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# Regulation and Deregulation Processes in CEE Countries and International Business: the Case of Poland


## Abstract

*This chapter focuses on the trends and offers an assessment of the regulatory and deregulatory changes taking place in those selected Central and Eastern European Countries from the viewpoint of international business. The authors also attempt to analyze the influence of the regulatory and deregulatory changes upon the conduct of international business in these countries as well as the effect of such changes upon the values of macroeconomic indicators achieved by the countries analyzed. As regards the latter, however, it should be pointed out that it is very difficult to distinguish between the effects achieved as a result of regulatory and deregulatory practices and the overall effects achieved resulting from a combination of other factors, and nearly impossible to quantify the same.*


## Introduction

The problem of regulation and deregulation of business activities is the focus of much attention on the part of a number of international organizations devoted to improving the climate for business, in particular of international business. As an example one may cite reform of the regulations of the OECD. The countries of Central and Eastern Europe (CEE) find themselves in a situation *sui generis* in this regard. In making the transition from centrally planned economies to free-market economies they engaged in a widespread scheme of both deregulation - freeing business from the regulations involved in centrally planned administration - and regulation: introducing new laws necessary to build the fundamentals of a free market such as a capital market, a two-level banking system, etc. At the same time these countries either attained membership or seek to attain membership in a number of international organizations also engaged in both regulatory and deregulatory processes.

The within analysis focuses on those aspects of the regulatory and deregulatory processes in selected CEE countries which most directly affect international business practices: direct foreign investment (DFI) and foreign trade. This paper focuses on the trends and offers an assessment of the regulatory and deregulatory changes taking place in those selected CEE from the viewpoint of international business. The authors also attempt to analyze the influence of the regulatory and deregulatory changes upon the conduct of international business in these countries as well as the effect of such changes upon the values of macroeconomic indicators achieved by the countries analyzed. As regards the latter, however, it should be pointed out that it is very difficult to distinguish between the effects achieved as a result of regulatory and deregulatory practices and the overall effects achieved resulting from a combination of other factors, and nearly impossible to quantify the same.

## 1. The Theoretical Framework

The processes of regulation and deregulation occur simultaneously in the contemporary world economy. The term “regulation”, for the purposes of our analysis, is equated with the sum of normative regulations and acts in force in the business sphere whose aim is to influence and shape the economic activities undertaken by business entities. The process of deregulation, on the other hand, is understood to encompass all activities whose aim is to free business entities from proscriptions, prohibitions, and restrictions which limit their freedom of choice in carrying out business activities. It should be kept in mind that the processes of regulation and deregulation are carried out on various levels: global, mega-regional, regional, sub-regional, and national (see Chart no. 1).

Regulation of business practices at the global level is carried out by the WTO and the UN Committee on Permanent and Sustainable Development. This form of regulation consists primarily of the imposition of technical, ecological, and health and safety norms and standards designed to promote permanent and sustainable development in the world economy. The deregulation imposed by these institutions encompasses primarily a process of step-by-step liberalization of the capital and goods markets (annulment of tariff duties and quantity restrictions in world trade as well as the prohibition on offering foreign investors incentives which have the effect of deforming or disorganizing free world trade).

Regulation and deregulation at the mega-regional level consists of the binding normative provisions and regulations imposed on member countries of organizations which register countries in similar economic positions, of which the OECD is a prime example. The most important of its provisions relating to international business can be found in the Capital Movements Code, Current Invisibles Code, as well as in its binding directives relating to various spheres of economic policies.

Regulation at the regional level refers to the binding norms and directives imposed by integrating regional organizations such as the EU, MERCOSUR, NAFTA, APEC, and others. In Europe undoubtedly the dominant integrating organization is the EU, which has attained the highest degree of economic deregulation of international economic (market) transfers, while at the same time implementing a highly advanced regulatory system in certain economic spheres and in the process of harmonizing economic policies.

In Europe one also encounters a sub-regional regulatory and deregulatory level, such as in the case of CEFTA, an organization combining candidate countries who are in the process of negotiating accession agreements with the EU.

One also encounters regulatory and deregulatory practices at the national level, which encompasses the legal norms and regulations contained in the economic policies of various countries aimed at strengthening the positive and eliminating or diluting the negative effects of opening their markets to world trade and at assisting national economic development.

## 2. Government Policies of the countries of Central and Eastern Europe vis a vis international business

In the world economy, the process of removing barriers to the free flow of capital has been underway for more than twenty years. The various countries of the world - both the highly developed and developing nations – compete among themselves for DFI capital. The basic strategies are the same: either the offering of foreign investment incentives (benefits, exemptions, special regulations) or implementing a policy of strengthening economic "fundamentals" (infrastructure, education, economic stability, etc), or both, with the aim of improving the attractiveness of their respective countries as a location for DFI (Ch. Oman, 2000). The countries of Central and Eastern Europe are no exception. Their policies as regards foreign investors underwent fundamental change during the systemic transformation period. They abandoned the restrictive policies which had been implemented, primarily for doctrinal reasons, during the years when they operated as centrally planned economies. It may be said that during the early phase of the transformation most countries in the region implemented policies which granted foreign investors a specially privileged status vis a vis domestic enterprises, inverting the principle that one should treat others as one treats one's own on its head. While presently the countries of Central and Eastern Europe have readjusted their policies to providing similar treatment for foreign and domestic enterprises, this by no means means that they have forgotten about or are no longer competing for foreign investment. One only need look at the legal regulations in place in the Czech Republic, the extensive government programs in Hungary, or the draft legislation being worked on in Poland to see that support for attracting foreign investment continues to be high.

The competition to create and implement policies favoring foreign investment springs from the conviction that DFI brings significant economic advantages to the host country, and that well-crafted policies can promote and expand upon such advantages. Paradoxically, in the age of globalization host countries competing for DFI have fewer and fewer policy tools at their disposal to attract the same. This is primarily a result of their membership in the WTO, which applies its principles alike to its highly-developed, developing, and transforming member countries. The binding Agreements on Subsidies and Counterveiling Duties and on Trade-Related Investment Measures (TRIMS/ WTO) restrict the policy options available to the member countries. Countries which are members of the OECD are also bound to implement the Capital Movements Code. And finally, the countries of Central and Eastern Europe which are candidate countries for accession to the EU must be prepared to fully respect the functioning of the single internal market upon accession.

