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THE ROLE OF FOREIGN CAPITAL INVESTMENTS AND THE EUROPEAN UNION FUNDS IN MANAGEMENT OF REGIONAL AND LOCAL DEVELOPMENT

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Paper abstract

A shortfall of capital constitutes a major barrier for regional and local development. Introduced economical and social transformations started a decade ago opened Polish economy to the inflow of foreign capital.

Both the central government as well as regional and even local authorities spent a lot of efforts to attract foreign investments into the country and as a result of these exertions at the end of 2002 foreign investment stock exceeded 65 Bln US dollars, including more than 61 Bln dollars in huge investments (exceeding 1 Mln dollars).

The peak inflow of foreign direct investments to Poland was in 2000 when more that 10 Bln US dollars reinforced Polish economy. However, significant drop was observed in the following years (2001 – 7 Bln dollars, 2002 – 6 Bln dollars). Over the course of political and economical transformation of Polish economy and transition into the market-driven economy near 50 thousand business ventures engaging foreign capital were formed. Unfortunately only a little bit more than 700 found favourable business environment in the Lublin region.

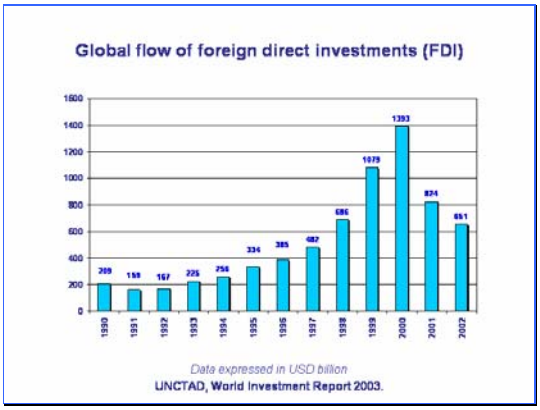
The Lublin region is the third largest region in Poland. As revealed by our survey presently some 22% out of 213 communes in the region, recognize the importance of foreign direct investments in stimulating local social and economical development and it is reflected in their development strategies. Joint venture companies with foreign capital operate in 87 communes of the Lublin region, and 93 local communities have successfully applied for structural funds made available by the European Union to the newly accessing countries (PHARE – 32 communes, SAPARD – 81 communes). As regards diversification of financial resources to support local development a trail has already been blazed by many local communities successfully attracting foreign capital and the EU funds.

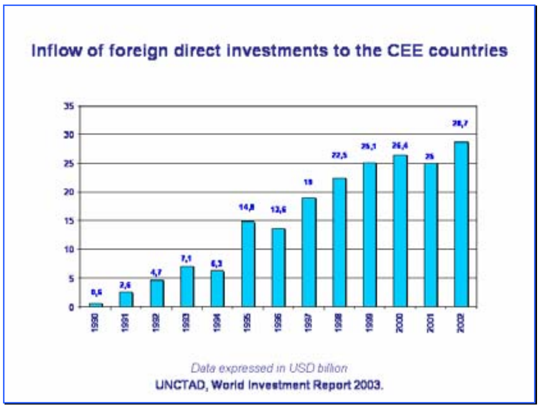
The present paper, based on the research carried out by Department of Economics of Lublin University of Technology, surveys the actual role and perspectives of old and emerging opportunities in terms of financing local and regional development.

Foreign Direct Investments as a form of financing and stimulus for development

According to data compiled by the United Nations Conference on Trade and Development (UNCTAD), the overall value of global foreign direct investment (FDI) inflows in 2002 amounted to some USD 651 billion, which compared to a period of 1999-2001 is a significant decline. In figures it is a drop of about one-fifth and about a half in comparison to 2001 and 2000 respectively. Global economic slowdown could be rightly blamed. However, despite this negative global tendency and previous forecasts made by UNCTAD, the inflow of foreign direct investments to the Central and Eastern European (CEE) countries amounted to approximately USD 29 billion and in 2002 was even higher by 15% than a year earlier.

