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Report No. 54627-PL

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

FOR A PROPOSED LOAN

IN THE AMOUNT OF EUR 1 BILLION

(US$1,331,300,000 EQUIVALENT)

TO THE

REPUBLIC OF POLAND

TO SUPPORT AN

EMPLOYMENT, ENTREPRENEURSHIP, AND HUMAN CAPITAL DEVELOPMENT POLICY PROGRAM

DEVELOPMENT POLICY LOAN

(THIRD IN A PROGRAM OF THREE)

May 11, 2010

Poverty Reduction and Economic Management Sector Management Unit
Central and South Central Europe and the Baltic Countries Department
Europe and Central Asia Regional Office

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POLAND

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of April 30, 2010)

US$ 1.00: EUR 0.751: PLN 2.936 variable

ABBREVIATIONS, ACRONYMS & TERMS

AAA	Analytic and Advisory Activities
ALMP	Active Labor Market Programs
BEEPS	Business Environment and Enterprise Performance Survey
CEE	Central and Eastern Europe
CP	Convergence Program
DB	Doing Business
DC	Defined Contribution pension plan, in Poland, funded and privately managed
EC	European Commission
ECA	Europe and Central Asia Region
ECB	European Central Bank
ERM2	Exchange Rate Mechanism (2nd phase)
ESA	European System of Accounts
ESF	European Social Fund
EU	European Union
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
Gmina	Municipality/commune administrative unit (2,478)
GNI	Gross National Income
GUS	Main Statistical Office
HBS	Household Budget Survey
IALS	International Adult Literacy Survey
IBRD	International Bank for Reconstruction and Development
IFIs	International Financial Institutions
IMF	International Monetary Fund
KNF	Financial Supervision Authority
KRUS	Farmers' Insurance Fund
LFS	Labor Force Survey
LM	Labor Market
Matura	Exam taken at the end of secondary education
MIC	Middle Income Country
MLSP	Ministry of Labor and Social Policy
MNE	Ministry of National Education
MOE	Ministry of Economy
MOF	Ministry of Finance
MOH	Ministry of Health
MOT	Ministry of Treasury
MTEF	Medium-Term Expenditure Framework
MYSFP	Multi-Year State Financial Plan
NBP	National Bank of Poland
NDC	Notional Defined Contribution, pay-as-you-go pension plan
NHF	National Health Fund
NHS	National Health Service
NUTS	Nomenclature of Territorial Units for Statistics (EU geocode identification)
OECD	Organization for Economic Cooperation and Development
OPF	Open Pension Fund
PARSP	Post Accession Rural Support Project
PBB	Performance Based Budgeting
PFM	Public Finance Management
PISA	Program for International Student Assessment
PIT	Personal Income Tax
Powiat	County administrative unit, (379) NUTS3
PPP	Public Private Partnerships
PTE	Pension Fund Association
SME	Small and Medium Enterprises
SOE	State Owned Enterprises
TA	Technical Assistance
TWA	Temporary Work Agencies
VAT	Value Added Tax
Voivodeships	Province administrative unit (16), NUTS2
ZUS	Social Insurance Institution

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REPUBLIC OF POLAND
THIRD PROGRAMMATIC POLICY LOAN (PL3)
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LOAN AND PROGRAM SUMMARY
REPUBLIC OF POLAND

EMPLOYMENT, ENTREPRENEURSHIP AND HUMAN CAPITAL DEVELOPMENT POLICY PROGRAM

(THIRD POLICY LOAN IN A PROGRAM OF THREE)

Borrower	REPUBLIC OF POLAND
Implementation Agency	MINISTRY OF FINANCE
Financing Data	Amount: EUR 1 billion (US$1,331,300,000 Equivalent) Terms: IBRD Flexible Loan at 6 month LIBOR for Euro plus variable spread, with a 20 year maturity and 7 years of grace period, with level repayment pattern of the principal amount.
Operation Type	Programmatic (3rd of 3), single-tranche
Main Policy Areas	Labor markets, social assistance, public financial management, education, health, pensions and private sector development
Key Outcome Indicators	1. Employment rate to be maintained at 58 percent in 2010. 2. Poorest quintile of households to receive 38 percent of social assistance benefits in 2010. 3. General government deficit to be maintained at 6.9 percent of GDP in 2010, and public debt at 53.1 percent of GDP in 2010. The general government deficit to decline to below 3 percent of GDP in 2012 and public debt to remain below national public debt limits. 4. Pre-school enrollment rates of 3-5 year olds to increase to 60 percent in 2010. 5. Hospital debt to be lowered to PLN8.5 billion in 2010. 6. The average contribution fee charged by Pension Fund Association to Open Pension Fund members to be reduced to 3.5 percent in 2010. 7. Poland's share in total intra-EU trade in services to increase to 2.5 percent in 2010.
Program Development Objective(s) and Contribution to CPS	This is the third and final lending operation supporting a policy program aimed at accelerating Poland's convergence with EU living standards. PL3 continues to support Government measures to mitigate the impact of the global crisis on households, workers and businesses. With the recovery gaining speed, it also supports Government efforts to unwind the extraordinary anti-crisis policies and step up reforms to reinforce Poland's growth prospects. The three main Program Development Objectives are to (i) mitigate the social cost of the economic slowdown; (ii) strengthen public finance; and (iii) pursue structural reforms. The PL series is central to the Bank's 2009-13 Country Partnership Strategy (CPS). The overarching goal of the CPS is to support Poland's convergence towards EU living standards, and is based on four pillars: (i) Growth and Competitiveness; (ii) Public Sector Reform; (iii) Social and Spatial Inclusion; and (iv) Regional and Global Public Goods. Reforms of public financial management, private sector development, labor markets and social sectors are key elements of the first three pillars of the CPS.
Risks	There are three main risks as the Government takes the next step in its reform program with the Bank. First, Europe's recovery from the global financial

	crisis, which triggered a sharp and synchronized contraction, could be sluggish or followed by a 'double-dip'. This could undermine growth in Poland, would jeopardize fiscal outcomes and might give rise to pro-cyclical expenditure cuts. Mitigating factors include low inventory levels, some pent-up demand, low interest rates and stepped-up utilization of EU funds. In addition, the authorities' solid track record over the last years has assured good access to financial markets, which should provide adequate access to credit to borrow through any further slowdown or downturn, as long as credible commitment to medium-term fiscal and structural reform is documented. Second, in spite of the recent improvements in global financial markets, heightened financial strains could return, especially if policy support is withdrawn prematurely or policy coordination deteriorates. Similarly, renewed deterioration of macroeconomic conditions could lead to a further increase in non-performing loans and additional credit tightening by banks. Mitigating factors include the strong initial condition of Poland's financial system, and the strong credibility in the conduct of monetary policy by the country's central bank and the regular stress-tests undertaken by the financial supervisor KNF. Third, a prolonged deterioration of economic prospects could undermine public support for the Government reform program. Without such reforms, the remaining rigidities in the labor and product markets and the large public sector in Poland could become a drag for future growth. Mitigating factors include the Government's strong commitment to the fiscal development and consolidation strategy and Vision 2030, and the broadly recognized need for a reduction in the fiscal deficit in view of the constitutional public debt limit of 60 percent of GDP and Poland's commitments under the Stability and Growth Pact.
Operation ID Number	P117666

IBRD PROGRAM DOCUMENT FOR A

PROPOSED THIRD PROGRAMMATIC POLICY LOAN TO THE

REPUBLIC OF POLAND

TO SUPPORT AN

EMPLOYMENT, ENTREPRENEURSHIP, AND HUMAN CAPITAL DEVELOPMENT POLICY PROGRAM

I. INTRODUCTION

1. **Poland has shown remarkable resilience to the global financial crisis.** In the decade leading up to the crisis, Poland's increasing integration with Europe had brought about strong economic expansion and rapid convergence to European Union (EU) income levels. As the crisis broke out, this integration made Poland vulnerable to the collapse in regional capital, trade, and labor flows. Poland's companies, workers, and households have so far weathered well the impact of the global financial crisis. The good performance reflects, among other factors, a diversified and flexible economy, fairly strong macroeconomic balances going into the crisis, and a timely policy response of the Polish authorities during the crisis.

2. **While Poland has withstood the global financial crisis better than other countries in the region, it faces stark social and economic challenges in politically sensitive times.** The short-term recovery remains fragile, with significant risks for businesses and families, and the medium-term growth and convergence prospects uncertain. Like other countries in Europe, Poland faces the challenge of advancing economic reforms needed to stay competitive in a world of reduced capital flows and discriminating financial markets. It needs to bring about medium-term fiscal consolidation while safeguarding crucial social and infrastructure programs.

3. **This is the third policy loan (PL3) in a program of three lending operations supporting Poland's goal of convergence with EU living standards.** PL3 continues to support the Government's successful policy response to the economic slowdown. Key reform initiatives included the anti-crisis stability and development plan; the reduction in the tax wedge; the phasing out of early retirement pensions; and the amendments of the law on freedom of business operations, the public finance act and the 2009 state budget. Following the second policy loan, PL3 will continue to support Government measures to mitigate the impact of the global crisis on households, workers and businesses. With the recovery gaining speed, it also supports Government efforts to unwind the extraordinary anti-crisis policies and step up reforms to reinforce Poland's growth prospects.