The most important limitations on the formulation of pro-foreign investment policies seem to be the restrictions arising from the aforementioned WTO Agreements on the one hand, and the limited effectiveness of and lack of funds to provide incentives for foreign investment on the other. The provisions of the WTO treaties categorically prohibit the application of investment incentives for foreign investors which would have the effect of deforming or disorganizing foreign trade, even though from the point of view of many of the developing countries such investment incentives might make good economic sense. Such incentives, sometimes still being applied (UNCTAD 1996), may also lead to deforming effects similar to those achieved by traditional trade barriers, and for this reasons member countries of the WTO are subject to discipline for applying them. In addition, it is worth noting that using public funds to offer investment incentives does not guarantee achievement of expected results, and runs the risk of "overpaying" for expected returns. In addition, if too many incentives are offered, governments may simultaneously have to pay out allocations while losing long term revenues, none of which will guarantee that DFI will remain in place once the incentives expire.

The foreign investment policies of the countries analyzed herein underwent a natural evolution during their systemic transformations. In the early phase they passed laws which granted fundamental guarantees to foreign investors and even gave them privileges not available to domestic enterprises, while at the same time annulling restrictions in place from an earlier period. The accession of Poland, Hungary and the Czech Republic to the OECD began a process of deregulation, strengthened by their preparations for membership in the EU. The principle of treating foreign enterprises the same as domestic ones has become the norm. At the end of the 1990's the countries analyzed herein have begun to provide investment incentive packages for both foreign and domestic investors, although their conditions are framed in such a way that they are often easier to be fulfilled by foreign investors.

## 3. Regulation and deregulation of international business activities in Central and Eastern Europe, with special emphasis on the case of Poland.

For the countries of Central and Eastern Europe the initial phase of the systemic transformation process, which encompassed transformation from centrally-planned economies to free-market economies, ushered in a period of vastly increased contact with the highly-developed countries, especially those of Western Europe, and a breaking away from the Soviet-controlled COMECON system previously in place. As a result foreign trade patterns were fundamentally realigned from East to West. This process was greatly assisted by the signing of Agreements with the European Community and EFTA as well as the mutual trade contacts implemented within the framework of the CEFTA Agreement. An additional significant input to the overall liberalization process was the increase in foreign trade with non-European countries as a result of the CEE countries' active membership in the WTO. The crowning event in the first phase of the transformation process was the acceptance of three CEFTA countries - Poland, the Czech Republic, and Hungary - into the OECD. This meant the gradual integration of their economic policies into the legal processes of regulation and deregulation implemented via the multi-lateral system of foreign trade, both in terms of adjusting their legislation and liberalizing their markets vis a vis the flow of capital and goods.

In terms of the adjustment of the existing legal framworks in the above-mentioned countries to correspond to those prevailing in the highly-developed countries, undoubtedly the prime role has been played by the harmonization process imposed upon the EU candidate countries in the latter half of the 1990's to prepare them for their future membership in the EU. The Association Agreements signed by the candidate countries mandated the liberalization of their markets with regard to industrial manufactures and in the services sector. As regards industrial manufactures, the EU, EFTA, and CEFTA Agreements require that the countries of Central and Eastern Europe totally open their markets by the end of 2001, and in the services sector by the end of 2003. His liberalization process in largely synchronized with that required within the context of the countries' WTO membership, although it should be noted that in some cases the EU Agreements are more restrictive, as for example in the case of allowable incentives for the export of manufactured goods[1] than the WTO Treaties (ECE/UN, 1997). It should be noted that many of the mechanisms designed to encourage and support free trade contained in the existing Agreements and Treaties continue to be highly under-utilized due to the lack of awareness on the part of both the administrative agencies overseeing the process and the businesses engaged therein (in particular small and medium-sized firms). As an example one could sight the various special protective clauses contained in the Association Agreements with the EU, use of which is almost nil.

As a result of the twin processes of economic transformation and integration with the Western European structures, the CEE countries analyzed herein have already almost totally opened their economies to the flow of manufactured goods and products ( with the exception of automobiles and liquid fuels, the restrictions upon which are scheduled to expire this year), nearly fully opened to the flow of services, and are significantly advanced in the step-by-step process of opening the foreign trade market to agricultural products in accordance with the CEFTA and Association Agreements. With regard to the services market the mandated liberalization process required the immediate introduction of a national treatment clause applicable to construction, consulting, and transportation (road transportation, with the exception of cabotage between the CEE and EU countries) and financial (banking and insurance) services, as well as the conclusion of liberalization of the telecommunications industry and

[1] The Association Agreements with the EU prohibit the CEE countries to offer export credit subsidies for export of manufactures to the EU, while the same are permitted within the WTO for countries "in transition" until the end of 2002.

in transactions involving the delivery of high-tension electricity and natural gas (see Table 2).

This liberalization process is characterized by a high level of deregulation. At the same time, however, the transformation process has required the implementation of an elaborate system of norms, primarily technical and ecological, to allow the CEE countries to trade with the advanced economies of the Western Europe (EC regulations) and to participate in the global market (WTO and UN regulations) (ECE/UN, 1998).

Table 3 sets out the scheme of regulation and deregulation of FDI in the case of Poland. As has been earlier set forth, the scheme of regulation and deregulation concerning this sphere of activity stems from both the nature of economic transformation as well as the obligations arising from agreements signed in the process of implementing such transformation. The transformation process required that foreign investors receive fundamental guarantees for their investments, and the accompanying agreements signed mandated far-reaching trade liberalization (liquidation of permission requirements, access to markets previously protected from foreign investment, freedom for businesses to make independent decisions regarding foreign trade, etc.). In the case of Poland, far-reaching liberalization of the capital market vis a vis the highly-developed countries, including DFI, was mandated by Poland’s entry into the OECD. While such far-reaching liberalization was not required by earlier-signed Association Agreement with the EC, the fact that it is accomplished puts Poland in a position to join the EU’s capital movement structure, and thus this issue is not a significant problem in the present negotiations concerning Poland’s future membership in the EU. According to the document “Poland’s Accession Negotiations to the EU, 2001”, following ten years of deregulation only the following restrictions remain in place:

– restrictions regarding the purchase of real estate by foreign non-residents;
– limitations on DFI in the audio-visual industry, gambling and lottery operations, and in the air transportation industry;
– restrictions on the free movement of capital in the financial market;
– unequal treatment of foreign investors in the privatization process (the problem of offering so-called “golden stock”);
– application of security requirements to institutional investors in the financial services market (investment funds, insurance, and retirement funds).

In conjunction with the ongoing negotiations with the EU the liberalization process will continue, and Poland is presently drafting legislation designed to remove the remaining obstacles.