Fig. 1. The global FDI flow and the influx of foreign direct investments to the Central and Eastern Europe countries over the years 1990-2002





Year	FDI inflow in Bln USD	
	Globally	*To CEE countries*
1990	209	0.6
1991	159	2.6
1992	167	4.7
1993	225	7,1
1994	256	6.3
1995	334	14.8
1996	385	13.6
1997	482	19.0
1998	686	22.5
1999	1079	25.1
2000	1393	26.4
2001	824	25.0
2002	651	28.7

Source: UNCTAD's World Investment Report.

According to the most recent FDI 2003 Confidence Index®, based on the annual survey of executives from the world's largest transnational corporations carried out by the Global Business Policy Council of a global management consulting firm A.T. Kearney, Poland become the fourth most preferred investment destination worldwide.

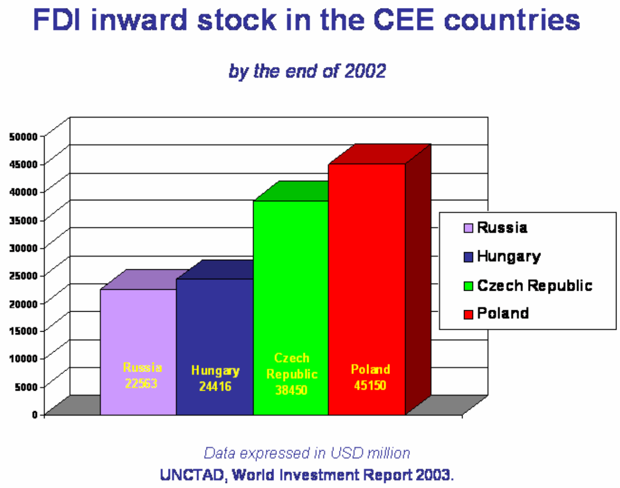
Although as stated by the research performer the survey conducted among CEOs, CFOs and other top executives of global 1000 companies and results of the study are intended for general information purposes solely and do not constitute investment or other business advice, it is strongly believed in Poland that progressing economic reforms, EU accession and building on existing high levels of investor confidence will help Poland to increase the FDI influx to the country, despite drops reported in recent years.

Fig. 2. The most attractive destinations of foreign direct investments in 2003 as revealed by the A.T. Kearney's 2003 Confidence Index®.

Source: A.T. Kearney, FDI 2003 Confidence Index®, September 2003.

Key FDI drivers in Poland include the biggest market size in this part of Europe, constantly improving business environment and a great deal of successful privatizations of state-owned enterprises as well as progressing integration with the world and European economy.

Fig. 3. FDI inward stock in the Central and Eastern Europe countries as of the end of 2002.

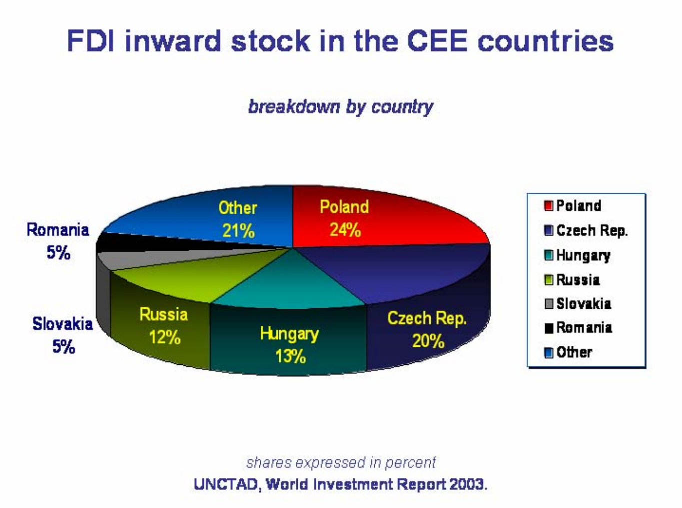


Source: World Investment Report 2003, UNCTAD.

The amounts of foreign capital that flows into a particular country or region may rightly be deemed as a direct evidence of that country's or region's attractiveness in the eyes of foreign investors who unquestionably are the most careful economic observers. Thirteen years of economic and political reforms and especially successful transition into market oriented economy put Poland in the leading position in the region in terms of attracting foreign capital.

