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Lucyna Kornecki
Embry-Riddle Aeronautical University, korneckl@erau.edu

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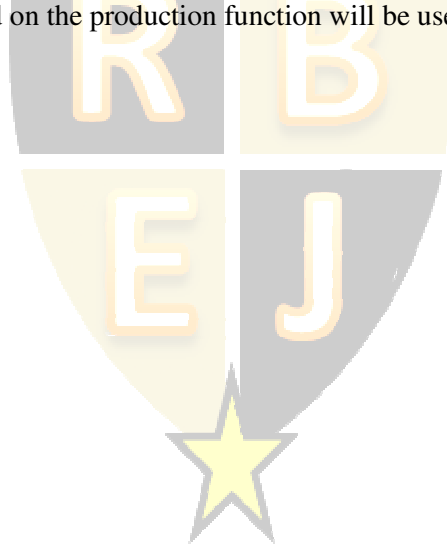
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FDI in central and eastern Europe: business environment and current FDI trends in Poland

Lucyna Kornecki
Embry Riddle Aeronautical University

ABSTRACT

The Central and Eastern European Countries (CEEC) acknowledge foreign direct investment (FDI) as an essential tool in the development and modernization of their economies. The first part of this paper centers on economic stability and FDI inflows in the CEE indicating the Polish leadership in inward FDI inflow. The section of this study focuses on Poland and provides a description of business environment and current FDI trends in Poland. It analyzes the factors influencing the inward FDI in Poland, such as: economic stability, cost of labor, EU membership, regulatory framework. It presents the current FDI trends in Poland, such as: number of foreign firms, geographic origin of inward FDI, inward vs. outward FDI. The future research will focus on the impact of inward FDI stock on economic growth in Poland. To analyze the impact of the FDI stock on output growth in the Polish economy, a model of the economic growth based on the production function will be used.



Introduction

Attracting foreign investment has become a key component of national strategies for Central and Eastern European (CEE) countries (www.poland.gov.pl/index.php?document=1638).

Foreign direct investment in Poland has increased in the past twenty years, to become the most common type of capital flow needed for stabilization and economic growth. Foreign capital coming into the Polish economy has fulfilled a very important role in the process of privatization and restructuring. Poland seeks to attract and promote foreign investment and to liberalize its economy to ensure free movement of capital and profits. Poland became a member of the European Union (EU) on May 1, 2004

(http://www.eurunion.org/eu/index.php?option=com_content&task=view&id=34&Itemid=43).

The EU membership has shaped major aspects of economic policy and new legislation. Poland is the largest economy among the CEE countries with the population of 38.6 million. This compares to 10.244 million in the Czech Republic, 10.063 million in Hungary, 5.392 million in Slovakia, and 2.004 million in Slovenia. The most of the statistics used in this paper is based on the Polish Information and Foreign Investment Agency (PAIIZ) sources.

This study utilized as well archival data (1960-2006) from the following sources: United Nations Conference on Trade and Development (UNCAD), United Nations Economic Commission for Europe (UNECE), World Investment Reports, as well as other selected databases.

In 2005 Poland was the 5th most preferred investment location worldwide. Poland jumped from 12th to 5th place in the Index since 2000, which was driven by increased interest from U.S. and European investors. One in 10 global investors indicated they will make first-time investments in Poland.

<http://www.paiz.gov.pl/index/?id=59112692262234e3fad47fa8eabf03a4>

Economic stability and inward FDI: CEE comparison

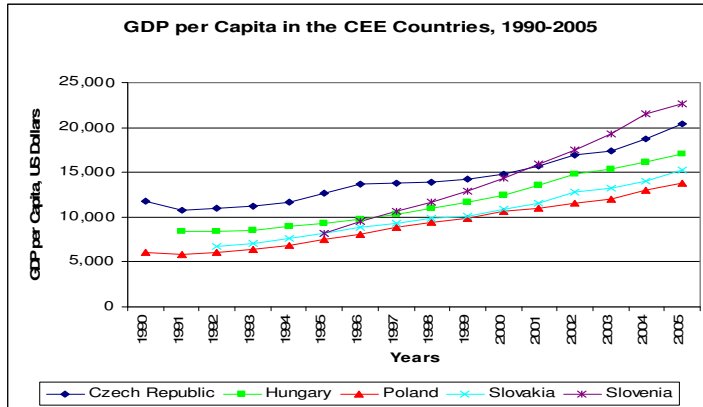
Increasing standard of living: GDP per Capita, CEE comparison

