

Aleksander Rezmer

Faculty of Engineering Sciences, Gdańsk School of Higher Education

Legal stability as a factor determining investment attractiveness of a country

Abstract

The aim of the article is to highlight the importance of legal stability as a fundamental factor determining investment attractiveness of a country. The main assumption of the article is the positive role of FDI on a host country's economy. That is why shaping investment attractiveness is a key issue that governments have to address. FDI flows in the world and in Poland have been presented. Features of good law were identified and legal stability was defined. The legal stability in Poland was analyzed and a case study was applied to present how changes of law have influenced the owners of wind power generators. The main conclusion from the research is that it is necessary to improve investment climate in Poland, including legal stability, as some of Polish assets, such as low cost and availability of labour are running out.

Keywords: legal stability, FDI.

Introduction

The aim of the article is to highlight the importance of legal stability as a fundamental factor determining investment attractiveness of a country. The main assumption of the article is the positive role of FDI on the host country's economy. That is why shaping investment attractiveness is a key issue that governments have to address. One of the simplest ways to attract foreign investors is to provide them with financial incentives, such as tax reductions. However, there are other forms of improving climate for investment that do not require direct financial involvement. Efforts to create a stable, non-corrupt business environment are also of paramount importance. Stable business environment does not mean, however, that changes do not occur. They do, but they should be reasonable, predictable and have a proper timing. These changes ought to positively affect all dimensions of business environment.

One of the key elements of investment climate is the efficiency of the legal system. Investors need to know in advance about all the procedures, requirements and their costs. They are deeply concerned about the legal regulations in the industries they want to invest in. What is more, they would like to work in stable legal conditions and all rapid, unnecessary changes in the legal system are unwelcome by them because they may have a strong impact on the feasibility of the investment.

Knowing all that, it is worth putting a scientific question if Poland features legal stability and how it may affect the investment attractiveness of the country.

1. Foreign Direct Investment in the world economy

According to the World Bank's definition (World Bank, 2018), FDI refers to direct investment equity flows in the reporting economy. It is the sum of equity capital, reinvestment of earnings, and other capital. Direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy. Ownership of 10 percent or more of the ordinary shares of voting stock is the criterion for determining the existence of a direct investment relationship.

Since 1990s there has been significant growth in FDI net inflows in the world (Fig. 1). There are many factors that have contributed to this process, such as technological advancements, liberalization of international trade and investment, globalization and the development of transnational corporations. As FDI has a positive effect on economic growth, employment and export (Maček, Bobek, Vukasović, 2015), developing countries see the opportunity to develop faster by means of FDI absorption that leads not only to the creation of workplaces, but also means know-how diffusion and business opportunities for local companies. That is why countries sometimes even compete in order to attract some global investors, for example Poland and Slovakia negotiated with TATA the location of a huge car factory of Jaguar Land Rover and Slovakia was granted this investment due to significant public aid offered to the investor (Puls Biznesu, 2015).

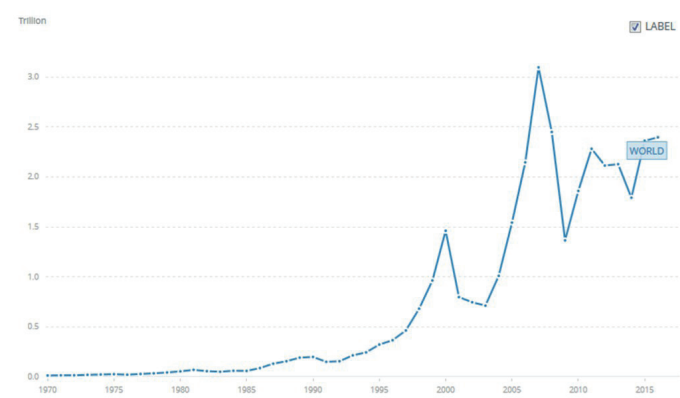


Fig. 1. FDI net inflows in the world 1970–2017 in trillions USD

Source: *Foreign Direct Investment FDI*, World Bank, 2018, retrieved from: www.worldbank.org.

Poland is a country that has greatly been affected by FDI. Such investment has enhanced the economic growth in Poland and generated a great number of jobs. The indisputable assets of Poland have always been good geographic location in the heart of Europe, membership in the European Union that gives the access to the common market and affordable, well-educated labour and a big market size. The FDI net inflows in Poland are presented in Fig. 2.

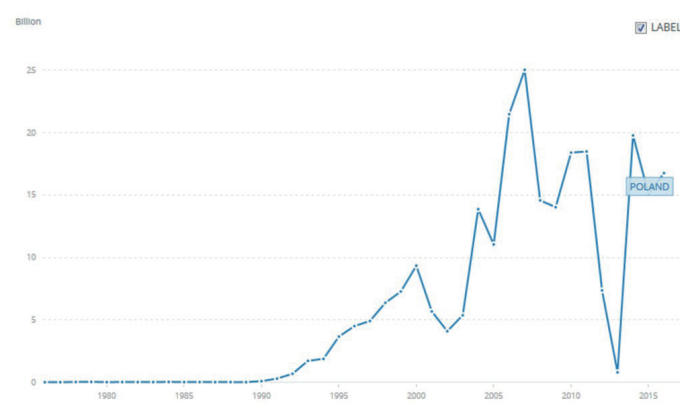


Fig. 2. FDI net inflows in Poland 1975–2015 in billions USD

Source: *Foreign Direct Investment FDI*, World Bank, 2018, retrieved from: www.worldbank.org.

