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# FINANCIAL DEPENDENCE OF THE POLISH ECONOMY

## ABSTRACT

The article present the structure of net international investment position (NIIP) of Poland and on that basis to specify the degree of financial dependence of our country on external business entities. The stated data unequivocally points to the essential disproportion between the amount of capital which inflows to Poland and the stream of its outflow. Additionally, a part of external liabilities are the foreign portfolio investments and the remaining foreign investments, which are usually of speculation nature. It causes a considerable degree to which Polish economy is dependent on the foreign capital.

**Key words:** financial dependence, international investment position, IIP

## 1. INTRODUCTION

The fact that any economy partakes in global economy brings many advantages as well as many dangers at the same time. The majority of countries still try to maximize their integration at any cost, thus abolishing the successive obstacles to the flow of the factors of production. What can be subsumed under the benefits of the participation in the global market is the following: the better availability of commodities, the expansion into new markets, the easier access to modern technologies, the possibility of the acquisition of cheaper sources of raw materials, the availability of better qualified and cheaper labour power etc. The potential dangers of the participation in the global market are mainly the following: the necessity of competing with corporations, whose capacities is way beyond the capacity of an ordinary business enterprise; the vulnerability of economies to external turmoil of both economic and political nature; the possibility of national business entities being outdone by foreign business entities, the augmented competition on the national market and finally the risk of business enterprises and the whole economies being dependent on external entities.

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The economies deciding on doing away with the barriers of production factors flow, especially the capital, must be aware of the fact that they become the part of the most demanding and competitive market. Thus, they must be prepared for the consequences related to the above. On the one hand, there emerge foreign business entities which would like to build factories, shops or banks on the territory of a given country; on the other hand, national business entities move the part or of the whole of their business activities abroad.

Foreign business entities will also want to take part in the capital market of the that would-be world-wide economy by buying companies' shares or treasury bonds. It will be probably done (the other way round) by national entities. Thus, the streams of capital flow relating to a given economy with the global market. Now the question emerges related to the proportion between the amount of the capital inflowing to the country and the one outflowing from the country. The purpose of this paper is to present the structure of net international investment position (NIIP) of Poland and on that basis to specify the degree of financial dependence of our country on external business entities.

## **2. FINANCIAL DEPENDENCE AS A REALM OF ECONOMIC SAFETY OF A COUNTRY**

The history of XX century showed that the use the weapon of mass destruction makes the great number of soldiers as well as civilians die in military conflicts. Maintaining the army will become a major burden for the budget. The necessity of incessant modernization, purchasing modern weaponry, investing in modern technologies entail huge spendings. In the face of all these facts, many countries realized that nowadays economic power is as essential as the military one.

Influencing international environment through the actions of economic nature yields roughly as good or sometimes even better results than through military actions. So, one deliberately started to use various forms of economic pressure ranging from the rationing the source of natural resources to financial blackmail itself.

Thus, the essential realm of national safety policy is these days the policy related to economic safety. On the other hand, the concept of economic safety is understood in a variety of ways in the professional literature; however, for the sake of the present study, one can assume the simplified working definitions which says that economic safety is the "ability of the economic system of a country to unthreatened development- it means the lack of external and internal economic threats" (Jurkowska-Zeidler, 2008). According to the most general conceptualization, that very economic threat may come from three main areas, that is, raw-material one, food industry and financial one. The more complex approach is represented by the experts of the World Economic Forum, who in one of the reports distinguished as many as 37 areas of threats, divided into five risk groups: economic, geopolitical, environmental risk, social and technological one ("Global Risk 2011", p.3–50).