There are a variety of indicators assessing transition outcomes in the CEE transforming economies. This paragraph will be limited to GDP per capita, as it represents standard of living indicator in the CEE. It indicates increasing output performance during the transition period. All of the transitioning CEE countries have been building the new economic system via deregulation of prices, liberalization of trade, privatization, external assistance and capital market development.

Since 1992, GDP per capita in all analyzed CEE countries has been increasing dynamically. Currently, the relatively high GDP per capita shows Slovenia (22.632 US Dollars) in comparison with the Czech Republic (20.417 US Dollars), Hungary (16.994 US Dollars), Slovakia (15.214 US Dollars) and Poland (13.791 US Dollars).

The lowest GDP per capita in Poland relates to the highest population numbers among transforming CEE countries, while the highest GDP per capita in Slovenia relates to the lowest population numbers.

**Figure 1. GDP per Capita (US Dollars)
CEEC Comparison, 1990-2005**

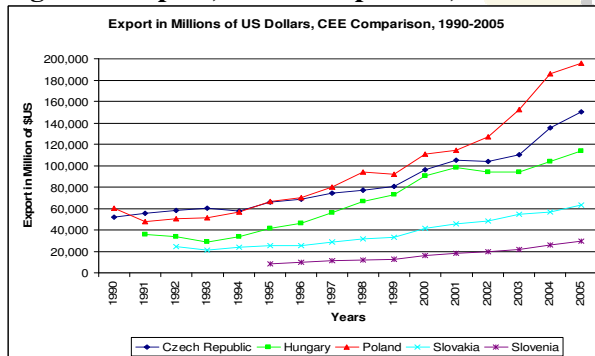


Source: UNECE Statistical Database, Economic Statistics:
http://w3.unece.org/pxweb/Dialog/statfile1_new.asp

Openness of the Polish Economy: leadership in export and import, CEE comparison

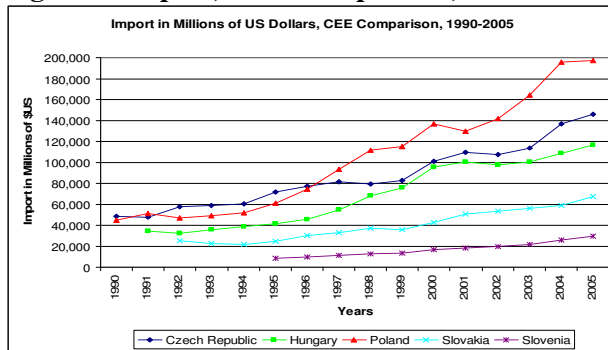
The impressive economic growth in the CEE economies resulted in the growing level of export. Between 1990-2005, Poland was a leading exporter in comparison with the Czech Republic, Hungary, Slovakia and Slovenia (Figure 2). For last several years Poland's firms have been exporting more goods abroad and earning good profits. Among the exporters there are many foreign investors, what indicates that the FDI contributes to higher export in the host countries. Products produced in Poland have been enjoying great success abroad, due to their high quality. Considering the size of imported goods and services in million of USD Poland is a leader among the CEE countries (Figure 3).

