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Polish Market of Production Factors and the Process of European Integration

Abstract

This paper analyses and evaluates the integration process between Poland and the European Union with respect to the market of production factors, paying special attention to FDI and the labour market. Some consequences of liberalization of the capital and labour markets for the Polish economy are also discussed. The integration processes taking place between Poland and other EU member states in the two segments of the factor market are irregular. Formal integration of the capital markets is complete and actual integration is well underway. The Polish labour market and labour markets in other member states have not been integrated yet, even though some countries have opened them to the Polish workers.

Introduction

The capital flows between Poland and highly developed countries, including EU member states, could be gradually liberalized, because Poland met the OECD membership requirements. This situation essentially boosted her preparations to introducing the free movement of capital already in the pre-accession period. On 1 October 2002, Poland established the freedom of foreign exchange transactions in relations with the OECD countries[1].

The process that allowed the free movement of capital and the freedom of establishment has extensively influenced the micro economic sphere in Poland.

[1] *Foreign exchange act of 27 July 2002*, Official Journal No 141, item. 1178.

The group of firms with foreign capital that appeared in the secondary sector of the Polish economy affects country's entire economy, as well as operations of domestic businesses, via the demonstration effects, cooperation with local firms and competition. In the Polish financial sector foreign financial institutions prevail. This fact affects the macro economic parameters, but mainly the operational environment of companies. The liberalization of the movement of capital (other than foreign direct investments – FDI) has provided domestic business organizations with better opportunities of becoming players in the European capital and financial markets.

This study analyses and evaluates the integration process between Poland and the European Union with respect to the market of production factors, paying special attention to FDI and the labour market, and the process's consequences for the Polish economy.

1. Foreign direct investments between Poland and other EU member states

Poland started to liberalize capital movements (FDI) in early 1990s. Successive Parliament Acts gradually introduced the national treatment rule, according to which foreign entrepreneurs (investors) cannot receive a less favourable treatment than domestic businesses. This triggered a surge of foreign investments flowing to the Polish economy. Another reason for FDI inflows, apart from the liberalization of regulations and basic guarantees for investors, was privatization that enabled the acquisition of domestic firms, as well as general processes boosting economic grow that clearly emerged in mid-1990s.

In the decade of the 1990s and at the beginning of the 21st c., the number of firms with foreign capital was growing steadily in Poland, as a combined effect of processes driving transition and integration with the EU. A GUS survey (Central Statistical Office) conducted in 2005 covered 16,837 enterprises with foreign capital, but the actual number of registered organizations was much larger than that[2]. A trend analysis reveals that the absolute numbers of registered foreign-owned firms increased the most at the outset of the transition period. Then the annual increases gradually declined (excluding 1996) and in 1998 the share of foreign-owned firms in the total number of organizations making up the national economy started to decrease. It must be remembered, however, that only part of the firms become operational following their registration; others

[2] *Działalność gospodarcza podmiotów z udziałem zagranicznym w 2005*, GUS, Warsaw 2006, p. 10.

decide to suspend their activities, launch a liquidation process, or the foreign partners withdraw**.**

According to UNCTAD estimates, by the end of 2005 foreign direct investors placed in Poland US$ 93.3 bn altogether. The amount exceeded over 2.5 times the stock of foreign direct investments made in Poland in 2000[3]. The annual inflow of FDI directed to Poland in 2005 was estimated at US$ 7.7 bn against US$ 12.9 bn one year earlier. This shows the amplitude of oscillations of FDI flowing to Poland. It must be remembered, however, that FDI inflows received by the Polish economy in years 2002 and 2003 were estimated at merely US$ 4 bn (see table 1). Unofficial data for 2006 show that the decline in FDI inflow to Poland was curbed and foreign investors' activity increased so much that in 2006 the inflow almost doubled compared with 2005. The factor that probably improves Poland's appeal to foreign investors is the country's economic growth and EU membership.

FDI structure by investor's country of origin indicates high intensity of FDI flows coming from the EU member states; the flows' absolute values kept growing, as well as their share in the total annual inflow of FDI. According to GUS surveys, the 2005 share accounted for 87%[4]. The major foreign investors in Poland are based in the Netherlands (27% of total foreign capital), Germany (16.3%), and France (15.9%)[5].

