	1	0	transport service
Total number of firms: 41	Total Investments: 313.8	Total Commitments: 290.39	Total Investments & Commitments: 604.19

* denotes firms without a Polish partner: 5

FRANCE

Investor	Investments: Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Thomson Consumer Electronics	147	37	TV tubes and sets
France Telecom	45	100	telecommunications
Socpresse (Hersant)	10	0	publishing
Michael Marbot	10	0	food processing
Credit Lyonnais	7.9	0	banking
Societe General*	6.9	0	banking
L'oreal S.A.	6.7	0	cosmetics
BSN Gervais Danone	5	0	food processing
Renault S.A.	3.6	0	vehicles distribution
Bernard Moteurs	3.3	0	manufacturing of engines, bicycles, and other machines
Saur	3.1	0	distribution of water
CBC (Companie Generale de Batiment et de Construction) Pullman Int.	3	0	hotel
Snell	2.5	4	dairy products
Credit National	2.5	0	banking
Regis Rouselle	1.6	2	warehouse "Elekroland"
Euro-Rscg Worldwide S.A.*	1.6	0	communication services
M.D. Digout	1.4	0	dairy products
Mapain	1	0	bakery
Peugeot	1	0	motor industry
Total number of firms: 19	Total Investments: 263.1	Total Commitments: 143	Total Investments & Commitments: 406.1

* denotes firms without a Polish partner: 2

NETHERLANDS

Investor	Investments (Equity & Loans)	Commitments	Branch of the economy
Philips	64.8	39.7	electric appliances
ING Bank	56	0	banking
AT&T	33.6	56	telecommunications
Pan-Gas	18	40	natural gas distribution
Imeko-Holding NV	8	0	milk products, packaging
Breing Netherlands Company	7.5	6	food processing
SHV Europa B.V.	7	23	wholesale trade center
ABN-AMRO Bank	3.6	0	banking
Nijhoff Wassink*	2.9	0	sole distributor of Volvo trucks (trade infrastructure investment)
Total number of firms: 9	Total investments: 201.4	Total Commitments: 164.7	Total investments & Commitments: 366.1

* denotes firms without a Polish partner: 1

AUSTRIA

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Ilbau GmbH	33	0	hotels, office buildings
Brau AG	25	0	distributor of soft drinks for Coca-Cola Company
Warimpex	20	0	hotels, office buildings
Alpla	16	0	bottle production plant
Rogner GmbH	15	0	hotel
Creditanstalt	13	0	banking
Raiffeisen-Centrobank SA*	7	0	banking
Greiner	6	0	insulating and foam materials production
Leier	4	0	construction material plant
Billa	4	0	retail trade
Penetex	3.2	9.3	food processing
Eduscho	2.8	0	coffee processing
Harris	2.5	0	trade
Kosme*	2	0	bottle production
Artberger Bergbahnen AG	2	0	transport services in tourism
Wilkosz	1.5	0	construction

Osterreichische Investitionskredit AG	1	0	banking
Total number of firms: 17	Total Investments: 106	Total Commitments: 9.3	Total Investments & Commitments: 167.3

* denotes firms without a Polish partner: 2

SWITZERLAND

Investor	Investments: Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Nestle	50	0	confectionery
Solco Basel*	3.5	0	pharmaceutical
Kronospan	8.5	10	paper products
Szwajcarski Fundusz Rzadowy	7	0	agriculture
Kaufring AG	4	0	photography (trade & service)
Ost Commerz Holding	1.5	0	food processing
RIG Rentsch	0	8	paper packaging
Total number of firms: 7	Total Investments: 106	Total Commitments: 18	Total Investments & Commitments: 124

