



## THE FOREIGN DIRECT INVESTMENT ENVIRONMENT IN POLAND

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## Introduction

Multidimensional nature of economic processes typical for modern world and the intensity of inter-linkages between economic actors in the global market are manifested on the unprecedented scale. This process is enhanced as a result of increasing globalization, which leads to the loss of all kinds of boundaries, such as time and space, national-state boundaries, boundaries of the economies, industries and organizations, as well as less tangible boundaries, such as cultural norms<sup>1</sup>. This kind of conditions in the global economy imply the intensification of activities of foreign investors looking for suitable locations for their projects. Investors are forced to modify their activities in terms of the assumed and desired objectives and methods of operating. These decisions should be based on the values typical of a global orientation: complexity, creativity, future orientation and performance, and cooperation<sup>2</sup>. Transnational corporations, in addition to traditional exports, use foreign direct investment (FDI) to take advantage of demand in local markets.

FDI inflow is the most desirable form of absorption of foreign capital. From the host country's perspective, it does not result in an increase in foreign debt, which is characteristic for other sources of external financing such as loans and credits. FDI contributes to increase the level of innovation of the country through the additional effects such as transfer of modern technology and know-how in organization and management.

Factors which cause the inflow of FDI in the literature are called locational qualities<sup>3</sup> that determine the place of investment location. Their quality also determines the level of investment risk and investment attractiveness of the country. The capital is invested where most favorable conditions for business and profit prospects dominate. Intensive competitive struggle continues to raise foreign capital. Knowledge about the location qualities, which anticipate the choice of the country as an investment location, plays a major role in the economic development and a proper adaptation of policy of expanding FDI inflows.

Stage of economic development determines the level and nature of competitiveness of its economy, hence countries at different levels of development attract a different nature of foreign investment. In developing countries, it is FDI searching of the cheaper factors of production, which dominates. Then there is FDI aimed at productivity and the inexpensive workforce, while in the most developed countries there is FDI that is seeking strategic and knowledge-based assets.

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<sup>1</sup> B. Siuta, P. Litwa, *Determinanty lokalizacji bezpośrednich inwestycji zagranicznych w świecie*, Zeszyty Naukowe Akademii Ekonomicznej w Krakowie, nr 731, 2006, s. 309.

<sup>2</sup> Ibidem, s. 310.

<sup>3</sup> M. Majewska, *Determinanty napływu zagranicznych inwestycji bezpośrednich w świetle konkurencyjności gospodarki Polski*, [w:] D. Kopycińska (red.), *Problemy wzrostu gospodarczego we współczesnych gospodarkach*, Wyd. PRINT GROUP, Szczecin 2006, s. 103.

The scientific literature marks out a wide range of factors that affect investors' decisions where to invest capital. J.H. Dunning, one of the leading theoreticians of the phenomenon of transnational corporations' (KTN) operating, has proposed a division of decision-making motives into four groups: market-based, based on the resources, based on the efficiency and strategy<sup>4</sup>. In traditional sense, FDI inflows are determined primarily by<sup>5</sup>:

- size and the absorption of the internal market;
- inexpensive and well - skilled workforce;
- geopolitical position;
- international policy;
- international position.

In contrast, other studies indicate much more complex factors affecting investment attractiveness in the scale of both the economy as a whole, as well as its individual regions. Crucial, in this context, are<sup>6</sup>:

- economic image of the location;
- mental attitude of the population;
- positive attitude of local authorities in relation to investors;
- the social climate;
- promptness and flexibility of administration;
- attractiveness of the place;
- communication connections;
- supply of skilled workforce;
- taxes, incentives, subsidies;
- outlet in the region;
- vocational training centers;
- cultural and entertainment offer;
- research institutes and the possibility of cooperation;
- supply of production space, office, warehouse, etc.;
- proximity to suppliers and subcontractors.

In terms of increasing FDI inflows it is appropriately targeted policy of the considered state, which plays a strategic role. Such a government activity should be manifested itself in the right identification of the host country's interests, correlated with the interests of foreign investors.

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<sup>4</sup> A. Zaorska (red.), *Korporacje transnarodowe w Polsce. Wyzwania w dobie globalizacji i regionalizacji*, Difin, Warszawa 2002, s. 48

<sup>5</sup> B. Siuta, P. Litwa, *Determinanty lokalizacji...*, op. cit., s. 3.12.

<sup>6</sup> E. Dobrodziej, *Kapitał zagraniczny w Polsce*, Oficyna Wydawnicza Ośrodka Postępu Organizacyjnego, Bydgoszcz 1999, s. 123.

This study aims to analyze the factors which increase and reduce (limit) FDI inflows into Poland. A proper understanding of the conditions affecting the choice of investment projects locations is crucial for the policy of FDI inflows stimulating in countries that connect their economic development with the influx of foreign capital.

## 1. Foreign Direct Investment in Poland: synthetic picture

Started in 1990, systemic changes in Poland have resulted in favorable modification in terms of legislation, institutional, and economic regulations. In this way, the transformation has created favorable conditions for FDI inflows. Poland is systematically strengthening its position among a group of the fastest developing countries in Central and Eastern Europe. The strength of this phenomenon is demonstrated by \$ 85 billion invested in Poland since the beginning of the 90s<sup>7</sup>.

It should also be noted that in according to the methodology of the World Economic Forum, Poland is in the transition period between stages of economic development based on improving economic efficiency and the highest stage - stage of the economy based on innovation. It shows the high competitive position of Poland in terms of FDI attracting, which results in the transfer of innovative solutions. Different stages of economic development have been presented in Table 1.

**Table 1 Stages of economies' development according to them methodology of the World Economic Forum<sup>8</sup>**

Stage of development	GDP per capita at current prices(in USD)
Stage 1 – Factor driven	< 2000
Transition from stage 1 to stage 2	2000-3000
Stage 2 – Efficiency driven	3000-9000
Transition from stage 2 to stage 3	9000-17000
Stage 3 – Innovation driven	> 17000

Source: *The Global Competitiveness Report 2008-2009*, WEF 2008, p. 7., ([www.weforum.org/pdf/GCR08/GCR08.pdf](http://www.weforum.org/pdf/GCR08/GCR08.pdf))

Companies operating on the global market are willing to choose Poland as the place of their investments in Europe. A number of new investment projects is growing steadily. This trend is particularly evident in the following sectors: R&D services, automotive, electronic and chemical ones.

Since 2000, Poland has recorded an increasing trend in FDI inflow. Table 2. shows FDI inflows into Poland in the years 2000-2007. FDI in 2007 amounted to 119.707 million. Comparing to the previous year, they increased by 24.153 million € (25.3%). In 2008, there was a decline in the value of liabilities of foreign direct investment, which amounted to 115.116 million. This decrease was due to the depreciation of the zloty by 16,5% in relation to the euro<sup>9</sup>.

<sup>7</sup> *Perspektywy polskiej gospodarki*, Ministerstwo Finansów, Warszawa, wrzesień 2006, s. 3.

