

An Update on Polish Foreign Direct Investment: The Story of Intrall Rus: A Case Study on Transformation

Richard J. Hunter, Jr.

Professor of Legal Studies, Stillman School of Business, Seton Hall University, South Orange,
New Jersey

Adjunct Professor of Law, Rutgers University School of Law, Newark and Camden, N.J

Leo V. Ryan, C.S.V.

Dean and Professor Emeritus, Kelstadt School of Management, DePaul University
Chicago, Illinois

ABSTRACT

This article is a discussion of the core importance of foreign direct investment in the transformation of the Polish economy. The authors have researched this topic for nearly twenty years and have previously published many articles on the topic. The paper discusses the “grand failures” of the former system; the key role played by Leszek Balcerowicz and his team of both Polish and foreign advisors; the main components of economic reform; and describes FDI inflows since the 1990’s. The paper focuses on FDI in 2011 with a discussion of a current FDI project—Intrall Rus.

Key Words: FDI; Central Planning; Economic Transformation; Case Study

1. INTRODUCTION

Foreign Direct Investment, more commonly known as FDI, occurs with the purchase of “the physical assets or a significant amount of the ownership (stock) of a company in another country to gain a measure of management control.” Ordinarily, FDI inflows are counted from a *10 percent stock ownership* in a company abroad. FDI is distinguished from straight *portfolio investment (also called passive investment)* that does not involve obtaining a *degree of control* in a company. Examples of portfolio investment involve the purchase of corporate debt securities, stocks, bonds, interest-bearing bank accounts, treasury bills, and notes. Portfolio investment has held a clearly secondary position in Poland in terms of both economic development and transition.

Professor Jack Behrman, a consultant to the United Nations Centre on Science and Technology for Development, is a leading and long-time expert in foreign direct investment. Dr. Behrman has identified both positive and negative impacts of foreign direct investment *inflows*

on host countries. In fact, many of these impacts are especially relevant to Poland. Among the *positive impacts* he lists:

- Increased domestic capital formation;
- Technology and management skill transfer;
- Regional and sectoral development;
- Fostering internal competition and entrepreneurship;
- Favorable effect on balance of payments; and
- Increased domestic employment, especially in lagging or “sunset” industries, such as those that use outdated and obsolete technologies or employ low-wage, low-skill employees. In Poland, they may include steel, coal, and shipbuilding.

One of the main reasons for the emphasis in Poland on attracting foreign capital and Foreign Direct Investment [FDI] into the Polish economy was that there were few *domestic* options available in 1989 for a rapid and radical transformation of the Polish economy that all parties agreed would be absolutely necessary. Why did the Polish economy essentially collapse in the period 1988-1989? Why did the system of state central planning, also known as the Command-Rationing System (CRM), itself so utterly collapse? The answer to these questions lies in an analysis and recognition of the “*four grand failures*” of the CRM which were exhibited both in Poland and in many nations in the region. These included:

1. Failure to create economic value or to improve the standard of living for the average Pole;
2. Failure to provide adequate individual and organizational incentives;
3. Failure to “measure up” to comparative economies, not only those advanced capitalist economies in the West, but also several “fraternal” socialist economies in Central and Eastern Europe (most notably, Hungary and Czechoslovakia — later the Czech Republic — and Slovenia); and
4. Failure to satisfy basic consumer needs, essentially creating an unofficial dollarization of the Polish economy through the existence of a large, open, “semi-official,” and surprisingly efficient “black market,” and the existence of “dollar” stores and shops such as the ubiquitous PEWEX shops. (Hunter & Ryan, 2006).

This article is a summary report on the issues surrounding Foreign Direct Investment in the Polish economy. It is based largely on primary academic research conducted over the past twenty years and a field report on a current investment project taking place in Poland in 2011.

2. BACKGROUND TO ECONOMIC REFORM

Leszek Balcerowicz served as Deputy Prime Minister and Minister of Finance in the government of Tadeusz Mazowiecki, who was the first democratically elected non-communist Prime Minister in all of Central and Eastern Europe since the end of World War II. Balcerowicz was the chief architect of many of the changes in the economy in Poland which were initiated

after 1989. (Hunter, Ryan & Shapiro, 2003). Balcerowicz was the chief architect of “shock therapy” in Poland and was especially influenced by the theoretical underpinnings developed by Harvard economist Jeffrey Sachs and former International Monetary Fund economist David Lipton. Professor Sachs had also been instrumental in the fundamental reform and restructuring of the Bolivian government starting in 1985.