Nevertheless, it is necessary to say that FDI is a way in which the world's largest corporations develop and it is not always sustainable growth. FDI often has a negative impact on the environment, culture and society, such as Danish pig farms in Poland (Pierwszy Portal Rolny, 2006).

2. Legal stability as a feature of a good legal system and a determinant of investment attractiveness

There are numerous factors that businessmen analyse before taking decisions regarding their investments. That especially concerns decisions of international expansion. The process of selection a market is complex and usually begins with in-depth analysis of potential host countries. A useful tool to conduct such an analysis is PESTLE framework that is a mix of political, economic, social, technological, legal and environmental factors. A good legal system is based on proper legislation and should be effective. In terms of effectiveness there are numerous issues that should be taken into account. The system should allow to resolve cases in court fast, cheaply and faultlessly. However, the quality of law itself is also a crucial issue. Good law can be characterized by a few key features. It ought to be:

- simple,
- comprehensive,
- accessible,
- be based on moral values,
- clearly states what is allowed and what is not,
- stable.

Stable legal system does not mean no introduction of changes at all. The aim is to introduce changes only when they are really necessary. The appearance of new technological advancements is always a challenge for the lawmakers. For example, the introduction of e-cigarettes created the need for reinterpretation of many legal acts (Gazeta Prawna, 2016). Flexibility of law is an important element of a good legal system (Siciwena, 2013). Flexibility of law means that it ought to keep up with social

change. According to her, law should not be too rigid to prevent change with the dynamic society and circumstances, places, times and other factors should definitely be considered in the making of a law. However, the changes ought to be predictable. Before the introduction of new legislation there ought to be a process of discussion over the issue so that anyone deeply concerned about incoming changes could express his or her opinion about it. Secondly, the changes in the law should reflect the intentions of the politicians mentioned during their campaigns. The political victory of a particular political party should clearly indicate the direction of legal changes. A good example of predictable changes in the Polish law is the process of adjustment to the EU legal regulations.

3. The stability of Polish legal system

In Poland since the political and economic transformation there has been a rise in the number of laws that have been passed (Fig. 3). The rapid legislation during a few years prior 2004 can be explained by Polish efforts to comply with the laws and regulations of EU in the process of accession. However, it is really difficult to identify any factors that contribute to the even more rapid rise in the number of pages of legal acts that is happening now.

In 2016 more than two thousand legal acts were passed and around half of them concern business (Polityka, 2017). Needless to say that such a great number of new legal acts being passed means that there are numerous mistakes in them, because nobody is able to carefully examine such amount of text. That is why the process of legislation in Poland is sometimes called the production of law. However, that metaphor is not accurate because modern production systems guarantee very high quality which has nothing in common with the quality of quickly passed laws in Poland.

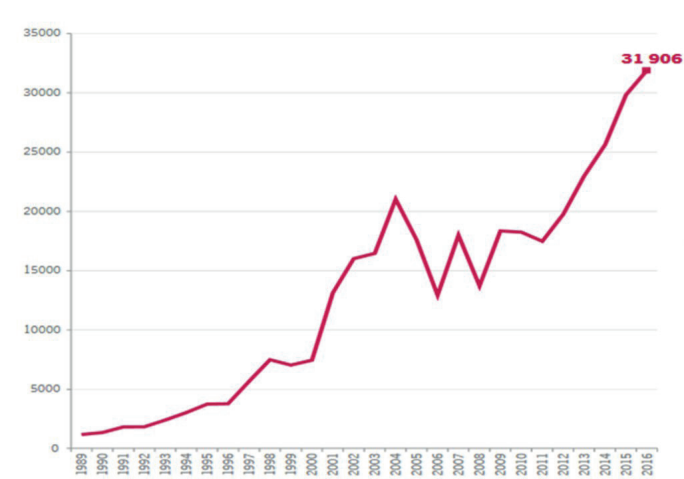


Fig. 3. The number of pages of legal acts passed in Poland 1989–2016

Source: *Produkcja prawa największa w historii*, Grant Thornton, 2017, retrieved from: www.grantthornton.pl.

A good example of quick legislation is increasing personal allowance that happened 29 November 2016 — the whole procedure took only one day. Grant Thornton has identified a few other factors that contribute to the poor production of law in Poland. First of all, around one fourth of new legal acts origins in Senate or Parliament — not in government. Such procedure allows to omit consultations that require time but give the opportunity to find mistakes and better balance the impact of new law on the concerned parties. Secondly, around half of legal acts are not discussed at the committees in Parliament — or these discussions are very brief and of symbolic significance. Finally, Senate hardly ever introduces corrections to new legal acts and so does the President of Poland. To sum up, laws passed in such a hurry are full of defects that require modifications in a form of further legislation and the whole legislative process becomes ineffective in spite of its impressive speed.