The position of firms with foreign capital in the Polish economy can be measured using a variety of indicators, such as:

1) the ratio of FDI stock to GDP,

2) the ratio of annual FDI flows to gross domestic investment,

3) the share of foreign-owned firms' revenues in total revenues,

4) the share of the firms' export and import in total export and import,

5) the ratio of employment in foreign-owned firms to total employment.

Transition and integration processes increased the foreign capital's involvement in the Polish economy via FDI and strengthened the position of foreign-owned firms among domestic businesses. This fact is evidenced by the following data:[6]

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[3] *Word Investment Report 2006.FDI from Developing and Transition Economies: Implications for Development*, UN, New York and Geneva 2006, Annex table B.2 and author's calculations.

[4] *Działalność gospodarcza podmiotów z udziałem zagranicznym w 2005…*, op.cit., p. 13.

[5] Ibidem.

[6] Based on UNCTAD, GUS and PAIiIZ data (Polish Information and Foreign Investment Agency) and author's calculations.

– FDI stock to GDP ratio increased from 0.3% in 1991 to 31.1% in 2005 (see table 2);
– annual FDI flows as a percentage of gross fixed capital formation increased from 1.8% in 1991 to 28.4% in 2004 and then declined to merely 14.6% in 2005 (see table 3);
– FDI structure by sector/branch indicates a decreasing share of FDI stock allocated to manufacturing, and a growing proportion of FDI in services (financial intermediation, trade, transport and telecommunications); such modifications of the sectoral structure of FDI follow trends that can be observed in highly developed countries;
– the role played by firms with foreign capital in the Polish economy is increasingly important. This is proved by their share in revenues derived from all types of operations conducted by all enterprises active in the national economy; the 2003 share was 38.8%, but in 2005 it went up to 50.9%;
– in 2005, firms with foreign capital employed 1,186,100 workers. Large firms with workforce exceeding 249 persons (5.3% of all foreign-owned firms) employed 68.7% of all workers. Employment in foreign-owned firms accounted for 9.2% of the economically active population and 12.9% of all workers with employment contracts in the national economy in 2005, and for almost 25% of those employed in the enterprise sector;
– when the firms' workforce is set against their revenues, then the production factor (labour) productivity turns out to be almost 4 times higher than for all firms;
– firms with foreign capital usually show a moderate propensity to export measured by the percentage of export sales in all types of revenues (20.6% in 2003)[7], but their participation in Poland's total export is essential (it reached 56.9% in the same year)[8];
– foreign-owned firms are relatively active investors; their 2005 spending on new fixed assets made up 28.7% of total investment outlays on fixed assets in the entire economy[9].

An analysis of foreign-owned firms' position in the Polish economy affirms the assumption that a group of organizations important for Poland's future economic growth has emerged. Because of their economic characteristics, they seem to be generally better prepared to competition in the single internal

[7] Calculated by the author based on: *Działalność gospodarcza…*, op.cit.

[8] B. Durka, J. Chojna, *Udział podmiotów z kapitałem zagranicznym w polskim handlu zagranicznym*, [w:] *Inwestycje zagraniczne w Polsce*, IKiCHZ, Warsaw 2004, p. 39.

[9] GUS data and author's calculations.

market than other businesses in the Polish economy. Relations between firms with foreign stakeholders and exclusively Polish-owned organizations are formed via competition as well as cooperation.

2. Benefits and costs arising from the integration of the capital and financial markets

Even the foreign-owned enterprises, probably the best prepared to become part of the single market, are not able to reduce costs and prices on a short notice, because the adjustment process of economic adjustments is not complete yet. In a longer perspective, however, we can expect that the analysed group of enterprises will become a growth-propelling element of the Polish economy able to survive the stiffening competition in the internal market, and that processes observable during the implementation and functioning of the EC single internal market will appear in the Polish economy too. Only then, the materialization of relationships discussed in the theory and practice of European integration will be possible[10]. On the one hand, costs should drop, which will probably reduce prices or increase firms' profit margins as well as their growth potential, and, on the other hand, the competitive pressures can be expected, compelling firm restructuring and bringing down so-called X-inefficiency. In the long term, the competitive pressures may also induce innovation and technological progress.