## 4. The Accomplishments of the CEE Countries in international business

Foreign direct investment (FDI) first entered the countries of Central and Eastern Europe as early as the 1970's. Some of these countries attempted to seek outside sources for financing their development independent of governmental loans, at the same time searching for a method that would be consistent with the reigning principles of centralized state planning. However, the fundamental contradiction between the market principles guiding foreign investors and the principles of a planned economy caused such FDI to be marginal.

The implementation of far-reaching systemic transformations throughout Central and Eastern Europe radically changed the attitudes of foreign investors toward the region as a location of FDI. In addition, the countries quickly adopted new laws granting foreign investors the necessary protections for their investments, including the right to transfer profits abroad, the retransfer of capital in the case of liquidation or sale, as well as the right to compensation in the event of nationalization or a taking by eminent domain. In addition, the very process of rapid, almost overnight, transformation lured investors with the prospects of new markets. It may be recalled that the transformations encompassed property ownership transformation, the creation of market segments, including especially the creation of a capital market, far-reaching changes in monetary and financial policies, de-monopolization of the market and implementation of fair trade practices, and liberalization of laws regulating access to world markets.

The positive reaction of foreign investors to the changes taking place throughout Central and Eastern Europe can be seen by a glance at Tables 5 and 6, which demonstrate the annual streams and accumulated investment of FDI into Central and Eastern Europe in the 1990's. At the beginning of the transformation period investment of FDI inward stock in the entire region was estimated at 3 billion USD, and by 1999 it comprised 103 billion USD worth of investment, a 34-fold increase.

The annual stream of FDI into the region was approximately 2.4 billion USD in 1991, and reached 21 billion USD by 1999. Although this constituted only 2.5% of total FDI worldwide, still the amount was of great significance to the region. About 70% of FDI into the entire Central and Eastern European region was invested in Poland, Hungary, the Czech Republic, and Slovakia. Their relative positions as countries receiving FDI has varied throughout this time. In the early phase of the transformation wave the most attractive country in the region for foreign investors was Hungary. By the latter half of the 1990's, Poland occupied first place in terms of total FDI invested in the region, a position now occupied by the Czech Republic. The reasons for this variation in terms of locating FDI in the region are connected with the varying paces of privatization, fluctuating changes in the indicators of economic growth, and the attractiveness of varying investment incentives offered to foreign investors.

The relative scale of FDI engagement in the overall economies of the countries analyzed herein can be seen by examining some basic economic indicators, such as: 1) inward FDI stock as a percentage of GDP; (2) inward FDI flows as a percentage of gross fixed capital formation; and (3) inward FDI stock per capita. Viewed in these terms, the scale of FDI in the region overall is comparable to the scale for the rest of the world. On the other hand, the relative scale of FDI engagement in the respective countries analyzed herein varies greatly (see Table 7). The relativity indicators are highest for Hungary, which testifies to the great importance of FDI in the economic development of that country. For example, the share of inward FDI stock relative to the GDP of Hungary was 33% in 1998, while inward FDI flows constituted more than 18% of Hungary's gross fixed capital formation for the same year (UNCTAD, 2000), averaging a per capita flow of almost 1900 USD. Slovakia is at the other end of the scale among the analyzed countries, where the values for the same indicators listed above constituted just 12.1% and 6.1% respectively, and per capita flow was only slightly greater than 460 USD. While data for the entire region is incomplete, there is no doubting the increasing penetration of FDI throughout the region in the 1990's. Its effects are most evident in Hungary, where for example foreign affiliates were responsible for 27% of overall employment in Hungary in 1997, including almost 43% in industry, and the share of foreign affiliates in total economic turnover reached 48%, including 67% in industrial turnover (Measuring globalization, OECD, 2000).

In terms of the structure of foreign investment according to country of origin, it is readily visible that the dominating position is held by investors from the European Union Member States. Their share in overall FDI in the region fluctuates between 65-87% (OECD, 2000; PAIZ 2000). This can be explained by the twin factors of proximity as well as the ongoing process of European integration, which significantly improved the climate for investment beginning with the signing of the Association Agreements at the beginning of the 1990's.

The sectoral structure of FDI in the region is characterized by certain common and long-term trends. At the beginning of the transformation period, 2/3 to 4/5 of FDI in the region was located in industrial manufacturing (Sector II), while by the end of the 1990's the share of this Sector in overall FDI in the region fell to a range between 2/5 and1/2 (OECD, 2000; PAIZ 2000). The share of FDI in service industries (Sector III) has risen in proportion to its decline in industrial manufacturing. FDI in Sector I industries has been minimal throughout the entire analyzed period. A close analysis of the data concerning FDI in industrial manufacturing reveals that the pattern of such investment has been very similar in all the countries analyzed. Of greatest interest to foreign investors have been the food processing and automotive industries, and of least the advanced technology industries. In the service industries a significant proportion of FDI has been located in financial services as well as in trade and maintenance services. It is worth noting that a general overview of the sectoral structure of FDI in the region is similar to that pertaining throughout the world.

In the 1990's the countries of Central and Eastern Europe implemented policies of fundamental reorientation in foreign trade, shifting the direction from the East (the former Soviet Union and satellite countries) to the West (primarily the European Union). This was closely connected with the fact of signing Association Agreements between the CEFTA countries and the European Community and EFTA. The most drastic reorientation occurred in the Czech Republic, followed by Poland and Hungary, while the shift was the weakest in Slovakia (see Table 1).

The process of implementation of the Association Agreements, which mandated the mutual liberalization of foreign trade restrictions, led to a worsening of the foreign trade deficits in the CEFTA countries. While Hungary, the Czech Republic, and Slovakia managed to reverse this trend in the 1990's and even obtain small foreign trade surpluses, Poland's foreign trade balance has systematically worsened and reached a deficit of 10.5 billion USD in 1999 (see Table 2). The asymmetry built into the liberalization provisions of the Association Agreements, as well as the delayed access to EU markets for so-called "sensitive products", which encompass textiles, steel, coal, and agricultural products, led to a significant restructuring in the patterns of foreign trade between the countries analyzed herein and the EU in the 1990's (see Table 3). As regards the export of coal and coal-derived products, the most significant restructurization occurred in the Czech Republic and Poland; as regards steel and steel products, in the Czech Republic, Hungary and Poland; while as regards agricultural products the most significant changes occurred in Hungary and Poland (see Table 3). As regards textile and clothing products, where the CEFTA countries enjoyed a significant comparative advantage due primarily to the low costs of labor, a trend of gradual worsening can be observed beginning in 1997-1998, which is especially evident in the cases of Poland and Hungary (see Table 9) (Z. Wysokinska, 2000).