The analysis of current primary literature indicates that the history of financial dependency is related to three fundamental theoretical currents: dependency theory, world-systems theory and the theory of globalization (Szeptycki, 2013; Edelman, Spero & Hart, 2009). The idea of dependency originates from the studies concerning the situation of the Latin American countries. The pioneers of this theoretical account claimed that then dominant

economic theories could not adequately explain the economic situation of Latin American countries. The proponents of that approach thought that what is to blame for the problems of the above-stated countries is not the external factors but the structure of the international system (Valasco, 2002; Topik, 1998). In the professional literature, one can encounter different typologies of theoreticians' achievements within theory of dependency; however, it seems that it grew out of two fundamental traditions: American-Marxist and Latin-American structuralism (Vernengo, 2004). Independently of the above traditions, the proponents of the theory of dependency indicate the existence of the relation of dependence between developed countries and poor peripheries. The world was divided into the developed capitalistic economies (the root) and relatively weakly developed economies (peripheries) (Baran, 1957).

In the context of the present study, it is worthwhile to refer to the definition by one of the most recognized representatives of structuralist tradition. T. dos Santos posits that by dependency we should understand the situation in which the economies of some countries are conditioned by the development and the expansion of other economies the former ones were subject to. The relations between the economies assume the form of dependency when some countries (the dominating ones) can develop and remain the self-maintaining ones whereas the other countries (the dependent ones) can do so only as a mere reflection of the above-stated expansion (Santos, 1970).

The improvement on the theory of dependency and its vital modification is the world-system theory. According to that theory, the global system took shape in the world, global system being divided into three fundamental layers- the root, semi-peripheries and peripheries (Wallerstein, 1974). That distinction in advance determines the role and the future of a given country in the world system, both of which are shaped by historical conditions. The strategies aimed at growth and economic development and the current economic policy to this degree are, according to the advocates of the above theory, of little significance because the world system as a whole determines the destination of a country. Apart from that, there is no special possibility of leaving such a system with the warranty of stabilizing growth at a high level.

The proponents of globalization hint at the fact that nowadays there has emerged the global network of interdependent financial markets forming in principle the homogeneous organism of similarly reacting organs. Obviously, the significance of its particular composing parts and their respective roles in the whole mechanism is different. The nature of interdependencies is not uniform in the whole system, their kind is determined usually by the role played by a given economy on the global market.

The most important danger related to globalization relates to the possibility of the sudden reversal of the capital stream resulting in the mass outflow of capital from a given country (a group of countries) (Oręziak, 2004). "Even if particular countries from the legal standpoint maintain their independence, the process of globalization in reality does not leave them with any other choice that to transform their economic policy – and the monetary and budget policy in particular – to gain and maintain the trust of participants of international financial markets. Globalization makes their economic growth be more and more dependent on the international competitiveness of their respective economies. Competitiveness, in turn, is determined to a large extent by the cost of capital acquired by businesses, the cost of labour power and tax burdens. The countries in which the above cost is relatively low relatively easily attract the foreign capital.

Thus especially the countries of the so-called emerging markets were able to acquire big foreign financing, which essentially contributed to the growth of their respective economies. At the same time, these countries are still grossly dependent on the inflow of foreign capital. It cause a relatively high budget deficits to be still valid in the balance of current payments and contributes to the accumulation of the external debt” (Oręziak, 2004, p.164).

Independently of the preferred theoretical understanding, the financial threat is growing to be the major area of economic threats for a given country. That very threat may be differently understood. First and foremost, in the context of the assumed definition, one should note the lack of possibilities of financing the growth of economy. It may be related to the lack of financial means for the current state operations or by the fact that the public and self-government sector is overburdened with debt. Yet, what is equally important is to pay attention to the dangers of speculation by the foreign business entities. Such operations may be oriented at the specific changes on the debt market, at influencing the exchange rate of securities or directly at the growth or the currency exchange rates (ISB, 2013).

Due to such actions, there might appear the phenomenon which is referred to in the professional literature as economic dependency or more narrowly-speaking, the financial dependency of a country. Financial dependency is defined as a relation between the countries which hinders the freedom of making use of one’s own resources or reaping benefits. This very relation involves making attempts at influencing the decisions taken by a given country by dint of economic instruments. It is a long-term process occurring on the basis of bilateral economic relations, which relation as a consequence give rise to disproportions in each other’s dependencies.

