

7 Foreign direct investment and the balance of payments in Poland

Introduction

The role of foreign direct investment (FDI) in the modern world cannot be underestimated. In most countries FDI has become crucial in accelerating economic growth, especially in a situation of insufficient savings and technological backwardness. This applies to the Polish economy where FDI only started to appear on a large scale from 1989.

Literature discusses the various aspects of the significance of FDI in Poland, with analyses concerning its impact on employment, labour productivity, investment, foreign trade and innovation, both in macro-economic and regional terms.¹

The main research problem in this study was to define the trends in the size and structure of FDI inflows to Poland and the cost of servicing them. This study will show the structure of the burden on the balance of payments from the costs of this form of capital inflow into Poland. The examined period covers 2004–2015, i.e. the period when the National Bank of Poland used the new balance of payments manual (BPM6)

¹ Compare, e.g. J. Hybel, *Wpływ bezpośrednich inwestycji zagranicznych na zatrudnienie i produktywność pracy*, “*Ekonomika i Organizacja Gospodarki Żywnościowej*” 2007, No. 63; K. Starzyk, *Bezpośrednie inwestycje zagraniczne a handel zagraniczny*, Akademia Ekonomiczna, Kraków 1997; M. Maciejewski, *Wpływ bezpośrednich inwestycji zagranicznych na zmiany struktury towarowej polskiego eksportu*, “*Studia i Prace WNEiZ*” 2015, Vol. 3, No. 41; M. Wachowska, *Rola bezpośrednich inwestycji zagranicznych w promowaniu dyfuzji wiedzy w polskiej gospodarce. Analiza cytowań patentowych*, “*Studia i Prace WNEiZ*” 2015, Vol. 3, No. 41; *Rola bezpośrednich inwestycji zagranicznych w kształtowaniu aktualnego i przyszłego profilu gospodarczego województwa łódzkiego*, ed. J. Świerkowski, Łódzkie Towarzystwo Naukowe, Łódź 2011; J. Pietrewicz, *Wpływ zagranicznych inwestycji bezpośrednich na rozwój gospodarczy regionów*, PAN, Warszawa 1995; H. Nakonieczna-Kisiel, *Rola podmiotów z kapitałem zagranicznym w gospodarce województwa zachodniopomorskiego*, “*Studia i Prace WNEiZ*” 2015, Vol. 3, No. 41.

containing data on FDI not compatible as those from previous years, being presented according to the old balance of payments manual, BPM5.²

1. Changes in FDI statistics introduced by the new manual

According to the OECD definition, foreign direct investment is considered evident when the direct investor owns directly or indirectly at least 10% of the voting power of the direct investment enterprise.³ This gives the investor an influence over the management of an enterprise. This shows then that the new manual (BPM6) had not introduced any changes concerning the very essence of FDI.

In the new manual, FDI includes not only shares and other forms of equity capital, reinvested earnings, and loans from foreign investors, but also trade credits and funds for the purchase of properties.⁴ These new components increase the value of FDI inflows.

The new FDI statistics primarily take into account the residence of the direct investor. There are no changes in the classification of investments in Polish direct investment enterprises, those still being classified as FDI. Changes in the assignment to FDI or Polish investment abroad concern the assets of direct investment enterprises in direct investors and transactions within an enterprise group. The direction of these investments is determined by the residence of the enterprise (parent company in the group).⁵

In the new manual, direct investment is presented according to the state of assets and liabilities, while the old manual divided them into FDI in Poland and Polish direct investment abroad. Currently, the assets include two items: receivables of Polish investors and receivables from

² Cf. *Informacje o zmianach w statystyce bilansu płatniczego i międzynarodowej pozycji inwestycyjnej w 2014 roku*, NBP, www.nbp.pl (accessed September 2016).

³ Cf. *Statystyka bilansu płatniczego. Uwagi metodyczne*, Departament Statystyki NBP, Warszawa 2015, p. 20, www.nbp.pl (accessed September 2016).

⁴ Cf. *Inwestycje zagraniczne w Polsce 2014–2015*, IBR, KiK, Warszawa 2016, p. 8.

⁵ Cf. *Inwestycje zagraniczne w Polsce 2012–2014*, IBR, KiK, Warszawa 2015, p. 6.

foreign investors. Liabilities include liabilities to foreign investors and the liabilities of Polish investors.⁶ This approach allows a more accurate determination of whether investments are controlled by the domestic or foreign enterprise.