<sup>8</sup> WEF conducts research on sustainable economic growth and social well-being since 1979. Rankings are compiled on the basis of the Global Competitiveness Index and published in the annual Global Competitiveness Reports.

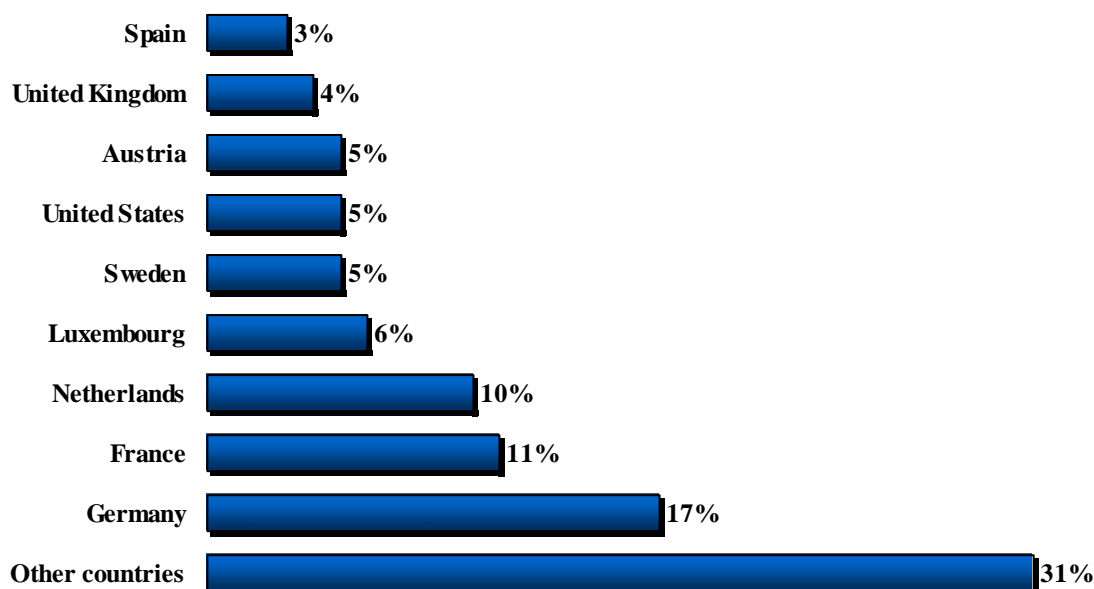
<sup>9</sup> *Information about foreign direct investment in Poland in 2007*, National Bank of Poland, Warsaw 2008.

**Table 2 Foreign Direct Investment in Poland (million EUR)**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>Foreign Direct Investment in Poland</b>	36.792	46.686	46.139	45.896	63.601	76.785	94.554	119.707	115.106
<b>Equity capital and reinvested earnings (profits)</b>	27.253	35.100	34.365	33.239	50.879	61.779	74.884	94.4431	87.313
<b>Other investments</b>	9.539	11.586	11.774	12.657	12.808	15.006	20.670	25.276	27.793

Source: Based on International investment position of Poland in 2007, National Bank of Poland, Warsaw 2008, p. 13., ([www.nbp.pl/statystyka/dwn/iip2007.pdf](http://www.nbp.pl/statystyka/dwn/iip2007.pdf)) and data for the period 1994-2008 ([http://www.nbp.pl/home.aspx?f=/statystyka/m\\_poz\\_inwest.html](http://www.nbp.pl/home.aspx?f=/statystyka/m_poz_inwest.html)).

In turn, a strong increase in FDI inflows into Poland in 2000-2007 resulted primarily from transactions recorded in the balance of payments (the purchase of shares Polish direct investment companies and a positive balance of merchandise trade) and the favorable exchange rate differences, and also appreciation of the zloty in relation to the major world currencies. In that year the largest inflow of capital (87%) from EU countries was recorded, mainly from Luxembourg, the Netherlands, Germany and France<sup>10</sup>. In terms of FDI inflows into Poland, the rising trend is evident, as a result of relatively low labor costs and an attractive geographical location - essential criteria for potential investors. However, this situation may change, because investors tend to assign greater importance to the quality of business environment.



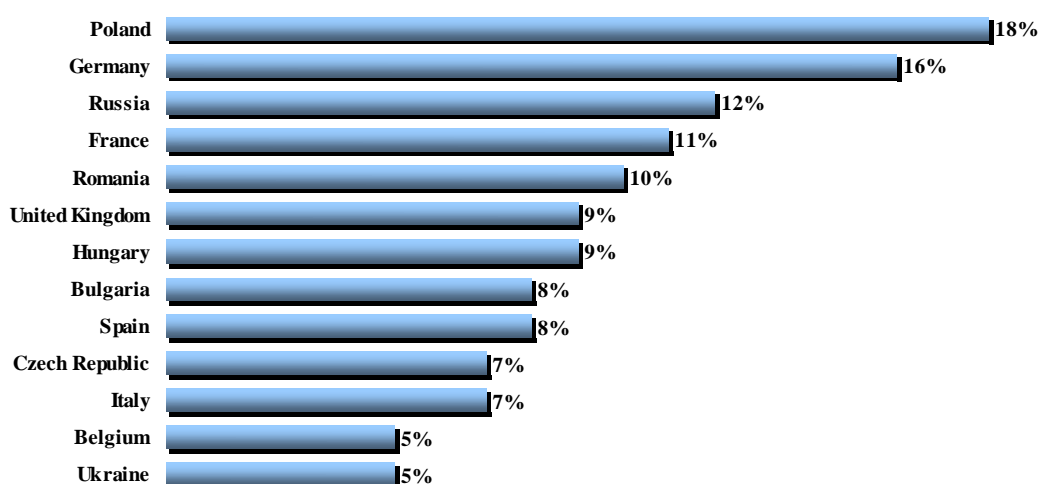
**Graph 1 FDI inflows into Poland in 2007 by the country of origin of the foreign shareholder**

Source: *Zagraniczne inwestycje bezpośrednie w Polsce w 2007 roku*, NBP, Warszawa, styczeń 2009, s. 18.

<sup>10</sup> *Międzynarodowa pozycja inwestycyjna Polski w 2007 roku*, NBP, Warszawa 2008, s. 14.

In the EU pre-accession period Poland was perceived from the perspective of high-risk investment. The sources of that included the collapse of the dynamics of positive macroeconomic indicators, limited access to bank loans and capital markets and the issue of access to short-term loans<sup>11</sup>. EU membership has significantly improved the image of Poland as a reliable business partner. This is confirmed by the various rankings of investment attractiveness.

In the report published in June 2008 by the consulting company Ernst & Young, Poland was ranked in the first place in Europe in terms of attractiveness for foreign investment (see Graph 2.)<sup>12</sup>. However, constantly in the forefront of the most attractive countries for investment are China and India.



**Graph 2 Locations in Europe considered in the context of new investment projects rated by Ernst & Young (in %)**

Source: *Bezpośrednie inwestycje zagraniczne w Polsce (wg stanu na koniec 2007 roku)*, Ministerstwo Gospodarki, Departament Analiz i Prognoz, Warszawa, grudzień 2008, s. 22.