According to statistics developed by Polish Information and Foreign Investment Agency after the first half of 2003 the accumulated value of foreign capital invested in Poland exceeds USD 68.3 billion, which is more than in any other country of the region.

Fig. 4. FDI inward stock in Central and Eastern Europe as of the end of 2002, breakdown by country.



Source: World Investment Report 2003, UNCTAD.

According to data compiled by Polish Information and Foreign Investment Agency, after the first six months of 2003 foreign companies invested in Poland USD 2.53 billion, which unfortunately was USD 702 million less than over the same period of 2002. The bulk of the capital that was invested in Poland in the first half of 2003, originated from the EU countries (74% of the total FDI stock invested in Poland). It is worthy to mention that a growing number of investors headquartered in the United States and Asia (chiefly Japan and South Korea) invest through their European subsidiaries.

In the first half of 2003, the majority of foreign capital came from companies registered in the Netherlands (USD 1.26 billion which represents 50% of the total value of FDI in Poland). The second most important group of foreign investors were German companies (USD 356.5 million). The third most active group of investors were transnational corporations. They accounted for 11% of the total FDI inflow (USD 267.2 million). An increasing inflow of investments from geographically distant regions like Philippines (USD 40 million after the first six months of 2003) or Republic of South Africa (USD 32.2 million) should also be noticed and welcomed.

By the mid-2003, there were 993 companies from 36 countries included on the Agency's List of the Major Foreign Investors in Poland. Over the first six months of 2003 those investors created nearly 9,000 new jobs

Polish regional economies to grow require immediate investments in almost all sectors. As a result of relatively low GDP it seems to be impossible to increase considerably a stream of funds transferred to the regions by Polish government. Such a boost could be a sort of a flywheel for regional economies. In 2002 GDP in Poland was equal to US$ 198 Bln, while in Germany it was US$ 2,392 Bln, in France – 1,677 Bln, Norway – 222 Bln and in Italy – 1,422 Bln. In 2002 GDP per capita in Poland was 5,120 US dollars, while in Germany it was equal to 29,210 US dollars, in France – 27,890 dollars, in Italy – 24,700 dollars, and in Norway GDP per capita was as much as – 48,710 dollars. In 2002 the rate of growth of GDP in Poland was 2.9%. [World in Figures 2003 – Świat w liczbach, 2003]

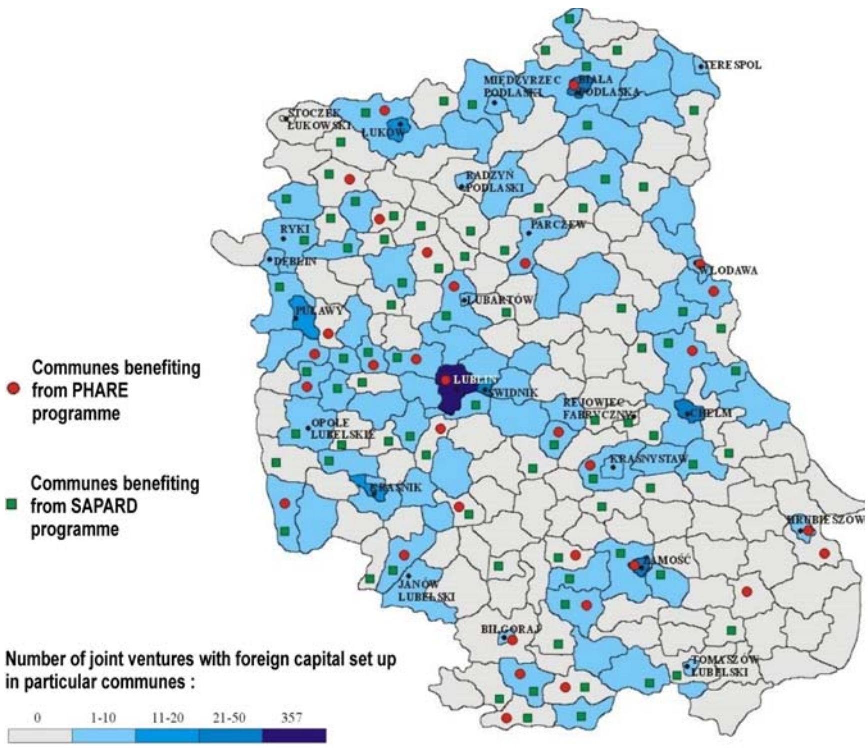
Thus, any sizeable increase of investment outlays could be achieved at the cost of significant cuts elsewhere, including consumption, welfare and other social expenses which bears a risk of harsh backlash against the government policy, if not major social outcry. This is the reason why significant boost of external capital is required. As a result of efforts in the whole period of transformation of Polish economy from 1989 up to the end of 2002 FDI stock reached US$ 65,114 Bln dollars, including US$ 61,447 Bln dollars in big investments exceeding 1 million dollars.