Beginning in 1998-1999, the CEFTA countries analyzed gained access to the EU market for their industrial products free from tariff and quota restrictions. As a result of this process, the share in exports to the EU of natural resource-consuming goods, earlier usually classified as "sensitive", was significantly reduced. The share in the exports of such goods in the overall exports of Poland, the Czech Republic, and Slovakia to the highly-industrialized countries fell by approximately 50%, falling in Poland from 37% to 17%, and in the Czech Republic and Slovakia from 10% to 5%. This reduction in the share of such goods in relation to overall exports is also connected with the application of EU ecological norms and standards to such products. For example, the share in Poland's overall export of goods classified as "environmentally harmful" fell from 57% in 1992 to 46% in 1998 as a result of the application of EU norms (Z. Wysokinska, 2001).

As a result of the twin processes of systemic transformation and European integration, an improvement was noted in the competitive position of high tech goods and products exported world-wide from the CEFTA countries analyzed (see Table 4). In the case of Poland this is especially evident as regards telecommunications equipment; in the case of Hungary as regards computers; in the case of the Czech Republic as regards telecommunications, space and aeronautics, and research and development equipment. As regards Slovakia, this improvement is less evident and concerns primarily research and development equipment (see Table 10).

## 5. Conclusions

1) The CEE countries subjected their economic systems to widespread both regulation and deregulation in the 1990's as a result of the obligations they undertook by signing multi-lateral agreements with the WTO, EU, EFTA, and CEFTA designed to enable them to engage in open trade on the world market.
2) As a result of the aforesaid regulatory and deregulatory schemes implemented, the CEE countries can be characterized as open economies and have created a favorable business climate for international business which allows their domestic business entities to plug into the network of international trade.
3) The combined effect of systemic transformation and liberalization through the implementation of regulatory and deregulatory schemes must be assessed positively, as confirmed by the economic indicators attained.
4) Overall economic growth in the so-called "Wyshehrad Group" of Central and Eastern European countries (Poland, Czech, Hungary, and Slovakia) during the period 1992-2000 was characterized by systematic economic growth of approximately 2 percentage points higher than the overall

worldwide average[2]. The rate of economic growth in the CEE countries was highest from 1994-1996, and in the latter half of the 1990's declined to 2-4%.

5) GDP per capita in Poland, measured in terms of USD, rose from $2155 per annum in 1992 to $3056 in 1995 and $3725 in 1999. For comparison purposes, the same economic indicator for 1999 was $4790 for Hungary, $3662 for Slovakia, and $5161 for the Czech Republic, where it was the highest among the CEFTA countries. If one revises the GDP per capita for Poland to take into account actual purchasing power, then the Polish GDP per capita becomes approximately doubled, equaling $8650 USD. This level, however, is about three times lower than the actual average GNP per capita, measured in USD, for the member-states of the European Union, which was $22, 588 in 1999. It is also interesting to look at the GDP per capita in terms of purchasing power in the European Union countries, where the German per capita GDP of 25,729 USD retained the same purchasing power and the French per capita GDP of $23,724 had a purchasing power of only $22, 067, while the Spanish GDP per capita of $15,220 had a purchasing power of $18,215 and the Portuguese GDP per capita of $11,438 was the equivalent of a purchasing power of $16,703.

6) The inflation rate in the CEFTA countries analyzed herein systematically declined during the 1990's: in Poland it fell from 480% in 1990 to 7% in 1999; in the Czech Republic from 24% to 4%; in Slovakia from 16% to 6%; and in Hungary from 36% to 10%. The CEFTA countries were also bound to implement the WMF criteria aimed at creating monetary stabilization, in particular to consistently reduce the size of their budget deficits in the 1990's in relation to GDP: in Poland the annual budget deficit fell from 6% of GDP in 1992 to 2.1% in 1999; in Hungary from 7.3% in 1992 to 3.5% in 2000; and in the Czech and Slovak Republics their budget deficits at the end of the 1990"s did not exceed 2.4% and 3.3% of GDP respectively.

7) The relatively high costs of credit in the CEFTA countries analyzed constituted a significant barrier to the development of small and medium-sized domestic enterprises throughout the 1990's. The highest annual interest rate for credit was recorded in Poland following implementation of Poland's "shock therapy" economic program in 1990, when the inflation rate reached 480% and the annual credit interest rate 540%! The situation quickly stabilized according to plan, however, and the annual credit interest rate fell to 54.6% in 1991 and has been characterized by a systematic declining trend thereafter, falling to 17% in 1999. This pattern of declining

[2] According the IMF, the overall worldwide average was 2.8% from 1995-1997, and 3% in 1996/97.

bank interest rates can be observed throughout the entire region, in Hungary falling from 35% in 1991 to 12% in 2000; in the Czech Republic from 14% in 1993 to 7.2% in 2000; and in Slovakia to a lesser degree, where the annual bank interest rate fell from 21% to 14.4%.[3] It is worth noting that the difference between the interest rate and the inflation rate was significantly higher for Poland and Slovakia, where it reached 9-10 percentage points, with the attendant negative consequences on economic growth. In Hungary and the Czech Republic, on the other hand, the difference between the interest and inflation rates was only 2-3%.

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[3] All the statistics given in this section were gathered from official national publications of the countries analyzed.

**Table 1. Changes in the foreign investment policies of selected countries of Central and Eastern Europe**

| Stages – characteristics | Poland | Hungary | The Czech Republic[a] | Slovakia[a] |
|---|---|---|---|---|
| I. First phase of transformation: | X | X | X | X |
| 1. Provision of basic guarantees for foreign investors. | X | X | X | X |
| 2. Granting of greater privileges to foreign investors than to domestic | X | X | | |
| 3. Protective tariff measures (automobile industry)) | X | X | | |
| 4. Tax incentives | X | X | X | X |
| 5. Restrictions | X | | X | X |
| II. Mid -1990's (WTO, OECD) Deregulation. Gradual implementation of the principle of equal treatment for domestic and national enterprises. | X | X | X | |
| 1. Elimination of the requirement to obtain special permission. | X | | | |
| 2. Partial liberalization of the regulations concerning purchase of real estate by foreigners. | X | X | | |
| 3. Freedom to engage in FDI for citizens of member state countries of the EU | X | X | X | X |
| 4. Freedom to engage in FDI for citizens of member state countries of the OECD | X | X | X | |
| III. End of 1990"s Competition for DFI: incentives-based policies | X | X | X | |
| 1. Tax incentives | | X | X | |
| 2. Subsidies and grants | | X | X | |
| 3. Special economic zones | X | | | |
| 4. Free-trade zones | | X | | |
| 5. Special regulation of activities | | | | |

| | | | | | |
|---|---|---|---|---|---|
| such as off shore | | | X | | |

Note that until 1.01.1993 The Czech Republic and Slovakia were one state.