In July 2008, on the list of 120 the most attractive countries from a business perspective published by the Forbes magazine, Poland was 33 so 6 positions higher than in 2007<sup>13</sup>. This ranking was based on the economic and social spheres criteria. Denmark, Finland and Ireland took the leading positions, while Poland has proved to be more attractive than such countries as Spain, Slovakia and Greece. In turn, on the list of 25 European countries which concerned the real estate market presented by Cushman & Wakefield (The European Distribution Report 2008), Polish economy took 5th place just behind Belgium, the Netherlands, Hungary and the Czech Republic<sup>14</sup>. In this analysis used the criteria of labor costs level and transport infrastructure were taken into consideration.

<sup>11</sup> Zob. M. Majewska, *Determinanty napływu...*, op. cit., s. 107.

<sup>12</sup> Ibidem, s. 22.

<sup>13</sup> Ibidem, s. 23.

<sup>14</sup> *The European Distribution Report 2008*, Cushman & Wakefield, July 2008, 194.88.148.122/ef/ce/48/93/3566\_ziarecom.pdf

**Table 3 Poland in the ranking of targeting locations of industrial activities and logistics in Europe in 2008, Cushman & Wakefield**

<b>Country</b>	<b>Ranking 2008</b>
<b>Belgium</b>	1
<b>Netherlands</b>	2
<b>Hungary</b>	3
<b>Czech Republic</b>	4
<b>Poland</b>	5
<b>France</b>	6
<b>Germany</b>	8
<b>United Kingdom</b>	11
<b>Spain</b>	17
<b>Finland</b>	21
<b>Sweden</b>	25

Source: Based on *The European Distribution Report 2008*, July 2008.

Positive results in most international surveys ranking obtained by Poland show a strong potential of the Polish economy in attracting foreign direct investment. This proves also positively assessed economic situation and investment climate in Poland. It also shows that the Polish economy has entered on the path of dynamic growth.

## **2. Foreign Direct Investment environment in Poland**

Investment climate provides suitable conditions to companies running or starting up the business. It depends on the quality of economic and institutional environment. These conditions, when determining the opportunities for economic development, prejudice simultaneously the investment attractiveness of the location. Positive investment climate is created by taking proper activities to minimize the costs and risks associated with the implementation of investment projects. Analysis of economic and institutional environment aims to specify the level at which the conditions determining FDI inflows into Poland are fulfilled.

### **2.1. Geographical conditions**

The globalization of the economy implies maintaining and improving the market position. This process must be considered in a wider geographical context. Investing abroad is an essential element of competitive struggle. Strategic location in the heart of continental Europe determines that Poland is perceived from the perspective of a convenient place to locate investments. In this way, investments

are finding their customers, both among European countries and third countries - European Union partners.

Location in Europe has allowed Poland to join the EU structures, which contributed mainly to strengthening of economic and political conditions in terms of investment attractiveness. Poland, because of 312.679 sq. km of territorial area, is the 9th largest European state, and 6th largest EU member country. The advantageous location also determines that investors in Poland have access to 250 million consumers within a radius of 1000 km<sup>15</sup>.

Poland borders on the Czech Republic and Slovakia in the south, on Germany in the west, Russia in the north and the Ukraine, Lithuania and Belarus in the east. Accession to the European Union on 1 May 2004 resulted in becoming the eastern Polish border also a part of the eastern border of the Union.

Due to the attractive geographical location Poland is situated on the main transit routes, as part of the trans-European road nodes. The availability of transport (rail, road and air) has a significant impact on the Polish investment attractiveness because of<sup>16</sup>:

- the possibility of supply of raw materials and components required to manufacture;
- the ability to provide final products to customers;
- the suitable conditions of passenger transport that create a possibility of direct meetings with suppliers, colleagues, consultants and customers.

In this way, investors are able, within a few hours, to get from Warsaw to the selected European capitals: Berlin, Prague, Moscow, Vienna, Vilnius, Minsk and Kiev.

Geographical position in Central and Eastern Europe also determines that Poland is assessed from the perspective of possibilities of buoyant development that results from the need to meet the convergence process with Western Europe countries. Location in the heart of Europe allows investors to develop activities in Poland and creates a possibility of export expansion to any desired markets. Favorable conditions result from the presence of the main routes on Polish territory leading from west to east and from north to south of Europe. Through the Polish territory 4 of 10 systematically developed and expanded Trans-European corridors lead: from Helsinki via Warsaw, with a branch to Gdansk, from Berlin via Warsaw, Minsk and Moscow to Nizhny Novgorod, from Brussels through Cracow to Kiev and from Gdansk to Brno.

Placement of investment projects in Poland gives potential investors the possibility of a wider expansion of exports to neighbouring markets. Proximity of the other geographic regions, including

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<sup>15</sup> *Napływ bezpośrednich inwestycji zagranicznych do Polski. Bariery i możliwości wzrostu*, Ministerstwo Gospodarki, Warszawa 2008, s. 9.

<sup>16</sup>T. Kalinowski (red.), *Atrakcyjność inwestycyjna województw i podregionów Polski 2008*, Ministerstwo Rozwoju Regionalnego, Instytut Badań nad Gospodarką Rynkową, Gdańsk 2008, s. 12, ([http://www.paiz.gov.pl/files/?id\\_plik=10527](http://www.paiz.gov.pl/files/?id_plik=10527))

Commonwealth of Independent States (CIS), characterized by relatively low unit labor costs, allows further increasing of economies of scale.

## 2.2. Economic situation

The quality of the economic environment is one of the basic categories of indicators having an impact on investors' decision-making process in terms of production size and volume of investment. In this area, the most important are: economic stability, market absorptivity, quality of economic and transport infrastructure as well as the level of fiscal burden and labor costs.

### 2.2.1. Economic stability

The global economic crisis in 2008/2009 slowed down an economic growth, but it is worth noting that in Poland there has been no decline in GDP. This situation is an exception to the experiences of the other European economies. In terms of the main macroeconomic indicators Poland achieves relatively good results. In the period 2004-2008 there was a strong economic growth in key economic sectors (services, industry, construction) in Poland.