* denotes firms without a Polish partner: 1

GREAT BRITAIN

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Mc Vitie's Group (United Biscuits)	29	23	confectionery
Pilkington	26	107.3	glass plant
Boc Group	20	70	technical gas output
Trusthouse Forte	4	0	hotel
Commercial Union	4	0	insurance
Cusson Group Ltd.	3.7	6.8	washing powder
British Sugar	3.5	0	sugar industry
Kodak Ltd.	2.8	0	photography (trade & service)
Shell	1.7	15	oil products distribution
Cadbury's Schweppes*	1	29	confectionery
Lettinane Investments Ltd.	1	0	food processing
ICL	1	0	computer equipment & software
British Gas Exploration & Production Ltd.*	0	25	gas exploration

British Vita*	0	9	production of insulating & foam materials
Total number of firms: 14	Total Investments: 97.7	Total Commitments: 285.1	Total Investments & Commitments: 282.8

* denotes firms without a Polish partner: 3

SWEDEN

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
IKI-A	29	11	furniture manufacture & sales
St. Lewandowski	19	0	furniture manufacturing, cosmetics
Intercellulosa AB	10	22.5	cellulose, paper, cardboards
Bildspedition AB	8	0	motor transport
Ericsson	2	15	telecommunication equipment for the military
Kemir Kemwater	1.5	0	chemistry
Isab	1	0	metallurgy
Trebruk AB	0	55	paper industry
Total number of firms: 8	Total Investments: 70.5	Total Commitments: 103.5	Total Investments & Commitments: 174

DENMARK

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Telecom Denmark & Great Northern Telegraph Company	20	0	telecommunications
Nordisk Wavin A/S	7.6	2.5	plastic installations
Globe Meat Technology A/S & Fundusz Inwestycyjny dla Europy Srodkowej i Wschodniej	7.5	0	food processing
Rockwool	7	0	production of mineral wool
NKT Cables A/S & Danski Rządowy Fundusz Inwestycyjny dla Srodkowej i Wschodniej Europy	6	0	manufacturing of wires
Danfoss A/S	6	0	manufacturing of thermostats

Danish Fast Food	2	0	bakery
Pagh Morups Bornekonfektion APS*	1.6	2	textiles
Elopak	1.5	0	dairy products
Skandpol International	1	0	hotel
Total number of firms: 10	Total Investments: 60.2	Total Commitments: 4.5	Total Investments & Commitments: 64.7

* denotes firms without a Polish partner: 1

CANADA

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
UNP Holdings Ltd.	14.5	2.5	machinery for food processing industry, packaging equipment, water heater manufacturing
Pratt & Whitney	9.2	2.5	aircraft industry
Rust Check Central Corporation	5	0	automobile rust treatment
RCI Rocon	3	0	containers for oceanic shipping
Northgate Trailer	3	0	production of prefabricated buildings
Bel Pagette	2	0	paging network
Bata Shoes	2	0	retail shoe stores
Canampol*	2	0	retail/wholesale outlet for building materials
Purity Packaging	2	0	cream container packaging equipment
Pol-Can Intertrade	2	0	bottled water/beverages plant
Northern Telecom	2	0	telecommunications
Polsko-Kanadyjski Bank Sw. Stanislawa*	1.6	0	banking
Chapman Ice Cream	1	0	production of ice cream
Total number of firms: 13	Total Investments: 49.3	Total Commitments: 5	Total Investments & Commitments: 54.3

* denotes firms without a Polish partner: 2

JAPAN

Investor	Investments: Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Toyota*	5	10	car distribution network

Mitsubishi Electric Industrial Co Ltd	4.8	13.2	batteries production
Nisho Iwai*	1	0	import and sale of Toyota automobiles
Itochu*	1	0	import and sale of Mazda automobiles
Kenematsu Goshu*	1	0	import and sale of Honda automobiles
Mitsui O.S.K. Lines	1	0	transport service
Sanyo Group	0	30	manufacturing of cash registers
Total number of firms: 7	Total Investments: 13.8	Total Commitments: 53.2	Total Investments & Commitments: 67

* denotes firms without a Polish partner: 4

SINGAPORE

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Min Hoong Development Co.*	13	60	building, reconstruction
Total number of firms: 1	Total Investments: 13	Total Commitments: 60	Total Investments & Commitments: 73