In the process of economic transformation, Balcerowicz was also aided by a well-prepared transition team consisting of both Polish nationals and so-called “Polonia” (émigré) specialists. The “Balcerowicz Team” consisted, among others, of Marek Dąbrowski, later deputy in the Ministry of Finance; Stefan Kawalec, first chief adviser, responsible for financial institutions; Janusz Sawicki, responsible for foreign debt negotiations; Andrzej Podsiadło, who oversaw state enterprises; and Grzegorz Wojtowicz, first deputy chairman of the Polish National Bank, and its chairman in 1991. All were graduates of the Faculty of Foreign Trade of the Central School of Planning and Statistics in Warsaw [in Polish, SGPiS], Poland’s premier school for state planning and for producing “policy experts.” Wojciech Misiąg and Ryszard Pazura were also deputies in the Ministry of Finance. In addition, the team included numerous *foreign advisers* — Jeffrey Sachs, David Lipton, Władysław Brzeski, Stanisław Gomułka, Jacek Rostowski, and Stanisław Welisz — and *Polish ones* — Karol Lutkowski, Andrzej Bratkowski, Antoni Kantecki, Adam Lipowski, Andrzej Parkola, and Andrzej Ochocki. Many of the foreign advisers were of Polish origin — so called *Polonia academics*.

Minister Balcerowicz was a Professor of Economics at the Warsaw Institute of Economics. Balcerowicz had graduated from the Faculty of Foreign Trade of the Central School of Planning and Statistics — now the Warsaw School of Economics. Between September 1972 and January 1974, Balcerowicz had studied business administration at St. John’s University in New York City, earning an MBA in 1974. In 1978, Balcerowicz presciently had established a “think tank” composed of ten young economists who would meet regularly to discuss and debate potential programs for economic reform. These informal meetings shaped the program of transformation adopted by the Mazowiecki government and subsequent Solidarity governments and greatly influenced all post-1989 Polish governments — both positively and negatively — in their policy assessments. (E.g., Sachs, 1993; Balcerowicz, 1995).

2.1 DERIVATIVE TRAITS OF THE COMMAND-AND-CONTROL SYSTEM

Balcerowicz identified certain *derivative traits* of the command-and-control economy that were in need of *immediate* reform. These included:

- Administrative *price fixing* by central authorities;
- *Isolation* of domestic producers from foreign markets;
- Excessive *regulation of imports* through licenses and import quotas;
- The tendency by central planners to engage in “*import substitution*,” often accomplished through rationing, queues, lines, and coupons;
- “*Soft budget constraint*” in which targets of planning were revised downward or inputs

significantly increased in order to meet plan targets, often based on political connections and not economic realities;

- The *lack of true commercial and financial institutions*;
- *Monopolization* of the state sector due to extreme organizational concentration, the centralization of organizational rights, and the lack of foreign competition; and perhaps most importantly,
- The *lack of any motivation mechanisms* for either line managers or workers.

Early in the process of economic transformation, Minister Balcerowicz decided on a strategy of transformation (Hunter & Ryan, 2009) that would be based on two overriding considerations: *A market economy was preferred over a centrally planned economy and a private market economy was preferred over so-called "market socialism"* that was adopted in China. (Hunter & Blodgett, 2009). The process of economic transformation in Poland is in itself quite instructive and has provided a more general model for other Central and Eastern European transition economies.

2.2 PILLARS OF ECONOMIC REFORM

The program was based on five philosophical *pillars of economic transformation*: (1) *rapid transformation* of the *monocentric* system of state central planning into a private functioning market economy; (2) *liberalization* of economic functions, especially in relation to foreign trade and foreign direct investment (Hunter & Ryan, 1997); (3) *privatization* of state-owned enterprises (SOEs) (Hunter & Ryan, 2007); (4) construction of an effective *social safety net*; and (5) *mobilization of international financial assistance* [IMF, World Bank] to support the process. (Sachs, 1993).

Mirroring the *Balcerowicz-Sachs model*, Poland undertook the following concrete actions as the main components of its process of economic reform:

- Liberalizing prices from state control, opening up of the foreign trade régime and the Polish market to the infusion of Foreign Direct Investment, and formalizing and simplifying the requirements for new market entry;
- Stabilizing inflation, public finance, and foreign debt;
- Effecting changes in the economy leading to privatization of state property and to an increase in the nature and volume of international trade;
- Remodeling and upgrading the important social-safety net, most especially, the pension, education, social insurance, and unemployment systems;
- Assuring eventual full convertibility of the Polish złoty;
- Gaining extensive external assistance (Hunter & Ryan, 1998, pp. 82-84) of the International Monetary Fund (IMF), and the "London" (private commercial creditors) and "Paris" Clubs (public creditors); and
- Creating new market institutions, a commercial code, a revised tax code, private property rights (Hunter, Ryan & Nowak, 1995), and a financial and capital market sector

(perhaps, most importantly, the creation of a viable stock market (de la Rosa, Crawford & Franz, 2004); Ryan, 1997) and a properly functioning central bank).