The new standards have introduced new signs which apply only to foreign assets in the financial accounts. In the previous manual BPM5, the 'minus' sign denoted an increase in assets (capital outflows), and a 'plus' sign denoted a decline (capital inflow). Under the new methodology, the plus sign means an increase in assets (capital outflow), while a minus sign denotes a decline in assets (capital inflow). The interpretation of signs in liabilities remained unchanged.⁷ In addition, the new manual introduced a new classification of FDI income, now included in the so-called primary incomes, not present in BPM5. The source is income from shares and other forms of equity capital, and interest on debt instruments (mainly loans). Income from shares and equity capital include dividends (in companies) attributable to a direct investor, shares in profits (in limited companies), transferred profits of branches, and re-invested earnings.⁸

In the structure of the balance of payments, FDI inflow transactions are recorded as liabilities (liabilities to foreign investors), while non-resident incomes from this form of invested capital are included as debit in primary income.

Trends in the size and the structure of FDI inflows in the analyzed period are described in section 2, and those in the income of direct investors in section 3.

2. FDI and financial account

In 2015, Poland attracted a total of 12.3 billion US dollars of foreign capital, almost 5 times less than the peak years 2007 and 2010. The structure of this capital was dominated by foreign direct investment. Since 2004,

⁶ *Ibidem*, p. 6–7.

⁷ Cf. *Informacje o zmianach w statystyce bilansu płatniczego...*, p. 4.

⁸ Losses of the direct investor are treated as negative reinvested earnings (cf. *Statystyka bilansu płatniczego, ...*, p. 20 and next).

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the share of FDI in gross foreign liabilities has averaged 45.7%, compared to 36% for portfolio investments and 18.3% for other investments (see Table 1). Such a structure of liabilities affected the financial stability of the economy, because in mostly required regular servicing regardless of the achieved economic results.

Table 1
The share of FDI in total inflow of foreign capital into Poland
(USD million, %)

Year	FDI	Portfolio investment (PI)	Other investment (OI)	Total	Structure		
					FDI	PI	OI
2004	13,868	10,573	-1,172	23,269	59.6	45.4	-5
2005	11,041	15,092	-1,734	24,399	45.3	61.8	-7.1
2006	21,473	1,707	10,139	33,319	64.4	5.1	30.4
2007	25,031	117	30,658	55,806	44.9	0.2	54.9
2008	14,574	-4,720	27,292	37,146	39.2	-12.7	73.5
2009	14,025	16,202	8,457	38,684	36.2	41.9	21.9
2010	18,395	28,921	12,921	60,237	30.5	48	21.5
2011	18,485	16,539	6,630	41,654	44.4	39.7	15.9
2012	7,358	20,100	-3,615	23,843	30.9	84.3	-15.2
2013	795	2,399	3,368	6,562	12.1	36.6	51.3
2014	17,275	3,940	79	21,294	81.1	18.5	0.4
2015	7,353	7,763	-2,804	12,312	59.7	63.1	-22.8

Source: own calculations based on NBP, balance of payments – annual data (August 2016).

The studied FDI flows (annual inflows) in the selected period showed strong fluctuations, but with a tendency to decrease in value. Until the outbreak of the financial crisis, the values generally increased, exceeding 25 billion USD in 2007. From 2008–2011 they ranged from 14 to 18 billion USD, to fall to just 0.8 billion USD in 2013, recovering to about 7.4 billion USD by the end of 2015 (see Figure 1).

The change of the inflow of FDI to Poland have also shown a downward trend. Only in five years was FDI higher than in the previous year, while in six years it was lower. The largest, a more than 21-fold increase in FDI inflow was recorded in 2014, resulting from the extremely low