Figure 2. Export, CEE Comparison, 1990-2005



Source: http://w3.unece.org/pxweb/Dialog/statfile1_new.asp, UNECE

Figure 3. Import, CEE Comparison, 1990-2005



Source: http://w3.unece.org/pxweb/Dialog/statfile1_new.asp,
UNECE Statistical Database, Economic Statistics

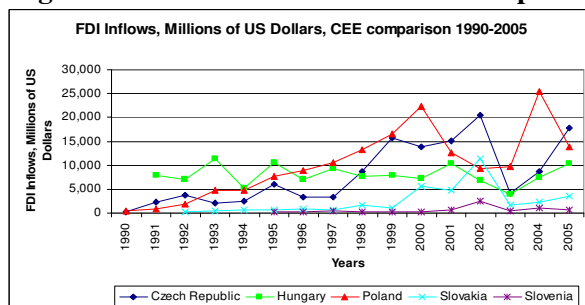
Poland's leadership in inward FDI: CEE comparison

Foreign direct investment (FDI) has increased in the past twenty years, to become the most common type of capital flow needed for the reconstruction, stabilization of the CEE economies and economic growth. The volume of FDI inflows has grown rapidly, as the Governments of the CEE countries have officially encouraged FDI and developed a FDI promotion programs providing substantial incentives for foreign companies (Vaknin, 2005).

Figure 4. presents FDI inflows into the CEE between 1990 and 2005. The size and increasing FDI inflows to transitioning CEE countries were impressive. Poland, Hungary, and the Czech Republic have become the most attractive destination for foreign investments. From 1990-2000, and in 2004, Poland was the leader in FDI compared to the other CEE countries.

The FDI in Poland increased from 3 million (USD) in 1990, to 10,000 million (USD) in the year 2000. The decline in FDI inflows into CEE countries between 2002-2003 was due to the end of privatization, as Greenfield projects generally smaller in size and spread over a longer period of time could not compensate for the fall in privatization-oriented FDI. Increase in the FDI inflows in CEE in 2003 and 2004 can be attributed to the EU membership (Kornecki, 2006).

Figure 4. Inward FDI Inflow: CEE Comparison



Source: <http://www.unctad.org/Templates/Page.asp?intItemID=3277&lang=1>,
UNCTAD World Investment Report 2006

The Inward FDI as a percentage of GDP: CEE comparison

The FDI inflow measures the amount of FDI entering a country during a one year period. The FDI inflow in transitioning CEE countries constitutes a high percentage of GDP. The inward FDI inflow as a percentage of GDP has been the highest in the in the Czech Republic (reaching 11.87% in 2002, 10.73% in 1999 and 8.49% in 2005) and Hungary (reaching 12.98% in 1993 and 11.12% in 1995).

Table 1. Inward FDI as a % of GDP, CEE Comparison 1990-2005

Year / Country	Czech Republic	Hungary	Poland	Slovakia	Slovenia
1990	0.20		0.14		
1991	2.01	9.04	0.36		
1992	3.31	8.12	0.76	0.80	
1993	1.84	12.98	1.90	1.33	
1994	2.08	5.64	1.80	1.75	
1995	4.62	11.12	2.63	1.32	0.74
1996	2.39	7.11	2.87	1.76	0.85
1997	2.31	8.87	3.12	1.08	1.69
1998	6.10	6.90	3.68	3.16	1.02
1999	10.73	6.71	4.33	2.08	0.49
2000	9.05	5.76	5.45	9.42	0.70
2001	9.42	7.40	3.00	7.51	1.87
2002	11.87	4.52	2.09	16.69	7.34
2003	2.31	2.54	2.12	2.25	1.19
2004	4.51	4.57	5.14	3.00	2.59
2005	8.49	6.01	2.65	4.21	1.44

Source: http://w3.unece.org/pxweb/Dialog/statfile1_new.asp.