II. COUNTRY CONTEXT

2.1. RECENT ECONOMIC DEVELOPMENTS IN POLAND

4. **The global economic crisis has ended Poland's fast economic expansion over the recent years, but in contrast to its neighbors Poland has avoided a decline in economic activity.**[1] Since late 2008, Poland has been hit by two shocks: the recession in high-income countries, which hurt external demand for exports; and the global financial crisis, which reduced capital inflows and thereby lowered domestic demand. Nevertheless, growth remained positive throughout the last four quarters. In fact, Poland is the only one of 27 EU member states whose economy has continued to expand throughout the crisis. Poland grew by 1.7 percent in 2009, while the EU declined by 4.1 percent and the EU10 region by 4.2 percent according to preliminary EC estimates.[2]

5. **Economic activity has rebounded since early 2009.** Year-on-year growth increased from 0.8 percent in the first quarter to around 3 percent in the fourth quarter. Based on year-on-year comparisons, industrial production improved from a 15 percent decline in January 2009 to a 8.5 percent increase in January 2010; the economic sentiment index from 87.8 percent in January 2009 to 93.7 in December 2009; and private investment improved year-on-year from a 5 percent decline in the first half of 2009 to a 2 percent decline in the second half of 2009. Inflation has remained near the upper limit of NBP's tolerance ban of 1.5 percent to 3.5 percent since September 2009.

6. **The narrowing in the trade balance provided the principal spur for growth.** In 2009, the GDP contribution was 2.5 percent from net exports, 1.6 percent from consumption, and -2.4 percent of GDP from investment and the statistical discrepancy. As imports contracted more than exports, the current account deficit narrowed to 1.6 percent of GDP in 2009 compared to 5.5 percent of GDP in 2008. Trade flows stabilized over the second half of 2009. Measured in Euro and on year-on-year basis, exports improved from a 30 percent decline in April 2009 to a 12 percent increase in December 2009; and imports from a 37 percent decline in April 2009 to a 3 percent decline in December 2009.

7. **Poland's economic slowdown is muted for a number of reasons.** First, Poland's relatively large domestic economy has limited its exposure to the decline in world trade. Exports accounts for only around 40 percent of GDP in Poland, compared to around 80 percent of GDP in the Czech Republic, Hungary, and the Slovak Republic. Second, the flexible exchange rate regime has facilitated the economy's adjustment to the external shock. While the zloty has been regaining value on the back of strengthening investor confidence since March 2009, the depreciation of the real exchange rate remains larger than in Poland's neighbors. Third, Poland's banking system has withstood the global financial crisis well. In part, this is because Poland's credit expansion was less dramatic than elsewhere in Central and Eastern Europe with credit to GDP amounting to less than 50 percent in 2008. Because Poland entered the crisis, with relatively strong

[1] Annex 7 shows selected charts on recent economic developments and the macroeconomic outlook.
[2] The EU10 countries include: Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia.

fundamentals, the Government has been able to implement policies that are now cushioning the impact of the slowdown.

8. **Although capital inflows have declined, the financial sector remains relatively sound.** Immediately after the collapse of Lehman Brothers in September 2008, the Polish interbank market froze. In the subsequent six months, the stock markets declined by close to one half and the zloty depreciated by about one third. In response to the stabilization of global financial markets in the spring and the precautionary one-year USD20.5 billion facility under the IMF's Flexible Credit Line (FCL) from early May 2009, the zloty appreciated more than 10 percent and the stock market recovered most of its losses since late March 2009. This has mitigated the strains on foreign-currency indebted corporations and households and helped to stabilize banks' profits in the third quarter of 2009. Subsidiaries of foreign banks have largely maintained their exposure, with private debt roll-over rates close to 100 percent relative to end-2008 levels, and credit default swap spreads of parent banks have come down significantly. Most banks retained 2008 profits to strengthen their balance sheets, and the capital adequacy ratio improved from 11.1 percent in March to 13.0 percent in September, safely above the minimum level of 8 percent. Non-performing loans of households have increased only moderately. While non-performing loans of corporates have increased noticeably, they remain modest as a percentage of GDP. Furthermore, foreign direct investment improved year-on-year from a 50 percent decline in the first half of 2009 to a 20 increase in the second half of 2009. In addition, overall corporate profitability and corporate bank deposits remain high. The NBP has also reduced the policy rate from 6 percent in November 2008 to 3.5 percent in August 2009 in support of the recovery. Nevertheless, bank lending standards have tightened and the interbank market is active only for short-term maturities, as banks prefer to hold on to liquidity in view of economic uncertainties.

9. **Fiscal policy shored up growth through automatic stabilizers and discretionary measures, and at the same time contained the rise in public debt through consolidation measures.** The general government deficit doubled to 7.2 percent of GDP in 2009 from 3.6 percent of GDP in 2008. About two-thirds of the increase was due to lower revenues. Poland adopted fiscal recovery measures of about 2 percent of GDP in 2009, which was the largest stimulus among the EU10 countries. This included the reductions in personal income tax legislated in 2007 and entering into force in early 2009, and increases in social and infrastructure expenditures adopted as part of the July 2009 supplementary budget and supported through accelerated utilization of EU funds. The supplementary budget also incorporated fiscal savings of about 1.4 percent of GDP through reductions in administrative spending and increases in dividends from state-owned companies.

10. **Poland's large fiscal deficit is related mainly to three factors.** First, as in other EU countries, the use of automatic stabilizers and fiscal stimulus to counteract the global economic crisis has increased budget deficits. Second, the large fiscal deficit reflects the shift to a funded public pension pillar in the late 1990s. This reform imposes considerable upfront fiscal cost, amounting according to Government estimates annually to around 3.2 percent of GDP for pension reform. Third, high fiscal deficits also reflect lack of progress in advancing public expenditure reforms, generous spending in recent years, and weak public expenditure controls. From 1995 to 2008, the overall fiscal

deficit averaged 4.2 percent of GDP, and the structural fiscal deficit 4.4 percent of GDP. Government expenditures exceeded revenues throughout this period, even at the peak of the economic cycle.

11. **The remarkably robust economic performance in 2009 suggests that the Government managed to strike the right balance between supporting the recovery and limiting the deterioration of public finances.** Financial markets have responded well to the Government's rising financing needs. Yields on government bonds have declined over the last half a year, although they remain somewhat above pre-crisis levels. The Government secured all external financing for 2009 without difficulties. The IMF staff assessment of the FCL review from November 2, 2009 concluded that Poland continues to meet the qualification criteria for access to FCL resources and remains committed to responding appropriately to actual or potential balance of payment pressures.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

12. **Growth is expected to accelerate steadily over the medium-term in line with an improving external environment.** It is projected to increase from 1.7 percent in 2009 to 3 percent in 2010 and gain more strength in 2011 (Table 1). The recovery is expected to be driven by improving global conditions, higher investments supported through increased EU funds, moderate consumption growth, and strengthening financial markets. As output is set to remain below potential output and the exchange rate appreciated over the last quarters, inflation is projected to be moderate in 2010 and remain subdued over the medium-term.

13. **The fiscal deficit is targeted to decline gradually and drop below 3 percent of GDP by 2012.** While Poland's fiscal position has held up fairly well in comparison to the EU (Box 1), medium-term fiscal consolidation is crucial for the Government's goal of early Euro adoption, to stay clear of the 55 percent of GDP national public debt limit (Box 2), and to protect priority spending for jobs and growth. In January 2010, the Government reiterated its commitment to reducing the fiscal deficit to 3 percent of GDP in the fiscal development and consolidation strategy and the convergence program update (Table 2). This target is consistent with the European Council recommendations issued in July 2009 as part of the initiation of the excessive deficit procedure.[3] The scale of the fiscal consolidation is set to increase over time, as selected expenditure savings are offset initially by higher capital investments, part of which are financed from EU structural funds. The rebalancing from public to private investment in 2012, together with faster growth of nominal GDP relative to index-based social expenditures, will support a large contraction of public expenditures as a share of GDP in 2012. In an alternative macroeconomic scenario which assumes a slower recovery in growth due to a weaker external environment, the Government still projects bringing down the fiscal deficit to 3 percent of GDP by 2013.

[3] Under the provision of the EU Stability and Growth Pact, if a member states exceeds the deficit-to-GDP ratio of 3 percent, the excessive deficit procedures is triggered at EU level. This entails several steps – including the possibility of sanctions – to encourage the member state concerned to take measures to rectify the situation.

14. **The Government is in the process of elaborating the details of the fiscal consolidation strategy.** This strategy lists a number of laws and resolutions which the Government intends to adopt by end 2010. According to the strategy, the main instruments identified to date for bringing about the reduction in the fiscal deficit are maintaining the public sector wage bill constant in real terms;[4] limiting the growth in other discretionary budgetary spending to 1 percent in real terms against the backdrop of a robust economic recovery; rationalizing non-discretionary spending; and broadening the tax base and strengthening tax administration (Box 3). The Ministry of Finance has already prepared draft assumptions for four initiatives (law on the stability of public finance; integration of uniformed services into main pension system; alignment of disability benefits with pension benefits; and removal of floor on public defense spending). Preliminary estimations suggest that the Government might have to plan for additional consolidation measures to reach the fiscal deficit target of 3 percent of GDP by 2012, especially if growth in economic activity and hence revenue collection turns out to be lower than expected.

15. **Beyond 2012, the Government aims to achieve a structural fiscal deficit of 1 percent of GDP, in line with the medium-term objective of the EU Stability and Growth Pact.** Such fiscal discipline is to be achieved with the help of a fiscal rule adopted as part of a new fiscal responsibility law that limits public expenditure increases during an economic upturn. Introducing multi-year binding expenditure ceilings and implementing a permanent fiscal rule would also contribute to keeping public expenditures below 40 percent of GDP over the long-term.

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[4] Over one-fifth of public expenditures, or about 10 percent of GDP, goes towards paying wages of public employees in Poland. The tightening of the labor markets in the run-up to the crisis fuelled public sector wage growth. Now, the outlook of the labor market has changed, and the need for fiscal consolidation make the public sector wage bill a important source of fiscal savings in coming years, as indeed many countries of the region have discovered. For example, expenditure on the wage bill of the state budgetary entities increased in nominal terms by 5 percent in 2006, 8 percent in 2007, 19 percent in 2008, and 9 percent in 2009.