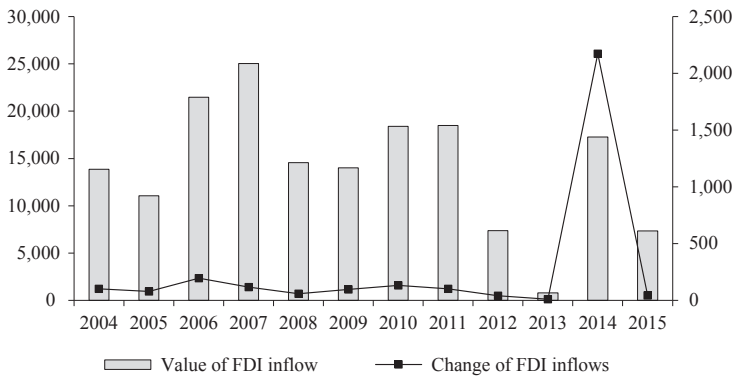


Figure 1. The size and change of FDI inflows to Poland (USD million)

Source: own calculations based on NBP, balance of payments statistics, quarterly data – analytical tables (August 2016).

value in the previous year. The reason for the decline in 2013 was the partial withdrawal of capital from the banking sector to improve economic indicators in parent banks, and secondly, a reduction in the activity of financial holdings with foreign direct investors.⁹ In other words, it was the result of the liquidation of a number of special purpose enterprises which involved ‘capital in transit’.¹⁰ Significantly, the decrease in the change of FDI inflows was also accompanied by a decline in the rate of return. The greatest profitability was recorded in 2003 (over 12%).¹¹ After 2004 the rate of return began to gradually decrease, reaching 8.8% by the end of 2014.¹²

In the structure of FDI flows, the largest share was taken by equity and investment fund, but that trend has been decreasing. In 2004, these

⁹ Cf. J. Przystupa, *Bezpośrednie inwestycje zagraniczne w Polsce w 2014 r. według Narodowego Banku Polskiego*, in: *Inwestycje zagraniczne w Polsce 2014–2015...*, p. 9.

¹⁰ Cf. D. Sadłakowski, *Analiza kosztów gospodarczych wynikających z napływu bezpośrednich inwestycji zagranicznych*, “*Studia i Prace WNEiZ*” 2015, Vol. 3, No. 41.

¹¹ *Ibidem*, p. 163.

¹² J. Przystupa, *op. cit.*, p. 18.

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accounted for as much as 97.6% of FDI, while by 2012 the share had dropped to only 36%. In this context, it is worth noting that in 2013, direct investors withdrew over 2.6 billion USD of this type of capital, and has only been since 2014 that this share has begun to grow again, just above 86% in 2015 (Table 2).

The analyzed forms of FDI inflows also include reinvested earnings. Data in Table 3 shows that foreign investors had virtually ceased to acquire equity and investment fund shares, and the value of FDI began to be influenced mainly by reinvested earnings. Until the outbreak of the financial crisis, their proportion in equity and investment fund shares was in the range of 43–55%; in the period 2014–2015 it increased up to 77–80%. In 2012 the profits were so large that to a significant extent it compensated for very large outflow of capital in the form of shares.

Table 2
The structure of FDI flows (USD million, %)

Year	Equity and investment fund shares		Including reinvested earnings		Debt instruments		Total
	USD mln	%	USD mln	%	USD mln	%	USD mln
2004	13,530	97.6	6,210	45.9	338	2.4	13,868
2005	7,896	71.5	3,416	43.3	3,145	28.5	11,041
2006	13,136	61.2	5,753	43.8	8,337	38.8	21,473
2007	17,065	68.2	9,340	54.7	7,966	31.8	25,031
2008	8,759	60.1	-1,116	×	5,815	39.9	14,574
2009	10,291	73.4	5,011	48.7	3,734	26.6	14,025
2010	13,071	70.7	7,574	57.9	5,324	28.8	18,395
2011	11,060	59.8	7,032	63.6	7,425	40.2	18,485
2012	2,654	36.1	5,662	214.8	4,704	63.9	7,358
2013	-2,636	×	4,644	×	3,431	×	795
2014	10,337	59.8	8,026	77.6	6,938	40.2	17,275
2015	6,366	86.6	5,124	80.5	987	13.4	7,353

Source: own calculations based on NBP, Balance of payments – quarterly data, analytical tables (September 2016).

This shows that foreign investors now do not make new investments in Poland, contenting themselves to only develop existing ones.¹³ Under the conditions of insufficient domestic savings in the economy, this phenomenon is highly disadvantageous and may indicate a loss of investment attractiveness of the country.

