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INTERNATIONAL INVESTMENT POSITION VERSUS EXTERNAL DEBT

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Abstract

The aim of the paper is to provide an answer to the question which phenomenon is a more accurate reflection of Poland's external imbalance: international investment position or external debt. In the first and the second part of the study the definitions and essence of both categories have been explored, in the third and fourth – tendencies in international investment position and the level of external debt, whereas the last part evaluates the external imbalance in Poland.

Keywords: external imbalances, international investment position , external debt.

JEL classification: F34.

Introduction

External debt and international investment position are two categories which allow drawing conclusions about external imbalance of a country[1]. These two concepts, however, are not synonyms in terms of either economics or statistics. A question arises as to the differences between the two categories and as to which one is a more accurate reflection of the imbalance in a country's economic and financial relations with the rest of the world.

An attempt to provide an answer to this question based on the Polish experience is the objective of this paper, the more that both the literature on the subject and socio-political journalism have so far concentrated on the interpretation of the payment situation of our economy (related mostly to external debt) rather than the impact of its international investment position.

The terms: external debt and international investment position were introduced by the National Bank of Poland (NBP) in 1999 and have become the basis for the official information on Poland's external imbalance. They take into account the international standards, especially the criteria developed by the International Working Group on External Debt Statistics (IWGEDS) next to external debt statistics developed by the International Monetary Fund (IMF) and the European Central Bank (ECB)[2].

1. The essence, entities involved and structure of instruments generating external debt

According to the IWGEDS, external debt is the amount, at any given time (usually year-end or quarter-end), of disbursed and outstanding contractual liabilities of residents of a country to non-residents to repay principal, with or without interest, or to pay interest, with or without principal. This definition has been set by the IWGEDS as the core definition[3]. The following aspects can be distinguished within this approach[4]:

1. This concept refers to the gross external debt since it encompasses only selected Poland's external liabilities without deducting external accounts receivable.
2. External debt includes:
   a) interest-free contractual liabilities which require payment;
   b) liabilities with undetermined pay date (such as bonds without maturity date);
   c) overdue and outstanding interest which is considered short-term debt until the debt has been repaid or restructured[5].
3. External debt does not include:
   a) equity participation, i.e. liabilities related to the inflow of FDI or portfolio investment in equity securities (stock);

b) contractual liabilities which have been only made available (such as a loan which has been granted but not used);

c) accrued interest payable[6].

4. It is not the currency but the concept of residence which distinguishes between external debt and domestic debt. It implies that external debt does not include securities denominated in foreign currencies and held by residents while it includes securities denominated in the local currency which are held by non-residents.

According to the IWGEDS, the National Bank of Poland classifies external liabilities by entities as follows:

- monetary authorities,
- general government,
- banks,
- other sectors.

The financial instruments which generate external liabilities, on the other hand, include:

a) loans from direct investors
b) debt securities held by foreign portfolio investors;
c) other investment, including:
   - trade credits,
   - loans,
   - currency and deposits (held by non-residents in Polish banks),
   - other liabilities.

The above-mentioned instruments were identified according to the list of 12 categories of financial instruments within the System of National Accounts (SNA) developed by the United Nations in 1993. The full list is presented in Table 1. The data for the above-mentioned entities and financial instruments is aggregated by the Statistics Department of the National Bank of Poland, and takes into account the IMF and ECB external debt statistics system which is based on the concept of the international investment position (IIP).

2. The essence and structure of the international investment position

This term is usually used to define a statistical statement of foreign assets and liabilities at the end of a reporting period – usually a year or a quarter of a year[7]. The IIP is a statement of accounts receivable and payable of a given country in relation to all the transactions with the rest of the world made from the viewpoint of a resident. The IIP balance informs whether a given country is a net creditor or debtor.