**Table 2. Deregulation and regulation in foreign trade in selected CEFTA countries**

| PHASE | DEREGULATION INSTRUMENTS | REGULATION INSTRUMENTS | EFFECTS |
|---|---|---|---|
| 1. **Preliminary transformation period 1989-1991** | Lowering of tariffs in all directions as a result of the „shock therapy" program in Poland – changes in the methods of accounting for foreign trade among the countries of Central and Eastern Europe – abolition of foreign trade monopolies. | | **Preliminary reorientation in the direction of foreign trade** |
| 2. **Signing of the European Association Agreements and coming into force of the Transitional Agreements; signing Agreements with EFTA and CEFTA. 1992-1993** | 1. Lowering of tariffs on foreign trade with the EC by about 27% for **manufactured** products imported from the EC/EU in 1992; one-time lowering of customs duties on agricultural products by 10%.<br>2. Preliminary reduction in customs duties for about 1/3 of imports from CEFTA and EFTA | **Introduction of administrative border procedures in effect in the EC in the form of the SAD (Single Administrative Document)**<br><br>**Anti-dumping clauses** | Applicable to hemitite natural products (1992), artificial fertilizers (1993), Portland cement (1994-1996), zinc (1995), wooden pallets (1995) |
| 3. **Entry into force of the European Association Agreements; -beginning of the liberalization process in the services market; continuing reduction of customs duties on goods within the framework of the Agreements with the UE, EFTA and CEFTA.** | **1995—1999:** implementation of reductions in customs duties on all remaining manufacturing products with the exception of automobiles, liquid fuels, and steel; graduated reductions in customs duties on agricultural products (in accordance with the WTO).<br>**2000-2001 –** implementation of reductions of all remaining tariffs on manufactured products; elimination of contingents on used cars and cars with catalysers;<br>**1994-** Granting of national treatemnt clauses for the construction sector with | **A general protective clause against excessive imports**<br><br>**A clause to avoid scarcities or shortages on the domestic market**<br><br>**A clause to avoid escessive trade imbalances** | Prohibition on the import of used combines(1994-1996); used motor vehicles older than 3 years (1994-1997); increased customs duties for used motor vehicles (1994-2001). Restrictions on the export of natural leather and leather goods; prohibitions and restrictions on the export of various scrap-iron products and waste materials from steel and cast-iron.<br><br>Introduction of a border-crossing tax from 1992-1996, incrementally reduced from 6% to 3% to 0%. |

| PHASE | DEREGULATION INSTRUMENTS | REGULATION INSTRUMENTS | EFFECTS |
|---|---|---|---|
| | the EU<br><br>**1995-1998** Acceptance of national treatment clauses for the remaining service sectors with the exception of the financial services, legal, transactional, and real estate agency sectors.<br>**1999-2003**- Granting of nationality treatment clauses for financial services, telecommunications, legal, and transactional sectors as well as for the installation and service of high tension electric wires and natural gas pipelines. | **A clause to combat monopolistic practices**<br><br>**A restructuring clause**<br><br>**A clause concerning the application of restrictions on foreign currency transactions:** it allows them to be applied in the granting or contracting of short-term and medium-term credit in such a manner that is not inconsistent with the provisions of the IMF | ----<br><br>Three such clauses were applied in Poland – in1994-1996 concerning telecommunications equipment; in 1998 as a result of negotiations with the EU a six-percent protective tariff for steel was extended for one year;<br>and from 1996-2000 a special customs duty based on the principle *erga omnes* was in force on petrochemical products |
| 4. **Membership in the WTO (15.IV 1994)** | 1. Liberalization of customs duties on manufactured goods by approx. 39% between 1995-1999<br>2. Liberalization of customs duties on agricultural products (following earlier implementation of tariffs) by 36% on average between 1996-2001<br>3. Liberalization of customs duties on high-tech goods within the framework of the ITA Agreement (Information Technology Agreement). Following | **Supporting export by the granting of export credit subsidies** (allowable in accordance with the WTO Agreement for countries "in transition" until 2002.).<br>Granting of income tax incentives for investment, so long as the same do not constitute prohibited state aids for export to the EU.<br>Granting of insurance and guarantees for export, including the guaranteeing of export credit insurance by State national treasuries. | Each year Poland's ratified budget sets a limit on monies which can be set aside for interest rate subsidies for export credit (in the 1999 budget this limit was 6.7 million USD, and in 2000 the sum of 10 million USD was envisioned). In practice, however, almost no enterprises apply for such interest rate subsidies. The authorizing regulations for the grant of such subsidies will expire in January, 2002.<br><br>In Poland, a special institution, the **Polish Corporation for Export Credit** |

| PHASE | DEREGULATION INSTRUMENTS | REGULATION INSTRUMENTS | EFFECTS |
|---|---|---|---|
| | implementation of the ITA in Poland in 1998 Poland reduced customs duties on most of the applicable products by 50%. Total abolition of customs duties on covered products took place in 2000. | | **Insurance Guarantees**, known as KUKE, S.A.[4], has been set up to handle the granting of export credit insurance guarantees offered by the National State Treasury. In addition a Policy Committee for Export Credit Insurance Guarantees has been established to elaborate the principles and guidelines for implementation of such aid.[5] The use of such export credit insurance guarantees in relation to overall export has been almost nil, however. In 1994 only 0.5% of overall export was covered by export credit insurance guaranteed by KUKE, which rose to only 1.12% in 1995, 1.45% in 1996, and 1.36% in 1997, and 1.89% in 1998.<br><br>The Czech Republic's **Corporation for Guarantees and Export Credit Insurance**, known as **EGAP**, was established in 1992 and capitalized by the State in order to oversee the Government's program of export credit subsidies. A special government fund has been set up to provide such subsidies, which are granted to cover up to 70% of the difference between existing national interest rates and international rates for export credit |

[4] The capital structure of this corporation is dominated by state ownership (97% of equity is owned by the State Treasury and the Polish National Bank). The corporation is supervised by the Ministry of Finance.