2.3 OUTSIDE ASSISTANCE

The *Paris Club* was comprised of nations that had financed Poland's public or *sovereign* debt. The *London Club* was comprised of private lenders, banks, and brokerage houses that had financed Poland's debt as well. The *Paris Club* is composed of 19 permanent members and other *official creditors* who have participated in some official lending. At the start of the transformation process, Poland's official *Paris Club* creditors included Germany (\$5.94 billion), France (\$3.63 billion), Austria (\$3.60 billion), the United States (\$3.46 billion), Canada (\$2.64 billion), the U.K. (\$1.65 billion), Italy (\$1.32 billion), and Japan (\$0.66 billion). Brazil, not a permanent member of the *Paris Club*, provided \$3.0 billion. Poland's *Paris Club* debt was reduced by a minimum of 50 percent — France and the United States agreed to a 70 percent reduction.

Poland's private or commercial *London Club* debt amounted to an additional \$13.2 billion in 1989. It was reduced by 45.2 percent, including a 37 percent reduction in interest and a 52 percent reduction in principal. Poland's largest *London Club* creditors included Salomon Brothers Inc., BFG Bank, Commerz Bank, Swiss Bank Corp., Lloyd's Bank, BNP, Standard Chartered PLC, Westdeutsche Landesbank, Societe Generale, Bank of America, and Dresdner Bank. Professors Bossak and Kalicki regard the agreement with the London Club as "the crowning achievement of not only long and sophisticated negotiations, but also the effect of consistent implementation of economic reforms in Poland and their high evaluation by the G-7, the Paris Club, the IMF, and the World Bank." (Bossak & Kalicki, 1994, p. 203).

Thus, it is important to note that from the outset, *the attraction of foreign direct investment was an important—perhaps indispensable—part of overall economic transformation of the Polish economy.* (Hunter, Shapiro & Ryan, 2003; Hunter & Ryan, 2001).

Poland was initially considered as an attractive destination for FDI because of the existence of three related factors: low cost but qualified labor; long-term market potential or yields greater than could be achieved domestically; and access to natural resources. However, once the initial rush to investment had occurred, continued success would be attributable to the interrelation of several factors: few restrictions on FDI would be imposed (Moran, 1998) in terms of targeted investments (Moran, 1998); "national treatment" would be offered to FDI, regardless of the country of origin; a relatively sound "company law" or commercial code¹ (Hunter, Ryan & Nowak, 1995) would be created, as well as transparent customs and tariff procedures; the Polish government would continue to foster and nurture FDI activities; and

¹ Included in these vehicles is the creation of a *joint-stock company*, wholly owned by the state, but managed as if it were a private company. This was the first—and critical step—in creating a capitalist economy from state-ownership.

Poland would be required to adopt an understandable and “perceived as fair” tax code. (Hunter & Hrechak, 1993; Hunter & Hrechak, 1994). All of these factors would be critical in assuring Poland’s international competitiveness as a site for FDI.

3. FDI INFLOWS

According to the Polish Information and Foreign Investment Agency [PAIiIZ] since the early 1990s, international business has so far invested over *USD 100 billion in Poland*. (PAIZ, 2011). This clearly ranks Poland as a regional leader. The most significant inflow of FDI could be observed in the period 2006-2007, the lowest inflow between 1994 and 1996.

The main investors, which have already located their capital in Poland, are as follows: Germany with 16.4% of total FDI amount, the Netherlands with 16.1%, Sweden with 13.44% and Luxemburg with 11.14%.

The main objects of FDI were: financial, legal, and accounting consulting companies (3,013 mln EUR); real estate companies (2,605 mln EUR); trade and companies engaged in “repair” (1,455 mln EUR); and industrial processing companies (1,442 mln EUR). [As of the writing of this paper, December 27, 2011, the value of the Euro to the Dollar was *1 Euro equals \$1.30736*.]