* denotes firms without a Polish partner: 1

IRELAND

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Golden Vale plc, Charleville Co., Cork	7	0	dairy products and food processing
Total number of firms: 1	Total Investments: 7	Total Commitments: 0	Total Investments & Commitments: 7

AUSTRALIA

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Brewpolepty Ltd.	6.3	13	beer, food processing
Total number of firms: 1	Total Investments: 6.3	Total Commitments: 13	Total Investments & Commitments: 19.3

SOUTH KOREA

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Daewoo*	5	20	manufacturing of electronics equipment
Total number of firms: 1	Total Investments: 5	Total Commitments: 20	Total Investments & Commitments: 25

* denotes firms without a Polish partner: 1

SOUTH AFRICA

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Boart International	3.4	5.5	mining machines
Total number of firms: 1	Total Investments: 3.4	Total Commitments: 5.5	Total Investments & Commitments: 8.9

Former YUGOSLAVIA

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Lec-Ljubljana	3	1	pharmaceutical s
Total number of firms: 1	Total Investments: 3	Total Commitments: 1	Total Investments & Commitments: 4

LUXEMBOURG

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
International Trading & Investment	2.3	0	construction and technical services
Total number of firms: 1	Total Investments: 2.3	Total Commitments: 0	Total Investments & Commitments: 2.3

GREECE

Investor	Investments Equity & Loans (USD million)	Commitments (USD million)	Branch of the economy
Best Foods SA-Oxonos*	2.1	0	food processing
Total number of firms: 1	Total Investments: 2.1	Total Commitments: 0	Total Investments & Commitments: 2.1

* denotes firms without a Polish partner: 1

Appendix D

Table D1. Direct Investment Flows in OECD Countries 1989-1993 (in USD million)**Inflows**

	1989*	1990	1991	1992	1993**
Australia	7,289	6,870	4,773	5,286	2,557
Austria	578	647	359	940	960
Belgium-Luxemb. ¹	6,731	8,162	8,919	10,791	8,616
Canada	2,027	6,597	6,544	4,963	2,468
Denmark	1,084	1,133	1,530	1,015	1,684
Finland	488	787	-247	396	593
France ¹	9,552	9,040	11,073	15,894	12,141
Germany	6,997	2,529	4,263	2,422	-286
Greece	752	1,005	1,135	1,144	..
Iceland ¹	-27	6	35	17	..
Ireland	85	99	97	102	..
Italy ¹	2,592	6,344	2,481	3,161	3,447
Japan ¹	-1,054	1,753	1,368	2,728	127
Mexico	..	2,633	4,762	4,393	4,901
Netherlands	6,367	8,765	4,934	5,883	6,803
New Zealand	434	1,686	1,695	1,089	2,564
Norway	1,511	1,004	-291	720	2,058
Portugal	1,740	2,594	3,168	2,994	..
Spain ¹	8,433	13,681	10,423	8,115	7,184
Sweden	1,523	2,029	6,315	241	2,438
Switzerland	2,254	4,458	2,613	465	..
Turkey	663	684	810	844	636
United Kingdom	30,369	32,897	15,934	18,165	14,449
United States	69,010	48,422	25,446	3,388	31,519
Total	159,335	163,825	118,139	95,156	106,093

Source: *Financial Market Trends*, June 1994, p. 16.

* Data for 1989 from: *Financial Market Trends*, June 1993, p. 44.

** Data for 1993 from: *International direct investment statistics yearbook*, 1994, p. 12.

All the data is based on official national statistics from the balance of payments prepared by OECD/DAF.