### **3. EXTERNAL FINANCIAL DEPENDENCY IN THE LIGHT OF INTERNATIONAL INVESTMENT POSITION**

The results of the actions which in effect may lead to financial dependency of a country, external entities may be found in monetary reports, which most usually are called (in accordance with the directives by the International Monetary Fund) are called the investment position. The present study is essentially the enumeration of the international assets and liabilities of a given economy.

The functional division of assets and liabilities thereby distinguishes between direct foreign investments, portfolio investments, derivative financial instruments, the so-called remaining investments and (exclusively in the case of assets) reserve assets (NBP, 2012). In the case of Poland, Polish direct investments abroad encompass the sum of one’s own capitals and reinvested profit and the so-called remaining direct investments. Within Polish portfolio investments abroad, the statistics show the sum of the value of equity securities, debt securities and the instruments of the financial market. The assets of remaining investments encompass the commercial credits given, the remaining credits and loans given, paper money, current accounts and deposits, and the remaining foreign assets being owned by Polish entities (with the distinction into National Polish Bank, governmental sector, banking sector, non-governmental sector and non-banking sector). In the case of foreign assets, the statistics distinguish additionally the official reserve assets, encompassing gold, SDR, the International Monetary

Fund reserve position, the amounts due in the convertible currencies and the so-called remaining amounts due (NBP, 2012).

The typology of Polish liabilities looks very similar. It embraces the same instruments. The difference is that what is recorded in this case is the value of foreign direct investments, indirect investments and derivative instruments and the remaining investments realized in Poland by foreign entities. The statistics of foreign liabilities does not encompass reserves. Comparing foreign assets and liabilities of a country allows for specifying its international investment position net:

$$\text{NIIP} = \text{foreign assets of a country} - \text{foreign liabilities of a country.}$$

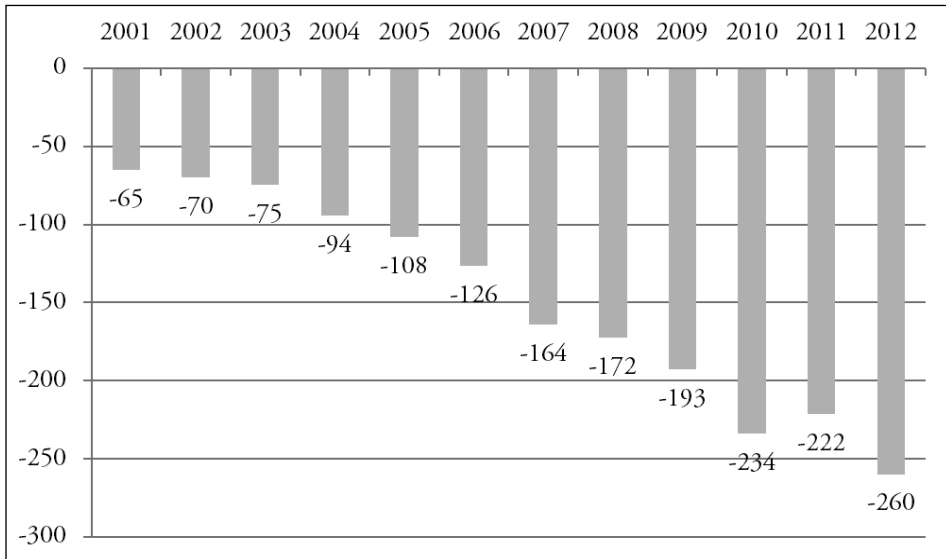
The international investment position net has an important bearing on the financial dependency scrutinized in the present paper. This situation is understood through the actions intended to influence the economies, through the influence on the directions and the amount of the streams of capital in the multifarious forms. In economic terms, the situation is reducible to allocate to a territory of a given country the proper amount and quality of foreign investments. If the sum of those investments considerably exceeded the amount invested abroad by our local entities, the international investment position net becomes highly negative. At one moment it may transpire that the economy is financially dependent on foreign business entities. The degree of that dependency encompasses capital market, the realm of public debt, private debt or other areas such as for instance- job market. When the proportions of the financial involvement of non-resident in the national economy are so gross that their sudden withdrawal might cause the destabilization, then the situation is getting dangerous.