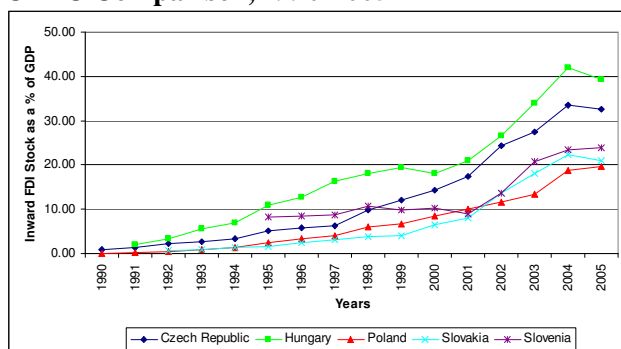
UNECE Statistical Database, Economic Statistics. Calculated on the base of GDP and FDI inflow

As Poland is the largest economy among the CEE countries FDI as a percentage of GDP in Poland is relatively low. Poland is aiming at 5% FDI inflow as a percentage of GDP (Table 1)

Inward FDI stock as a percentage of GDP: CEE comparison

The FDI inflow measures the amount of FDI entering a country during a one year period, while the FDI stock is the total amount of productive capacity owned by foreigners in the host country. It grows over time and includes all retained earnings of foreign-owned firms held in cash and investments.

Figure 5. Inward FDI stock as a % of GDP, CEEC Comparison, 1990-2005



Source: UNECE Statistical Database, UNCTAD World Investment Report 2006

The share of foreign stock as a percentage of GDP has been high in Hungary, the Czech Republic, Slovenia and Slovakia, and constitutes respectively 43%, 34%, 24%, and 22% of each country's GDP (2004). In Poland, the share of foreign stock as a percentage of GDP was much lower and amounted to 19% of GDP (Figure 5). The high percentage of foreign stock in GDP indicates that foreign capital plays a vital role in CEE economies and represents one of the most important indicators of the globalization process in CEEC.

All CEE countries acknowledge FDI as an essential tool in the development and modernization of their economies. The relationship between growing FDI stock and economic growth has motivated voluminous empirical literature. The research indicates a positive correlation between GDP and FDI stock in all CEE countries (Kornecki.....).

Business environment and current FDI trends in Poland

Macroeconomic Indicators

Poland is a democratic country with a stable market economy, a member of EU and a member of the Organization for Economic Cooperation and Development (OECD). The principal legal act governing business activity in Poland is the Economic Freedom Act of 2 July 2004. It regulates undertaking, running and closing businesses on the territory of Poland. A foreigners from the EU and the European Free Trade Agreement zones may undertake and run business on the same basis as the Polish entrepreneurs (<http://www.paiz.gov.pl/index/?id=7e05295a468401ec66e8c337855022ed>).

Poland is located in the centre of Europe between the wealthy Western Europe and the dynamically expanding Eastern Europe. The transport infrastructure in Poland has been modernized and rebuilt using the EU funds. The excellent air, roads, rail and sea transportation constitute a major factors influencing the development of international business in Poland (<http://www.paiz.gov.pl/index/?id=331cc28f8747a032890d0429b5a5f0e5>).

The GDP growth in Poland between 2000 – 2008 indicates strong economy. In 2006 and 2007 economic growth in Poland exceeded 6% (Table 2). The Polish economy is one of the fastest developing economy in Europe. Over the years 2009 - 2010 the rate of economic growth in Poland will probably be lower as a result of the current global economic recession.

Table 2. Economic Indicators, Poland 2000 - 2008

	2000	2001	2002	2003	2004	2005	2006	2007	2008
GDP growth rate	4.1	1.1	1.4	3.8	5.3	3.5	6.1	6.6	5
Unemployment rate	15	19.4	20	19	19.1	17.6	14.9	11.5	8
Inflation rate	10.1	5.5	1.9	0.8	3.5	2.1	1.0	2.5	2.8

Sources: <http://www.paiz.gov.pl/>, NBP, GUS, Ministry of Finance

The positive economic change in the Polish economy relates to the falling level of unemployment. Between 2002 and 2007 the rate of unemployment in Poland decreased from 20% to 8%. The favorable picture of the Polish economy is also influenced by relatively low inflation rate and the fact that it is kept under control. Between 2000 and 2008 inflation rate decreased from 10.1% to 2.8%. A low inflation rate has been noticeable since 2002 (Table 2.)