Table 1. Economic developments and prospects 2005-2012
(change in percent unless otherwise indicated)

	2005	2006	2007	2008	2009	2010	2011	2012
		Actual			*Est.*		*Projected*	
National Accounts								
GDP (billions PLN)	983	1,060	1,177	1,273	1,346	1,414	1,518	1,633
GDP (billions USD)	304	342	425	528	432	516	582	632
Real GDP growth (%)	3.6	6.2	6.8	5.0	1.7	3.0	4.5	4.2
Domestic demand growth (%)	2.5	7.3	8.7	5.5	-0.9	3.3	4.7	4.4
Gross domestic investment (% of GDP)	19.3	21.1	24.4	23.7	20.4	22.1	24.1	24.7
Gross domestic savings (% of GDP) 1/	18.4	19.0	20.8	19.7	20.3	21.0	24.1	23.9
Employment, LFS								
Number of employed (age 15 and above, th. pers.)	14,116	14,594	15,240	15,800	15,841	15,893	16,048	16,273
Unemployment rate	17.7	13.8	9.6	7.1	8.2	9.2	9.3	8.9
Fiscal Accounts of General Government (as % of GDP, ESA95)								
Expenditures	43.4	43.9	42.2	43.3	44.6	46.5	46.2	43.3
Revenue	39.4	40.2	40.3	39.6	37.4	39.6	40.3	40.3
Balance	-4.0	-3.7	-1.9	-3.6	-7.2	-6.9	-5.9	-2.9
Public debt as % GDP	47.1	47.7	45.0	47.2	50.7	53.1	56.3	55.8
External Accounts (billions USD)								
Current account balance	-3.7	-9.4	-20.3	-26.9	-7.1	-12.4	-14.9	-17.8
Current account balance, as % of GDP	-1.2	-2.7	-4.8	-5.1	-1.6	-2.4	-2.6	-2.8
Exports of goods and services	112.7	138.1	174.3	214.0	169.3	197.9	226.2	252.4
Imports of goods and services	114.7	144.3	186.6	235.0	170.2	202.1	232.5	260.2
Net capital inflows, as % of GDP 2/	3.9	3.4	7.8	4.7	4.7	4.4	4.0	3.1
Official reserves (in months of M of GS)	4.5	4.0	4.2	3.2	5.3	5.1	4.8	4.4
Indebtedness (external debt)								
Total external debt as percent of GDP	44.1	46.6	48.4	56.7	63.6	57.9	55.6	55.7
TDS/XGS in percent	35.0	34.6	29.8	45.5	59.7	46.3	38.6	33.9
Prices								
Consumer price inflation (period average)	2.1	1.0	2.5	4.2	3.5	2.1	2.7	3.2
Memo items								
PLN/EUR Exchange rate (average)	4.02	3.90	3.78	3.52	4.33	3.96	3.69	3.55
Total external debt (billions PLN)	433.5	493.7	569.9	721.1	856.3	818.3	844.7	909.5
Official reserves (millions USD)	42,571	48,484	65,745	62,180	75,340	85,496	93,779	95,412
Gross savings (billions PLN)	177.3	191.6	226.9	236.9	259.5	282.1	347.6	370.7
GDP (billions USD)	303.9	341.7	425.3	528.3	431.8	516.3	581.6	632.2

Notes:
1/ Derived as total savings minus the current account minus capital transfers.
2/ Derived as a sum of capital and financial account balance and errors and omissions.
Source: Poland's Convergence Program; and Bank staff projections.

Box 1: Comparison of the Fiscal Position in Poland and the EU

Aided by a better economic performance in Poland than in the EU, the fiscal position in Poland deteriorated less than in the EU from 2007 to 2009:

- *Lower increase in the fiscal deficit from 2007 to 2009*: The fiscal deficit increased from 0.6 percent of GDP to 7.2 percent of GDP in the EU, and from 1.9 percent of GDP to 7.2 percent of GDP in Poland.
- *Lower increase in government expenditures from 2007 to 2009*: Government expenditures increased from 45.7 percent of GDP to 50.0 percent of GDP in the EU, and from 42.2 percent of GDP to 44.6 percent of GDP in Poland.
- *Lower increase in public debt from 2007 to 2009:* Public debt increased from 58.7 percent of GDP to 75.6 percent of GDP in the EU, and from 45.0 percent of GDP to 50.7 percent of GDP in Poland.

Based on the targets of Government's announced in the 2010 updates of the convergence programs, Poland's fiscal adjustment is as or more ambitious as in the EU:

- *Larger projected reduction in the fiscal deficit from 2009 to 2012*: The fiscal deficit is projected to decrease from 7.2 percent of GDP to 4.3 percent in the EU, and from 7.2 percent of GDP to 2.9 percent of GDP in Poland.
- *Lower projected increase in public debt from 2009 to 2012:* Public debt is projected to increase from 75.6 percent of GDP to 85.3 percent of GDP in the EU, and from 50.7 percent of GDP to 55.8 percent of GDP in Poland.

Poland's long-term fiscal sustainability is bolstered by favorably dynamics of age-related expenditures. However, these projections include low replacement ratios of pensions relative to wages that might turn out to be politically and socially untenable.

- *Decline in age-related government spending from 2009 to 2035:* Age-related spending is projected to increase by 2.7 percent of GDP in the EU, and to decline by 2.7 of GDP in Poland. Poland is the only EU country where age-related government spending is projected to decline.

Note: For fiscal deficit and public debt statistics, EU refers to EU27 without Denmark, Cyprus, Lithuania, Malta, Portugal and Romania due to missing data.

Source: 2010 Convergence Program Updates, and EC (2009).

Box 2: Poland's Public Debt Ceilings

The Public Finance Law sets three precautionary thresholds: 50, 55, and 60 percent of GDP. The 55 limit was strengthened with the new Public Finance Law adopted in September 2009. Thresholds are subject to national methodology.

- A breach of the 50 percent limit implies that next year's budget deficit target must not be larger, as a ratio to revenue, than the projected outturn of the current year.
- A breach of the 55 percent limit implies that next year's budget deficit target must lead to a decrease in the state public debt-to-GDP ratio or the state budget must be balanced. A similar provision applies to local governments. In addition, the Government has to submit a debt reduction plan, together with the annual budget for year t+2, which should include: a nominal freeze in budgetary wages, pension indexation not higher than CPI inflation, and reviews of multi-year investment programs and spending programs financed by foreign credits. Local governments are allowed to have deficits only if related to EU programs or if financed by previous year surpluses. These actions aim to reduce the debt-to-GDP ratio in year t+2 below year t's level, implying either a balanced budget or a surplus that year.
- A breach of the constitutional 60 percent limit implies a freeze on any new government guarantees, a zero budget deficit target for the next year, and an enactment of a rehabilitation program that brings the public debt-to-GDP ratio below 60 percent of GDP.

Source: World Bank staff.

16. **External financing of the 2010 fiscal deficit is already effectively secured.** On January 11, 2010, the Government issued a 15-year euro-denominated bond of EUR3bn priced favorably at 148 basis points over the mid-swap rate. This was the Government's longest-dated offering of eurobonds since 2007. Including the scheduled loans from the World Bank and the EIB, Poland has already covered its planned external financing of the 2010 fiscal deficit. More than three-quarters of the financing of the fiscal deficit is expected to come from the domestic capital market (Table 2), part of which the Government had begun pre-financing in 2009.

17. **In spite of the increase in fiscal deficits during 2009 and 2010, public debt is projected to remain at sustainable levels**. The gradual economic recovery, a steady appreciation in the exchange rate, the fiscal consolidation, better public sector cash management and stepped-up privatization are projected to be sufficient to maintain public debt below key national and EU thresholds under the baseline scenario (Table 2). Stress tests suggest that public debt is set to remain below such limits even under an adverse scenario (Table 3). However, delays in the implementation of the announced fiscal consolidation measures could undermine the planned reduction in public debt.

18. **The Government's plan to reinforce the privatization agenda, which will enhance product markets and the business climate, is also a key measure to limit the rise in public debt.** The Government foresees an acceleration of privatization in 2010 and 2011 in line with improving market conditions in sectors such as finance, power, oil refinery, chemical sector, coal mining, copper, and defense. Receipts from privatization are expected to increase from PLN2.4 billion in 2008 to PLN37 billion in 2009 and 2010, out of which PLN7.0 billion (0.5 percent of GDP) were collected in 2009. The projections are subject to a number of risks, including the strength of the recovery, the stability of capital markets, and exchange rate developments. In July 2009, the Government introduced an electronic auction as a privatization method and some transactions were already made in such a way. In 2010, the Ministry of Treasury plans to introduce a new law on corporate governance to further facilitate the privatization process.

19. **The external position is improving**. While the current account is set to increase in 2010 as imports pick up on the back of stronger GDP growth, the recovery in exports and the adjustment in the zloty—according to IMF estimates the real exchange rate is broadly in line with fundamentals—are expected to keep the current account at moderate levels. In addition, solid private sector flows and the continued favorable access to international capital markets all suggest that the balance of payments will remain robust even under adverse economic scenarios (Table 4). The financing of the current account deficit through foreign direct investment and portfolio inflows is expected to improve further with the recovery of the economy and the return in confidence in global financial markets.