[5] This Committee was established by the Act of Feb. 21, 1997 (Dz. U. 1997, nr. 28, pos. 154).

| PHASE | DEREGULATION INSTRUMENTS | REGULATION INSTRUMENTS | EFFECTS |
|---|---|---|---|
| | | **Financing of export credit for domestic enterprises from public funds.**<br><br>Implementation of ISO standards. | covering foreign investment products.<br>**Export credit from public funds** is not available in Poland. Enterprises wishing to take out export credit must apply to commercial banks (either national or international) and such credit is thus available only at market rates. Because of the high cost of this type of credit it is seldom used in Poland.<br><br>On the other hand the **Exim Bank of Hungary**, established exclusively with State capital, was created to support Hungarian export either by providing direct export credit or making available funds to refinance export credit taken out through commercial banks. The total portfolio value of such preferential export credit supplied by the Hungarian Corporation for Export Credit (MEHIB) reached 800 million USD in 1998..<br><br>It is estimated that approximately 3000 firms in Poland have adopted ISO standards as of the beginning of 2001. |
| **Membership in the OECD - 1996** | | **Export credit granted at preferential interest rates pegged to the CIRR referential rate**<br>**Governmental Export Credit for the export of goods and services connected with developmental aid**<br>Developmental aid is regulated by the OECD Consensus[6] as well as the | **Poland is presently weighing the introduction of this instrument in 2002.** |

| PHASE | DEREGULATION INSTRUMENTS | REGULATION INSTRUMENTS | EFFECTS |
|---|---|---|---|
| | | regulations of the ODA (Official Development Assistance). Such aid may be the subject of either bi-lateral or multi-lateral treaties. Since 1998 Poland, Hungary, and the Czech Republic have observer status in the Consensus group. | |
| **5. Preparation for membership in the European Union.** | | **Implementation of EU directives regarding norms and technical standards for veterinary products, phitosanitary products, and consumer protection and ecological norms.** | By the end of 2002 Poland will have implemented approximately 170 EU directives and regulations concerning environmental protection; the remaining 14 are to be implemented between 2003-2010. As a result of the implementation of such directives and regulations to date, the share in Poland's overall export of environmentally harmful products was reduced from 57% to 46% between 1992-1998.[7] |

[6] See the "Arrangement on Guidelines for Officially Supported Export Credits" – a treaty establishing guidelines for the establishment of officially supported export credit, known in short as the OECD Consensus.

[7] Z. Wysokińska, Impact of Environmental Standards on Sustainable Competitiveness. The Case of Poland as a Country in Transition, Proceedings, IT&Fa, Washington D.C., 26-29 May, 2001.

**Table 3. Regulation and deregulation of international trade in Poland, 1989-2001**

| Phase | | Instruments | Effects |
|---|---|---|---|
| I. | **Beginning of transformation, 1989 – 1991. Signing of European Association Agreement.** | Provision of fundamental guarantees for foreign investors ( Act Concerning with Foreign Ownership, 1991) – freedom to transfer profits and capital abroad. Signing of Agreements protecting investments and avoiding double taxation. | **Cautious reaction by foreign investors:** DFI inflow in 1991 - 291 mln USD; (in the years 1985- 1990 the average annual inflow of DFI was 26 mln USD. |
| **II.** | **Entry into force of the Transition Agreement between Poland and the European Community - 1992.** | The Agreement did not implement the provisions of the European Association Agreement regarding free flow of capital. | Improvement in the general climate for investment; DFI increases more than two-and-a-half times in comparison to the previous year. |
| **III.** | **Entry into force of the European Association Agreement - 1994** | The Agreement committed both sides to assuring the free flow of capital for DFI involving companies created in accordance with the laws of the host country as well as for investments involving solely-owned enterprises created by citizens of the signing member countries. Concurrent with the entry into force of the Agreement, the EU bound itself to impose no new foreign currency restrictions; Poland is similarly bound with the beginning of the second phase of the Agreement's implementation. | The direct effects of the entry into force of the Association Agreement are difficult to define. Surveyed investors cited it as having a direct effect on their decisions to invest, and for creating a climate of economic stabilization. The yearly inflow of DFI in 1994 was 2.8 times larger than in 1992. |
| IV. | **Conclusion of the Uraguay Round. Poland joins the WTO – 1994/1995** | Entry into force of the Agreement on Trade-related Investment Measures. Poland commits itself to abolishing, within 2 years, incentive policies for foreign investors which have the effect of deforming or disorganizing foreign trade. Local content requirements, trade balancing requirements, maximum import limitations, exchange restrictions, and domestic sales requirements are categorically prohibited. | In 1995 the inflow of DFI in Poland increases by 95% in comparison to 1994. |

**Table 3. Regulation and deregulation of international trade in Poland, 1989-2001 – continuation**

| | | | |
|---|---|---|---|
| **V.** | **Poland's membership in the OECD 1995/1996** | Poland obliges itself to implement the principle of equal treatment of foreign and domestic investors; the liberalization of capital flow restrictions in relation to the member-countries of the OECD; as well as the partial liberalization of restrictions limiting the purchase of real estate by foreigners. Poland partially realizes its obligations in 1996 with the passage of amendments to the law concerning companies with foreign ownership and to the law concerning purchase of real estate by foreigners. It introduces a 3 year transition phase to implement the free flow of capital, including short-term capital. | The annual inflow of DFI to Poland in 1996 was approximately 4.5 bln USD, 22% higher than the previous year. |
| VI. | **Implementation of Poland's commitments as a member of the OECD and preparation for membership in the EU: 1996-2001** | Passage and entry into force of a new Act known as the „Law Governing Business Activities", which implements the principle of equal treatment of foreign and domestic investors (passed on Nov. 19, 1999 and entry into force on Jan. 1, 2001.) Legislative work in the Polish Parliament (Sejm) has resulted in a draft „European Act" which is designed to eliminate the remaining barriers to foreign investment in Poland. | In the years 1997 – 1999 FDI inflow into Poland increased by 1.5 times. According the data of Poland's Agency for Foreign Investment (PAIZ), which is not based on official statistical data, in the year 2000 FDI inflow into Poland was 10.6 bln USD, and the accumulated total of foreign capital currently invested in Poland is 49.4 bln USD. |

Source: own calculations.

**Table 4. FDI inflows into the Czech Republic, Slovakia, Hungary and Poland in 1991–1999**

**(USD million, %)**

| Country | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|---|---|---|---|
| Total CEE countries | 2448 | 4439 | 6757 | 5932 | 14267 | 12697 | 19034 | 19963 | 21420 |
| Of which: | | | | | | | | | |
| Former Czechoslovakia | 600 | - | - | - | - | - | - | - | - |
| Slovakia | - | 100 | 168 | 245 | 195 | 251 | 206 | 631 | 322 |
| Czech Republic | - | 1003 | 653 | 869 | 2562 | 1428 | 1300 | 2720 | 5108 |
| Hungary | 1462 | 1471 | 2339 | 1146 | 4453 | 2275 | 2173 | 2036 | 1944 |
| Poland | 291 | 678 | 1715 | 1875 | 3659 | 4498 | 4908 | 6365 | 7500[a)] |
| FDI inflows into Czech Republic, Hungary, Poland as % of total inflows into CEE countries | 96,1 | 73,3 | 72,1 | 69,7 | 76,2 | 66,6 | 45,1 | 58,9 | 69,4 |

a) Estimates

Source: UNCTAD FDI/TNC data base and own calculations.