The Cost of Labor

The FDI inflow to Poland have been developing in parallel with improvements in political stability and economic development (Chowdhury & Mavrotas, 2007). Strong Polish economy attracts foreign investors.

One of the most important factor that measures the attractiveness of an investment in a foreign country is a labor costs. The labor costs in the EU countries increases by approximately 2-3% annually. In the wealthiest countries of the old EU countries, an hour's labor costs 25 to 30 EUR on average, in Poland it's less than 5 EUR.

Poland's employment costs are among the lowest in all of Europe. The country's wage costs are not only less than those of Western Europe, but also lower than those of Slovenia, Slovakia, the Czech Rep., Hungary. The lower employment costs within transitioning economies are only to be found in Rumania, Lithuania and Bulgaria (<http://www.paiz.gov.pl/index/?id=9713faa264b94e2bf346a1bb52587fd8>).

The Impact of the EU Membership on FDI

Important factor influencing business environment in the CEE countries is their membership in the EU. Recent FDI inflows can be attributed to the positive impact of the EU enlargement in May of 2004. New EU countries have improved the business environment and introduced policy measures aimed at liberalization of the Polish economy. The EU membership reshaped conditions of doing business in the new member states and resulted in fundamental changes.

Business environment is treated as a location factor taken into account by investors while investing abroad. The EU policies and the national incentive based FDI policies constitute the most important driving forces influencing business environment in the CEE countries. The statistical data on an annual FDI inflows confirm the positive reaction of inward FDI to the EU membership (Kornecki, 2005). The implementation of the EU policies changed the following: trade policy, competition policy, consumer protection policy, environmental policy, public procurement policy, policy towards small and medium enterprises, social policy, transport policy and socio-economic cohesion policy (Witkowska, 2000).

The EU policy towards enterprises aims to promote entrepreneurship, encourage innovation, improve competitiveness of firms, create a financial climate encouraging business activities, and

promotion of cooperation between enterprises. The firms can also receive assistance from the EU structural funds. Between 2007 and 2015 Poland will receive over 67 billion EUR from the EU's budget. Poland will be the largest recipient of EU funding in the coming years. The EU grants may be allocated to projects from virtually all sectors of the economy and intend to raise the economic competitiveness, among others, through transport infrastructure development (Witkowska, 2007).

Regulatory Framework for FDI

A regulatory framework constitutes the basic guaranties for foreign investors and offers some incentives under the national policies to create more favorable investment climate to attract foreign investors.

In the first stage of transformation - the governments of the host countries granted foreign investors the necessary protection of their investments, including the right of profits transfer abroad in case of liquidation or sale.

The liberalization process during the next stage of transformation granted foreign investors a more privileges in comparison with domestic investors, offering them protective measures in some industries (e.g. automobile industry) and tax incentives (Wysokinska, Witkowska 2002). During the mid-1990's deregulation process resulted in elimination of the requirements to obtain special permissions by foreign investors to invest in Poland.

The characteristic feature of the third stage of policies' development was strong competition for FDI among the CEE countries and the introduction of a wide range of incentives offered to foreign and domestic investors (incentive-based policy). The CEE countries implemented tax incentives, subsidies and grants, special economic zones, free trade zones and special off shore regulations (Witkowska, 2007). Investment incentives in Poland include:

- Income tax exemptions related to activities carried out in special economic zones
- Subsidy for investors for training workers
- Subsidy for investors that meet one of the following conditions:
 - *The value of the new investment is at least EUR 10 million*
 - *The value of the new investment is at least EUR 500,000 and it results in development and modernization of an existing business, and maintains at least 100 jobs (or 50 jobs if investment is made in one of the priority locations) for at least 5 years*
 - *The new investment creates at least 20 new jobs*
 - *The new investment involves technological innovation*
 - *The new investment introduces modern, environmentally friendly technologies*

The local authorities provide investment incentives and various forms of aid within the Special Economic Zones (SEZ). The SEZ have been set up for the purpose of speeding up development of the certain regions in Poland by developing infrastructure and creating new work places. The SEZ concept represents successful connection of the needs of the investors with the needs of the particular regions

(<http://www.paiz.gov.pl/index/?id=0fd4b8a8354a77a3fa75e3d97e7a34e6>).