1. Reinvested earnings are not included in national statistics

Table D2. Direct Investment Flows in OECD Countries 1989-1993 (in USD million)

Outflows

	1989*	1990	1991	1992	1993**
Australia	2,831	1,012	2,026	42	605
Austria	855	1,663	1,288	1,871	1,404
Belgium-Luxemb. ¹	6,114	6,600	6,062	10,891	2,940
Canada	4,603	4,200	5,409	3,723	7,164
Denmark	2,027	1,509	1,851	2,225	1,379
Finland	3,106	3,263	1,049	406	1,831
France ¹	18,137	26,920	20,501	19,097	12,166
Germany	14,536	23,168	22,879	17,715	11,673
Greece	..	..	..	..	..
Iceland ¹	8	9	10	27	..
Ireland	..	..	..	..	..
Italy ¹	2,003	7,612	7,326	5,956	6,681
Japan ¹	44,130	48,024	30,726	17,222	13,600
Mexico	..	..	..	..	..
Netherlands	11,538	13,428	11,997	12,669	10,404
New Zealand	135	2,365	1,472	391	-1,245
Norway	1,352	1,478	1,840	434	885
Portugal	85	165	474	719	-152
Spain ¹	1,470	2,845	3,574	1,273	2,470
Sweden	9,738	14,493	7,026	1,219	2,017
Switzerland	7,852	6,372	6,543	4,899	..
Turkey	56	-16	27	65	14
United Kingdom	35,191	18,729	15,597	16,571	25,332
United States	30,167	27,705	32,098	37,122	50,244
Total	195,934	211,544	179,778	154,537	149,412

Source: *Financial Market Trends*, June 1994, p. 16.

* Data for 1989 from: *Financial Market Trends*, June 1993, p. 44.

** Data for 1993 from: *International direct investment statistics yearbook*, 1994, p. 12.

All the data is based on official national statistics from the balance of payments prepared by OECD/DAF.

1. Reinvested earnings are not included in national statistics

Table D3. Foreign Direct Investment in EAE-3: Inflows 1989-1993

	1989	1990	1991	1992	1993
FDI Inflows in USD million					
Malaysia	1,668	2,332	4,073	4,118	4,351 ^a
South Korea	758	715	1,116	550	
Peoples Republic of China	3,393	3,487	4,366	11,156	
FDI Inflows as % of GDP					
Malaysia	4.4	5.5	8.6	7.1	6.7
South Korea	0.3	0.3	0.4	0.2	
Peoples Republic of China	0.8	0.9	1.2	2.6	
FDI Inflows per Capita in USD					
Malaysia	96.14	131.30	224.04	221.28	233.80
South Korea	17.89	16.68	25.79	12.60	
Peoples Republic of China	2.99	3.02	3.73	9.39	

Source: *Balance of payments statistics yearbook*, IMF, 1993.

^a Data from: *International financial statistics yearbook*, IMF, 1994.

Table D4. Foreign Direct Investment in ELAE-3: Inflows 1989-1993

	1989	1990	1991	1992	1993
FDI Inflows in USD million					
Argentina	1,028	1,836	2,439	4,179	6,305 ^a
Chile	184	249	563	737	410 ^a
Mexico	3,037	2,632	4,762	5,366	4,901 ^a
FDI Inflows as % of GDP					
Argentina	1.3	1.3	1.3	1.8	2.5
Chile	0.7	0.8	1.7	1.8	0.9
Mexico	1.5	1.1	1.7	1.6	1.5
FDI Inflows per Capita in USD					
Argentina	32.20	56.81	74.56	126.25	188.27
Chile	14.20	18.91	42.05	54.19	29.69
Mexico	35.95	30.55	54.21	59.93	53.73

Source: *Balance of payments statistics yearbook*, IMF, 1993.

^a Data from: *International financial statistics*, IMF, December 1994.

Appendix E

Table E1. Share of Polish Main Export and Import Partners in Total Foreign Trade.