Apart from equity and investment fund shares, FDI inflows also include debt instruments (mainly loans). That percentage in 2004 was small at only 2.4%, but in the following years showed a rising trend. It was particularly high in 2012, more than 3/4 larger than shares and capital shares. This shows that direct investors, by granting more loans and credits which required regular servicing, increased Polish foreign debt.¹⁴

3. FDI and current account

The debit in the analyzed period, i.e. income of foreign investors from direct investment in Poland, showed an increasing trend. At the end of 2015 it amounted to 15.7 billion USD and was about 2/3 higher than in 2004, while in the past 5 years it has usually been almost two times higher (see Table 3). Worse still, since 2009 this figure significantly exceeded the value of FDI flows, which should be regarded as a phenomenon particularly dangerous for the Polish balance of payments. In 2015, dividends owed to creditors accounted to 7.9 billion USD, almost 3 times more than at the beginning of the period; reinvested earnings amounted to more than \$5 billion (nearly 1/5 less), and paid interest on loans was 2.6 billion USD (almost 4 times more).

¹³ Cf. also J. Sawicki, *Wpływ BIZ na stabilność finansową*, in: *Inwestycje zagraniczne 2014–2015...*, p. 87.

¹⁴ More on this subject in: H. Nakonieczna-Kisiel, E. Bilewicz, *Analiza przekształceń w strukturze zadłużenia zagranicznego Polski w latach 2004–2015*, "Miszelanea Oeconomicae" 2016, Vol. 1.

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Table 3
The value and growth of income of direct investors in Poland
(USD million, %)

Year	Dividends		Reinvested earnings		Interest on loans		Total	
	USD mln	2004 = 100	USD mln	2004 = 100	USD mln	2004 = 100	USD mln	2004 = 100
2004	2,682	100.0	6,299	100.0	658	100.0	9,560	100.0
2005	5,133	196.9	3,413	54.2	734	109.9	9,280	97.1
2006	6,464	247.9	5,753	91.3	1,002	150.0	13,219	138.3
2007	8,114	302.5	9,339	148.3	1,454	217.7	18,907	197.8
2008	12,098	451.1	-1,116	×	2,048	306.6	13,030	136.3
2009	7,590	283.0	5,010	79.5	1,794	268.6	14,394	150.6
2010	9,463	352.8	7,574	120.2	2,355	352.5	19,392	202.8
2011	9,950	371.0	7,032	111.6	3,013	453.6	19,995	209.2
2012	9,283	346.1	5,662	89.9	3,241	466.2	18,186	190.2
2013	11,264	420.0	4,644	73.7	3,298	493.7	19,206	200.9
2014	9,797	365.3	8,026	127.4	3,311	495.7	21,134	221.1
2015	7,900	294.6	5,131	81.5	2,629	393.6	15,660	163.8

Source: as in Table 2.

Dividends had the largest share in the structure of total revenues of direct investors. In 2015, the share was over 50%, almost 4/5 higher than in 2004. It is worth noting that the record dividends were received by foreign investors in 2008 (over 12 billion USD, which accounted for 92.8% of total revenue). This demonstrates the enormous costs incurred by the Polish economy during the financial crisis. It also demonstrates the very dangerous trend of a sudden outflow of FDI from the economy during a global downturn. Reinvested earnings in 2015 constituted approximately 33% of total debit flows to direct non-residents. Compared to 2004, the percentage dropped 2 times, and four years later (in 2008) investors even experienced loss in this regard (negative reinvested earnings – see Table 4).

The trends of increased transfers of dividends and reduced reinvested earnings were accompanied by an increase in interest payments on loans received from direct investors. From 2008–2015 it accounted for

about 12%–18% of debit, while in previous years the share was 7–8%. This means that after the financial crisis, direct investors preferred lending to companies with foreign capital, which of course resulted in the aforementioned increased Polish foreign debt.

Table 4
Structure of income of foreign investors in Poland (%)

Year	Dividends	Reinvested earnings	Interest	Total income
2004	28.1	65.9	7.0	100
2005	55.3	36.8	7.9	100
2006	48.9	43.5	7.6	100
2007	42.9	43.4	7.7	100
2008	92.8	–8.5	15.7	100
2009	52.7	34.8	12.5	100
2010	48.8	39.1	12.1	100
2011	49.8	35.2	15.0	100
2012	51.0	31.1	17.8	100
2013	58.6	24.2	17.2	100
2014	46.4	38.0	15.7	100
2015	50.4	32.8	16.8	100

Source: as in Table 2.