As we already indicated, the movement of capital between Poland and the EU countries was liberalized in the pre-accession period, which entailed substantial involvement of foreign capital in the Polish economy (also in forms other than FDI) and in operations in the Polish financial market. For the foreign capital, especially its types that are more mobile than FDI, accession means stability and higher transparency. The domestic investors and consumers should expect the same. For businesses operating in the capital and financial markets the most important are Poland's efforts to meet the convergence criteria. Stability of prices and lower interest rates influence all firms. As a result of consistent endeavours to meet the criteria, the returns on capital in the Polish economy would continue to gravitate toward the level of returns earned in the single market. Consequently, both business and consumer loans would become cheaper. Obstacles impeding domestic organizations' access to loans that can be observed today would be reduced, because of growing competition in the

[10] W. Molle, *Ekonomika integracji europejskiej. Teoria, praktyka, polityka*, Fundacja Gospodarcza NSZZ „Solidarność", Gdańsk 1995; J. Pelkmans, *European Integration. Methods and Economic Analysis*, Longman, Harlow-New York 1997 (2nd edition 2001).

banking sector and the availability of banking services in the single internal market. For businesses, the future introduction of a common currency would mean lower transaction costs.

Accession affects all segments of the capital and financial market and it is consequential for businesses. Regarding **foreign direct investment,** Poland can benefit from the investment creation and diversion effect, because accession strengthens her location advantages and makes more attractive to EC-based investors and those in the third countries. The intensity of FDI flow stimulation will depend on the GNP growth rate, as a strong correlation between FDI flows and GNP growth is well known. In the developed countries, a 1% increase (or a drop) in real GNP induced in a longer term a real FDI increase (or drop) by 3.4%[11]. Even if a slightly different relationship is assumed for a less developed country, the same multiplier mechanism working either upwards or downwards is certainly activated. If we add a suitable member state's policy towards foreign investors, aimed to enhance Poland's existing location advantages, then the FDI inflow can still be meaningful for the economy. This would mean further consolidation in the Polish economy of the group of foreign-owned enterprises capable of operating in the single market environment and competing. Considering that the privatisation is drawing to a close, the FDI inflow will mainly take the form of greenfield investments and create new jobs both in the entire economy and around the investing firms (indirectly, via cooperation and subcontracting). Apart from other benefits, the creation of new jobs and retention of the existing ones at home improve consumers' position and increases their demand, with all positive consequences of the process.

When an integrated group grows bigger, then firms operating on its territory seek optimal locations. In the case of Poland, this mechanism implies an inflow of investments directed both to mature industries offering low-priced and skilled workforce and technologically advanced industries, if seeds of clusters are planted. The other case requires that the emerging network of cooperation be supported by the technological policy measures, as well as adequate educational policy. Classical investments helping avoid customs tariffs should not be expected, when the tariffs are generally low and the protection of the Polish market against third countries' economic impacts has been additionally weakened with the acceptance of the external customs tariff. In the long term, offensive investments replacing imports are possible, as a reaction to the dynamic effects of the customs union, such as economic growth and market expansion.

[11] D. A. Julius, *Global Companies and Public Policy. The Growing Challenge of Foreign Direct Investment*, Printer Publishers, London 1990, pp. 28-29.

Within the enlarged integrated group, FDI reorganization and rationalization can also be anticipated. The enlargement will make transnationals modify their international manufacturing processes. In Poland, this course of events may lead to the liquidation of some offices and branches that the transnational corporations established in our country. However, Poland may benefit from an inflow of rationalised investments, i.e. those made by third countries, if the customs union's dynamic effects appear, such as cost reductions in the medium and long term and advantages offered by improving X-efficiency.

Accession did not expose the banking sector to major shocks owing to the substantial revealed advantage of foreign capital in the sector, as well as adjustments made. The banking sector will continue to consolidate, competition will keep building up, the range and quality of services will be tailored to meet customers' needs, and further interest rate reductions will be compelled. Stability and trust, so desired in the sector, will probably not be upset. Improved availability of investment loans can be expected.