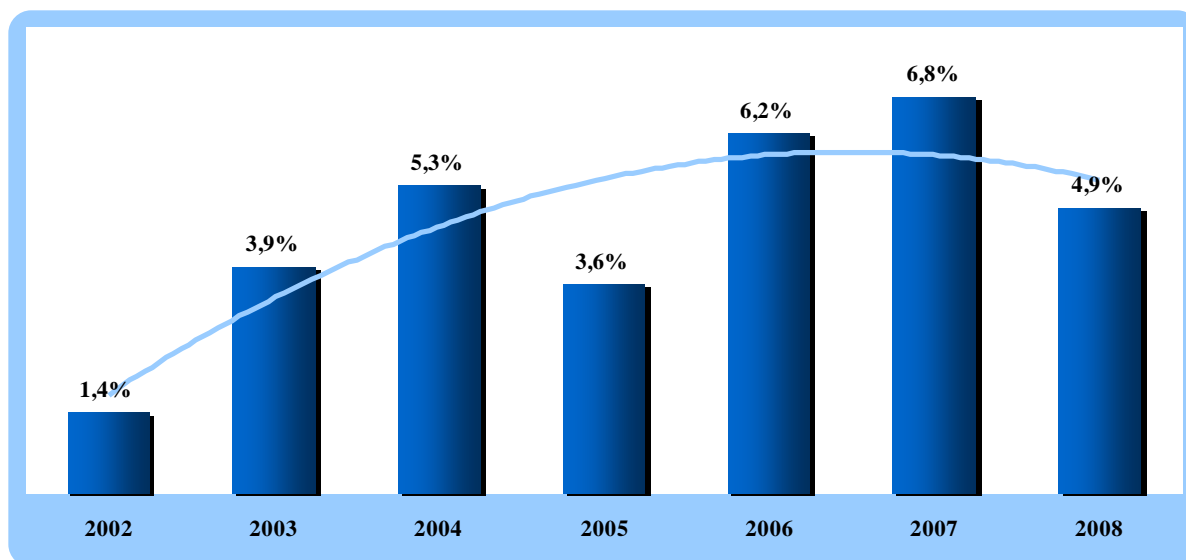
**Table 4 Basic economic indicators (in PLN)**

	2002	2003	2004	2005	2006	2007	2008
<b>GDP in current prices (millions)</b>							
	808 578	843 165	924 538	983 302	1 060 031	1 176 737	1 272 838
<b>Balance of current payments (millions)</b>							
	-22 467	-21 275	-37 383	-12 052	-28 908	-55 434	-64 490
<b>Foreign debt (millions)</b>							
	325 818	401 257	388 708	433 524	493 721	569 926	721 130
<b>Inflation (annual average percentage change of HICP)</b>							
	1,9	0,7	3,6	2,2	1,3	2,6	4,2
<b>Yearly average exchange rate</b>							
<b>1USD</b>	4,0795	3,8889	3,6540	3,2348	3,1025	2,7667	2,4092
<b>1EUR</b>	3,8557	4,3978	4,5340	4,0254	3,8951	3,7829	3,5166

HICP – Harmonized Index of Consumer Price

Source: National Bank of Poland, Central Statistic Office

GDP growth in the years 2002-2008 is shown in Graph 3. An average GDP growth rate in Poland in 2003-2008 amounted to 6%<sup>17</sup> per annum. In turn, the volume of GDP in 2008 reached 1 272 838 million PLN. In this way, Poland was ranked at 21st position among the largest economies in the world and in 6th position in Europe. The upward trend in terms of the volume of GDP, even in a global economic downturn, argues for a relatively high level of economic stability.

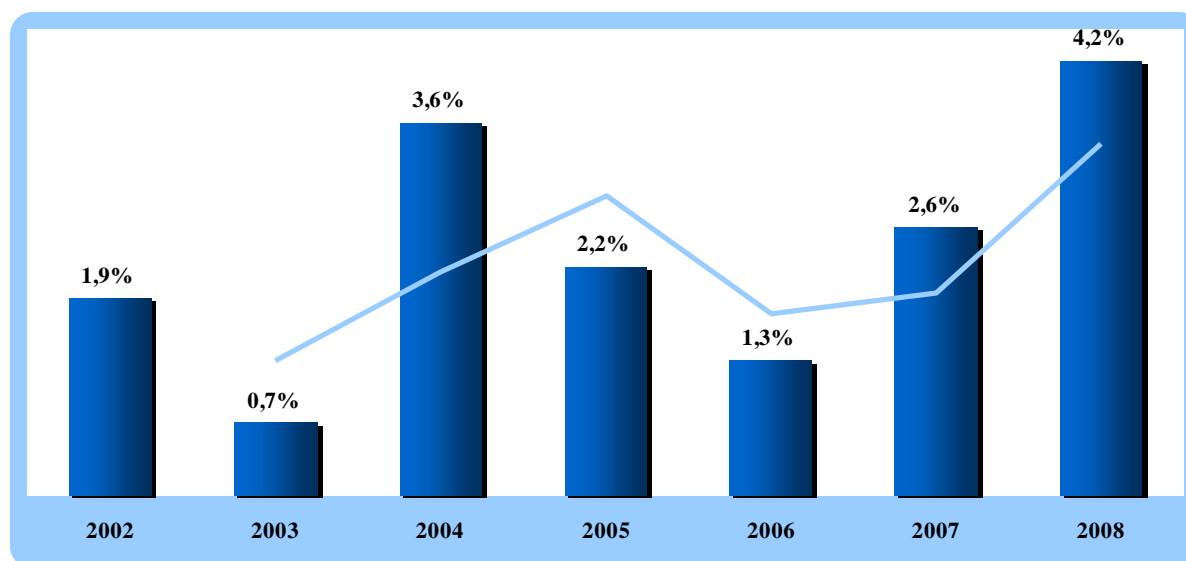


**Graph 3 GDP growth in the years 2002-2008**

Source: Central Statistic Office

In Poland there is a long-term maintenance of a surplus of imports over exports, as the Table 4 shows. The negative current account balance in Polish international trade increased significantly over last two years reaching -64 490 million PLN in 2008. Moreover, the foreign debt is a worrying phenomenon that has a negative impact on the image of Poland. In 2008, the debt rate was on the level of 721 130 million PLN.

<sup>17</sup> PAiIZ, ([http://www.paiz.gov.pl/dlaczego\\_polska/silna\\_gospodarka](http://www.paiz.gov.pl/dlaczego_polska/silna_gospodarka)).



**Graph 4 Annual average inflation rate 2002-2008**

Source: Central Statistic Office

Inflation in Poland is relatively low. During the period 2002-2008 the harmonized index of consumer prices (HICP) was below 5% (Graph 4.). After the accession to the EU inflation rate increased slightly, reaching 4.2% in 2008.

In the period 2002-2008 there was a trend to strengthen the zloty both in relation to USD and EUR. In the case of exchange rate in relation to dollar there was a constant appreciation. In contrast, the process of strengthening of Polish currency in relation to euro was interrupted by periods of depreciation - 2003-2005. Finally, exchange rate was 2.4092 in relation to dollar and 3.5166 in case of euro. In this regard it should be noted that the strengthening of zloty in relation to the major currencies may be an indicator that will reduce FDI inflows.

Analysis of basic economic indicators demonstrate essentially that the Polish economy is characterized by stability and potential for attracting FDI. Polish GDP volume has not decreased as a result of global economic crisis, in contrast to the most countries of the region, including the highest developed economies of Western Europe. In addition, domestic demand is also maintained on a satisfactory level. The main factor that could decrease FDI inflows is strengthening of the Polish currency, both in relation to USD and EUR.

