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MANAGING IN A TURBULENT INTERNATIONAL BUSINESS ENVIRONMENT

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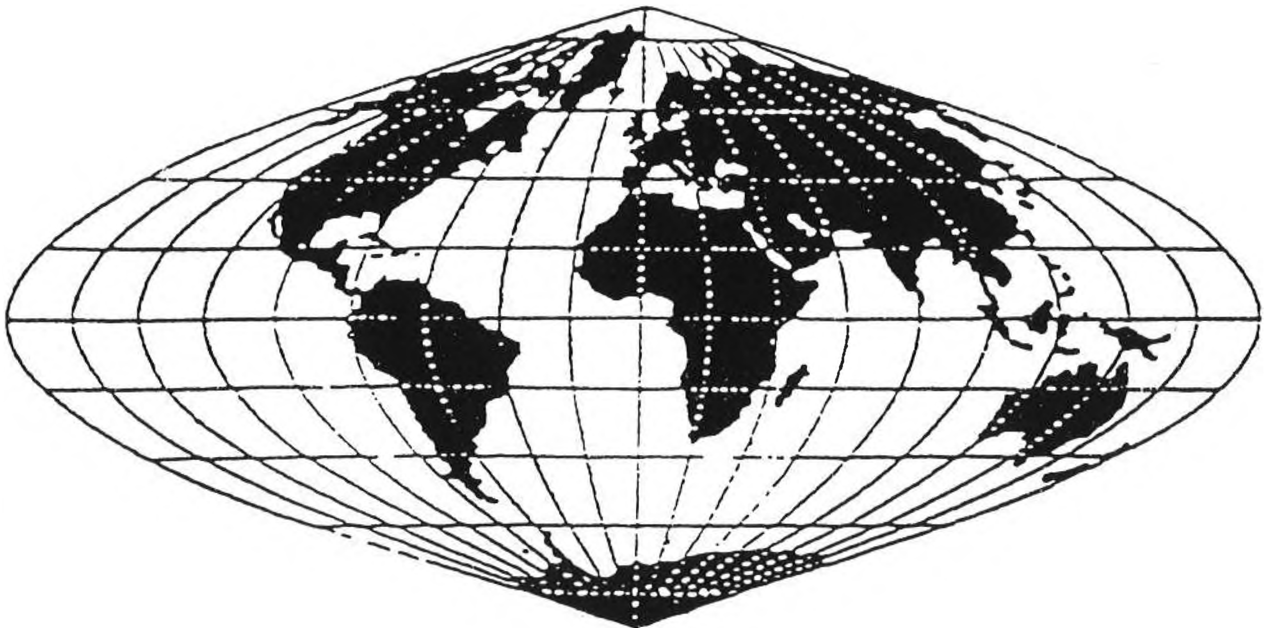

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On the Competitiveness of a Transitional Economy. The Case of Poland

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This study attempts to explore the impact of a deficit on the current account of the balance of payments of a country successfully proceeding on the path of transformation to a market led economic system, on the competitiveness of its firms. Two models are investigated dealing with the competitiveness issue, with the focus set on the role of stimulating exports. The last part contains policy recommendations on measures addressed both to domestic and foreign owned companies operating in Poland. The need is stressed for clear and long term guidelines and solutions from the policy decision makers.

Poland as a country undergoing transition to a market led economy has been simultaneously proceeding on a path of accelerated integration with its global environment. These processes have created intense interdependence and interfacing of the emerging Polish market with the markets of other countries and have brought numerous positive results. Through increased participation in international trade and international investment Poland's economy is successfully being modernized and restructured. Its inhabitants have access to a variety of goods and services that were never available to them in the previous economic system. The net result has been evidenced by the growth rate of GDP in the years 1990-1999 presented in Table 1.