The biggest inflow of foreign investment to Poland was reported in 2000 – over 10 Bln US dollars. However, the influx of foreign investments dropped in subsequent years to 7 Bln US$ in 2001 and 6 Bln US$ in 2002 [Businessman, 2003, p.16].

By the end of 2002 more than 46.5 thousand enterprises with foreign capital were formed in Poland, while in the Lublin region only 728 were established, which stands for 1.5% of all joint ventures set up in the country. Even though the number of new local businesses is not impressing, and could even be depressing, social and economic impact was quite positive, which means more than 30 thousand retained and newly formed work places and new technologies brought into the regional industry. According to questionnaire research carried out in local businesses with foreign capital 62% of them acquired technologies no older than 3.5 years [Bojar, 2001, p.81]. In addition to that and as a result of foreign investments local firms started to introduce modern and hugely effective management systems. It is anticipated that this desirable trend will continue and even expand in the upcoming future.

Up to the date some 22% out of 213 local communities in the region that have developed their development strategies understand how important role could foreign capital play in terms of social and economic development of their communities. Joint venture companies with foreign capital operate in 87 communes of the Lublin region, and 93 local communities successfully applied for structural funds made available by the European Union to the newly accessing countries (PHARE – 32 communes, SAPARD – 81 communes). As regards diversification of financial resources to support local development a trail has already been blazed by many local communities successfully attracting foreign capital and the EU funds. Also other local communities should follow this example and supplement their financial resources with external funds.

Fig. 5. Participation of communes in the Lublin region in PHARE and SAPARD and the number of joint ventures operating in particular communes.



Source: Research made by the author.

In connection with upcoming enlargement of the European Union and accession of new states, including Poland a dedicated questionnaire research was carried out. The research covered over 80% of communes in the Lublin region and its aim was to assess to what extent local communities are prepared to operate in new environment and structures, and especially to evaluate their capacity to absorb and properly utilize funds made available to them by the European Union.

Development strategy as an important instrument of management

Development strategy that could be defined as a general set of goals and actions to be undertaken in a certain precisely investigated environment is one of the essential tools used in management of local economic and social development. It should encompass mission and vision of further development within a certain time horizon, strategic domain, competitive advantage as well as goals and operational programs to be realized [Wiatrak, ..., p.87].

As discovered in the research approximately 75% of surveyed local communities in the Lublin region have developed development strategies, mostly long-term strategies focused on improvement of quality of life of their inhabitants. Given the geographical location of the region and its natural environment, local communities attach huge weight to the development of agriculture (88% of local communities), agro-tourism (32%), and food processing (20% of local communities). Only 10% of researched communes professed interest in development of local industry. These are communes located around major cities of the region, to wit: Lublin, the capital of the region and 2 major cities Zamosc and Chelm located in the eastern borderland near the frontier with the Ukraine.

Table 1. Development directions declared by authorities of researched communes.

Agriculture	88%
Tourism	32%
Production of vegetable raw materials	26%
Animal farming	24%
Trade	24%
Food-processing industry	19%
Industrial crop growing	16%
Other industry	10%

Source: Research made by the author.