Current FDI Trends

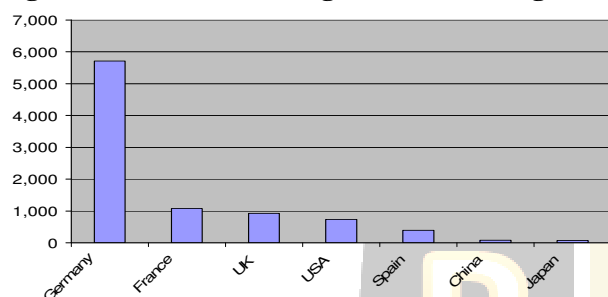
Number of foreign firms and the origin of FDI

FDI is seen as an essential factor stimulating sustained economic growth, expansion of capital stock, increase in productivity, employment and innovation and technology transfer (www.poland.gov.pl/index.php?document=1638). After the collapse of

the communist regime, Poland entered the transition path toward a market economy and identified the positive effect of foreign direct investment (FDI) on the transition process. Foreign capital inflow was considered an important factor facilitating the privatization and reconstructing process of Central and Eastern European (CEE) economies. Currently,

Most of the foreign investments in 2006 (87.9%) came from the European Union countries (<http://www.paiz.gov.pl/index/?id=d2ddea18f00665ce8623e36bd4e3c7c5>). Currently, the old EU countries hold the highest share of productive capacity owned by foreigners in Poland. The biggest number of foreign firms investing in Poland in 2006 (Figure 6) originated from Germany (5,718) in comparison with France (1, 075), UK (927) and USA (733).

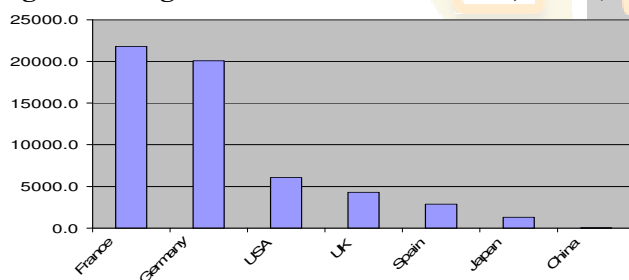
Figure 6. Number of foreign firms investing in Poland, 2006



Source: <http://www.paiz.gov.pl/index/?id=59112692262234e3fad47fa8eabf03a4>,
Central Statistical Office (CSO), National Bank of Poland (NBP)

Figure 7. shows the value of FDI inflow in Poland in million PLN and indicates that the highest inflows originated from France (21,790) and Germany (20,069) followed by USA (6,076), UK (4,302), Spain (2,881) and Japan (1,287).

Figure 7. Origin of inward FDI in Poland, 2006 (in million PLN)



Source: <http://www.paiz.gov.pl/index/?id=59112692262234e3fad47fa8eabf03a4>
Central Statistical Office (CSO), National Bank of Poland (NBP)

Greenfield investment

The structure of FDI inflow to Poland shows an increasing interest in Greenfield investment, which means new investments started from scratch, as opposed to already existing Polish enterprises being taken over by foreign firms. In 2006 nearly 60 percent of FDI flows were attributed to the Greenfield investments. Privatization is no longer a major source of FDI inflows in Poland .

In the past foreign investment in Poland focused on selling products on the domestic market. Recently Poland compete for Greenfield investments on export to EU markets in the manufacturing sector and in the services sector. In manufacturing sector the following industries

accounted for most FDI: automotive, chemical and metal investments. The FDI inflows have been shifting as well from the manufacturing sector towards the services sector.