**Table 5. FDI inward stock in the Czech Republic, Slovakia, Hungary and Poland in 1990–1999 (USD million, %)**

| Country | 1990 | 1995 | 1998 | 1999 |
|---|---|---|---|---|
| Total CEE countries | 2959 | 36355 | 84153 | 102697 |
| Of which: | | | | |
| Slovakia | 81 [a] | 1248 | 2502 | 2044 |
| Czech Republic | 1360 [a] | 7352 | 14375 | 16246 |
| Hungary | 569 | 10007 | 15862 | 19095 |
| Poland | 109 | 7843 | 22479 | 29979 |
| FDI inward stock in above countries as % of CEE total FDI inward stock | 71.6 | 72.8 | 65.6 | 65.6 |

a) Stock data prior to 1992 are estimated by subtracting flows.

Source: As in table 5.

**Table 6. Selected indicators of the importance of FDI in CEECs**

| Country/region | Inward FDI stocks as a percentage of GDP, 1998 (%) | Inward FDI stocks per capita, 1999(USD) | Inward FDI flows as a percentage of gross fixed capital formation, 1998(%) |
|---|---|---|---|
| Slovakia | 12.1 | 464[a)] | 7.6 |
| Czech Republic | 26.1 | 1580 | 17.5 |
| **Hungary** | 33.2 | 1897 | 18.3 |
| Poland | 15.1 | 776 | 15.8 |
| CEE countries average | 12.1 | - | 12.9 |
| The world average | 13.7 | - | 11.1 |

a) 1998

Source: UNCTAD, GUS and my own calculations.

**Table 7. Realignment of Foreign Trade in Poland, the Czech Republic, Slovakia, and Hungary (in%)**

| Year | Poland | | The Czech Republic | | Slovakia | | Hungary | |
|---|---|---|---|---|---|---|---|---|
| | Eastern Europe and the former USSR | EC/EU | Eastern Europe and the former USSR | EC/EU | Eastern Europe and the former USSR | EC/EU | Eastern Europe and the former USSR | EC/EU |
| **Import** | | | | | | | | |
| 1985 | 54,3 | 20,4 | 74,8 | 8,9 | | | 49,5 | 21,8 |
| 1989 | 32,2 | 34,2 | 55,0 | 18,0 | | | 39,3 | 29,1 |
| 1990 | 21,9 | 45,8 | 43,8 | 24,0 | | | 31,7 | 32,5 |
| 1995 | 15,4 | 64,7 | 24,3 | 61,1 | 52,0 | 34,8 | 22,1 | 61,5 |
| 1997 | 14,5 | 63,8 | 21,1 | 51,5 | 46,7 | 39,5 | 17,8 | 62,8 |
| 1999 | 14,0 | 65,0 | 17,4 | 64,0 | 22,8 | 51,7 | 14,4 | 64,4 |
| **Export** | | | | | | | | |
| 1985 | 48,3 | 23,8 | 70,5 | 9,5 | | | 52,4 | 16,0 |
| 1989 | 34,9 | 32,7 | 53,9 | 18,5 | | | 41,1 | 25,0 |
| 1990 | 21,4 | 47,2 | 42,5 | 26,9 | | | 28,5 | 35,2 |
| 1995 | 17,3 | 70,1 | 25,8 | 61,0 | 52,1 | 37,4 | 20,0 | 62,8 |
| 1997 | 24,1 | 64,2 | 26,8 | 60,2 | 46,7 | 39,5 | 15,4 | 71,2 |
| 1999 | 17,1 | 70,6 | 19,5 | 69,2 | 28,9 | 59,5 | 12,7 | 76,2 |

Source: Own calculations based on official national statistics of the countries analyzed.

Overall import and overall export = 100%.

**Table 8. Trade balances of the countries of Eastern and Central Europe with the EC (in mln dol.)**

| Year | Czechoslovakia | The Czech Republic | Slovakia | Hungary | Poland |
|---|---|---|---|---|---|
| 1970 | -42,7 | | | -37,8 | 30,7 |
| 1975 | -234,4 | | | -382,3 | -1.512,1 |
| 1980 | 4,5 | | | -325,9 | 114,5 |
| 1985 | 108,1 | | | -402,0 | 518,8 |
| 1990 | 50,9 | | | 417,3 | 2.309,5 |
| 1995 | | -2.237,3 | 159,6 | -1.437,7 | -2.742,8 |
| 1999 | | 132,5 | 222,2 | 1.010,2 | -10.491,5 |

Source: same as Table 7.

**Table 9. Export share of „sensitive" goods (textiles, coal and steel and their products, agricultural products) in overall export to the EC/EU (in %)**

| Goods | Year | Czechoslovakia | The Czech Republic | Slovakia | Hungary | Poland |
|---|---|---|---|---|---|---|
| Textiles | 1990 | 9,3 | | | 9,3 | 5,7 |
| | 1995 | | 7,84 | 11,19 | 13,91 | 15,95 |
| | 1997 | | 8,39 | 10,17 | 9,12 | 15,38 |
| | 1999 | | 6,27 | | 7,55 | 13,58 |
| Coal | 1990 | 3,2 | | | - | 8,1 |
| | 1995 | | 3,59 | 0,02 | 0,21 | 5,44 |
| | 1997 | | 2,05 | 0,03 | 0,00 | 5,55 |
| | 1999 | | 1,12 | | 0,03 | 3,60 |
| Steel | 1990 | 13,3 | | | 5,2 | 7,4 |
| | 1995 | | 7,94 | 14,13 | 3,62 | 4,64 |
| | 1997 | | 5,40 | 11,46 | 1,89 | 3,51 |
| | 1999 | | 3,13 | | 0,99 | 2,60 |
| Agricultural Products | 1990 | 7,9 | | | 28,4 | 18,3 |
| | 1995 | | 5,30 | 2,81 | 14,49 | 8,03 |
| | 1997 | | 2,99 | 2,28 | 7,91 | 7,17 |
| | 1999 | | 3,76 | | 5,95 | 6,15 |