Table 1. Growth rate of GDP

Year	Rate (%)
1990	-11.6
1991	-7.0
1992	2.6
1993	3.8
1994	5.2
1995	7.0
1996	6.0
1997	6.8
1998	4.8
1999	4.1%

(Source: Statistical Yearbooks of the Republic of Poland – Central Statistical Office, Warszawa)

But the access to the global economic system has not been without tensions and threats. One of them has been connected with the difficulty of ensuring external economic equilibrium The deficit on the current account was mainly due to trade imbalance. Table 2 presents Poland's trade balance in the years 1990-1999.

The data clearly indicate that the foreign trade deficit which appeared in 1993 was steadily rising (with the exception of 1994). In 1997 the deficit of current account amounted to 4.3 billion USD which constituted 3.2% of the country's GDP, whereas in 1998 it amounted to 6.9 billion USD or 4.4% of GDP. In reality the magnitude of the trade deficit was somewhat diminished by revenues from the non registered cross-border trade conducted by individuals, mainly on Poland's western and eastern borders.

The negative trade balance was generated mainly by the exchange with the countries of the European Union. According to customs statistics, registering the flow of commodities and not payments actually made, the said deficit with EU increased from -7.3 billion USD in 1996 to -10.5 billion USD in 1997 and to -12.9 billion USD in 1998. It should also be noted that a significant factor influencing Poland's trade balance has been the balance of foreign trade conducted by foreign owned companies operating on the Polish market. In the years 1994-1998 it reached respectively -2.8 billion USD, -3.9 billion USD, -7.4 billion USD, -10 billion USD and -11.6 billion USD. This steady increase was due to rising import requirements by foreign firms connected with their investments in Poland, many of them modernizing their output potential as well as from a high demand for subsequent supply imports (Durka, 1998).

The high and aggravating deficit in foreign trade has not been experienced by Poland alone. It is evident that other countries which opened up their economies and joined the then existing EEC (Spain, Portugal and Greece) went also through a period of worsening of the trade balance and they financed the deficit on the current account with a surplus on the capital account (Nowicki, 1997). In all those cases it was necessary to implement adequate economic policy measures in order to prevent overheating of the economy and diminish inflationary pressure.

Table 2. Commodity payments in the years 1990-1999

Specification	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Commodity payments in bill. USD										
Revenues from exports	10863	12760	13997	13585	16950	22878	24420	27233	30122	26347
Payments for imports	8249	12709	13845	15878	17786	24705	32574	38521	43842	40727
Balance	2214	51	512	-2293	-836	-1827	-8154	-11289	-13720	-14380

Source: Ocena sytuacji spoleczno–gospodarczej w 1997 roku wraz z elementami prognozy na 1998 rok, Rzadowe Centrum Studiow Strategicznych, Warszawa luty 1998 oraz Polski handel zagraniczny w latach 1998-1999, Instytut Koniunktur i Cen Handlu Zagranicznego, Warszawa 1999, Rzeczpospolita – August 22, 2000.

The key issue that emerges from the above mentioned data and observations concerns the measures that should be adopted in order to increase and stimulate exports. In a wider context the question arises as to what should be done to increase the country's competitiveness. It has been shown that the country's export capacity is insufficient and definitely unsatisfactory from the point of view of maintaining the trade balance in equilibrium. On the other hand the said export capacity has experienced considerable growth due to the systematic modernization of the economy in general. A marked role in this process has been played by foreign companies which through FDI have transferred technology, managerial and marketing know how into Poland. One must note however that in many cases the technology brought in was not of the latest generation or state of the art. Nevertheless even so it was still more advanced than that existing in competing domestic enterprises. The investing multinational firms were behaving and treating Poland exactly according to R. Vernon's international product life cycle theory (Vernon, 1966) as a less developed country where products in their later stages of their life cycle could be profitably marketed. Of course there are also sectors where product life cycles have become shorter as in, for example, the computer software industry and where the latest innovations and manufacturing technologies have been introduced in the Polish market to maintain the competitiveness of foreign entrants and/or Polish firms that have made contractual agreements with foreign suppliers of such products and technologies (Gorynia, Wolniak, 2000).

Also, the demand for imports has not been in itself very high. More important is the fact that the rate of import growth has been high and the volume of imports did not correspond with the payment capability of the whole economy.