### **2.2.2. The size of market**

One of the main factors taken into account by investors is the size and capacity of the market for potential investments. In this context, Poland is in the relatively favorable position because of the demographic potential and the dynamics of domestic demand. The volume of GDP and domestic demand dynamics are key measures of the market size.

38.135 million population of Poland makes a well-developed market. In the region of Central and Eastern Europe Poland is the largest market with a high degree of absorption and differentiation. It is also the 6th market in the EU and the 32nd in the world<sup>18</sup>. In addition, the proximity of the other absorbent European markets enables the investors to export all or part of production. Size of the Polish market gets good assessments among investors (over 70%)<sup>19</sup>. According to the Global Competitiveness Index 2008-2009 (GCI) by the methodology of the World Economic Forum, Poland was ranked at 20th positions in the list of 134 countries in terms of the market size. The volume of GDP is the main criterion for measuring the market size, which is taken into account during decision-making by investors. The growing trend of growth in GDP can be regarded as a key stimulant of FDI inflows in the case of Poland.

### 2.2.3. Domestic demand

The main determinant of Polish GDP growth, which also characterizes the market absorptivity, is domestic demand. According to Eurostat estimates, GDP grew in the second quarter of 2009 by 1.9%<sup>20</sup>, so similarly to the same period in 2008. This result was higher than in the most EU countries. Analyzing the data in the Table 5., the rising trend of domestic demand should be noted, which in 2008 amounted to 1,323.4 million PLN, about 112.9 million PLN more than in 2007.

**Table 5 Domestic demand 2002-2002 in current prices (millions PLN)**

	2002	2003	2004	2005	2006	2007	2008
<b>Domestic demand</b>	<b>836.5</b>	<b>865.8</b>	<b>946.2</b>	<b>990.5</b>	<b>1,079.1</b>	<b>1,210.5</b>	<b>1,323.4</b>
<b>Domestic demand/GDP relation</b>	<b>103.5</b>	<b>102.7</b>	<b>102.4</b>	<b>100.7</b>	<b>101.8</b>	<b>102.9</b>	<b>104.0</b>

Source: Central Statistic Office

### 2.2.4. Labor costs

The importance of labor costs for the investment attractiveness of a country or region results from differential workforce prices depending on the country. Most of the investment projects invested by companies in foreign markets are based on labor-intensive production. Labor costs depend primarily

<sup>18</sup>PAIIZ, ([http://www.paiz.gov.pl/dlaczego\\_polska/znaczący\\_rynek\\_zbytu](http://www.paiz.gov.pl/dlaczego_polska/znaczący_rynek_zbytu)).

<sup>19</sup> Based on survey research by Instytut Badań nad Gospodarką Rynkową „Klimat inwestycyjny w Polsce w 2008 roku”. The survey included 84 companies conducting business in Poland– 35 domestic companies and 49 foreign firms.

<sup>20</sup> Ibidem.

on three factors: the size and structure of present employment, remuneration for work and non-wage costs of employment.

The majority of Polish labor force is employed in the services sector. Employment growth in this sector is also the most dynamic. This represents a positive response to the growing trend of investments in the higher order services centers.

**Table 6 Number of employees in 2002-2007**

	2003	2004	2005	2006	2007
<b>Total</b>	12640,7	12720,2	12890,7	13220,0	13771,1
<b>The agricultural sector</b>	2144,6	2145,1	2143,8	2145,2	2149,9
<b>The industrial sector</b>	3489,9	3519,7	3535,0	3694,3	3923,4
<b>The services sector</b>	7007,2	7055,4	7211,9	7380,5	7697,8

Source: Central Statistic Office

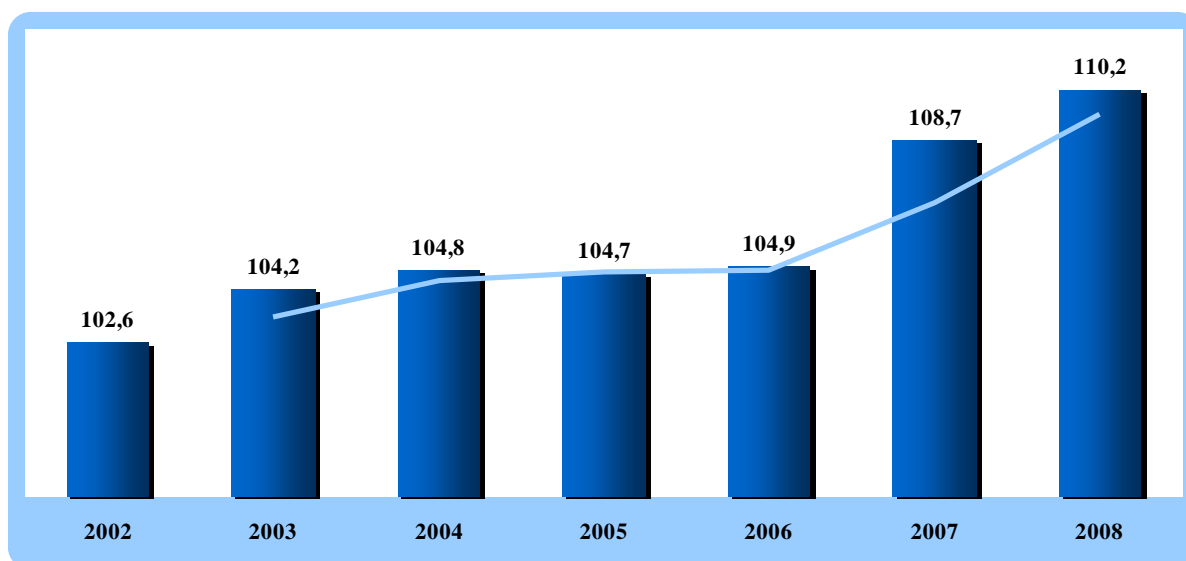
Unit labor costs in Poland are relatively lower and more competitive as compared to other European countries or the USA. Labor costs are rising in the European Union by about 2-3% per year. The growing trend is much faster in the new EU countries, especially those with high economic growth rate. In Poland the labor costs growth is estimated at 4% per annum. Still, the differences between countries are very large. In the richest countries of the “old” EU the average salary amounts to 25 to 30 euro per hour. In Poland, in turn, less than 5 euro. Employment costs in Poland are one of the lowest among 27 countries in Europe.

**Table 7 The average monthly salary in the national economy in the years 2002-2008**

	2002	2003	2004	2005	2006	2007	2008
<b>The average monthly salary</b>	2 133,21	2 201,47	2 289,57	2 380,29	2 477,23	2 691,03	2 943,88
<b>Dynamics (the previous year=100)</b>	102,6	104,2	104,8	104,7	104,9	108,7	110,2

Source: Central Statistic Office

In the years 2002-2008, average gross wages showed a growing trend. Especially in the years 2007 and 2008 there was a significant increase (see Graph 5.). A constant increase in labor costs makes them slowly lose their strategic importance in the evaluation of location by foreign investors. In this case, the most attractive for investments particularly in the field of outsourcing projects are developing countries.