Additionally, we must emphasize the fact that financial dependency facilitates the speculations by financial corporations. As practice has shown, the above entities readily takes advantage of that opportunity, for example by manipulating the currency exchange rate, the value of securities or the valuation of treasury bonds (Osiecki, 2009). In any case, speculations are not exclusively exercised by corporations alone. Even the governments of many countries do so by manipulating the rates of their own currencies, for example to achieve the desired currency translation level for the external debt (Asman, 2011).

#### **4. THE INTERNATIONAL INVESTMENT POSITION AS A MEASURE OF THE FINANCIAL DEPENDENCY OF A COUNTRY**

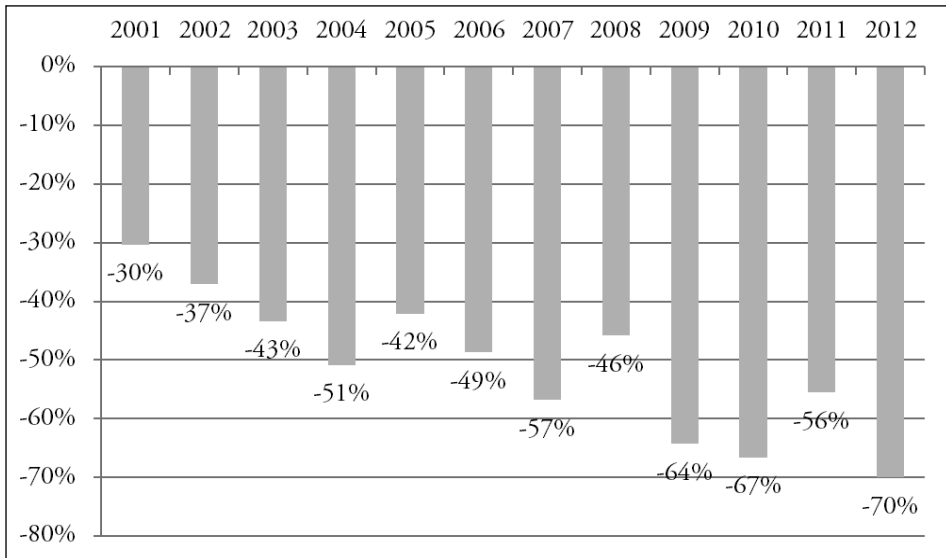
The international investment position of Poland in the whole period scrutinized in this paper was negative. What is more, that position deteriorated almost with every successive year. Analysing the data in the figure 1, one must recognize the fact that the dynamics of deterioration of the studied parameter was significant.

Fig. 1. The net international investment position of Poland in the years 2001–2012 (in billion EUR)



Source: EUROSTAT.

Fig. 2. The net international investment position of Poland vs nominal GDP in the years 2001–2012 (in %)



Source: EUROSTAT.

Net IIP of Poland at the beginning of the period scrutinized here reached the level of about 65 billion EUR. Then, it deteriorated with each successive year until 2010, when it reached 234 billion EUR in 2011, there occurred a barely noticeable improvement of that parameter, which reached the level of about 221 billion EUR then. The last year scrutinized, that is 2012, reestablished the deterioration of the international investment position net of Poland – brought it to the level of almost 260 billion EUR. The biggest dynamics of decreases was recorded back in 2007, almost 30%. NIIP dynamically deteriorated also in 2004 – by over 26% and 2010 – by over 26%.

The nominal values of the international investment position net do not fully reflect the situation of the country understood in terms of its investment position. That is because that data does not correlate the value of NIIP with the potential of a given economy. The more detailed information on this subject is provided by the comparison of NIIP with the national domestic product of a given economy.