The deficit on the current account has been to a large extent neutralized by the surplus on the capital account which was in turn due to the continuing inflow of foreign capital, most of in the form of foreign direct investment. The crucial question here is whether the growth of the deficit on the current account might not rise the risk of investing in Poland and stop or reduce considerably the present and future inflows of foreign capital. This very unfavorable possibility applies much more to portfolio investments which are governed by short term financial goals such as the expected rate of return. Foreign direct investment from which Poland's economy draws much more advantages, is of course much less volatile in its movements across national boundaries, but the above mentioned danger of a slowdown in investment applies to this category as well. It is believed that the occurrence of this negative scenario considerably increases once the deficit on the current account has passed the 7% share in the country's GDP. The latest figures available show that after August 2000 this ratio reached 7,7% but at the end of the year it is expected to be somewhere between 6,9 and 7,8% (Rzeczpospolita, October 3, 2000). Nevertheless up till now no sign of decreasing FDI into Poland has been observed.

General Models of Competitiveness Promoting Policy

Considering all the threats and challenges facing Poland in the process of integrating with her international environment and the world economy certain prescriptions can be identified for Poland's economic policy. Two approaches address the general problem of achieving higher competitiveness in the context of reducing the deficit on the current account:

1. The concept of concentrating on exports alone in order to make them more competitive on world markets (the enclave model),
2. The concept of upgrading the competitiveness of the whole economy (the integral model).

The enclave model assumes that exports should be treated on a preferential basis. Measures stimulating exports are treated as a relatively autonomous segment of economic policy. Moreover the special treatment of exports is usually accomplished at the cost of abandoning or limiting support for the non export sectors.

The following concepts and policy instruments can be employed in the enclave model:

1. Financial instruments supporting exports such as guarantees and export insurance, then direct financing in the form of loans, credit lines and grants, then subsidizing interest rates on export credits and tax relief on investments made by exporters (Rutkowski, 1999).

2. The concept of strategic trade policy creating comparative advantage in selected industries, usually those with advanced technologies and already in the course of advanced integration with the world markets. Attempts at such integration made on the basis of current or ad hoc motives usually prove to be unsuccessful when making long term and strategic decisions (Hubner, 1994; Brander, Spencer, 1985).

In the framework of this concept one can introduce for example export subsidies but the use of this instrument is regarded as unfair competition by foreign competitors, their governments and international trade organizations (like the WTO). Thus if indeed export subsidies are used one has to be prepared for the possibility of being forced into „subsidy wars" with retaliating countries. Other negative effects might include overinvestment in the subsidized industries, false investment signals based on low price levels of the subsidized products and difficulties in securing the necessary funds for subsidizing from the state budget (Gorynia, 1996; Gorynia, 1998).

A more viable alternative in this respect seems to be to induce foreign firms to invest in those selected industries by offering them preferential treatment through tax holidays or tax reductions and/or support of state funding of investments in elements of local material and social infrastructure which are considered as essential and indispensable by foreign investors. If the government does not want to have those selected export industries dominated by foreign capital it can extend the proposed preferences also to local, Polish-owned companies. This way it becomes absolved of being accused of favoring foreign firms only, which does not in itself, as practice has shown in other countries, eliminate the most probable outcome that foreign investors will still be in the lead and command a major share of the export business. There is numerous evidence that overall foreign firms with manufacturing facilities in Poland have consistently demonstrated better export performance and allocated more of their output for export than domestic competitors. In 1996 the share of exports in total sales of foreign owned companies was 13,9% whereas for domestic firms only 8,8%. The share of the value of exports by foreign entrants in the total value of Polish exports rose from 25% in 1994 to 43% in 1997. Their similar share for imports was however higher and also rose from 32,9% in 1994 to 49,9% in 1997 (Durka, Chojna, 1998).

In the integral model the general aim is to improve the level of competitiveness of the whole economy and not just selected industries that constitute the preferred export sector. In the current economic situation of Poland and in the context of her international environment the principal strategic issue that has to be addressed is the production of competitive goods and services that will find buyers on both the domestic as well as foreign markets (Plowiec, 1997).