Box 3: Fiscal Consolidation Measures

Reform Area	Measures
Public Finance	
1. Sustainable reduction of the structural fiscal deficit to 1 percent of GDP	• Limit the growth in discretionary budgetary spending to 1 percent over inflation over the next few years • Keep the public sector wage bill constant in real terms • Reduce the share of non-discretionary budgetary spending • Introduce public expenditure rule through a new public financial stability law to prevent a pro-cyclical spending pattern • Use performance-based budgeting, multi-year frameworks and public expenditure reviews to improve the quality of public spending
2. Improved information on public debt	• Report on implicit pension and non-pension liabilities
3. Improvement in public financial planning, execution, reporting, and cash management	• Introduce comprehensive electronic planning and reporting • Expand performance-based budgeting and multi-year planning • Improve information flow through an effective roll-out of the IT system • Develop a uniform accounting system • Improve cash management of the public sector by moving deposits of public entities on the Treasury account
Pensions	
4. Increase of retirement age, especially for women	• Initiate gradual increase and equalization of the retirement age for women and men which would not include people over 55
5. Alignment of disability benefits with pension benefits	• Introduce uniform principles of calculation of disability benefits and retirement benefits in the pension system
6. Integration of special schemes	• Integrate uniformed services (soldiers, policemen, firemen, and others) into public pension, disability and health care systems from January 1, 2012 onwards • Consider equalizing retirement age for newcomers from January 1, 2012 onwards • Initiate gradual reform of the farmers' retirement and disability pension system while maintaining KRUS as stand-alone entity
7. Strengthening of 2nd pillar	• Consider reforms to increase the effectiveness of pension pillars through external benchmark for OPF investments; life-cycle approach; and phasing out OFE investment limits. • Introduce ban on promotion and advertising activities of OFE and further reduce administration fees • Resolve the problem of rising accounting public debts generated due to different classification of pension contributions collected in OFE and on individual pension account in ZUS.
Tax collection	
8. Expansion of tax base	• Introduce obligatory cash registers for certain professions • Limit VAT exemptions on car purchases
Privatization	
9. Acceleration of privatization	• Achieve PLN25 billion privatization proceeds in 2010 • Facilitate privatization through electronic auctions and other procedures • Increase Treasury receipts of privatization revenues • Promote the sale of public agricultural land to farmers

Source: Fiscal Development and Consolidation Strategy and Convergence Program Update January 2010.

Box 4: Fiscal Consolidation of Social Expenditures and Public Wages

Reforms of public spending in social sectors and wages could make an important contribution to fiscal consolidation over the next few years. The experience of other countries shows that successful fiscal consolidation is often to a large extent expenditure-based because they reflect deeper structural reforms and a stronger political commitment to adjustment. In Poland, there are three big ticket items for fiscal consolidation of public expenditures over the next three years. As mentioned in subsequent boxes, there are other important structural public expenditure reforms but they will provide fiscal savings only in the longer-term. Such expenditure rationalization would not have to sacrifice spending on vital reforms, such as universal pre-school for 5 year-old or hospital corporatization, or undermine the provision of social assistance to poor and vulnerable people:

- pensions – by reaping the dividends of the tightening of early retirement provisions through the increase in employment rates; and ensuring moderate pension indexation;
- public wages – by enhancing the control over the wage bill through (i) limiting the capacity of spending agencies to use vacant positions to finance salary increases and (ii) curtailing the growth of the adjusted wage bill to CPI inflation.
- education – by allowing school funding to reflect demographic changes.

Ensuring commitments from local governments to contribute to the fiscal adjustment of the public sector wage bill and other spending is clearly important. For example, local governments spend more on public sector wages than the central government, as they cover the bulk of public social sector employees. In addition, better public expenditure management can make a crucial contribution to deliver outputs and outcomes with fewer resources. Reviews of public expenditure programs could help identify high-priority social and economic programs that should be shielded from expenditure cuts, and identify areas where the private sector can play a greater role in the provision of infrastructure and services. There is also room for improvements in the operational efficiency of public expenditures through a more efficient implementation of public activities.

Source: Poland PER (2010).

Table 2. Fiscal developments and prospects 2005-2012
(percent of GDP unless otherwise indicated, ESA95, General Government)

	2005	2006	2007	2008	2009	2010	2011	2012
		Actual			*Est.*		*Projected*	
Revenues	39.4	40.2	40.3	39.6	37.4	39.6	40.3	40.3
Taxes	20.6	21.7	22.7	22.8	20.5	21.7	21.8	22.4
Social security contributions	12.3	12.2	12.0	11.4	11.3	11.1	11.1	11.3
Other	6.5	6.3	5.6	5.4	5.6	6.8	7.4	6.6
Expenditures	43.4	43.9	42.2	43.3	44.6	46.5	46.2	43.3
Gross fixed capital formation	3.4	3.9	4.2	4.6	4.9	6.4	7.5	6.1
Other expenditures	40.0	40.0	38.0	38.7	39.7	40.1	38.7	37.2
o/w wages and salaries	10.0	9.8	9.6	10.0	10.2	9.9	9.5	9.1
o/w social benefits	17.5	17.3	16.2	16.2	17.2	17.0	16.4	15.8
o/w interest payments	2.8	2.7	2.3	2.2	2.4	2.7	2.8	2.7
Balance								
Overall	-4.0	-3.7	-1.9	-3.6	-7.2	-6.9	-5.9	-2.9
Primary	-1.2	-1.0	0.4	-1.4	-4.8	-4.2	-3.1	-0.2
Structural	-4.0	-4.1	-2.9	-4.4	-7.1	-6.6	-5.8	-2.9
Financing	4.0	3.7	1.9	3.6	7.2	6.9	5.9	2.9
Domestic	2.8	3.2	1.2	3.4	4.3	4.0	4.1	2.2
Foreign	0.9	0.5	0.6	0.1	2.4	1.1	1.5	0.5
World Bank	0.0	0.0	0.0	0.0	0.5	0.2	0.1	0.1
Other	0.9	0.5	0.6	0.2	0.9	1.5	1.4	0.4
Privatization	0.3	0.0	0.1	0.1	0.5	1.8	0.3	0.2
Public Debt	47.1	47.7	45.0	47.2	50.7	53.1	56.3	55.8
National methodology	47.5	47.8	44.8	47.0	49.5	50.4	52.5	51.6

Notes: The rise in government expenditures and revenues as percent of GDP reflects the impact of EU structural funds. The IMF is currently revising these series.
The main difference in the public debt definitions between ESA95 and national methodology is the treatment of the off-budgetary funds such as the debt of the National Road Fund which is included in the first but not in the latter.

Source: Poland's Convergence Programs and Bank staff projections.

Table 3: Stress Tests of Public Debt Projections (% of GDP)

	2010	2011	2012
PLN depreciation by 10% against currency basket	1.2	1.2	1.2
GDP growth lower by 1 percentage point	0.5	1.0	1.4
Borrowing requirements higher by PLN 1 billion a year	0.1	0.1	0.2
Joint effect of exchange rate, GDP growth and borrowing requirements	1.8	2.4	2.9

Source: Poland's Convergence Programs and Bank staff projections.

Table 4. External Financing Requirements and Sources 2008-2012
(millions USD)

	2008	2009	2010	2011	2012
	Actual	*Est.*		*Projected*	
Financing requirements	109,481	94,900	97,503	98,762	99,448
Current account deficit	26,909	7,082	12,439	14,876	17,791
Debt amortizations	82,572	87,818	85,064	83,886	81,657
Financing sources	107,517	108,060	107,659	107,045	101,081
EU funds	5,828	7,498	7,657	15,978	14,277
FDI (net)	11,747	8,610	11,558	9,898	9,610
Equities (net)	2,021	615	671	645	699
New borrowing and debt rollover	97,867	101,001	91,712	87,315	85,657
Other	-9,946	-9,664	-3,939	-6,791	-9,162
o/w errors and omissions	-21,556	-21,556	-10,778	-10,778	-10,778
Change in reserve assets	1,964	-13,160	-10,156	-8,283	-1,633
Gross External Debt (% of GDP)	56.7	63.6	57.9	55.6	55.7
Gross external debt (PLN, mln)	721,130	856,337	818,309	844,689	909,475

Source: Poland's Convergence Programs and Bank staff projections.

20. **Despite an uncertain economic environment, the macroeconomic policy framework is considered adequate for the proposed Policy Loan.** The macroeconomic policies implemented prior to and during the global crisis have helped to ensure continuous growth in 2009. Most of the latest high frequency indicators, including industrial production, retail sales, unemployment rates and economic confidence, suggest a modest recovery of economic activity in recent months. The announced policies are supportive of a gradual recovery of economic activity, keeping external imbalances in check and narrowing fiscal deficits over the medium-term. Low inventory levels, some pent-up demand, low interest rates and stepped-up utilization of EU funds could support a stronger-than-expected rebound of the economy. However, downside risks are significant. They include a weak recovery in the EU, depressed investment levels in view of lack of financing, and slow progress on growth enhancing

structural reforms. Policy makers need to remain vigilant and undertake timely and adequate measures in case the recovery is weaker than expected.

21. **Despite recent consolidation efforts, Poland faces major fiscal challenges.** The budget deficit needs to be reduced to stabilize the public debt-to-GDP ratio and to meet the criteria for euro adoption. The 2010 deficit target strikes an appropriate balance between accommodating the still feeble economic situation and medium-term consolidation objectives. However, the fiscal development and consolidation strategy entails politically difficult decisions and will require strong and steadfast implementation. The authorities are prepared to take additional measures, if necessary, to ensure attainment of the fiscal objectives, and are strongly committed to strengthen the fiscal framework.

2.3. SOCIAL IMPACT OF THE SLOWDOWN

22. **The social impact of the economic crisis has been muted.** The steady growth in the economy, Government schemes to strengthen the labor market, and adequate funding of social and unemployment benefits have together contained the rise in unemployment and poverty. This, along with financial market stability, has limited household vulnerability to credit market shocks. According to estimates from the European Commission, overall social protection spending increased from 24.2 percent of GDP in 2007 to 25.3 percent of GDP in 2009. Means tested social assistance in Poland is comprehensive and relatively well targeted compared to programs in other countries in Central Europe, although leakage and coverage of benefits remain a challenge.