4. Impact of FDI servicing costs on the balance of payments

The influence of FDI servicing on the structure of the Polish balance of payments can be shown by a comparison of the related debit with individual incomes in the balance of payments. Throughout the analyzed period FDI servicing accounted for about 8% to 14% of revenues from exports of goods, and from 25% to 63% of the exports of services (however, in both cases these relationships showed decreasing trends). The analyzed payments generally exceeded 2–2.5 times secondary income, while capital revenues, mainly due to foreign investments of residents and wages of Poles working abroad for less than one year, exceeded secondary income

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3% to 2/3. After the outbreak of the financial crisis, this ratio decreased to about 20–40% (see Table 5) due to the global recession and reduction in the scale of emigration from Poland.

Table 5
Income of foreign direct investors compared to other incomes
in the Polish balance of payments (%)

Year	Income of foreign direct investors as % of:			
	income from exports of goods	income from exports of services	secondary income	primary capital income
2004	13.1	63.0	241.2	166.7
2005	10.6	34.6	189.9	103.2
2006	12.2	58.6	218.7	112.0
2007	14.0	59.5	248.8	138.2
2008	7.8	34.0	140.5	91.5
2009	10.8	45.8	197.9	134.4
2010	12.4	54.8	283.7	151.7
2011	10.8	48.9	236.9	140.0
2012	10.0	44.3	232.6	121.5
2013	9.7	43.0	239.2	125.8
2014	10.0	43.9	268.1	139.1
2015	8.2	36.0	244.0	125.6

Source: as in Table 2.

This strong burden of the specified incomes in the balance of payments with the amount of payments to direct investors should have a large asymmetry in the flow of this form of foreign capital. In the analyzed period, FDI liabilities were generally 2–3 times higher than assets, and in extreme cases even 6–7 times higher. This FDI flow asymmetry is shown in Figure 2. Additionally, the size of the burden on the balance of payments with FDI servicing costs is evidenced by the fact that until 2013 the payment of dividends, profits, and interest payments were financed by inflows of FDI, and in subsequent years – due to the reduction

in inflows – by net exports. In 2015, FDI servicing involved as much as 93% of net exports.¹⁵

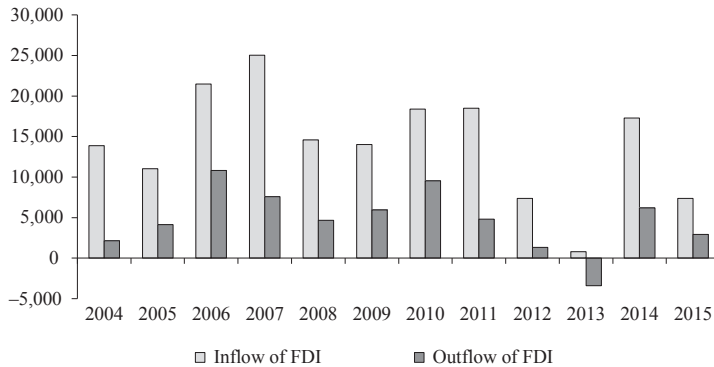


Figure 2. The inflow and outflow of FDI from Poland (USD million)

Source: as in Table 2.

Conclusions

As a result of the analyses, this research provides the following answers:

1. In the analyzed period, the value of FDI inflows to Poland was decreasing and was characterized by strong fluctuations. The relative significance of shares in FDI decreased, while the share of re-invested earnings, loans, and borrowings increased. This indicates a loss of investment attractiveness of the country and a reduction in financial stability.
2. Revenues of direct investors have been increasing, and after the outbreak of the financial crisis it even exceeded the FDI flows. Debit was dominated by dividends and interest from loans, with gradually decreasing reinvested earnings.

¹⁵ Cf. J. Sawicki, *op. cit.*, p. 86.

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3. FDI servicing proves to be expensive for Poland. It has been higher than the income from primary and secondary capital; it also accounted for about 11% of income from exports of goods and nearly 47% of income from exports of services.
4. In terms of declining FDI flows, servicing of investments is currently being financed by net export revenues.

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