According to this approach economic policy should develop competitiveness in a complex and integral fashion, i.e. it should not differentiate the instruments used for improving the performance of exporters from those designed for stimulating competitiveness of producers on the open domestic market. This coincides with the concept of a liberal-institutional industrial policy (Gorynia, 1995). The essence of such policy lies in promoting widely conceived development and entrepreneurship. Policy instruments used here are usually of a universal and undifferentiated character:

The liberal-institutional industrial policy consists of measures stimulating competitiveness, privatization and economic selfgovernment. In the framework of enhancing competitiveness the following types of activities can be identified:

- supporting investment
- supporting innovations, research and development
- supporting education and training
- diversifying business risk
- supporting creation of information systems
- stimulating diffusion of information

These measures remain undifferentiated also as to what kind of companies registered in Poland take advantage of them, i.e. they do not distinguish between those that are Polish and foreign owned. However it is worth stressing here that most such measures are not necessary and of little interest to foreign, especially big multinational corporations. They already have all those elements which these measures are designed to achieve. The only dimension which is important for all foreign firms is the potential improvement of the general infrastructure of doing business in Poland that once achieved can definitely lead to a better rating of the country's attractiveness to foreign investors. Survey data show that 44.4% of foreign owned firms indicated the lack of sufficient infrastructure as an important and very important barrier in establishing operations in Poland (Wolniak, 1998).

Therefore the focus of the said measures is on domestic firms which need to boost up their competitiveness to be able to compete with foreign entrants on the domestic market. But these domestic Polish firms will be fighting a

loosing battle if they do not engage in entering foreign markets themselves. The first and obvious stage is getting to those markets is by exporting. But the management of many Polish firms is guilty here of short sightedness. It believes that success achieved through exports should be cultivated and maintained by concentrating on further export development. It is not aware or does not have the resources or the will to seek and secure resources for further stages of foreign presence, especially for foreign production through direct investment. There is one factor however that shows those firms very vividly the effects and advantages of foreign direct investment: it is the presence and expansion of foreign firms in Poland which are gaining substantial market shares and control over an increasing number of key sectors of the Polish economy.

Policy Recommendations

Many Polish firms are small and financially too weak to be capable of exporting at all. The remedy here lies in economic policy measures focused on increasing their competitiveness by enabling and facilitating those firms to merge, consolidate, form strategic alliances or enter into other forms of cooperation. But Polish firms do feel the competitive pressure on their backs and it must be this pressure coming from the market that should be the main guiding force in changing their structure and strategy. State support is essential but its role should be treated as only secondary and complementary to the initiatives and actions undertaken by the firms themselves.

Some Polish companies have already started to expand along this path, mostly into the neighboring countries of Eastern Europe. Exploiting the continuing expansion of the Polish economy as evidenced by the rate of GDP growth, they strive to gain a firm foothold in these markets and then selectively expand their market shares. It is much faster in the transforming economies of Eastern Europe than in the highly developed regions of the world that Polish firms are likely to gain sizeable or dominant shares in the local markets.

It is worth noting here that collaboration with strong Western firms in form of alliances does not always have to imply a weaker, subservient position of the Polish partners. Indeed the experience of Japanese and South Korean firms shows that through developing learning processes they were able to evolve from the weaker to the dominant partner in their alliances with stronger US and European companies (Hamel, Doz, Prahalad, 1995, p.152). Two decades were necessary for such evolution to occur and it is an open question whether this is a relatively long or short time period. The main idea for the Polish firms is to develop their core competencies which embedded in new products and technologies could form a solid base for their competitive advantage.

All of what has been said above does not preclude the necessity of being present through exports and foreign production in other regions of the world, especially in the European Union and in the developing countries, in many of which Polish brand names have through exports become quite familiar (Gorynia, Wolniak, 2000).