Coupled with the deterioration of the nominal international investment position net of Poland in the years 2001–2012, there also occurred the deterioration of the rate pointing at the proportion between Polish NIIP to its gross national product. That proportion increased in the scrutinized period – shifting from 30% in 2001 to as much as 70% in 2012. Still, in a few years, the amount of the studied variable was lower than in the previous year; yet, generally the trend in that period was the descending order. It must be additionally stressed that it is one of the biggest values of the scrutinized indicator among all the member states of EU. However, there are some countries in which the international investment position exceeds – 100% (Latvia, Portugal and Ireland), but in many countries it does not exceed – 50%, or it is even positive (Luxemburg, Belgium, Holland, Germany, Denmark, Finland).

It is open to debate whether the international investment position net in Poland is good or poor. Whether the authorities ensure the proper level of financial safety for the economy or whether they attempt to limit the financial dependency of our country. Recently, the data which was fervently aired in Poland was the one published by Deutsche Bank and referring to the level of foreign-currency reserves (Breźnicki, 2014). Some politicians claim that Polish reserves are too big, thereby adducing to the case of Great Britain as a better developed and more populated country, at the same time having smaller foreign-currency reserves<sup>1</sup>. However, it should be noted that comparing the international investment position net with the level of foreign-currency reserves unequivocally indicates that Polish reserves cover only slightly more than 30% of the negative IIP whereas the British ones over 43%. On the other hand, one can refer to the case of USA, where the foreign-currency reserves are enough to cover only 14% of the negative IIP or France for that matter, where the proportion studied here is similar to the one in Poland – slightly more than 32%. Certainly, among the countries belonging to the top fifteen of possessors of foreign-currency reserves, the majority of them boasts of the positive international investment position; however, among the remaining countries (having the negative indicator) there is no correlation as to the proportion between IIP to foreign-currency reserves. Still, it seems that the higher the proportion of covering the negative IIP, the better.

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<sup>1</sup> Poland occupies 20th position in the world in terms of the amount of foreign-currency reserves

Table 1. The coverage ratio of net international investment position by official reserve assets and total foreign liabilities

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
official reserve assets /net IIP	-46	-41	-36	-29	-33	-29	-27	-26	-29	-30	-34	-32
total foreign liabilities /net IIP	25	24	22	18	19	17	17	16	18	19	20	19

Source: EUROSTAT.

It is worthwhile to note the tendency related to the changes in covering the negative international investment position by dint of official reserve assets of Poland [see table 1]. That tendency is irregular; however, in comparison with the beginning of the scrutinized period, that is the years 2001–2002, when the scrutinized parameter amounted to more than 40%, its end is characterized by the significantly lower proportion of the official reserve assets to NIIP, that is about 32%.

Apart from the above value, it is worthwhile to analyze the proportion between the official reserve assets to foreign liabilities as a whole in Poland. That portion is obviously even lower. It transpires that official reserve assets do not even cover 20% of foreign liabilities. That parameter is particularly important for the young and still growing economy. In the case of turmoil on the global market, such an economy is still treated the same by the investors as the countries of the higher risk for investments. Possessing appropriately high level of foreign-currency reserves is necessary in this case.

The proportion of external liabilities to the official foreign-currency reserves, the previous rate also decreased in the scrutinized period. At its beginning, it amounted to 25%, in the middle of it – even 16%, and at the end – 19%.