23. **While labor market outcomes have worsened over the last year, the deterioration was modest compared to other countries in the region.** Unemployment rates increased according to the Labor Force Survey from 7.3 percent in March 2008 to 8.9 percent in December 2009, or by about 300,000 people. This was the fourth lowest increase among the EU countries, where overall unemployment rose from 6.7 percent to 9.6 percent over this period (Box 5). As the rise in unemployment was compensated by an increase in labor force participation, the employment rate remained unchanged at close to 60 percent in 2009. Moderation in real wages growth, which declined from 7 percent in the second quarter of 2008 year-on-year to close to 1 percent in the third quarter of 2009, has helped to stabilize employment. The economic slowdown is affecting foremost workers with only basic education level and limited work experience, most of whom are young. As in the EU overall, unemployment rates for workers aged 15 to 24 increased in Poland more than twice compared to the overall increase. The regional distribution of unemployment in Poland has remained broadly unchanged during the recent slowdown. Unemployment is highest in areas where state farms used to dominate (the North, West, and along the Eastern border), as well as in the old industrial regions. Unemployment is low in metropolitan centers and regions in the center-west with a diversified economic structure—this includes the city of Warsaw, localities around Warsaw, Upper Silesia and Krakow. Peripheral rural areas have not seen increases in unemployment, as they have few links to sectors hit by the global crisis, such as trade and construction industries.

24. **The Labor Fund is well placed to alleviate the impact of the economic crisis on the labor market.** The rise in unemployment creates strong pressure on labor market expenditures. Workers who lose their jobs claim unemployment benefit and expect government's assistance in finding a new job. There is also a pressure to protect the existing jobs, for example by means of government wage subsidies. These expenditures act as an automatic stabilizer and dampen the fall in income and demand. However, all this creates fiscal strain. Fortunately, the Labor Fund holds sufficient resources to cope with the rise in such expenditures thanks to the substantial surplus accumulated during the period of falling unemployment. Simulation results suggest that there will be enough resources to finance unemployment benefits and active programs under the falling employment and high unemployment scenario until at least 2011 (Box 6). This is important given that the unemployment benefit goes mainly to poorer households and is thus an effective poverty mitigation instrument. At the same time the unemployment benefit system is not overly generous and thus does not create significant labor supply disincentives.

Box 5: Impact of the Economic Slowdown on the Labor Market

The impact of the economic slowdown in Poland on employment has been modest. While inflows into unemployment expectedly have surged in the wake of the crisis, outflows from unemployment remain significant, although are somewhat lower than before the crisis. Inflows into unemployment were in October some 20 percent higher than a year earlier, and inflows due to lay-offs were twice as high. But the outflow rate from unemployment to jobs is 5.8 percent, compared to 7 percent a year ago. This indicates that the Polish economy creates new jobs, and the job prospects for the unemployed, although significantly worse than before the crisis, are not grim. Nonetheless, the crisis gave rise to a substantial increase in the number of unemployment benefit claimants, which is currently over 60 percent higher than a year earlier.

While unemployment has increased, total employment has remained roughly stable thanks to an increase in the labor force participation rate and favorable demographic developments. Labor force participation increased especially among older workers, which can be attributed, at least in part, to the recent tightening of the early retirement provisions. However, employment stability has been achieved largely thanks to a growth in self-employment (outside agriculture), which made up for the fall in wage and salary employment. For example, the number of jobs in the corporate sector dropped by 2.4 percent in the last year. This is a significant decline, but still moderate compared to job losses experienced by most EU countries.

Despite weaker labor demand, wages continue to grow, although at a lower rate. The average wage in the national economy increased by 4.9 percent over one year, or by about 1.4 percent in real terms. Wage growth was driven by wage increases in the public sector (public administration, education, health care) of over 6 percent. In contrast, wages in the corporate sector increased by only 3.9 percent.

The limited increase in unemployment and the continued growth in real wages imply that the impact of the crisis on poverty is likely to be limited. However, as in other countries, the worsening of labor market conditions negatively affected job prospects of disadvantaged labor force groups, such as youth, the low-skilled, and non-standard workers. For example, the youth (19-24) unemployment rate increased over 5 percentage points in one year and currently exceeds 20 percent. The employment rate fell most among workers with less than secondary education.

Source: World Bank staff.

Box 6: Impact of the Rise in Unemployment on Labor Fund Finances

The current economic crisis and rising unemployment puts a strain on the Labor Fund which finances both passive and active labor market programs in Poland. Will the Fund's resources be sufficient to finance the increasing demands for unemployment benefit payments and active labor market programs? Simulation results suggest that the Fund will be able to cover the increased program expenditures under different scenarios of unemployment dynamics until 2011. This box presents simulation results under two scenarios.

Scenario 1 is based on the unemployment rate that was endogenously determined within a structural macroeconomic model used by the Warsaw-based Institute for Structural Research.

Scenario 2 is based on the unemployment rate consistent with the government's projections from April 2009.

The dynamics of the LFS unemployment rate under different scenarios.

	2008	2009	2010	2011
Scenario 1	6.7	8.5	8.8	8.9
Scenario 2	6.7	11.2	11.7	10.6

Source: Institute for Structural Research.

Under Scenario 1, the Labor Fund remains in surplus. It declines from 30 percent of revenues for the 2008 baseline to 17 percent in 2009, 7 percent in 2010, and 4 percent in 2011. Under Scenario 2, the Labor Fund maintains a surplus of 4 percent of revenues for 2009, but incurs a deficit of 10 percent in 2010 and 6 percent in 2011. However, the Fund still will be able to cover the increased expenditures due to the substantial reserve built from 2005 to 2008, when the Fund was running a substantial surplus. Furthermore, for 2009, even the Scenario 1 unemployment projections turned out to be too pessimistic. Unemployment in 2009 remained at around 8.1 percent.

Source: World Bank staff.

25. **Poverty has only increased modestly during the economic slowdown.** Poverty continued in 2008 its steady decline of the last few years on the back of a growing economy, rising household incomes and falling unemployment (Box 8). The current economic slowdown is likely to result in some losses in both labor income and employment compared to what would have occurred without the global financial crisis. However, the continuous expansion of the economy, stable employment rates and wage levels together with public transfer schemes and automatic stabilizers (i.e. unemployment insurance) have ensured that there are no significant increases in poverty (Box 8).

Box 7: Changes in Poverty and Inequality in 2008

Poverty declined continued its downward trend in 2008. Real per capita income and expenditures increased in 2008 by, respectively, 8.0 percent and 7.1 percent. The rise in household resources translated into a lower poverty based on the commonly used poverty lines in Poland. Taking the social assistance threshold as poverty line, poverty declined from 14.6 percent in 2007 to 10.6 percent in 2008. Adjusting the social assistance threshold for inflation would still imply a reduction to 12.0 percent. Only the relative poverty measure, based on 50 percent of average expenditures, registered a statistically insignificant increase. The Gini coefficient suggests that inequality remained unchanged in 2008. The poverty profile remained broadly unchanged. The incidence of poverty is high among the unemployment, particularly when combined with low education of the head of household, many children in the family and residence in small towns or rural areas.

Table: Poverty and Inequality Trends from 2004 to 2008

	2004	2005	2006	2007	2008
Social assistance threshold	19.0	18.0	15.1	14.6	10.6
Subsistence minimum	12.0	12.0	7.8	6.6	5.6
50% of average expenditure	20.0	18.0	17.7	17.3	17.6
Subjective poverty line	27.3	22.5	18.3	17.4	15.3
Gini coefficient	0.344	0.345	0.340	0.340	0.339

Source: HBS, GUS, World Bank staff.
Notes:
The social assistance threshold has remained constant since 2004.
Subsistence minimum is based on the subsistence minimum basket.
Subjective poverty lines for a given type of households are more or less equivalent to the income level declared by the respondents as merely sufficient.

Source: World Bank staff.

Box 8: Employment, Poverty and Distributional Impacts of the Crisis in Poland
Brief overview of results from microsimulation exercises

Macroeconomic Impacts

Overall GDP growth in Poland is expected to be 1.5 percentage points lower in both 2010 and 2011 as a result of the crisis, compared to what it would have been without the crisis. However, GDP growth in Poland remained positive in 2009 and expected to gain strength in 2010 and 2011. The loss in GDP growth relative to the non-crisis scenario is attributable to a projected fall in industry, construction and service sectors.

To estimate how these macroeconomic impacts would translate into changes in household income, **we use a microsimulation approach that superimposes macroeconomic projections on behavioral models built on pre-crisis household data.** The macroeconomic shocks are transmitted to households through changes in employment, labor earnings, and non-labor income (including remittances from migrants).[5] To measure the impact of the crisis, comparisons are made between scenarios with and without crisis for 2010 and 2011.

Impacts on Employment and Income

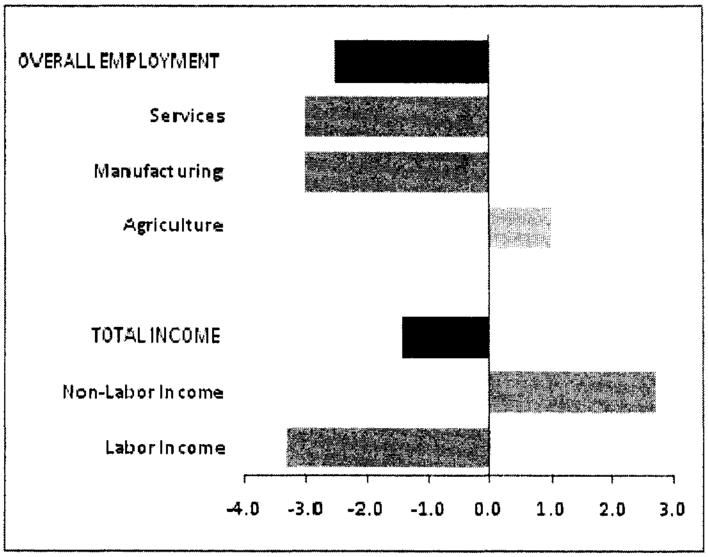
Labor market shocks can be decomposed into shocks to employment and earnings. **Employment rates are**

[5] The model is loosely based on the approaches described in Bourginon, Bussolo, and Pereira da Silva (2008) and Ferreira et al. (2008), but simplified in the sense that it is not linked to a general equilibrium model. Instead, the simplified model takes the macroeconomic projections for a specific country and year as given, and extrapolates the microeconomic snapshot of future impacts from these projections.

expected to fall by about 3 percent in 2010 and 4 percent in 2011 due to the crisis. The shock is spread out fairly evenly across male and female workers, as well as across the industry, construction, and services sectors. Agricultural employment is unaffected in 2010 and in fact rises in 2011 as a result of the crisis, consistent with the sectoral GDP projections.