The nature of economic policy measures addressed to foreign firms can also have an important influence, through the behavior of those firms, on the state of the country's balance of payments. The basic dilemma here is whether these measures should stimulate and favor the inflow of foreign direct investment, perhaps even up to the point of offering tariff and non-tariff protection to foreign firms holding major shares in key sectors of the Polish economy? Or should the available material and financial state resources be allocated to the creation and consolidation, and then accelerated expansion of big Polish firms, which thereafter would be strong enough to effectively compete with foreign entrants on the domestic as well as foreign markets? A rational approach in this respect should dictate a middle of the road course and should therefore encompass the following steps:

1. Creating appropriate macroeconomic conditions conducive to general economic growth, limiting inflation and maintaining currency stability. Those factors constitute in the mid term the best motive for continuous inflow of foreign capital.

2. Continuing the privatization process of state owned firms as an attractive investment option for both Polish owned and foreign companies. This activity seems to be coming to its natural end since in the next few years all the available state owned property will have been privatized. It should be noted here that if no preferences are made either for foreign or domestic firms the foreign owned will usually have more resources, offer better bids and win. The competitive power relationship might later on eventually turn in favor of the new, big, private Polish companies but most probably at that time there will be no more state property to be privatized.

3. Avoiding granting incidental and far reaching privileges to big multinational companies as a precondition of investing in Poland. An indication to proceed on this path has been given to the Polish government this year by the Commission of the European Union which demanded that Poland close all special economic zones which offer special privileges to companies that invest in them. Those privileges include a corporate income tax holiday for 10 years and a tax relief of 50% of the said tax due for the next 10 years. The Polish authorities after some hesitation have decided to adopt a firm stand on this issue saying in effect that privileges once acquired by foreign investors cannot be

revoked. The compromise solution was that no new investors would be given the right to operate in those zones.

4. Eliminating the remaining regulations discrimina-ting foreign firms intending to enter the Polish market, restricting entry only to armaments or national security sensitive sectors like airports.

5. Offering support for domestic firms of all sizes, embarking on the path of concentration of production, introducing modern technologies as well as exporting and investing abroad. In all the above cases antimonopoly legislation would not be applicable. Further support measures should include tax relief and availability of preferential long term investment credit through credit guarantees and credit insurance schemes.

6. Supporting ecological and natural environment oriented investment by Polish firms.

A safeguard against the occurrence of any slant in Polish economic policy biased towards domestic firms and discriminating against foreign entrants lies in Poland's membership in OECD and in her efforts to become a full member of the European Union. It is very likely that both those organizations would rigorously oppose and seek to redress any such slant being implemented by the Polish authorities.

Those responsible for determining Polish economic policy are being subjected to pressure exerted by various organizations and social groups which demand a much greater degree of control over the inflow of foreign capital. Representatives of small and middle sized trading companies (mainly retail stores) for example have been vigorously protesting against the practically unrestrained and massive expansion of super and hypermarket chains coming mainly from France and Germany and forcing the smaller local competitors out of business at an accelerated rate.

On the other hand there have been instances where multinational corporations have used their economic power in order to extract concessions from the government concerning their activity in Poland. In one such case the South Korean company Daewoo which invested in Poland in the motor vehicle industry pressured the government to eliminate tariffs on imported car parts. This allowed the Koreans to stay competitive on the Polish market. It should be observed however that the arguments used by the government in applying the said tariffs to Daewoo were not very convincing to start with. They were based on the contention that the Daewoo parts were coming from cars which were dismantled before being sent to Poland and therefore did not meet the test for exemption from tariffs for new and unused parts.

To all that has been said about the weak competitive positions of Polish companies one must add the inherent weakness of the domestic capital market. Its still shallow character limits the expansion and investment capacities of domestic firms that want to participate in the privatization process, that want to innovate, upgrade and develop their output capacity, technological capability and marketing. The recurring practice of using ad hoc or case by case solutions and regulations that shape or influence the competitiveness of firms on the Polish market, be they domestic or foreign owned, is most unfortunate and reveals the lack of systemic policy measures and the pressing need to have them introduced.

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