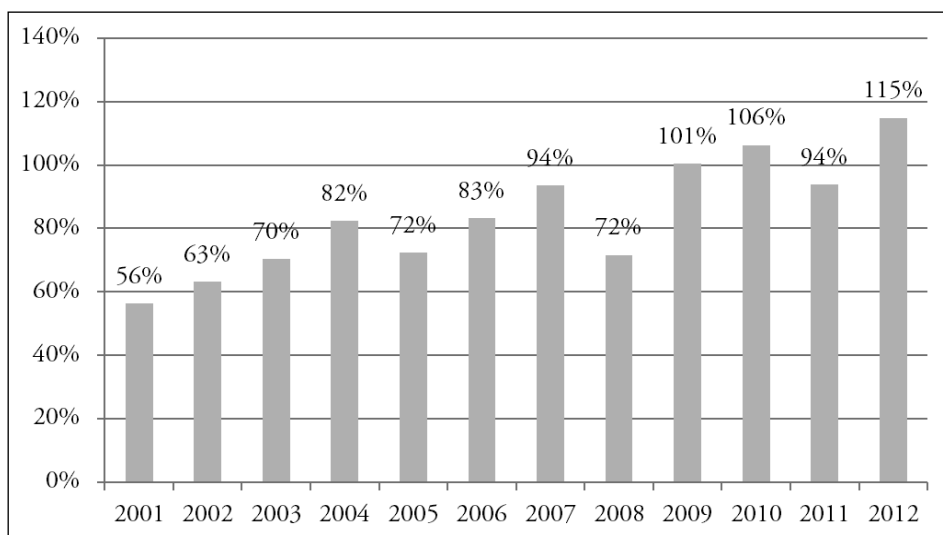
The negative value of the international investment position means that the sum of external liabilities significantly exceeds the sum of external assets. One may additionally suppose that external assets are in this case relatively small. Due to that, the important information characterizing the situation in the scrutinized period is the proportion of external liabilities to GDP. It is also one of the fundamental indicators measuring the amount of the potential financial dependency of the economy of external business entities. That indicator pertaining to Polish economy considerably deteriorated in the scrutinized period.

The growth of the proportion between external liabilities to GDP from 56% in 2001 to as much as 115% in 2012 means that financial dependency of Polish entities of external financial means more than doubled in the scrutinized period. Despite the fluctuations, one can easily notice, by analyzing the data in the Figure 3, the considerable tendency of the growth. Exceeding the nominal value of GDP by external liabilities indicates a high degree of the dependency of Polish economy of foreign capital.

In the face of such significantly high external liabilities of Poland (in relations to its GDP), it is worth investigating its structure. It is because it is widely known that some of the instruments are more sensitive to fluctuations or their sudden withdrawal than others. It seems that in this respect, the relative situation slightly improved in the scrutinized period. There occurred the slight growth of the share of direct investments in external liabilities. As is known, this sort of investments is highly impervious to any changes of economic situation.

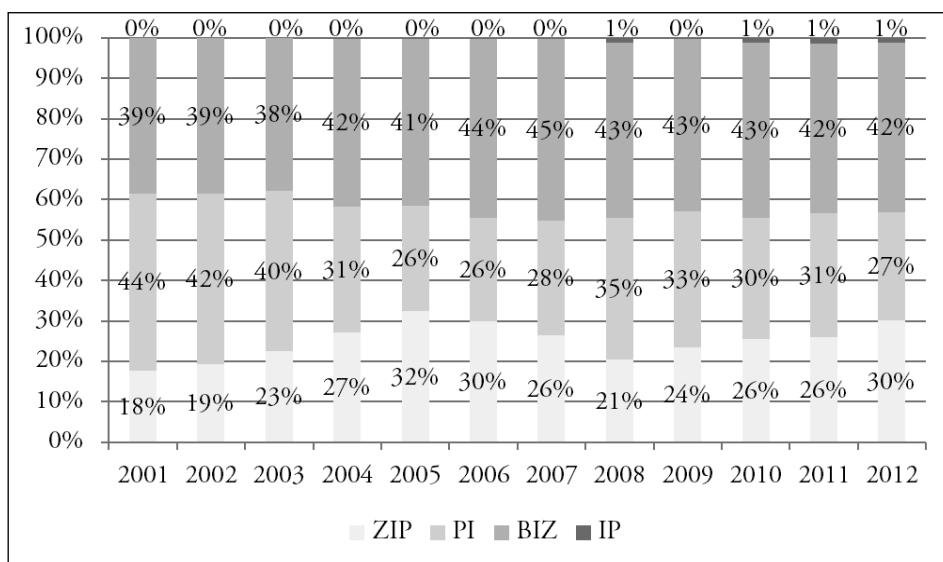


Fig 3. Polish foreign liabilities ratio to gross domestic product in the years 2001–2012



Source: EUROSTAT.