1989		1990		1991		1992	
Main Export Partners							
Soviet Union	20.8	Germany	25.1	Germany	29.4	Germany	31.4
W. Germany	14.2	Soviet Union	15.3	F. Soviet Union	11.0	Netherlands	6.0
Great Britain	6.5	Great Britain	7.1	Great Britain	7.1	Italy	5.6
Main Import Partners							
Soviet Union	18.1	Germany	20.1	Germany	26.5	Germany	23.9
W. Germany	15.7	Soviet Union	19.8	F. Soviet Union	14.1	Russia	8.5
Austria	6.0	Italy	7.5	Austria	6.3	Italy	6.9

Source: *Rocznik statystyczny handlu zagranicznego 1993* (Foreign trade statistical yearbook 1993), GUS, 1993, p. 2.

Table E2. Structure of Foreign Trade in Poland by Group of Countries.

Year	Developed c.	CEE	Developing c.
Exports			
1989	43.0	37.2	19.8
1990	58.6	23.2	18.2
1992	71.9	15.4	12.7
Imports			
1989	46.9	33.5	19.6
1990	63.8	23.2	13.0
1992	72.4	16.3	11.3

Source: *Rocznik statystyczny handlu zagranicznego 1993* (Foreign trade statistical yearbook 1993), GUS, 1993, p. 4.

Table E3. Structure of Foreign Trade in Poland by Branches: 1989-1992.

Branch	Exports				Imports			
	1989	1990	1991	1992	1989	1990	1991	1992
Fuel and energy	9.6	10.1	10.7	10.6	12.4	20.7	18.7	16.8
Metallurgy	10.5	14.6	15.9	16.8	8.8	6.9	4.3	4.5
Electrical & machinery	38.4	29.3	22.4	24.3	36.3	39.8	37.4	35.6
Chemical industry	10.5	12.0	11.6	12.1	15.2	11.6	12.6	17.4
Mineral industry	1.3	1.7	3.4	3.2	1.3	1.3	1.7	2.3
Wood & paper	2.9	4.1	6.5	7.6	1.9	1.6	2.5	3.6
Light industry	5.5	6.4	6.1	8.5	7.6	6.1	6.1	4.5
Food industry	9.6	10.0	10.0	9.8	9.5	7.8	10.5	8.5
Other industrial branches	0.6	0.6	1.2	0.6	1.7	2.1	3.1	3.1
Construction	5.9	4.8	4.8	-	0.0	0.0	0.0	-
Agricultural products	4.1	5.4	6.6	5.4	4.9	2.0	3.1	3.6
Forest products	0.3	0.4	0.5	0.6	0.1	0.0	0.0	0.0
Other branches	0.8	0.6	0.3	0.5	0.3	0.1	0.0	0.1

Source: *Rocznik statystyczny handlu zagranicznego 1993* (Foreign trade statistical yearbook 1993), GUS, 1993, p. 10.

Appendix F

Table F1. State Enterprises in the Process of Privatization by Provinces (as of December 31, 1993)