Figure: Employment and Income Impacts

2010 - without increase in transfers
(% change between benchmark and crisis)



Earnings per worker are predicted to be 1.3 and 3.3 lower in 2010 due to the crisis, with the largest declines occurring in manufacturing and construction. The losses are especially high in the industry and construction sectors, and the impact is expected to be worse for both sectors in 2011 than in 2010. Also, male workers appear to suffer greater income losses in percentage terms than do female workers, although both genders suffer similar employment shocks. Since males have higher incomes to start with, the crisis appears to reduce the gender gap in incomes to some extent. The combination of lower employment levels and individual earnings translates into **household labor income being 3.3 and 4.7 percent lower in 2010 and 2011 respectively as a result of the crisis** (Figure 1).

By contrast, non-labor income is higher under the crisis scenario, mainly due to a generous unemployment insurance system and, to a lesser extent, an increase in family allowance transfers to recipient households. Two scenarios are computed with respect to non-labor income. Both scenarios include a projected increase in unemployment insurance payments.[6] In addition, the first scenario reflects no increase in social transfers while the second includes the 20 percent increase in family allowance transfers approved implemented as part of the crisis response package. In both scenarios, non-labor income is around 3 and 2 percent higher in 2010 and 2011 respectively. This is largely due to unemployment insurance payments being higher as a result of the crisis, as the number of unemployed workers increases. Since non-labor income accounts for about 30 percent of the average household's income, the increase in non-labor income offsets some of the losses in labor income and cushions the shock for households.

Poverty and Distributional Impacts

The impact of the crisis on overall poverty rate and depth is projected to be small and further mitigated by unemployment insurance benefits and, especially, the increase in social transfers. As a result of the crisis, the poverty headcount rate in 2011 is projected to be higher by 0.5 percentage points

[6] This assumes that every worker who becomes unemployed receives an amount equal to the average annual payment of unemployment insurance per worker.

with the increase in social transfers and 0.7 percentage points without the increase; the impact is even smaller in 2010 (Table). In other words, the increase in family allowance transfers in response to the crisis is expected to reduce the poverty impact by about 0.3 and 0.2 percentage points in 2010 and 2011 respectively. The poverty gap, which measures the depth of poverty, follows a similar pattern to the poverty headcount.

Table: Crisis impact on poverty and inequality indices

	Baseline	With Crisis		Impact of Crisis *(Crisis – No-crisis)*	
	2007	2010	2011	2010	2011
Without increase in transfers					
-Headcount rate (%)	17.3	14.3	13.6	0.4	0.7
-Poverty gap	5.0	4.3	4.0	0.2	0.2
With increase in transfers					
-Headcount rate (%)	17.3	14.0	13.3	0.1	0.5
-Poverty gap	5.0	4.2	3.9	0.0	0.1

Source: Microsimulations using macro projections and EU-SILC (2007)

Most income losses are felt in the middle of the income distribution. Although changes in aggregate inequality measures appear to be negligible, this masks important changes in income distribution. Eight to ten percent of households in the middle of the income distribution (3th-8th deciles) suffer a negative income shock large enough to push them to a lower income decile. These shocks are mainly associated with losses in labor income in the manufacturing and construction sectors. Some upward movements also occur, especially at the bottom of the income distribution, due to increases in non-labor income (i.e. social transfers).

Impacts are larger in urban than in rural areas and, within urban areas, they are largest among those at the bottom of the distribution. Large impacts among poor and vulnerable households in urban areas are likely the result of weaker attachments to the labor markets and employment in informal/less productive jobs. In contrast, in rural areas it is those at the top of the distribution and with access to non-farm employment, who are most affected.

Source: World Bank staff.

26. **The moderate impact of the economic slowdown on household budgets has enabled households to continue servicing their loans.** The rise in household access to credit has exposed Polish households to potential credit market shocks, although the vulnerabilities are weaker than in some other EU10 countries (World Bank 2009a). At the end of 2008, household debt reached 25 percent of GDP, the fourth lowest ratio among the EU10 countries. About half of this debt was housing loans. Payment obligations may increase as a result of the crisis for three reasons. First, about 40 percent of bank loans were foreign currency denominated, exposing households to exchange rate depreciation. Second, most households have loans that have variable interest rates, which means that their interest payment obligations may rise as average interest rates rise. Third, those who have recently lost their jobs will have an even more difficult time meeting their payment obligations.[7] Fortunately, the stable employment rate and positive real wage growth have

[7] A stress test in Poland suggests that unemployment shocks (compared to interest rate or exchange rate shocks) have the highest impact on probability of default. Modest increases in unemployment can increase the share of loans in default by over 5 percentage points (Żochowski and Zajączkowski 2007 and 2008).

protected household incomes. Household debt is also well distributed, with total household debt repayment exceeding one fifth of household budgets in only 16 percent of Polish households, the lowest share among seven EU10 countries with available data. In addition, the appreciation of the zloty since March 2009 has limited balance sheet effects for households with foreign exchange mortgages. Moreover, stabilization of the financial markets and the low interest rate environment have helped maintain household access to affordable borrowing. Finally, as discussed below in Section III, the Government has initiated programs to support vulnerable households with mortgages. As a result, non-performing loans of households have increased only moderately from 3.5 percent in 2008 to 4.9 percent in September 2009, and non-performing loans for mortgages have increased from 1.0 percent in 2008 to only 1.4 percent in September 2009.

III. THE GOVERNMENT'S REFORM PROGRAM

27. **Government policies continue to balance support for a broad-based, sustainable economic recovery with medium-term fiscal stabilization.** More than one year after the outbreak of the global financial crisis, Poland has managed successfully to shore up economic growth, strengthen financial markets and sustain social outcomes. Signs of recovery are also appearing across the EU, with the halt of the sharp decline in economic activity and the improvement in market confidence. However, the strength of the recovery remains uncertain. A key policy issue is when to phase out the extraordinary support to the economy and the financial sector, which was adopted as part of Poland's Stability and Development Plan in line with the European Economic Recovery Program from November 2008. The strategy for exiting from the broad-based anti-crisis policies has to strike an appropriate balance between stabilization and sustainability concerns. The Government shares the EU Council's assessment from October 22, 2009 that it is still too early to withdraw the support, as the recovery is not yet secured. As soon as the recovery is firmly under way, the stimulus measures will be gradually withdrawn and a conservative fiscal stance restored to make room for a private sector led recovery. A sustainable medium-term reduction in the fiscal deficit is required in view of Poland's commitments as part of the EU stability and growth pact, the Government's goal of early euro adoption, and in keeping with its own national public debt ceilings. Increasing the quality of public finances and intensifying structural reform are desirable even in the short term and will foster potential output growth and debt reduction.

28. **Reform of public sector spending is also required to bring about structural changes envisioned as part of the Government's strategy for 2030.** This vision, presented in autumn 2009, entails a fundamental transformation from a "welfare society to a workfare society". The need for this transformation arises from the challenges of globalization, energy deficiency, climate change, and population aging. The aim is to build a competitive, innovative and energy efficient economy supported by a performing state for a socially and regionally cohesive society. Taking the current economic crisis as a stepping stone for Poland's modernization, Vision 2030 provides a framework for long term development anchored in specific targets to inform the process of designing, developing and implementing public interventions (Table 4).

Table 4: Selected Targets of Vision 2030

• Increase the long-term growth rate from 4 percent to 5 percent
• Increase and equalize the retirement age at 67 years
• Increase the employment rate from 60 percent to 75 percent
• Ensure universal early education of children
• Close the life expectancy gap to the most developed countries in Europe
• Increase the share of social transfers going to the poorest 10 percent households from 10 percent to 30 percent.

Source: World Bank staff based on Government's document Poland 2030 Vision.

29. **In response to the challenges arising from the current economic environment and the need for structural reform in line with Vision 2030, the Government has continued to make significant advances in the reform agenda.** Crucial policy measures adopted since summer 2009 include additional steps to safeguard financial stability, the anti-crisis package to preserve employment and promote job creation, the reform of unemployment benefits to increase incentives for job search, the liberalization of the regulation for temporary work agencies, the reform of family benefits to increase effectiveness in alleviating poverty, the reduction in management and contribution fees charged by the private pension funds, the reform of health financing to enhance the stability of the health system, the roll-out of syllabus reform in schools, and the adoption of the law on delivery of services. Overall, Government policies pursue four main objectives:

- To safeguard the stability of the financial sector
- To mitigate the social cost of the economic crisis
- To strengthen public finance
- To pursue structural reforms.

3.1. SAFEGUARDING THE STABILITY OF THE FINANCIAL SECTOR

30. **Expanding on the anti-crisis package adopted in November 2008, the Polish authorities have taken further measures to safeguard financial stability since summer 2009.** In June 2009, NBP has extended the maturity of its repo transactions to 6 months. In September 2009, NBP announced as contingency measures to improve liquidity its readiness to extend its repo transactions to 12 months, purchase banks' bonds directly in the secondary market, and use corporate promissory notes as security for central bank funding. NBP has also undertaken top-down stress tests showing that the banking system is robust to adverse scenarios. KNF, the financial supervisor, has been successful in encouraging banks to retain their 2008 record profits, which helped to increase capital adequacy from 11 percent in March 2009 to 13 percent in September 2009. KNF has also approved a new capital adequacy regulation temporarily allowing banks to strengthen their capital by issuing subordinated debt. In addition, KNF has stepped up work on systematic bottom-up stress tests in the banking sector. KNF also supported new legislation, currently under review by the Supreme Court, which subordinates credit unions to the supervisory powers of the KNF, reducing systemic risks.