**Graph 5 The dynamics of average gross wages in the national economy 2002-2008**

Source: Central Statistic Office

## 2.2.5. Transport infrastructure

Transport infrastructure in Poland is a major barrier to FDI inflows. This negative situation is primarily enhanced by:

- undeveloped infrastructure, including roads, rail and air;
- unfinished highway network and chronic process of building;
- lack of effective links between different types of transport - for example, the connection port-rail, air-traffic;
- insufficient domestic and international air links.

The main reason for this situation is primarily not properly prepared investment areas. Many of the properties, which could be used for investment projects, have not established legal status. In addition, these areas often belong to several economic entities. That greatly complicates the transparency of ownership structures. Problematic are also long-term procedures in the courts. A great number of public institutions is also involved.

Insufficiently developed technical infrastructure makes it necessary to involve the investor's own funds. Equally problematic is the lack of proper space management. According to the report

prepared by PAN on behalf of the Ministry of Construction in 2007, only 19.7% of the country is covered by the existing local plans<sup>21</sup>.

In terms of infrastructure modernization in Poland, it is worth noting about certain positive outlook. According to the European Aviation Safety Agency (EASA), Poland is one of the best emerging markets of air services in the region. In this way, accessibility for foreign investors is increasing by reducing the spatial and time distance. The number of flights is systematically increasing, including low-cost airlines. Moreover, Polish government administration and local government have plans of building several regional airports and road and rail communication connections with the major cities.

Poland accessing to the European Union has committed itself to adapt the domestic transport infrastructure to the standards of the Union. Furthermore, the functioning of the common market requires a trans-European projects, which will enable free movement of people and goods. Poland has an important task to improve road and rail transport through building the highways and restructuring the Polish State Railways (PKP). Ministry of Infrastructure implements a plan to build highways and national roads under the framework of government "Entrepreneurship-Development-Work II" project. Railway Company is currently implementing a modernization program aimed to improve railway routes and border-crossings infrastructure.

Costs of transport in Poland have been considerably reduced as a result of Polish accession to the Schengen Zone on 21 December 2007. An agreement also concerns air and sea border crossings. The Schengen Agreement is a guarantee of rapid and easy movement between countries of the agreement.

## **2.2.6. Economic infrastructure**

In terms of economic infrastructure in Poland, the main determinants of FDI inflows are special economic zones and the presence of scientific research centers.

### **Research centers**

Infrastructure of research units is relatively well developed, however, there is a descending trend in this area. In the years 2002-2007 there was a systematic reduction in the numbers of research institutes, central laboratories and research-development centers. During these years the number of universities has increased. This situation is positive to FDI inflows due to increasing number of high-skilled workforce. Decreasing trend in R&D units is particularly negative because of the increasing share of investment in services that require higher-developed infrastructure, research and development centers.

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<sup>21</sup> *Napływ bezpośrednich inwestycji zagranicznych do Polski – bariery i możliwości wzrostu*, NBP, Warszawa 2008, s. 6.

**Table 8 Scientific and research – developments units**

	2002	2003	2004	2005	2006	2007
<b>Specification:</b>						
<b>Total</b>	338	314	300	296	313	280
<b>Research institutes</b>	139	135	135	133	132	127
<b>Central laboratories</b>	10	8	7	8	8	6
<b>Research-development centers</b>	62	58	55	53	50	47
<b>Higher education institutions</b>	119	128	128	143	147	150

Source: Central statistic Office

### **Special Economic Zones (SEZ) in Poland**

Special Economic Zone is a favorable combination of investors' needs and the needs of individual regions. Special Economic Zone allows to conduct business on preferential terms. Enterprises which have been granted special permits to operate within the zone may obtain public assistance in the form of tax relief. SEZ also has the appropriate infrastructure, which allows investors to engage in an activity. In Poland there are 14 SEZ, which together occupy an area of over 11 thousand ha<sup>22</sup>. They are: Kamiennogórska SSEMP, Katowicka SEZ, Kostrzyńsko-Słubicka SEZ, Cracow Technology Park, Legnicka SEZ, Łódzka SEZ, SEZ EURO-PARK MIELEC, Pomorska SEZ, Słupska SEZ, SEZ Starachowice, Suwalska SEZ, EURO-PARK TSEZ WISŁOSAN, Wałbrzyska SEZ and Warmińsko-Mazurska SEZ. Operating within the zone creates a number of advantages for investors<sup>23</sup>:

- tax exemption (CIT or PIT);
- plot fully prepared for investments at a competitive price;
- free help in dealing with the formalities associated with the investment;
- exemption from property tax (in some communities).

Businesses operating within the zones may also apply for regional aid, according to the new Regional Aid Map for the period 2007 – 2013. The amount of aid to investors operating in each region will be presented later in this work. Moreover, large companies can obtain tax relief of an amount up to 50% of the eligible cost in the majority of Polish regions. The same regional aid has been increased by 10% for medium-sized enterprises and 20% for small companies<sup>24</sup>.

Due to the revision of the SEZ Act, the amount of tax exemption was conditioned on bearing expenditure on investment and the creation of new jobs<sup>25</sup>. Operating within the SEZ requires several conditions<sup>26</sup>:

<sup>22</sup> In 2009.

<sup>23</sup> PAiIZ, (<http://www.paiz.gov.pl/index/index.php?id=26310c700ffd1b5095454f336ae96648>).

<sup>24</sup> Ibidem.

<sup>25</sup> Ustawa o SEZ z dnia 20 października 1994 roku znowelizowana została w wyniku przystąpienia Polski do UE. Ostatnia nowelizacja miała miejsce 30 kwietnia 2004 roku, weszła w życie 31 maja 2004 roku.

<sup>26</sup> Investor's Guide – Poland..., op. cit., s. 121.

- investment expenditure should amount to at least EUR 100 000;
- the entrepreneur's own share should be at least 25%;
- investment should be maintained for at least 5 years from the investment completion date (3 years for small and medium enterprises - SME);
- newly created workplaces must be maintained for at least 5 years from the employment date (3 years for SME).

### **2.3. Political conditions**

One of the principal factors affecting the investment climate is suitable political stability. Foreign investments are invested primarily in countries with well-established democratic system and a stable and responsible economic policy.

In this case, Poland is considered, from a perspective of politically stable place, as appropriate to conduct business. Undeniably, in this terms, the most important advantage is a membership in the international structures, such as:

- European Union EU,
- North Atlantic Treaty Organization NATO,
- Organization for Economic Cooperation and Development OECD,
- World Trade Organization WTO.

Membership in the EU from 1 May 2004 is the guarantee of a dynamic economic development which may increase FDI inflows. Harmonization of Polish legislation with EU law implies the liberalization of trade - the introduction of simplified procedures, the elimination of customs duties in trade with EU countries and the validity of a common customs tariff to third countries. The single market also operates on the basis of the four freedoms of movement of goods, persons, services and capital.

Functioning in the structures of WTO<sup>27</sup> obliges Poland to comply with regulations to protect the market against unfair competition, dumping or excessive imports. Transparency of international trade rules results in further improvement in export terms on the markets of WTO member countries.