Province	State enterprises	State enterprises in privatization process by:							
				liquidation			capitalization		
	Total ^a	Total	%	Art. 19	Art. 37	Total	Art. 5	Art. 6	Total
Total	8,441	2,526	29.9	1,082	917	1,999	341	186	527
Warszawskie	621	172	27.9	52	84	136	27	9	36
Bialskopodlaskie	57	15	26.3	9	6	15	0	0	0
Bialostockie	161	45	28.0	17	19	36	4	5	9
Bielskie	179	59	33.0	19	14	33	19	7	26
Bydgoskie	277	81	29.2	32	27	59	17	5	22
Cielmskie	51	15	29.4	7	5	12	2	1	3
Ciechanowskie	87	33	37.9	15	17	32	1	0	1
Czestochowskie	125	50	40.0	30	11	41	5	4	9
Elblaskie	148	28	18.9	19	6	25	3	0	3
Gdanskie	330	99	30.0	31	40	71	21	7	28
Gorzowskie	140	53	37.9	31	19	50	2	1	3
Jeleniogorskie	181	37	20.4	9	14	23	9	5	14
Kaliskie	131	38	29.0	14	11	25	10	3	13
Katowickie	762	226	29.7	78	78	156	35	35	70
Kieleckie	231	53	22.9	29	14	43	10	0	10
Koninskie	66	19	28.8	9	5	14	2	3	5
Koszalinskie	174	59	33.9	39	16	55	4	0	4
Krakowskie	254	94	37.0	37	37	74	15	5	20
Krosnienskie	85	29	34.1	24	3	25	4	0	4
Legnickie	116	24	20.7	12	9	21	1	2	3
Leszczynskie	76	25	32.9	8	14	22	2	1	3
Lubelskie	227	68	30.0	31	30	61	5	2	7
Lomzynskie	49	11	22.4	8	3	11	0	0	0
Lodzkie	325	120	36.9	46	50	96	15	9	24
Nowosadeckie	75	21	28.0	12	5	17	2	2	4
Olsztynskie	228	100	43.9	66	26	92	8	0	8
Opolskie	260	81	31.2	29	26	55	20	6	26
Ostroleckie	60	15	25.0	7	7	14	1	0	1
Pilskie	129	33	25.6	26	3	29	3	1	4
Piotrkowskie	109	38	34.9	17	9	26	6	6	12
Plockie	112	28	25.0	13	9	22	5	1	6
Poznanskie	327	107	32.7	40	47	87	14	6	20
Przemyskie	71	25	35.2	18	2	20	2	3	5
Radomskie	133	27	20.3	14	7	21	4	2	6
Rzeszowskie	137	33	24.1	11	17	28	2	3	5
Siedleckie	95	28	29.5	10	16	26	1	1	2
Sieradzkie	64	15	23.4	6	6	12	1	2	3
Skierniewickie	59	21	35.6	14	5	19	1	1	2
Slupskie	123	38	30.9	23	11	34	1	3	4
Suwalskie	111	42	37.8	24	14	38	3	1	4
Szczecinskie	292	70	24.0	10	45	55	11	4	15
Tarnobrzesckie	81	26	32.1	12	7	19	4	3	7
Tarnowskie	71	25	35.2	7	11	18	4	3	7
Torunskie	158	47	29.7	19	18	37	6	4	10
Walbrzyskie	211	52	24.6	30	8	38	6	8	14
Wloclawskie	86	24	27.9	13	8	21	2	1	3

Wroclawskie	318	97	30.5	22	50	72	12	13	25
Zamojskie	74	16	21.6	8	3	11	1	4	5
Zielonogorskie	204	64	31.4	25	27	52	8	4	12

Source: *Dynamika prywatyzacji* (Dynamics of privatization), Ministerstwo Przekształcen Własnościowych (Ministry of Privatization), 1994, pp. 21-23.

* Data from Ibid, pp. 15-18.

Table F2. Progress of Privatization in Poland from August 1, 1990 to March 31, 1994 (cumulative data)

		State enterprises in privatization process						
		Total	by capitalization			by liquidation		
			Total	Art. 5	Art. 6	Total	Art. 19	Art. 37
31.12.1990	a	87	38	38	0	49	18	31
	b	7	5	5		2	0	2
30.06.1991	a	525	147	147	0	378	195	183
	b	65	5	4		60	6	54
31.12.1991	a	1,249	260	234	26	989	540	449
	b	228	27	27		201	19	182
30.06.1992	a	1,747	444	274	170	1,303	729	574
	b	391	0			391	53	338
31.12.1992	a	2,056	480	297	183	1,576	857	719
	b	612	51	51		561	86	475
30.06.1993	a	2,266	501	316	185	1,765	968	797
	b	707	0			707	126	581
31.12.1993	a	2,526	527	341	186	1,999	1,082	917
	b	977	98			879	172	707
31.03.1994	a	2,611	547	358+3*	186	2,064	1,125	939
	b	1,062	101			961	203	758

Source: *Dynamika prywatyzacji* (Dynamics of privatization), Ministerstwo Przekształcen Własnościowych (Ministry of Privatization), 1994, p. 34.