The bulk of surveyed local authorities and self-government bodies have incorporated into their official mission statements improvement of quality of life of inhabitants, yet as much as 73% of them recon that available funds first and foremost should be spend for investments. They expressed view that investments are far more important than day-to-day care about the dwellers' needs. Such an approach maybe deemed to be a clear-cut sign of departure from welfare oriented policy towards more active and far-sighted policy focussed on stimulation and support of local development.

Table 2. Preferred appropriation of funds as declared by authorities of surveyed communes (in case of significant growth of available funds).

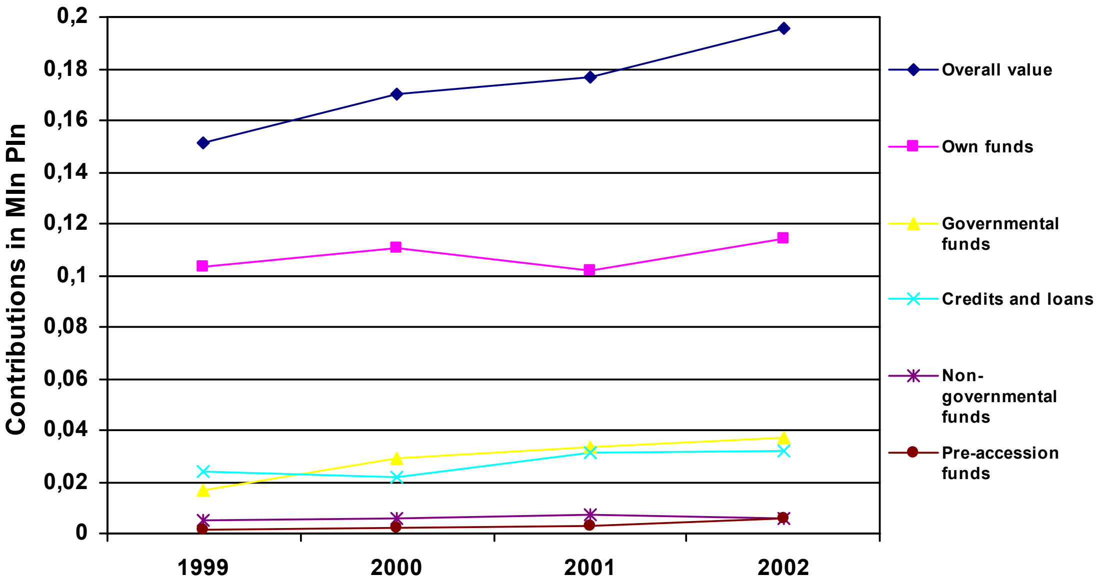
Communal investments	77%
Road construction	49%
Incentives for investors	28%
Education	27%
Promotion of local communities	23%
Welfare	10%
Housing industry	4%
Health care	3%

Source: Research made by the author.

As revealed by our research any increase in financial resources first and foremost communes would spend for communal investments (77%), road construction (49%), a variety of incentives for investors (28%), education (27%) and promotion (23%). They seemed to be rather reluctant to finance welfare (10%), housing (4%) and health care (3%).

Development of local infrastructure is perceived by local authorities as a sine qua non condition for further economic and social development of the region. Good infrastructure attracts foreign capital and encourages social activities of inhabitants. Poor infrastructure, especially in traditionally rural areas is a major barrier inhibiting any development and restraining access to education and labour market.

Fig. 6. Sources of financing of communal investments in 1999-2002.



Source: Survey made by the author.

Traditionally a shortfall of locally available capital is a major hindrance that local authorities have to grapple with when any decisions as to development of the region are to be taken. The most urgent are investments in infrastructure that may be a flywheel of local economy and could further attract foreign investors. Regional capability to attract foreign capital hangs on the quantity and more importantly on the quality of other local assets, especially access to market, available human potential, existing business supporting institutions, as well as transportation and communication infrastructure [Miszczuk, 2003, p.24].