The worldwide economic downturn in 2008-2010 ironically had made Poland a very attractive place for FDI. During this period, Poland was seen as a stable and growing economy—one of the few on the European continent. (Hunter & Ryan, 2011). However, by the mid-point of 2011, the advantage that Poland had in successfully weathering the worldwide economic crisis has largely disappeared. Stability, which had been a hallmark of Poland’s economy over the past two to three years, has largely returned to most of the European continent—with the exception of Greece, Ireland, Italy, Spain, and perhaps Portugal. Investors could look elsewhere for FDI opportunities and an expanding business environment.

In 2010, foreign direct investment (FDI) in Poland totaled 7.54 billion euros—which was 2.4 billion lower than 2009. The Polish Information and Foreign Investment Agency had earlier projected that FDI would reach almost 10 billion euros in 2010. Surprisingly, Polish investment abroad (FDI outflows) increased in 2010 to 3.78 billion euros from 3.72 billion euros in 2009. [At the writing of this paper, May 18, 2011, one euro was valued at \$1.462.] However, 2010 should not be characterized as a failure either. As noted by Slawomir Majman of PAIiIZ:

“In the first quarter of 2010, PAIiIZ was running altogether 142 projects compared to 82 at the same time last year. The completion of all the projects now under way will within the next few years generate more than 34,000 new jobs. In the first quarter of 2010, 29 projects were signed. 6,000 new jobs will emerge from them. Only 10 projects (creating 2,000 jobs) were signed at this time last year.” (Consulate General of the Republic of Poland, 2011).

In terms of the future of FDI in Poland, UNCTAD, the United Nations agency for trade and development, estimates that global investment flows may rise to \$1.5 trillion in 2011, followed by an even stronger \$2 trillion in 2012. Poland will certainly benefit from this overall improvement in the world economy.

4. POLAND AND FDI IN 2011

Two areas have been magnets to foreign investment in the Polish economy: the *automotive industry* and *service centers* of global corporations which have employed qualified staff (especially involving language proficiency) in Poland. Once again the availability of qualified workers in Poland has been noted as the most important pre-condition to attracting significant FDI. The *Federation of International Trade Associations* reports on the main positives for Polish FDI as follows:

“A fast-growing economy, location in central Europe, a multilingual work force and cheap labor costs make Poland an internationally attractive country. Poland also enjoys a well managed healthy economy, which is withstanding the crisis better than other European countries. Unlike other Central European countries, its population did not have to resort to loans in foreign currencies, in particular Swiss, a fact which protects the population from maximum debt.” (FITA, 2011).

5. A BRIEF CASE STUDY

One key example of current FDI activity is Russia’s *Intrall Rus*, which has announced plans to build a research center and automotive plant in Pomerania. The Polish facility is being designed to support a Russian operation to construct delivery vans in Stavropol.

After the initial plans have been finalized, Intrall Rus intends to construct a manufacturing plant for commercial vehicles, light delivery vans, and all-terrain vehicles.

The first stage of construction will involve 22 million euros and will consist of the construction of a research and development (R&D) center for the design of new vehicles. Total investment is expected to top 270 million euros. The project will begin in the last quarter of 2011 and the first vehicles are scheduled to be produced in early 2014. Company officials indicate that 2,500 to 5,000 vehicles are expected to be produced each year. Intrall Rus has also indicated that the company is expected employ 50 Polish-trained engineers at the facility and 500 to 600 production workers. A second phase of construction will attempt to link the manufacturing process with a variety of components and parts suppliers.

Local authorities in the Pomerania region are full partners in the enterprise, promising to work with local employment agencies and governmental authorities in recruiting and training employees and in cooperative efforts with technical schools and regional universities in creating degree and training programs for future staff and management. Thus, FDI activity may

serve as a model for further cooperative efforts that have recently damaged by tensions between Russia and Poland.

6. SOME CONCLUSIONS

It is now very obvious that the attraction of FDI into the Polish economy has been a mainstay of both political and economic policy. Without a doubt, the future progress of both the political and economic systems will continue to depend on the core attractiveness of Poland as a destination for significant investments in Poland in FDI.

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About the Authors

Richard J. Hunter, Jr., is Professor of Legal Studies, Seton Hall University; Adjunct Professor of Law, Rutgers University School of Law; Treasurer, Polish Institute of Arts and Sciences of America; author/coauthor of more than forty articles and two books relating to economic transition in Poland and Eastern Europe; presenter at numerous UN programs on development sponsored by UNITAR.

Leo V. Ryan is Dean and Professor *Emeritus* of the Kellstadt School of Business, DePaul University; former Dean of the College of Business at the University of Notre Dame; former President of the Society for Business Ethics; author/coauthor of more than forty articles and three books relating to economic transition in Poland and Eastern Europe.