Table 1. SNA classification of financial instruments

No.	Assets	No.	Liabilities
1.	Monetary gold and SDRs	1.	–
2.	Currency and deposits	**2.**	**Currency and deposits**
3.	Other deposits	**3.**	**Other deposits**
4.	Treasury bills, short-term bonds and other short-term debt securities	**4.**	**Treasury bills, short-term bonds and other short-term debt securities**
5.	Long-term debt securities	**5.**	**Long-term debt securities**
6.	Trade credits	**6.**	**Trade credits**
7.	Other short-term loans	**7.**	**Other short-term loans**
8.	Other long-term loans	**8.**	**Other long-term loans**
9.	Net equity of households in life insurance reserves and in pension fund reserves	9.	Net equity of households in life insurance reserves and in pension fund reserves
10.	Other accounts receivable	10.	Other accounts payable
11.	Quoted shares	11.	Quoted shares
12.	Unquoted equity	12.	Unquoted equity

Source: NBP, www.nbp.pl.

The National Bank of Poland presents in the IIP the foreign assets and liabilities according to international standards. Foreign accounts receivable include equity and debt assets whereas accounts payable include participation and debt liabilities. Their complete list is presented in Table 2.

Among all the sectors of the economy, the following groups of entities are empowered to trade with the rest of the world[8]:

- National Bank of Poland,
- monetary financial institutions (banking sector),
- general government and non-government sectors,
- other sectors (mostly enterprises).

These considerations reveal that the IIP, which encompasses similar entities yet more instruments, is a broader reflection of a country's relations with the rest of the world than the list of transactions comprising external debt. The explanation is that the liabilities in external debt do not include:

a) equity held by foreign direct investors;

b) equity securities held by port folio investors;

c) net equity of households in foreign life insurance reserves and in pension fund reserves[9], i.e. categories 9–12 listed in Table 1.

Table 2. Financial instruments in Poland's international investment position

Assets	Liabilities
1. Direct investment abroad	1. Direct investment in reporting economy
1.1. Equity capital and reinvested earnings	1.1. Equity capital and reinvested earnings
1.2. Other capital	1.2. Other capital
2. Portfolio investment	2. Portfolio investment
2.1. Equity securities	2.1. Equity securities
2.2. Debt securities	2.2. Debt securities
3. Financial derivatives	3. Financial derivatives
4. Other investment	4. Other investment
4.1. Trade credits	4.1. Trade credits
4.2. Loans	4.2. Loans
4.3. Currency and deposits	4.3. Currency and deposits
4.4. Other assets	4.4. Other liabilities
5. Reserve assets	

Source: own study based on *NBP, Międzynarodowa pozycja konkurencyjna Polski w 2009 roku*, Warsaw 2010.

All those instruments, according to the definition, are not included as liabilities because they do not require repayment of principal and/or interest. Their impact on the scale of transactions with non-residents which are denominated in foreign currencies, however, can be significant owing to the necessity to transfer income (earnings) made by direct investors and dividends on participation capital.

Most of the IIP data is derived from the balance of payments, yet it is also affected by exchange rate differences, valuation differences, reclassification or correcting entries[10]. In individual years they can lead to significant changes in IIP levels which are unrelated to the transactions with the rest of the world as reflected in the balance of payments.

Those theoretical considerations will be now verified on the basis of the statistical data for the years 2001–2010. In practice, both categories describing Poland's relations with the rest of the world in that period will be estimated: first the IIP, and then external debt.

3. Tendencies in Poland's international investment position

The data in Table 3 shows that the 2010 net IIP amounted to nearly minus EUR 224 billion whereas the beginning of the decade saw a much higher level of minus EUR 65 billion. Poland, as compared and contrasted to the rest of the world, was a structural net debtor which was related to its higher dynamics and higher absolute levels of liabilities than assets.

Table 3. Poland's International investment position and external debt in the years 2001–2010