The insurance sector is very likely to stabilize after accession and then it may expand in the long term, together with progressing economic growth and increasing wealth of consumers. More foreign investments are probable, as well as stronger competition and adjustment of products to consumers' likes and purchase power.

The market of securities, so sensitive to all kinds of changes, should benefit from lower uncertainty as to the future course of economic policy and Poland's determination to meet the convergence criteria. Even though the portfolio investors are driven by many factors, they will probably show a dose of optimism.

The above analysis of possible costs and benefits concerning the capital and financial markets suggests that benefits outnumber costs. Processes observed in various segments of the market indicate its growing internationalization and integration with the single capital and financial markets in the Community.

3. Assessment of integration processes taking place in the Polish labour market prior to accession

Trying to integrate country's labour market with the European Union is a difficult and long-lasting undertaking[12] and so processes taking place between

[12] Z. Wysokińska, J. Witkowska, *Integracja europejska. Dostosowania w Polsce w dziedzinie polityk*, PWE, Warsaw 2004.

the EU and Poland should be assessed in this context. Two analytical aspects can be identified:

- establishment of the freedom movement of persons/workers between the integrating parties;
- adjustment of laws regulating certain aspects of the market's functioning in Poland, which process is important for the entire group.

In the opinion of some EU member states, the free movement of persons and the Polish nationals' freedom to seek employment in the EU member states continues to be a difficult problem. The European Treaty granted Poland's workers a modest access to the EU labour market[13]. The Treaty provided only a general legal framework allowing Polish workers to seek jobs in individual member states, but the member states could independently decide on the scale of the access. This subject turned out to be the most difficult, when accession terms and conditions were negotiated. The Community established a seven-year interim period expressed by the formula 2+3+2 that restricts Polish workers' freedom of employment in the European Union[14]. During the first two years of the interim period, the EU member states could start opening their labour markets until all restrictions were removed. Some member states declared their being ready to unblock their labour markets the day Poland would access the EU and kept their promise. As a result, large numbers of Polish workers estimated at several hundred thousands to 2 million people migrated from the country. Poland decided to implement the reciprocality clause in the interim period, but on 17 January 2007, the country fully opened its labour market to workers from other member states[15].

[13] E. Kawecka-Wyrzykowska, *Przepływ pracowników*, [in:] *Unia Europejska. Integracja Polski z Unią Europejską*, Warsaw 1997, pp. 409-415; see also: *Rezultaty Układu Europejskiego w dziedzinach pozahandlowych*, [in:] *Unia Europejska. Przygotowania Polski do członkostwa*, E. Kawecka-Wyrzykowska (ed.), E. Synowie, IKiCHZ, Warsaw 2001, pp. 646-647.

[14] *Raport na temat rezultatów negocjacji o członkostwo Rzeczypospolitej Polskiej w Unii Europejskiej*, www. kprm.gov.pl

[15] *Regulation by the Minister of Labour and Social Policy dated 10 January 2007 that repealed the regulation defining the scope of restrictions applying to foreigners' employment on the territory of the Republic of Poland* (Official Journal Of Poland, No. 7, item 54).

Employment of foreigners in Poland

On 17 January 2007, the Minister of Labour and Social Policy published a regulation dated 10 January 2007, which repealed a regulation concerning the extent of restrictions applying to the employment of foreigners on the territory of the Republic of Poland (Official Journal of Poland, No. 7, item 54).

The new regulation has cancelled the obligatory possession of work permits by foreigners to whom interim periods stipulated in international agreements apply.

In practice, on 17 January 2007 nationals of Austria, Belgium, Denmark, France, the Netherlands, Lichtenstein, Luxembourg, Germany, Norway, and Switzerland were given the right to seek employment without having to apply for the obligatory work permit. Other citizens of the EU/EEA member states had already been granted the right under the reciprocality clause provided in the Treaty.

Consequently, all:

1) citizens of EU member states,
2) citizens of EEA member states other than EU members states, and
3) citizens of non-EEA states included in the free movement of persons under agreements the states signed with the European Community and its member states

can take jobs in Poland without requesting work permits.