As a result of poor competitiveness of the Lublin region and resultant very low capital engagement of foreign investors in local economies, local self-government bodies and communes are forced to finance development of existing infrastructure with their own very limited funds complemented with government financial support. It is rightly believed that better infrastructure would, under certain circumstances, increase interest of potential foreign investors in the region and would induce them to bring in significant capital.

In the analysed period investment outlays in the Lublin region showed growing tendency, however funds spent for that purpose by communes as compared to their overall budgets are declining in about 55% of communes. The overall value of investments made by surveyed communes in a time span ranging between 1999 and 2002 increased by some Pln 50 Mln (a growth from Pln 150 Mln in 1999 up to some Pln 200 Mln in 2002).

European funds – new sources of financing of regional and local development

The main goal of the EU policy is to ensure social and economic cohesion between member states and regions. All members collaborate with the European Commission to develop a variety of programs and agree upon the range of support. As a result of that effort a variety of specific programs have been developed and phased in, including those provided within the framework of Structural Funds and Cohesion Fund. One of the major objectives of the European Union is to increase competitiveness of its economy and make it the most competitive economy in the world. This includes improvement of existing infrastructure, investments in human potential and promotion of innovations [Sadownik, 2003].

According to survey made by the author 33% of local and regional authorities and self-government bodies in the Lublin region applied for funds with PHARE (rate of acceptance – 56%), 49% with Sapard (87% motions approved), ISPA – 5% (11% applications approved), 46% of local communities applied with World Bank (60% applications approved for financing), EBRD – 2% (100% approved) and 19% of local communities sought assistance from other resources (82% applications approved).

Established in 1989 program PHARE *(Poland and Hungary Assistance in Restructuring Economies)* was aimed at providing financial and organizational assistance to Central and Eastern European countries transforming their economies from state controlled to market-oriented economies and building democratic systems. Within the circle of PHARE objectives was also reintegration of Central and Eastern European economies with both European and world economy. Subsequently PHARE was extended onto other countries of the region. Commencing on 1998 along with new orientation of the program indicative PHARE budget was introduced. Up to 2006 30% of annual budget is to be spent for institutional building associated projects, and 70% for investment projects. As mentioned above our research established that 33% of local communities in the Lublin region sought financial assistance from PHARE and 56% communes were successful in their efforts.

On January 1, 2000 came into effect the Special Accession Programme for Agriculture and Rural Development - SAPARD. The programme which comes under responsibility of DG Agriculture aims to help candidate countries deal with problems of structural adjustment in their agricultural sectors and rural areas, as well as in the implementation of *acquis communautaire* concerning the Common Agricultural Policy as well as related EU legislation. SAPARD is budgeted until the end of 2006. However, as set out by the European Union bodies candidate countries such as Poland may only benefit through SAPARD between 2000 and the time they join the European Union. In case of Poland it is May 1, 2004. SAPARD that finances major agricultural and rural development projects has an annual budget of EURO 520 million. Almost a half of surveyed local communities in the Lublin region (49%) applied for SAPARD funds and 87% of projects received support.

Instrument for Structural Policies for Pre-Accession often called ISPA, which has an annual budget of € 1,040 million and comes under the responsibility of the Regional Policy Directorate General finances major environmental and transport infrastructure project. Over a time span ranging from 2000 to 2006, a total of € 1,040 million a year will be made available for infrastructure projects in the field of environment and transport. The main priorities in preparing the applicant countries for accession with the European Union include familiarising them with the policies and procedures of the Union, helping them catch up with EU environmental standards, especially those concerning drinking water, wastewater, waste materials and pure air, as well as development and linking with trans-European transport networks. A circle of eligible applicants include local communities and their organisations as well as other public institutions. In the Lublin region only the city of Lublin was able to tender a successful project for establishment of a state-of-the-art wastewater purification plant.

European Bank for Reconstruction and Development (EBRD), an international finance organization established in 1991 is aimed at providing support for economic transformations in Central and European Europe countries and former USSR countries as well. The support provided by EBRD is contingent upon development of democracy and observance of the human laws in a given country. Both governments and private institutions may apply. About 2% of communes applied for co-financing by EBRD funds, all were successful. First and foremost EBRD finances construction of roads and development of water-supply systems. According to our research 46% resigned from applying for EBRD funds because of shortage of co-financing matching EBRD criteria, a lack of eligible projects was revealed by 29% communes and 2% communes showed no interest in EBRD funds for other reasons.