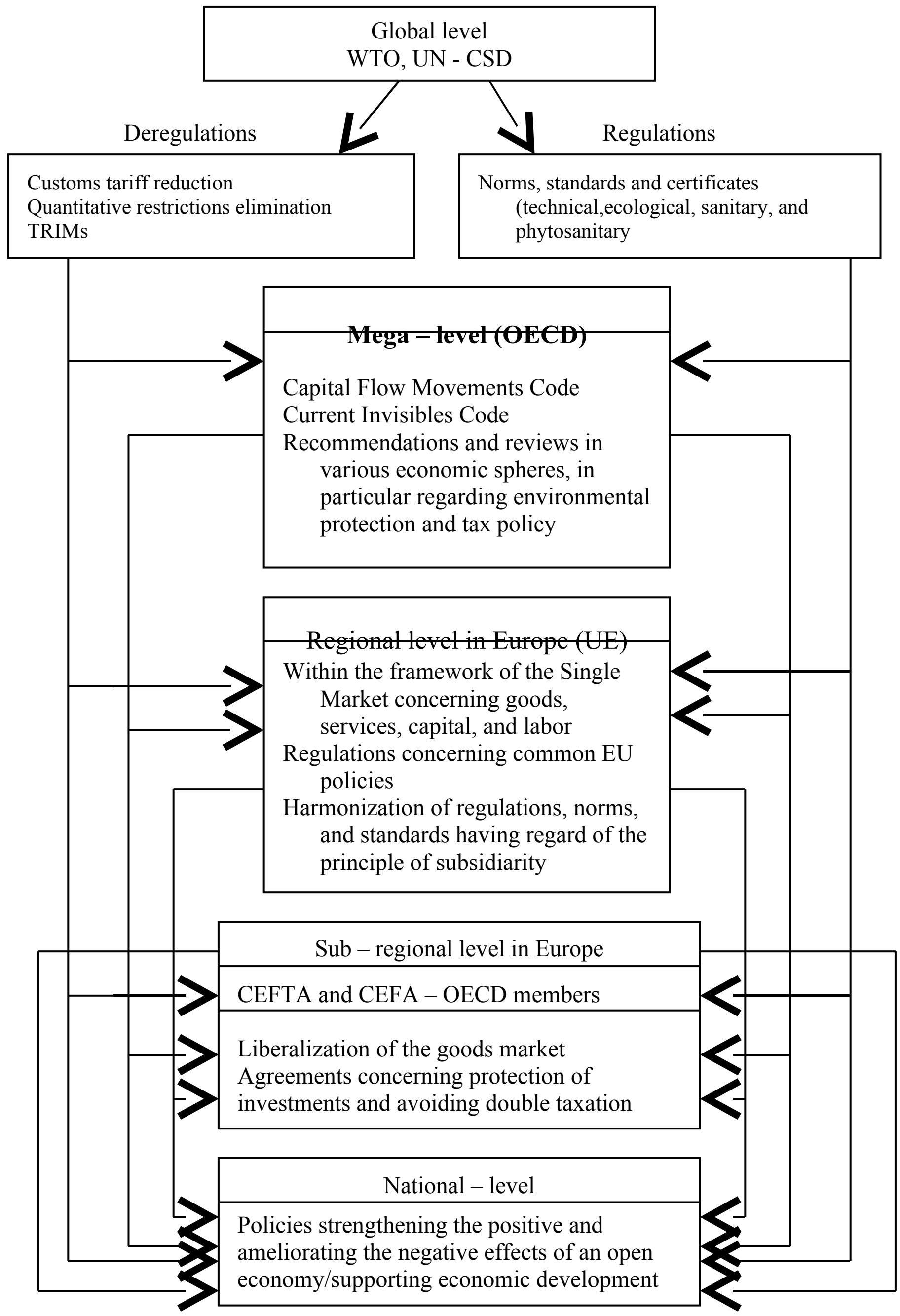
Source: same as Table 7.

**Table 10. Geographical Structure of High-Tech Exports, 1980-1997 ( in %)**

| Region | Year | Overall High-Tech Goods | 541.5 | 752 | 764 | 776 | 792 | 87+881+ 884+885 | 951 |
|---|---|---|---|---|---|---|---|---|---|
| Worldwide | 1992 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 |
| | 1995 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 |
| | 1996 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 |
| | 1997 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 | 100,00 |
| The Czech Republic | 1992 | 0,01 | 0,00 | 0,01 | 0,05 | 0,00 | 0,01 | 0,01 | 0,06 |
| | 1995 | 0,10 | 0,02 | 0,06 | 0,11 | 0,08 | 0,00 | 0,21 | 0,13 |
| | 1996 | 0,11 | 0,01 | 0,06 | 0,13 | 0,06 | 0,15 | 0,19 | 0,40 |
| | 1997 | 0,12 | 0,03 | 0,06 | 0,10 | 0,06 | 0,26 | 0,18 | 0,53 |
| Hungary | 1992 | 0,10 | 0,33 | 0,01 | 0,30 | 0,01 | 0,08 | 0,11 | 0,21 |
| | 1995 | 0,08 | 0,46 | 0,01 | 0,24 | 0,02 | 0,01 | 0,12 | 0,11 |
| | 1996 | 0,07 | 0,37 | 0,01 | 0,19 | 0,02 | 0,01 | 0,13 | 0,12 |
| | 1997 | 0,26 | 0,30 | 0,82 | 0,24 | 0,03 | 0,00 | 0,13 | 0,14 |
| Poland | 1992 | 0,06 | 0,00 | 0,02 | 0,05 | 0,05 | 0,06 | 0,07 | 0,73 |
| | 1995 | 0,08 | 0,36 | 0,01 | 0,08 | 0,11 | 0,05 | 0,10 | 0,72 |
| | 1996 | 0,09 | 0,20 | 0,03 | 0,12 | 0,10 | 0,11 | 0,11 | 0,35 |
| | 1997 | 0,09 | 0,01 | 0,02 | 0,16 | 0,10 | 0,06 | 0,10 | 0,39 |
| Slovakia | 1992 | 0,01 | 0,00 | 0,00 | 0,01 | 0,00 | 0,00 | 0,01 | 0,11 |
| | 1995 | 0,04 | 0,00 | 0,01 | 0,05 | 0,00 | 0,01 | 0,09 | 0,91 |
| | 1996 | 0,04 | 0,00 | 0,00 | 0,06 | 0,00 | 0,00 | 0,07 | 0,78 |
| | 1997 | 0,03 | 0,00 | 0,01 | 0,08 | 0,01 | 0,01 | 0,07 | 0,05 |

Source: own calculations based on the data base COMTRADE/ONZ.

**Scheme 1. Deregulations and regulations in international business (FDI and foreign trade)**



Source: own elaboration.