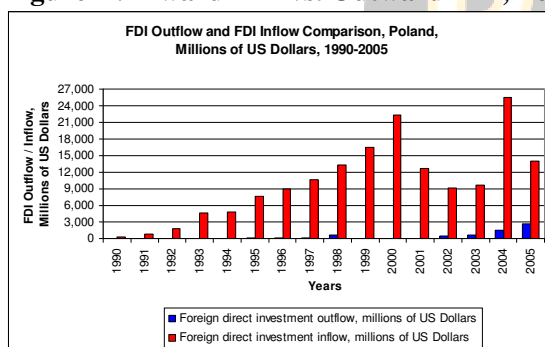
(www.paiz.gov.pl/index).

To increase attractiveness of FDI and competitiveness with the Czech Republic, Slovakia and Hungary, Poland must improve the road infrastructure, develop a fast rail routes, develop a technical infrastructures in the fields of water supplies, sewers and electrical energy and work on reasonable prices of telecommunications services. What is particularly important for encouraging foreign investors relates to improvement of the functional process of firms registration.

Inward FDI vs. Outward FDI

The inward FDI outperformed outward FDI in Poland. The value of FDI located in Poland in 2006 (USD 22.123 million) was higher by 81.9% when compared to the previous year (USD 12.162 million). The greatest amount of FDI inflow in 2006 was invested in real estate and other business activities (USD 7.197 million), manufacturing (USD 5.241 million), trade and repairs (USD 3.150 million), financial intermediation (USD 2.448 million), and buying and selling of real estate by nonresidents (USD 1.336 million).

Figure11. Inward FDI vs. Outward FDI, Poland (1990 -2005)



Source:<http://www.unctad.org/Templates/Page.asp?infItemID=3277&lang=1>,
UNCTAD World Investment Report 2006

The last decade has made it clear that foreign direct investment created employment, increased productivity and exports, and led to transfers of knowledge and technology to the host countries. In 2007, according to data by National Bank of Poland 57 foreign investment projects were completed and 17,798 jobs were created

(<http://www.paiz.gov.pl/index/?id=59112692262234e3fad47fa8eabf03a4>).

Conclusions

The collapse of communism and the advanced Economic Integration of Europe shaped the global development in the twenty-first century. The inward FDI has increased in the CEE in the past twenty years to become the most common type of capital flow. Most of the time Poland was the leader in FDI compared to the other CEE countries. As Poland is the largest economy among the CEE countries FDI as a percentage of GDP in Poland is relatively lower than in other CEE countries. Poland is aiming at 5% FDI inflow as a percentage of GDP.

FDI stock as a percentage of GDP in Poland amounted to 19% of GDP in 2004. The high percentage of foreign stock in GDP indicates that foreign capital plays a vital role in the Polish economy. The GDP growth in Poland indicates strong economy. In 2006 and 2007 economic growth in Poland exceeded 6% and corresponding with a falling level of unemployment (8%) and relatively low inflation (1.8%). Economic stability and the impressive GDP growth in the Polish economy resulted in the high growth of exports. The economy export as a percentage of GDP has been increasing during the process of transformation reaching 38% in 2004. Poland's employment costs are the lowest among other transforming economies in Europe and constitute important factor attracting foreign investors.

The EU policies and the national incentive based FDI policies are driving forces influencing business environment in the CEE countries. Important factor influencing business environment in the CEE countries is their membership in the EU. Recent inflows can be attributed to the positive impact of the EU enlargement in May of 2004. Aiming to attract FDI, the CEE countries have created a regulatory framework, which constitutes basic guaranties for foreign investors but also offered some incentives under the national policies to create more favorable investment climate and attract foreign investors.

Foreign capital inflow was an important factor facilitating the privatization and reconstructing process in the CEE during beginning of the transition process. Currently, FDI is seen as an essential factor stimulating sustained economic growth. Most of the foreign investments in 2006 (87.9%) came from the European Union countries and the biggest number of foreign firms investing in Poland originated from Germany, France and USA. Currently nearly 60 % of FDI inflows were attributed to Greenfield investments. Privatization based FDI is no longer a major source of foreign inflows in Poland. Recently Poland compete for Greenfield investments on export to EU markets in the manufacturing sector and the services sector.

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