Citizens of Bulgaria and Romania have been exempted from any employment restrictions since 1 January 2007, i.e. from the date the countries accessed the European Union. The citizens of the two countries are directly covered by article 87, item 1, par. 8, letter a) of the employment promotion and labour market institutions act of 20 April 2004 (Official Journal of Poland, No. 99, item 1001, with amendments). According to the article, EU citizens do not have to hold work permits. The repealed regulations imposing restrictions on foreign workers’ employment on the territory of the Republic of Poland did not apply to citizens of the two states.

Source: http//www.eures.praca.gov.pl.

The main reason for which negotiations of the accession treaty's provisions on the free movement of workers was difficult was some countries' concerns (chiefly Germany and Austria) that their labour markets might be destabilised, if such freedom were immediately available. In the case of Poland, arguments speaking for the introduction of an interim period were (and still are) a high rate of unemployment in the country, lower wages and generally lower living standard as measured by GDP per capita. The factors are the main short- and medium-term determinants underlying external migration of the labour force (a production factor)[16]. Some of the concerns are not so exaggerated.

In January 2007, the rate of unemployment in Poland stood at 15.1% and was lower by 5 percentage points than in January 2003[17]. In that month, the rate of unemployment reached a record high level in the last decade – 20.7% (data based on the National Census of Population and Housing and National Agricultural Census). Even though the rate declined, its level continues to spur out-migration among some groups of the economically active persons. In the pre-accession period, the following consequences of the free movement of workers between Poland and the EU were anticipated:

- net outflow of labour force from Poland to the EU, improving the condition of the Polish labour market,
- increased outflow of highly skilled workers to the EU member states, impairing Poland's economic efficiency[18].

The present situation in Poland partly confirms the predictions.

One working hour in Poland still costs much less than in the EU. In 2000, its cost per industrial worker in Poland was estimated at 4.3 euro, i.e. more than six time less than in Germany, where it was 27.5 euro (1999 data)[19]. The gap dividing labour costs in Poland and less developed EU member states was not that large. The cost of one working hour in Poland was over 3.5 times less than in Spain, over 2.5 times less than in Greece and only 1.5 less than in Portugal.

Labour costs per one hour of work in Poland in 2004 were 4.72 euros for one hour paid and 5.45 euros for one hour worked. Labour costs in industry were

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[16] J. Pelkmans, *European Integration…*, p. 188.

[17] GUS data, www.stat.gov.pl/dane_spol_gosp/praca_ludnosc/stopa_bezrobocia/index.htm.

[18] E. Kwiatkowski, *Integracja z Unia Europejską a polski rynek pracy*, Conference proceedings, Płock 2000, pp. 12-13.

[19] *Statistical Yearbook of Labour*, GUS, Warsaw 2001, p. 273 and author's calculations.

4.45 and 5.16 euros for one hour paid and one hour worked, respectively[20].

Although the differences may attract foreign investments to labour-intensive industries in Poland and thus keep groups of workers at home, they also contribute to variations in the earned income and motivate Polish workers to seek jobs in other member states.

Variations in earned income are a fact, which is confirmed by data on average gross nominal wages in Poland and some EU countries. In Poland, average wages in 1999 amounted to 395 euros in the entire economy (without agriculture, forestry, and fishery) and were over 1.5 times lower than in Portugal[21]. In the next years, the average levels of monthly wages increased. In 2004, an average wage was estimated at 557 euros[22].

The dynamics of average gross real wages in Poland and other CEE countries in the 1990s pointed to their growth. GUS data for Poland indicate that in years 1992-1999 they grew by 21%[23]. Between 2000 and 2005, the average level of gross nominal monthly wages increased by 25.6%[24]. However, the growth was not equal across all branches of economy and did not meet society's expectations, either. The present out-migration from Poland is induced by persisting and relatively high unemployment and wage trends.

Legal adjustments in the labour market in Poland aimed to help the country meet EU membership requirements applying to the following areas:[25]

- mutual recognition of professional qualifications,
- coordination of the social security systems,
- labour law,
- civil rights (right of residence and voting rights).

[20] *Koszty pracy w gospodarce narodowej w 2004r.*, GUS, Warsaw 2005, p. 40 and author's calculations; the calculations used euro/zloty exchange rate as of 31 December 2004.

[21] *Statistical Yearbook of Labour*, GUS, Warsaw 2001, p. 270 and author's calculations.