Category	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
IIP Euro millions										
Assets	55.9	49.4	46.4	58.5	77.8	89.6	106.6	97.1	107.5	133.4
Liabilities	121.2	119.5	121.0	152.8	186.0	215.9	271.2	270.0	302.1	357.1
Net IIP	–65.3	–70.1	–74.6	–94.3	–108.2	–126.3	–164.6	–172.9	–194.6	–223.7
Net IIP /GDP (as %)	–30.8	–33.5	–38.9	–46.0	–44.2	–46.4	–52.8	–47.6	–62.5	–63.2
Net IIP /exports of goods and services (as %)	113.7	117.1	117.0	123.0	119.2	115.1	129.8	120.2	160.7	152.3
External debt Euro millions	81.5	81.0	85.1	95.3	112.3	128.9	158.6	173.7	194.4	253.4
External debt/GDP (as %)	38.4	38.7	44.4	46.6	45.9	47.4	51.0	47.5	62.6	66.5
External debt /exports of goods and services (as %)	141.8	135.3	133.6	124.3	123.6	117.4	124.9	130.0	160.4	160.2
Principal+interest/ exports of goods and services (as %)	31.5	28.2	30.7	36.2	32.9	30.3	34.8	35.1	48.6	49.9
External debt /IIP liabilities (%)	67.2	67.8	70.3	62.4	60.4	59.7	58.5	64.3	64.8	65.9
Expenditure in investment earnings Euro millions	4,500	4,044	5,069	11,050	11,132	14,907	19,321	16,241	16,578	18,358
IIP liabilities /GDP (as %)	57.1	57.0	63.2	74.6	76.0	79.3	87.0	74.4	97.0	100.9
IIP liabilities/ exports of goods and services* (as %)	260.6	242.2	224.7	232.1	239.8	231.1	253.1	223.3	301.5	243.1

* For the years 2001–2003 only exports of goods.

Source: own study based on NBP data, www.nbp.pl.

In 2010 the accounts payable nearly doubled (reported a 194.6% increase) as compared to 2001 whereas the accounts receivable increased only by 92.3%.

Particularly rapid increases in Poland's foreign liabilities have been reported since 2004. It should be related to the transition of our economy rather than its opening to the rest of the world under contemporary circumstances of Poland's membership in the European Union and the related deregulation of capital flows as mobility of goods had been liberalised earlier – in the years 1992–2001 a free trade zone between Poland and the Commonwealth was functioning.

This increasing negative balance in the IIP was an ever higher burden to the country's GDP. At the end of 2010 this ratio doubled as compared to the beginning of the analysed decade – amounting to 63.2% as related to the initial 30.8%. On the one hand, it points to Poland's better economic and financial integration with the rest of the world. On the other hand, however, it implies the country's worse reputation as debtor that is less and less able to repay its debt. The latter is supported particularly by the worrying levels of IIP in relation to exports of goods and services: in 2010 the ratio of the negative IIP balance to the inflows related to exports of goods and services amounted to 152.3% whereas in 2001 it was only 113.7%.

4. Changes in Poland's external debt

Poland witnessed also a gradual increase in its external debt in the analysed period. At the end of 2010 our total debt exceeded EUR 235 billion which means a threefold increase in relation to 2001 (see: Table 3). Particularly rapid increases in external debt – like in the case of the IIP – have been observed since Poland joined the European Union. In the years 2001–2003 the average annual debt growth rate amounted to 2.2% whereas in the years 2004–2010 this figure increased more than seven times (up to 16.4%).

External debt became an ever greater burden also to the GDP and exports of goods and services. In 2010 it accounted for 66.5% of GDP (as compared to 38.4% in 2001) and 160.2% of exports of goods and services (as compared to 141.8% in 2001). It implies that our capability to repay external debt has markedly deteriorated. It is noteworthy to observe that the rapid growth in the debt service ratio was particularly dangerous to our economy since timely repayment of principals and interest determines not only the liquidity but also solvency of an economy. The debt service ratio, however, remained throughout that period above the 30% safety threshold set by the World Bank. Even worse, in 2010 this ratio – at nearly 50% – was by two thirds higher than the safety limit.

Taking all the above data into consideration, one should point to the most relevant ones in terms of the evaluation of Poland's external debt. In other words, it has to be decided whether the external imbalance is better explained with the statistics describing external debt or IIP.