4. Case study: Changes of legal regulations concerning wind power generators in Poland

The aim of the case study is to show how unpredictable legal changes can negatively affect the industry that attracts FDI. The research concerns the production of electricity in an environmentally friendly way. This industry is of paramount importance for Poland because on one hand it provides energy that is necessary for the development of the economy and contributes to the energetic self-sufficiency and stability, on the other hand it enables to comply with the EU's policies on the green energy production.

In May 2016 new legislation regulating wind generators was passed. The changes included the minimum distance from the generator to housing areas that in reality was 1.5–2 km. In fact, that led to the situation in which it is impossible to find location for new turbines and the industry is unable to develop. What is more, the definition of a wind power generator was changed and in 2017 it unintentionally led to the increase in the property tax a few times. That is because the turbine is mounted on a mast and previously the property tax only concerned the value of masts, whereas after the change the tax was from the value both a mast and a turbine and the latter is worth much more. The new law restricted the construction of generators that already had construction permits and also did not allow for upgrades of already existing turbines that would lead to the increase of their power output. Along with the new rules of selling green energy, all these changes were a huge blow for the whole industry, reducing profitability and leading to abandonment of new projects. As a result, an American company Invenergy, which has invested millions of dollars in wind power generators, filed for international arbitration against Poland (Invenergy, 2018).

It was obvious that the new law was with mistakes and the government has proposed an amendment that will solve the problem with the definition of wind power generator and allow for construction of the projects with valid construction permits. This solution will only partly satisfy the industry. However, the Minister of Energy has announced that after having collected various opinions during discussions there will be another amendment till the end of 2018.

The case study clearly shows that the industry of paramount importance for Poland is deeply affected by low legal stability and the announcements of the

government representatives indicate that this state of affairs will not improve. Such situation definitely discourages foreign investors from allocating their capital in Poland and has a negative impact of the image of Poland.

5. Conclusion

There are many determinants of investment attractiveness of a country and the majority of them can be, to some extent, shaped by the government. Undoubtedly, one of them is legal stability. As absorption of FDI is crucial for the economic growth of developing countries, creating a positive investment climate is of high importance. However, in the process of economic development, many attractiveness factors change. Usually these changes are positive. Due to FDI countries develop their infrastructure and the society becomes richer and more open. However, not all changes are favourable from the FDI point of view. A good example is Poland. For many years this country has been renowned for cheap, well-educated labour and high unemployment rate above 10% enabled companies to find employees very easily. Nowadays the situation is changing and a bigger recruitment project is difficult to conduct. The shortage of labour inflicts rise in salaries and that has a direct impact on the feasibility of many FDI projects, especially in manufacturing.

In order to mitigate the negative impact of the changes on the investment climate, it is necessary to put more effort to ease doing business. There are numerous fields of improvement, starting from infrastructure development, corruption or bureaucracy. The effectiveness of the legal system is of high importance as well. Sadly, the legal stability in Poland is on low level and the trend is negative. More and more laws are produced and their quality is deteriorating. The process of correcting mistakes and gaps in legal acts complicates the whole legislation and leads to even more frequent changes. It seems that politicians tend to forget that all these modifications have a direct impact on businesses. It is hard to say to which extent such legal instability discourages investors from abroad to locate their business in Poland or even forces the ones already present to withdraw their capital. Nevertheless, such legal issues contribute to the slow loss of investment attractiveness of Poland.

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Stabilność prawa jako czynnik kształtujący atrakcyjność inwestycyjną państwa

Streszczenie

Celem artykułu jest przedstawienie znaczenia stabilności prawa jako czynnika kształtującego atrakcyjność inwestycyjną państwa. U podstaw artykułu leży założenie, iż bezpośrednie inwestycje zagraniczne mają pozytywny wpływ na rozwój państwa i powinno się tworzyć korzystne warunki do inwestowania, a stabilność prawa uznano za jeden z istotnych składników otoczenia. Przedstawiono bezpośrednie inwestycje zagraniczne na świecie i w Polsce. Określono, jakimi cechami powinno cechować się prawo oraz co rozumie się poprzez stabilność prawną. Przeanalizowano stabilność prawną w Polsce oraz zastosowano studium przypadku, aby zilustrować wpływ zmian prawa na właścicieli elektrowni wiatrowych. Głównym wnioskiem płynącym z analizy jest potrzeba skuteczniejszego kształtowania klimatu inwestycyjnego w Polsce, w tym stabilności prawnej, gdyż dotychczasowe atuty Polski, takie jak tania i dostępna siła robocza, powoli się wyczerpują.

Słowa kluczowe: stabilność prawa, BIZ.