Membership in OECD requires to establish a National Contact Point (NCP), which is the entity responsible for providing guidelines at national level for multinational corporations. NCP in Poland is located in the Polish Information and Foreign Investment Agency (PAIiIZ). Basically guidelines developed by the OECD concern conducting business in a responsible and honest way.

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<sup>27</sup> Polska ratyfikowała porozumienie w 1995 roku.

Being a member of several international organizations makes Poland trustworthy and reliable business partner as a result of adjustments of the Polish regulations to the standards and regulations of these organizations.

### **2.3.1. Government Policy in attracting FDI**

Additional stimulant for FDI inflows is also pursued by the Polish government policy to attract investment, primarily based on tax reductions and subsidies to investors. Large prospects are connected with 2007-2013 EU structural funds.

#### **Structural Funds 2007-2013**

In 2007-2013 Poland will receive from the Structural Funds assistance in the amount of € 67.3 billion<sup>28</sup>. These funds will be implemented through a number of Operational Programs, among which the most important are: Innovative Economy, Human Capital and Infrastructure and Environment. Financial assistance will generally be granted in the form:

- investment grants;
- R&D activity grants;
- environmental grants;
- training grants.

Investment grants will be awarded only to those projects whose objectives will be based on improving and innovation. In this regard, projects should result in:

- creation of new technologies;
- creation of innovative logistics solutions;
- creation of technologically advanced products and services;
- increased productivity and the volume of exports;
- implementation of significant modifications in company.

The condition for receiving this type of financial support is to have adequate level of own contribution by investors, including the form of the loan. Obtaining the financial support is conditioned on a number of requirements for the project. An entrepreneur should define<sup>29</sup>:

- the project's objective;
- the expected effect and benefits from the project;
- the starting and closing date of the project, as well as the duration of each project stage;
- the project's implementation path;

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<sup>28</sup> Fundusze Strukturalne, (<http://www.fundusze-strukturalne.gov.pl/Wiadomosci/Archiwum+wiadomosci/2006/Fundusze+na+lata+2007-2013/Jak+skutecznie+wykorzystac+67+mld+euro.htm>).

<sup>29</sup> Investor's Guide – Poland..., op. cit., s. 119.

- the people involved in the project;
- the costs involved;
- the actions necessary in order to start project implementation;
- the limitations and threats to project implementation;
- an analysis of financial sources;
- an analysis of requirements to be met by the beneficiary and the project (whether it be eligible for co-financing or not);
- an analysis of the technical and financial aspects of the project.

**Table 9 Operational Programs available in Poland**

Specification	Amount in EUR billions
<b>OP Infrastructure and Environment</b>	27.9
<b>OP Innovative Economy</b>	8.3
<b>OP Human Capital</b>	9.7
<b>OP Development of Eastern Poland</b>	2.3
<b>OP Technical Assistance</b>	0.5
<b>16 Regional Operational Programs</b>	16.6

Source: Ministry of Regional Development

Rules about applying for financial support from the Structural Funds are specifically defined. However, the major barrier in this regard is the competition procedure which does not guarantee obtaining financial support.

## **Regional aid**

The most common form of assistance for foreign investors to implement projects in Poland is the regional aid. The amount of financial support depends on the localization of investment activity. The maximum intensity of regional aid is<sup>30</sup>:

- 50% - in areas belonging to the provinces: Kujawsko-Pomorskie, Lubelskie, Lubuskie, Łódzkie, Małopolskie, Opolskie, Podkarpackie, Podlaskie, Warmińsko-Mazurskie;
- 40% - in areas belonging to the provinces: Dolnośląskie, Pomorskie, Wielkopolskie, Zachodniopomorskie, Śląskie, in the period from 1 January 2007 to 31 December 2010 in the province Mazowieckie, with the exception of the Capital City of Warsaw;
- 30% - on land owned by the city of Warsaw and in the period from 1 January 2011 to 31 December 2013 - within the Mazowsze Province.

<sup>30</sup>PAIiZ, (<http://www.paiz.gov.pl/index/index.php?id=26310c700ffd1b5095454f336ae96648>).

Financial support under the regional aid may be awarded in the form of resources from EU funds and tax exemptions (CIT) for companies operating in the SEZ. Within the EU funds, investors are also able to use financial aid for training projects.

### **2.3.2. Lack of an effective system of investment incentives**

Undoubtedly, a system of public aid in Poland offers investors various options and benefits. However, the fundamental problematic issue of investment incentives is the lack of efficiency. This system does not allow precise determination of the amount of support at the stage of making the investor's investment decision. This factor strongly reduces confidence in the system of investment incentives.

In terms of support for individual investment projects, the government's program operates on the basis of a long-term program connected with the Public Finance Act. This requires a long-term legislative process and governmental individual ad hoc aid requires also notification to the European Commission.

The Polish government also offers financial assistance from the Labor Fund for Employment of the District Labor Office. However, this support is intended solely for registered as unemployed and meeting a number of specific criteria. Another limiting factor for FDI inflows in the area of government is insufficient system of incentives for entrepreneurs to invest in research and development projects. Obtaining a status of R&D center requires a minimum of 50% of the turnover from the sale of the results of their research and development.

## **2.4. Legal environment**

Since the mid-90s of the XX century in Poland the tendency of national treatment to foreign investors has been evident. Such treatment means an acceptance of general principles of equal treatments businesses under the foreign supervision, branches of foreign companies and other forms of direct investment with the terms of the functioning of national entities<sup>31</sup>.

### **2.4.1. Law regulating business activities of foreign investors**

Establishment and operation of enterprises with foreign capital in Poland is governed by the regulations of the Civil and Commercial Code. Legal basis in this regard is also the law of 2 July 2004 on freedom of economic activity. According to the Act, investors from the EU and the European Free Trade Area (EFTA), belonging to the European Economic Area (EEA), operate under the same legal regulations concerning the establishment and conduct of business as Polish entrepreneurs. In relation

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<sup>31</sup>B. Durek, *Inwestycje zagraniczne w Polsce*, Instytut Koniunktur i Cen Handlu Zagranicznego, Warszawa 1995, s. 9.

to foreign investors from outside the EU and EFTA, they are concerned by the same rules, under the condition of obtaining<sup>32</sup>:

- a permit to settle on Polish territory;
- permit long-term resident of the European Communities;
- a permit for permanent residence;
- refugee status;
- subsidiary protection;
- visa.

For the other foreign persons, there are allowed forms of legal economic activities, such as:

- limited partnership;
- limited partnership joint stock company;
- Limited Liability Company;
- plc.

Act on freedom of economic activity also introduced a number of facilities:

- reduced number of required documents;
- shorter time to completion of formalities;
- smaller number of activities is required to obtain permits or concessions.