To ease the credit crunch and help banks reduce credit risks, the government has introduced a credit guarantee program for SMEs offered by the state-owned bank BGK. On February 5, 2010, the Government approved the assumptions of the proposed legislation on consumer loans, which will harmonize Polish law with the new EU directive on consumer loans. In late February 2010, KNF approved a new recommendation to tighten criteria for local and foreign currency consumer lending. Aiming to broaden the supervision of consumer loans, it advises banks to introduce new lending procedures for both domestic and foreign currency loans.

Table 5: Government's Measures to Safeguard Financial Stability in Response to the Crisis

To increase bank's capital buffers	• Encouraged banks to retain earnings to boost own capital. With all profits from 2008 retained, capital-adequacy ratio increased from 11 percent in March 2009 to 13 percent in September 2009. • Introduced new capital adequacy regulation temporarily allowing banks to strengthen their capital, subject to the approval of the KNF, by issuing subordinated debt.
To provide zloty and foreign currency liquidity	• Introduced monthly three-month (and starting in May, six-month) repo operations. • Range of collateral for liquidity-providing monetary operations has been broadened and haircuts reduced. • NBP announced its intention to purchase banks' bonds directly in the secondary market, and use corporate promissory notes as security for central bank funding. • NBP has started providing euro, dollar, and Swiss franc swaps to domestic banks. • NBP has secured participation in the weekly euro-Swiss franc exchange swap operations of the Swiss National Bank and the Eurosystem. • The NBP repo line with the ECB of up to EUR10 billion has been arranged.
To intensify financial sector surveillance	• Increased frequency of stress testing and onsite inspections. • Requested banks to review their lending policy and contingency plans. • Requested banks to submit daily reports on new exposures to foreign entities. • Stepped up work on systematic bottom-up stress tests in the banking sector.
To promptly issue corrective measures	• Stepped up individual measures towards certain banks. For example, early warnings were issued to some banks to stop mortgage lending in foreign currency when they started experiencing FX funding difficulties. • Issued recommendations to a couple of small banks to increase their capital base as their CARs were falling close to 8 percent. • Planned consolidation for small banks that are not viable.
To boost confidence in the system	• The Bank Guarantee Fund law has been amended to increase the level of deposit guarantee from EUR22,500 to EUR50,000 and eliminate coinsurance. • NBP has undertaken a top-down stress tests showing that the banking system is robust to adverse scenarios. • The parliament passed a law to guarantee interbank lending. The government has set aside PLN40 billion for these guarantees. • KNF supported a new legislation, currently under review by the Supreme Court, which subordinates credit unions to the supervisory powers of the KNF, reducing systemic risks
To increase coordination between agencies	• Frequent meetings of the Financial Stability Committee to discuss issues and potential measures. The committee was legally established in the fall of 2008 and it is comprised of representatives from the NBP, KNF and MOF. • The KNF has been in close contact with parent banks and supervisors.
To boost domestic credit	• Increased the capital of state-owned BGK bank by PLN 2 billion, enabling it to increase lending • Increased the capital of state-owned PKO BP by PLN5 billion. • BGK introduced a credit-guarantee program for SMEs. • A USD500 million credit line from the World Bank for Polish SMEs is in the pipeline.

Source: IMF and World Bank staff.

3.2. MITIGATING THE SOCIAL IMPACT OF THE SLOWDOWN

31. **Strong policy intervention focused on recovery and social protection systems played a major role in mitigating the social consequences of the crisis.** The measures aimed at households amounted to 1.2 percent of GDP, the fourth largest stimulus among the EU member states, and the largest stimulus among the EU10 countries. The growth in the economy and the stability of the employment rate meant that the number of beneficiaries of social assistance and minimum income even declined slightly in the first nine months of 2009 compared to the same period last year (EC 2009). Stable employment, together with the continued rise in wages, has also played a crucial role in sustaining household incomes and domestic demand, as Poland's tax and benefit system provides less cushion of disposable income to unemployment shocks than in other EU countries.[8]

Labor Markets

32. **Poland has a relatively well developed system of labor market programs to support the unemployed.** Expenditures on labor market programs accounted in 2007 for about 1 percent of GDP, which is in the middle of the OECD range. Expenditures on active labor market programs (ALMPs), such as training, wage subsidies and public works, account for about 50 percent of total expenditures, while the remaining part is spent on unemployment benefits. Participants in ALMPs represent about 2.7 percent of the labor force against the OECD average of 4.3 percent. Certain challenges limit the efficiency and effectiveness of labor market programs (Box 9).

33. **Building on the reductions of the tax wedge from 2007 to 2009 through lowering disability contributions and personal income taxes, Poland has taken further measures to preserve employment and promote job creation**. The Government agreed with the social partners on a temporary anti-crisis package which came into force in August 2009 and will be phased out in December 2011 (Table 6). The act's main components include short-time working subsidy, greater flexibility in the adjustment of working hours, and the relaxation of rules governing the use of fixed-term contracts. The new regulation on working hours allows employers by collective agreement or agreement with employees' representatives to fix a reference period of working time up to 12 months (PL3 prior action). This is meant to encourage the adjustment of working hours rather than employment and thus to discourage layoffs. The short-time working subsidy is provided to enterprises which experienced a large fall in revenues (over 25 percent) in the wake of the crisis and reduced working hours or put workers on mandatory leave. The maximum subsidy per worker is equal to the amount of unemployment benefit (40 percent of the average wage). As regards fixed-term contracts, employers can now renew them more than three times in a row, with the maximum duration of one contract kept at 24 months.

[8] Income taxes and social benefits absorb only 30 percent of a 5 percentage point increase in the unemployment rate in Poland, compared to 34 percent in the US and 50 percent in the EU overall (Dolls et al 2009).

Box 9: Reforms Agenda for Labor Market Programs

- *Governance structure.* The highly decentralized structure for employment programs delivery limits MOL's scope to influence program design and to reallocate resources across regions and programs.
- *Increasing program costs.* The unit cost of most programs increased well above inflation in recent years without increasing job placement rates.
- *Regional allocation of funds.* Labor Fund resources are allocated to regions according to the formula that depends on the absolute number of the unemployed in the region. This limits the incentives to reduce registered unemployment, as lower unemployment implies lower transfers;
- *Substantial variation in cost-effectiveness across programs.* Some programs are costly while their benefits in terms of improved chances of sustainable employment are either low or uncertain.
- *Lack of impact of some programs.* Programs also differ substantially with respect to their net impact. A recent impact evaluation study found that job search assistance and counseling have little impact on the unemployed chances to find a job, even though in general job search assistance is found to be the most cost-effective program. This suggests that the quality of services provided is low.
- *Regional variation in programs' cost-effectiveness.* In some regions program unit cost and cost per job placement are much higher than in others irrespective of differences in regional labor markets. This implies that some local Labor Offices are more efficient than others.
- *Mixed evidence on program targeting.* Public works and wage subsidies appear well targeted to low-skilled unemployed and to rural areas and small towns but hardly improve future employment chances. Training and apprenticeships, the two largest programs, are only partially targeted to the less-skilled workers whose employment prospects are significantly worse than those of better skilled workers. Business support, the most expensive program, benefits mostly relatively well educated.

Source: World Bank PER 2010.

34. **Preliminary evidence indicates that few employers have used these measures to date.** According to the Guaranteed Employee Benefits Fund, by the end of January 2010 only 111 firms applied for a short-term working subsidy covering 9,577 employees compared to its original estimates of as many as 60,000 firms. Greater working time flexibility has proved to be a more popular instrument: by mid January 2010, 534 agreements on extending the calculation period for working time were approved. Overall, the public expenditures to support the temporary labor market measures are likely to remain below the planned PLN1.5 billion provided by the Labor Fund.

35. **The authorities have taken measures to discourage long-term unemployment.** As of January 1, 2010, the level of unemployment benefits will decline after three months in order to encourage the unemployed to seek a job immediately after their registration (PL2 prior action).[9] In addition, in order to improve employment prospects of the youth – a group particularly vulnerable during the period of weak labor demand – the Government also plans to introduce a new program referred to as *Better Start.* This program will enable local labor offices to design individually tailored action plans for young job seekers, combining training initiatives and job search assistance.

[9] In 2009, the unemployment benefit was set as a flat rate at PLN 551.8 during the first six months and PLN 575 during the second six months. From January 2010 onwards, the amount will rise to PLN 717 during the first 3 months of unemployment, and to PLN 580 thereafter. The maximum duration of benefits is 6 months in powiats (districts) where the rate of unemployment is less than 125% of the national average, 12 months in powiats where unemployment is less than 200% of the national average, and 18 months where unemployment is greater than 200% of the national average.

36. **To enhance labor market performance, the regulation of Temporary Work Agencies (TWA) was liberalized.** The aim is to improve employment prospects of disadvantaged workers who often are employed on temporary contracts (e.g. youth, workers with limited labor market experience, low-skilled workers). Specifically, the revised law no longer prohibits employers who in the last 6 months issued layoffs to use services of TWA. This allows employers who were hit by the crisis to hire temporary workers. Moreover, the revised law extends the maximum duration of temporary employment with one employer from 12 to 18 months. These changes make the services of TWA more attractive to employers, and thus improve the job prospects of temporary workers.

Social Assistance

37. **Relative to other branches of the social protection system, Poland's spending on social assistance is low.** Out of the 15.7 percent of GDP that Poland spent on social protection in 2007, only 1.4 percentage points was allocated for family and child allowances and minimum income assistance. The Czech Republic and Slovenia, which like Poland target family and child benefits based on income, spend 2.5 and 2.3 percent of GDP, respectively. Furthermore, there are concerns about coverage and leakage. Analysis of the 2007 household budget survey suggests that about 31 percent of the population who met the eligibility criteria for some form of targeted social assistance in 2007 did not receive any social assistance, while 47 percent of the population receiving social assistance benefits would be ineligible when eligibility is assessed by consumption. In addition, there is no clear improvement in performance from giving local governments a greater role in administering social assistance since 2003.