Fig 4. The structure of Polish foreign liabilities in the years 2001–2012



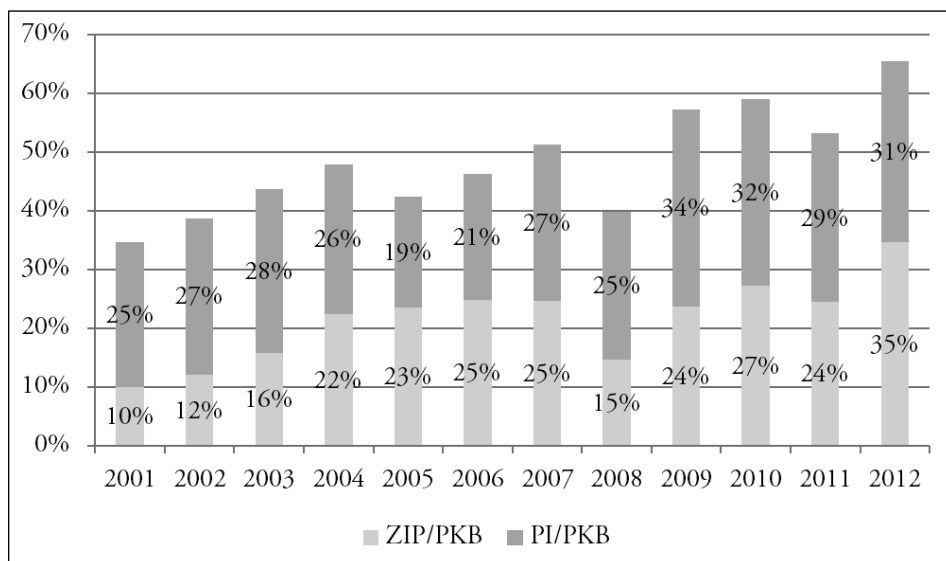
Source: EUROSTAT.

Usually, in the case of the occurrence of cyclical fluctuations the risk of the sudden withdrawal of investors from a given economy does not take place. The investors are simply too much rooted in such economies. It is the possessors of the portfolio of securities and bonds that

behave otherwise. In the case of economic turmoil, and thus the growth of risk, what happens is the increased outpour of investors from the economy.

It is worthwhile to emphasize the change of the proportion between the share of the external portfolio investments in the external liabilities as a whole and the share in them of the remaining external investments. At the beginning of the scrutinized period, the remaining external investments amounted to 18% of the external liabilities as a whole and the remaining investments to 44%. At the end of the period analyzed in the figure 5, the same distribution of the proportions took place, that is the proportion 30% to 27%.

Fig. 5. The ratio of foreign portfolio investment to GDP in Poland and other foreign investment to GDP in the years 2001–2012



Source: EUROSTAT.

As in the case of nominal value of external liabilities as a whole, also the nominal values of particular components of theirs do not provide full information as to the degree of financial dependency of the economy of “the sensitive” foreign investments. To get this information, one must relate the nominal values of investments to GDP.

That reference shows a noticeable in the longer term tendency for growth of the external portfolio investments in Poland. That growth is (with small exception during the financial crisis) in principle more rapid than the growth of national domestic product. The share of portfolio investments in GDP increased in the scrutinized period from about 10% in 2010 to about 35% in 2012. The proportion of the remaining investments to GDP increased, on the other hand, in the similar period from 25% to 31%. The sum of external portfolio investments and the remaining external investments in Poland amounted to in 2012 as much as about 66% of Polish GDP.

## 4. CONCLUSIONS

The above-stated data unequivocally points to the essential disproportion between the amount of capital which inflows to Poland and the stream of its outflow. Additionally, a part of external liabilities are the foreign portfolio investments and the remaining foreign investments, which are usually of speculation nature. It causes a considerable degree to which Polish economy is dependent on the foreign capital. Additionally, it should be stressed that the major part of indirect foreign investments in Poland boils down to buying Polish bonds by foreign business entities. It causes the situation in which not only the business enterprises are dependent to a large extent on external financing but also the public sector is so. The deteriorating state of the international investment position of Poland should be a clear sign for economic policy the priority of which should be to assure the external financial safety of the country and alleviating the undesired effects of financial dependency.

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