## 2.4.2. Taxes

Regulation of uniform tax system in Poland concerns to foreign investors (companies and individuals) to the same extent as the Polish economic entities. This system is based on 12 types of taxes. Although taxation rates are high in Poland, foreign investors have the possibility to benefit from tax exemptions. In order to avoid the double taxation, Poland has signed special bilateral agreements with more than 60 countries of origin of the taxpayer. These agreements have been developed basing on the standards of the OECD. This type of agreement is unquestionably an incentive for FDI. Foreign companies have the right to establish their subsidiaries in the Polish territory. The taxation rates for subsidiaries are similar to these used in case of the other forms of economic activity, such as limited liability and joint-stock companies.

In 2004 an income tax (CIT) rate has been reduced by 8 percentage points and it was set at 19%<sup>33</sup>. The level of income determines the rate at which wages of individuals employed in companies with the foreign capital are taxed. In 2005 it was 19%, 30% and 40%<sup>34</sup>. By contrast, a board member

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<sup>32</sup> PAiIZ, (<http://www.paiz.gov.pl/index/?id=a7f0d2b95c60161b3f3c82f764b1d1c9>).

<sup>33</sup> C. Pilarska, Polityka państwa w zakresie bezpośrednich inwestycji zagranicznych w Polsce, s 223, (<http://mikro.univ.szczecin.pl/bp/pdf/61/19.pdf>).

<sup>34</sup> Ibidem.

salary was taxed at 20%. 19% rate of corporate income tax is one of the lowest rates in Europe. It also applies to dividends arising from participation in the profits of legal persons that are established in Poland.

However, the exemption of corporate income tax operates only in the special zones. In this regard, businesses operating in the SEZ were devoid of the possibility of exemption in terms of losses in previous years. Exemption from property tax and some fees is an essential incentive for investors. This issue is governed by the law on local taxes and charges on 12 January 1991. The benefit from exemptions from property tax exists only in the case of a proper decision by the Municipal Council in this regard. The decision also requires notification to the OCCP and submitting it to the European Commission. Exemption from property tax under the *de minimis* aid can be granted in the amount of 200 thousand EUR and 100 thousand EUR in terms of the road transport sector over a period of 3 years<sup>35</sup>.

In terms of indicators that limited FDI inflows, entrepreneurs often indicate a lack of regulation clarity and the frequent revisions of tax laws in Poland. With a multitude of concepts of financial policy it connects uncertainty and investment risk.

### **2.4.3. Poor quality of law system**

Although the law in Poland provides many facilities for foreign investors in the form of tax exemptions and protects the interests of foreign investors, the basic barrier for to FDI inflows is the problem of enforcement and ambiguity of regulation. A problematic issue is also a certain flexibility in interpreting the legislation and the privileged position of offices in a dispute with operators and also steadily growing number of revisions.

Essentially, lawmaking in Poland limits FDI inflows, contributing to this lack of procedural transparency and inconsistencies. In terms of administrative procedures regulating the investment process, they are most often described as complicated and too slow, which increase the costs of business activity. This situation is similar in case of the administrative process of obtaining construction permits. Moreover, an investor should be prepared to face objections from a large number of social organizations (environmental protection, etc.). Long-term administrative procedures are also characteristic for recruiting foreigners by the investors. The process of obtaining residence permits and work in Poland may take several months. It is carried out simultaneously in Poland and the country of origin.

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<sup>35</sup> PAiIZ, (<http://www.paiz.gov.pl/index/?id=4275f89744278864da88c2fda68ec4e9>).

## **2.5. Social climate**

### **2.5.1. Human resources**

Undeniable stimulant for inflow of foreign investment is highly qualified personnel. Poland is characterized by the availability and potential of human capital. Well developed infrastructure of universities provides education for a highly skilled workforce.

**Table 10 Students by selected type of university in 2008**

	Number of students
<b>Total</b>	<b>1927762</b>
<b>Selected type of university</b>	
<b>Universities</b>	<b>526381</b>
<b>Technical universities</b>	<b>322111</b>
<b>Academies of Economics</b>	<b>356561</b>

Source: Central Statistic Office

Higher education is positively evaluated in the reports of such prestigious institutions like the World Economic Forum, which conducts research on international competitiveness. According to the global competitiveness index (GCI) developed by the WEF in 2008, Poland obtained 34<sup>th</sup> position in the area of higher education and training, among 134 surveyed economies in the world<sup>36</sup>. Among investors, there is often a perception that low labor costs go hand in hand with low-skilled workforce. In this context, it is necessary to promote the capacity and qualification of Polish workforce. This task is primarily the responsibility of government agencies involved in attracting foreign investors.

However, in terms of workforce investors must often deal with problem of getting and maintaining workers. This is due to a high level of employee rotation, especially in the area of investment outsourcing (shared service centers, IT services, call centers). In the case of employing foreigners, as mentioned before, investors face a long and complicated procedure for obtaining residence permits and work permits in Poland.

### **2.5.2. Trade unions**

Trade unions have undeniably strong position in Poland. Trade union activity plays a key role in terms of FDI inflows, which are connected with privatization program of the largest state enterprises. The goal of defending workers' rights and also contract negotiations in the privatized companies contribute to this . The situation prolongs negotiation process, which causes aggravation of the financial situation

<sup>36</sup> *The Global Competitiveness Report 2008-2009*, WEF 2008, s. 278, ([www.weforum.org/pdf/GCR08/GCR08.pdf](http://www.weforum.org/pdf/GCR08/GCR08.pdf)).

of the privatized enterprises and increases the costs of its operation. These types of activities contribute to the failure of investment projects and creating the image of Poland as a country with a high degree of investment risk.

## Summary

Several studies confirm Polish attractiveness to foreign investors in Europe, marking out the three main advantages: a convenient geographical location on major transit routes, the size of the internal market and relatively low labor costs, combined with well-trained staff. According to a study by KPMG in 2005 and 2006, over 80% of foreign investors rated their business conducting in Poland as good (75%) or very good (9.4%). Surveyed companies did not express negative evaluations of the effects of their investments. 75% of the respondents expressed their willingness to strengthen business and investment activities on the Polish market.

According to the report "Investing in Poland 2010" prepared by the Polish Agency for Information and Foreign Investment and the Warsaw Business Journal, the investment attractiveness of Poland is determined by strategic location, the size of the country, membership in the European Union and economic and legal stability.

It should be noted, however, that the investment opportunities in Poland are not fully utilized. This situation occurs especially in the area of regulation, namely the lack of transparency and clarity of legislation. Perceived investment risk is also increased by the strong position of trade unions.

Although, Poland has a well-educated personnel, it is necessary to continue improving and promoting the areas, such as education and high-skilled workforce. That may also provide intensive co-operation between business sector and academic institutions. According to a study by McKinsey Global Institute, in Poland more than 50% of engineers meet the requirements to work in international corporations, while in India the figure is 25%, and in China and Russia only 10%. Nevertheless, investments in research and development area are still at the insufficient level of development in Poland.

Principal localization of FDI investments are the developed countries, but greater acceleration of investment projects gain is evident in the case of developing countries and Central and Eastern Europe. This situation is particularly evident in terms of investment in centers of higher order services. This trend will continue in the near future.

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