* Three enterprises privatized on the basis of Art. 17 of the Act on Restructuring
a Initiated
b Completed

**Table F3. State Enterprises in the Privatization Process by Sectors
(as of December 31, 1993)**

Sector	State enterprises in privatization process						
	Total	by capitalization			by liquidation		
		Total	Art. 5	Art. 6	Total	Art. 19	Art. 37
Total	2,526	527	341	186	1,999	1,082	917
Industry	1,037	435	278	157	602	327	275
Construction	691	67	41	26	624	273	351
Agriculture	287	1	1	0	286	237	49
Forestry	12	3	3	0	9	6	3
Transport	142	12	10	2	130	112	18
Communication	1	0	0	0	1	0	1
Trade	232	7	6	1	225	79	146
Other	124	2	2	0	126	51	75

Source: *Dynamika prywatyzacji* (Dynamics of privatization), Ministerstwo Przekształcen Własnościowych (Ministry of Privatization), 1994, p. 47.

Table F4. State Enterprises in the Privatization Process by Size of Employment

		State enterprises in privatization process						
Employment size of an enterprise		Total	by capitalization			by liquidation		
			Total	Art. 5	Art. 6	Total	Art. 19	Art. 37
Total	a	2,526	527	341	186	1,999	1,082	917
	b	2,611	547	361	186	2,064	1,125	939
Up to 200	a	1,353	16	16	0	1,337	847	490
	b	1,411	18	18	0	1,393	886	507
201-500	a	509	89	73	16	420	154	266
	b	519	94	78	16	425	156	269
Over 500	a	664	422	252	170	242	81	161
	b	681	435	265	170	246	83	163

Source: *Dynamika prywatyzacji* (Dynamics of privatization), Ministerstwo Przekształcen Własnościowych (Ministry of Privatization), 1994, p. 50.

a Data as of December 31, 1993

b Data as of March 31, 1994

Table F5. Evolution of Restitution Claims in 1991-1993 in Poland

Year	Number of applications filed	%	Number of properties claimed	%
1991	1,761	38.3	2,319	35.4
1992	1,598	34.8	2,413	36.9
1993	1,236	26.9	1,815	27.7
Total	4,595	100.0	6,547	100.0

Source: *Magazyn informacyjny repriwatyzacji* (Information on re-privatization magazine), Ministerstwo Przekształcen Własnościowych (Ministry of Privatization), March 1994, pp. 6-8)

Table F6. Structure of Restitution Claims in 1991-1993 in Poland

Kind of property	Number of properties claimed	%
Agricultural land	1,429	21.8
Farm buildings	1,110	17.0
Squares and urban real estate	817	12.5
Forests	341	5.2
Industrial enterprises and printing houses	311	4.8
Grinding mills	144	2.2
Building lots (urban and rural)	304	4.6
Pastures	108	1.6
Pharmacies	324	4.9
Brickyards	66	1.0
Other	1,593	24.3
Total	6,547	100.0

Source: *Magazyn informacyjny repriwatyzacji* (Information on re-privatization magazine), Ministerstwo Przekształcen Własnościowych (Ministry of Privatization), March 1994, p. 10.

Table F7. Restitution Claims Sent from Abroad by Country of Origin in 1992-1993

Country of origin	Number of applications	%
Germany	264	71.2
United States	40	10.8
Great Britain	13	3.5
Canada	12	3.2
Australia	10	2.7
Sweden	5	1.4
Israel	4	1.1
France	4	1.1
Belgium	3	0.8
Norway	2	0.5
Ukraine	2	0.5
Italy	2	0.5
Switzerland	2	0.5
Other*	8	2.2
Total	371	100.0

Source: *Magazyn informacyjny reprivatyzacji* (Information on re-privatization magazine), Ministerstwo Przekształcen Własnościowych (Ministry of Privatization), March 1994, pp. 17-19).

* Other consists of Russia, South Africa, New Zealand, Austria, Chile, Greece, Brazil with 1 claim from each.

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