A questionnaire research carried out among communes in the Lublin region has proved that a shortage of own capital is the main barrier preventing communes from winning external funds.

The EU structural funds are available only to those regions where revenue per capita is lower than 75% of per capita revenue in the EU countries. In all Polish regions a per capita revenue averages out at 39% and in some regions it is even significantly lower, including the Lublin region (30%). Among the 10 countries newly accessing the European Union only 2 countries, to wit Lithuania and Latvia are poorer than Poland.

As revealed by our survey approximately 53% communes in the Lublin region have developed projects to be submitted to the European Union for financing, 66% have projects under development and 76% communes intend to develop projects eligible for co-financing by the EU funds.

Table 3. Levels of preparedness of communes in the Lublin region to apply and win external funds.

A percentage of surveyed communes that have developed projects to be submitted for financing by the UE	53%
A percentage of communes that have been developing project to be proposed for the EU financing	66%
A percentage of communes that will start developing projects	76%

Project are prepared or to be prepared by:

Properly trained staff	66%
External consulting firms	15%
Authorities consider employment and training of additional staff	18%

Source: Survey made by the author.

Pursuant to assessment developed by Institute of Public Affairs based in Warsaw the institutions concerned are not able to generate enough ideas to absorb all funds made available to Polish local and regional governments by the European Union. This is partly because they do not have sufficient administration and adequately trained clerks and civil servants. As revealed by the Polish Ministry of Economy it has developed a special data base of submitted projects. Database consists of some 600 records, but according to ministry's officials only one third of proposals tendered for the EU co-financing are properly devised and developed so they have a chance to meet all the EU criteria [Niklewicz, 2003].

Similar extremely disturbing situation is in the Lublin region where only 43% of researched communes have departments responsible for collaboration with the EU institutions (82% departments are one-clerk departments, while 18% employ more clerks).

Table 4. Levels of preparedness of communes in the Lublin region to apply and win over the EU funds.

A percentage of surveyed communes that have established departments responsible for collaboration with the UE and application for the EU funds	43%

including:

One-man departments	82% of surveyed communes
Departments employing more than 1 person	18% of surveyed communes

Source: Survey made by the author.

Structural policy implemented by the European Union changes over time and basing on previous experience is amended to match emerging needs as well as economic and social situation. Lessons learnt from the past show that the best results in terms of regional development are achieved when financial assistance is aimed at stimulating and strengthening existing local endogenous potential, including human potential, transport infrastructure, environmental investments, telecommunication infrastructure, support of local entrepreneurship and innovation.

Final remarks

Undoubtedly, regional development requires significant investments. Accumulation of own capital by communes requires time. Thus a significant boots of external capital to be brought into the region is desired, both government and brought into the region in a form of foreign direct investments. The success of Polish economical transformations rests in the country's capability to attract so huge foreign capital for so many years. Much needs to be done yet. Foreign investments in Poland are dropping every year and both central government and regional authorities and local self-government bodies strongly believe that this trend will be reversed soon.

Administrative reform phased in as a part of intense transformations of the country released energy, zeal and true enthusiasm in local communities. Communes undertake to eliminate backwardness accrued over years and catch up with standards in other EU countries, especially in terms of infrastructure, environmental issues, development of local entrepreneurship and the quality of life of inhabitants. Local communities recognize the challenge and chance at the same time that is given in a form of the EU assistance programmes. It hadn't always been so. An awful lot of opportunities have been neglected and missed. To increase capability of communes in the Lublin region to win over more funds currently on stand-by by within the framework of a variety of the EU assistance programs, communes need to improve their bureaucratic apparatus, including training of staff responsible for both development and implementation of long term strategies as well as operational plans and projects eligible for the EU funding. On top of that communes chronically wrestling with the lack or deficiency of capital should be given more opportunities of cheap credits necessary to complement the EU contribution.

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