5. Evaluation of Poland's external imbalance

When analysing the two categories describing our country, i.e. the net IIP and the external debt, it may be concluded that the latter figure was generally higher throughout the whole 2001–2010 period. The difference between them, however, was gradually decreasing – from approx. 25% at the beginning of that period to merely 2.1% at the end of 2006 (see: Table 3). In the following years this general trend sometimes reversed while the net IIP advantage was clearly decreasing as it oscillated between 0.1% and 3.6%. It was related mostly to exchange rate differences and other changes which affected the total assets and liabilities, and indirectly also the IIP balance. Negative exchange rate differences, adding to the negative IIP, originated in the depreciation of zloty towards Euro in the years 2007–2008[11]. At the beginning of the analysed decade, on the other hand, positive exchange rate differences impeded the IIP growth following the appreciation of the Euro to other currencies, particularly the US dollar, in which the remaining Polish assets and liabilities were denominated[12].

The fact that the IIP reached the same level as the external debt does not automatically imply that the two phenomena have the same economic meaning, i.e. that they provide the same explanation for our external imbalance. It should be borne in mind that the IIP balance is obtained as a difference between assets and liabilities which – as already emphasised – include both accounts receivable and payable related to debt as well as equity. External debt, on the other hand, reflects only the total amount of external liabilities, which do not include participation capital. Let us examine the IIP liabilities with external debt in order to define the differences between the two categories for Poland.

As the data in Table 3 suggests, external debt in the whole analysed period accounted for between 60% and 70% of the IIP liabilities. It means that the remaining 30–40% represented the transfer of earnings on direct investment and the dividends on equity securities acquired by non-residents. It is depicted as expenditure in the investment balance sheet which amounted to nearly EUR 18.5 billion in 2010, yet was still lower than the level reported in 2007 at as much as EUR 19.5 billion. Those figures were not accounted for by external debt although they need to be transferred abroad thus reducing the balance of the current account and adding markedly to our payment difficulties.

Since there are significant differences between external debt and IIP liabilities, the latter need also to be related to GDP. It proves that they present considerably more (over 50% on average) burden to GDP than external debt. Furthermore, whereas the ratio of external debt to GDP exceeded the safety threshold only in 2007 and the years 2009–2010, the IIP liabilities remained above the limit throughout the entire period of analysis to exceed even the actual level of GDP in 2010. The burden posed to the exports of goods and services was also significantly higher for IIP liabilities than external debt. Nearly in every year of the analysed period the payments to non-residents related to equity and debt were nearly twice as high as the total value of foreign currencies earned (in 2009 even three times) whereas the principal and interest payment accounted for between 28% and 50% of their amount.

Conclusions

Based on the evidence, the following conclusions can be reached:

1. International competitive position is a much broader category than external debt.
2. IIP, which covers both assets and liabilities, is a better reflection of the entire economic and financial relations with the rest of the world.
3. The term „net debtor" based on the balance of the IIP is a more precise depiction of external imbalance than the term „debtor".
4. The research carried out for Poland proves that net debtors need to make payments denominated in foreign currencies not only in the form of equity capital held by non-residents in its enterprises (as transfer of earnings) or acquired stock (as dividends) but they also have to service debt securities. Debtors, on the other hand, will only pay principals and interest on the latter.
5. The evidence from the research indicates also that the payment imbalance in the economy is greater and the international liquidity is lower if IIP liabilities are considered next to external debt.

Notes

[1] See Knap, Nakonieczna-Kisiel (in press).

[2] See Mesjasz (2000), p. 193–194 and *Międzynarodowa pozycja inwestycyjna Polski w 2009 roku* (2010), p. 5.

[3] See *External Debt: Definition, Statistical Coverage and Methodology* (1998).

[4] *Uwagi metodyczne NBP*, Departament Statystyki NBP, www.nbp.pl.

[5] See Mesjasz (2000), p. 195.

[6] Ibidem.

[7] See *Międzynarodowa pozycja inwestycyjna Polski w 2009 roku* (2010), p. 85.

[8] Ibidem, p. 3.

[9] See *External Debt Definition, Statistical Coverage and Methodology* (1992), p. 19.

[10] See *Międzynarodowa pozycja inwestycyjna Polski w 2009 roku* (2010), p. 7 and Kulig (2007), p. 98–104.

11. See Sokołowska (2011), p. 262.

12. See Sokołowska (2009), p. 65–66.

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