[22] *Concise Statistical Yearbook of Poland 2006*, GUS, Warsaw 2006, p.168 and author's calculations; the calculations used euro/zloty exchange rate as of 31 December 2004.

[23] *Statistical Yearbook of Labour*, GUS, Warsaw 2001, p. 272 and author's calculations.

[24] *Concise Statistical Yearbook 2006*, GUS, Warsaw 2006, p.168 and author's calculations.

[25] *Raport na temat rezultatów negocjacji…*, op.cit.; *Polska – Informacja do raportu okresowego Komisji Europejskiej'2002*, www.ukie.gov.pl; *Addendum do Informacji do raportu okresowego Komisji Europejskiej '2002; Analiza zmian w prawie polskim w związku z przystąpieniem Polski do Unii Europejskiej - konsekwencje dla konsumentów i przedsiębiorców*, UKIE, Warsaw, March-June 2003r., www.ukie.gov.pl.

Final remarks

The EU market of production factors is integrating, but the processes are long lasting and their course is rough. The capital market shows the highest degree of integration, but the labour market has not been sufficiently integrated yet[26]. In addition, the integration processes taking place between Poland and other EU member states in the two segments of the factor market are irregular. Formal integration of the capital markets is complete and actual integration is well underway. Freely moving flows of foreign direct investments between Poland and other member states exert a stronger and stronger influence on the Polish economy. Poland's membership in the EU made her a more attractive place for foreign investments.

The Polish labour market and labour markets in other member states have not been integrated yet, even though some countries have opened them to Polish workers. Forecasts of the possible impacts of Poland's EU membership on the labour market have come true. Factors that encourage out-migration from Poland are the relatively high rate of unemployment and low incomes.

Table 1. Foreign direct investments in Poland, years 1989-2005, US$ million

Year[a]	Cumulated FDI		Annual flows of FDI	
	UNCTAD data	PAIiIZ data[b)]	UNCTAD data	PAIiIZ data[b)]
1989	231 [c)]	.	11	.
1990	320	.	89	.
1991	611	.	291	.
1992	1 289	.	678	.
1993	3 004	2 830	1 717	2 830
1994	4 879	4 321	1 875	1 491
1995	7 843	6 831	3 659	2 510
1996	11 463	12 028	4.498	5 197
1997	16.593	20 588	4.908	5 678
1998	22.479	30 651	6.365	9.574
1999	29.979	38 913	7.270	7.891
2000	34 227	49 392	9 341	10 601
2001	42 433	56 806	5 713	7 119

[26] See J. Witkowska, *Rynek czynników produkcji w procesie integracji europejskiej. Trendy, współzależności, perspektywy*, Wyd. UŁ, Łódź 2001; Z. Wysokińska, J. Witkowska, *Integracja europejska. Dostosowania w Polsce w dziedzinie polityk*, PWE, Warsaw 2004.

Table 1. Foreign direct investments in Poland, years 1989-2005, US$ million – continuation

Year[a]	Cumulated FDI		Annual flows of FDI	
	UNCTAD data	PAIiIZ data[b)]	UNCTAD data	PAIiIZ data[b)]
2002	47 900	65 087	4 131	6 064
2003	52 125	72 047	4 589	6 420
2004	61 427	-	12 873	-
2005	93 329	-	7 724	-

Notes: a) Data as of the end of the year;
b) PAIiIZ data (Polish Information and Foreign Investment Agency) concern investments in excess of USD 1million;
c) FDI stock in Poland was estimated at US$ 220m;
d) Estimates.
Source*:* UNCTAD and PAIiIZ.

Table 2. FDI stock to GDP ratio, years 1991-2005

Country	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Poland	0.3	1.7	3.6	5.1	6.2	9.7	11.6	15.1	17.2	20.6	22.4	25.0	24.9	25.4	31.1

Source: UNCTAD data.

Table 3. Share of annual FDI flows in investment outlays on gross fixed assets, years 1991-2005

Country	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Poland	1.8	4.6	12.6	10.5	15.5	15.1	14.5	15.9	18.4	23.8	14.9	11.4	11.1	28.4	14.6

Source: UNCTAD data.