Box 10: Reform Agenda in Social Assistance

In order to come to a more definitive conclusion about what is contributing to large gaps in coverage, leakage to non-poor and otherwise ineligible households, and the impact of decentralization, a more thorough examination of benefit administration at the Gmina level is required using data that can capture improvements at the local level. Nevertheless, results using existing data are sufficiently robust to support these general recommendations:

- International experience suggests that large gaps in coverage typically reflect a lack of outreach to find households that are likely to be eligible but uninformed about their rights. This points to the need for ***more proactive outreach*** to vulnerable groups from local social welfare offices.
- Given that there is no robust evidence for better performance of the social assistance system in response to decentralization, a careful consideration of the appropriate role for local governments in the delivery of targeted social assistance is required. In particular, the Ministry of Labor could step up its ***monitoring and supervision of Gmina social welfare offices*** to ensure consistent application of standards and procedures. The disparities in performance across Voyvods could reflect serious differences in administrative capacity and practices across Gmina social welfare offices.
- Substantial leakage of benefits to non-poor groups could indicate a need for better and more frequent ***cross checking between administrative databases*** of different social protection programs, and with income and asset administrative data held by other government agencies.

Source: World Bank PER 2010.

38. **Following on the provision of a reserve in the 2009 budget to protect the vulnerable affected by the economic downturn, the Government has continued to strengthen the social assistance system.**

- First, means-tested core child benefits were increased by over 40 percent in November 2009 (PL3 prior action), and no changes were made to eligibility criteria. The expected outcome of this measure is a more progressive distribution of spending on social assistance transfers (Section IV.1).
- Second, a new law is in preparation to create favorable conditions for development of diverse forms of care of young children (e.g. nurseries, children's clubs, child-minders, and other arrangements) as well as improvements of standards in child care centers for children aged 0 to 3. The intention is to provide legal cover for child care arrangements without the stringent requirements imposed by the health code. This law is expected to improve the incentives for parents, particularly women, to participate in the labor force, as currently only 2 percent of children below 3 years of age are in child care. The legislation is expected to be adopted by the Council of Minister in the autumn of 2010.
- Third, the Government is finalizing draft legislation to move the system of foster care from institutional to household-based care. The law will also improve standards in existing foster care centers and support initiatives to strengthen the prevention through the appointment of municipal family assistants. The shift is expected to incur moderate fiscal up-front cost of PLN30 million but is expected to translate into considerable medium term financial savings, as well as better quality care for abandoned and orphaned children.
- Finally, the new act on state aid for repayment of certain mortgage loans to persons who lost their jobs came into force in August 2009. It provides governmental loans to persons who are unemployed since 2008 and have problems with mortgage loans. The Labor Fund has allocated PLN0.5 billion to finance this program. By end of

January 2010, fewer than 1,000 unemployed used this support, compared to original estimates of 45,000.

Table 6: Policy Responses to Mitigate the Social Impact of the Slowdown

To preserve employment	• The reference period for working time can be up to 12 months b collective agreement or agreement with employees' representatives. • Provision of financial aid was introduced for co-financing of the staffs training and co-financing of the remunerating the employees in the companies facing production shut-downs. It is estimated that around 250 thousands of their employees will benefit from the assistance.
To support job creation	• The amendment to the act on employment promotion and labor market institutions introduced a one-off grant for the unemployed person for undertaking business activity (up to 600% of the average remuneration). Moreover, the maximum amount for funding and joining a social cooperative has been increased (to 400% and to 300% of the average wage, respectively).
To strengthen the unemployment benefit system	• From January 2010 onwards, the level of monthly unemployment benefit will be increased by 20% (from 575 to 717 PLN) and will be regressive – after three months the amount of the benefit will fall by around 21% (to 563 PLN).
To support youth employment	• The program *Better Start* will support interventions include apprenticeships, training and support for business start-ups, financed from a special reserve of the Minister of Labor over PLN300 million.
To support mortgage payments of unemployed	• People who lost their jobs in the wake of the economic crisis will have their mortgage loan payments covered (up to PLN 1200 per month). Governmental loans will have to be repaid within 8 years in their nominal value (equal monthly installments paid after the two years of the support expiry). The scheme will be financed from the Labor Fund and the privatization income.
To support family's income	• From November 2009 onwards, core family allowances for children of all age groups were increased by over 40% in nominal terms. The attendance allowance for parents of disabled children was raised by around 24%. • The amount of 2009 state budget reserved to the implementation of a long-term "*Government Food Aid Program*" was increased from PLN 500 million to 550 PLN million. Its implementation is planned to be extended to the period 2010-2013.
To improve social infrastructure	• The stimulus package entails public investment expenditure increases spread over 2009 and 2010 of around 1.2% of GDP. The increase in public investment is intended to boost the construction sector, improve social infrastructure and help stabilise domestic demand.

Source: EC Social Protection Committee and World Bank.

3.3. STRENGTHENING PUBLIC FINANCE

Public Financial Management

39. **The recent strengthening of the national budgetary framework underpins the credibility of the Government's fiscal development and consolidation strategy (Section II.2.2) and supports fiscal sustainability.** The new Public Finance Law passed in August 2009 and adopted in September 2009, as supported by PL2, has enhanced the transparency, efficiency, and the quality of budgetary process (Box 11). New regulations strengthen the medium-term performance-based orientation of the budget. The 2010 budget was prepared in a performance-based budgeting format, including budgets of selected units outside the state budget. The PBB budget should be fully operational from 2013 onwards, and will be prepared together with the traditional budget.

Box 11: New Public Finance Act

The new Public Finance Act was signed by the President in September 2009, and will become effective as of 2010. It introduces the following changes:

Medium-term fiscal framework: The framework will consist of a 4-year rolling fiscal plan including policy goals, state budget revenue and expenditure projections, and the projected general government deficit and debt. Local governments, budgetary funds, and agencies are also expected to prepare 4- or 3-year rolling medium-term fiscal plans. Compared to present regulations—requiring only an indicative 3-year projection for the general government—the new law aims to strengthen the medium-term focus of fiscal policy and provide guidance on medium-term policy goals. Still, the medium-term fiscal plan, which does not require approval by parliament, remains non-binding, with only the state budget deficit for the following year constituting a limit for that year's budget. While the government could change this limit, it would require presenting to parliament a written explanation.

Enhanced debt safety procedures: The law maintains previous debt safety thresholds (50, 55, and 60 percent of GDP) but requires additional corrective actions if debt exceeds 55 percent of GDP. In addition, from 2012, the limit on the stock of local government debt of 60 percent of revenues and the limit on debt service of 15 percent of revenue will be replaced with a single rule. It applies the balanced budget rule normalized by the total local government debt stock averaged over the previous three years. Thresholds are subject to national methodology.

P***erformance-based budgeting (PBB):*** the government will have to show expenditures on PBB basis in justification of the annual budget and in medium-term plans; from 2012 onwards, PBB presentation will also be required for medium-term plans prepared at other levels of the government.

Consolidation of government: certain units will be liquidated (auxiliary units, own accounts, motivation accounts) or their activities limited (budget establishments serving the core municipal needs).

Stronger control and internal audit: internal auditors will be directly accountable to the minister, independent audit committees will be established as ministers' advisory bodies to ensure effective control, and large local governments will be required to have external audits of their budgets.

Treatment of EU funds: the funds will be separated from other items in the state budget, and their deficit/surplus not counted toward the state budget deficit; financing will be a new term in gross borrowing needs.

Source: IMF Country Report No. 09/314, World Bank staff.

Pensions

40. **The 1999 pension reform will help Poland to avoid major fiscal stress of the pension system related to the rapidly aging society, but a number of reform areas are still to be completed.** The traditional pay-as-you-go system inherited from the socialist times was replaced with a multi-pillar pension system that included a notional defined contribution scheme (the first pillar) and a mandatory fully funded defined contribution scheme (the second pillar). In recent years, the Government has been completing outstanding issues from the 1999 reform. In 2008, the Government revisited the occupational categories eligible for early retirement and tightened early retirement provisions to ease the fiscal burden of early retirement on the pension system, as supported by PL2. It is expected that these reforms reduce the number of people eligible for early retirement pensions from about 1.2 million to around 300,000. Important medium and long-term challenges include the low retirement age, especially for women; brining disability benefits in line with pension benefits; and a fiscal surplus over the next

two to three decades due to a large reduction in pension benefits relative to wages; defining the payout provisions from the second pillar; and integrating special schemes into the main pension system (Box 12).

41. **Given the increased importance of the second pillar in financing future pensions, the funded pillar of the pension system will need to become more efficient.** The global financial crisis has reemphasized the need to strengthen the second pillar (Box 13). The Government approved the law on limiting the management and contribution fees charged by the General Pension Society (PL3 prior action). As the crisis has shown, payout options need to be designed so that they are flexible enough to withstand market fluctuations while protecting workers. However, progress on adopting multiple portfolio legislation was put on hold as a result of a government debate about lowering transfers to the Open Pension Funds. The pension component of the Government's fiscal development and consolidation strategy focuses on strengthening the effectiveness of the second pillar.

Box 12: Reforms Agenda for Pensions

- ***Low retirement age, especially for women.*** The women's retirement age of 60 is low, 5 years below men's retirement age. This leads to low retirement benefits for women retiring at the set retirement age. Benefits for men are double the benefits for women, even though men's wages are only about one fifth higher than women's wages, as women retire so much earlier than men in spite of a higher life expectancy.
- ***Unreformed disability benefits threaten to swamp the system.*** Currently, more than two-thirds of pension benefits go to old age beneficiaries while only one in seven go to disability beneficiaries. With the sharp reduction in old age benefits, an unreformed disability system with its much higher benefits than old age benefits could result in a roughly equal share of spending allocated between old age benefits and disability benefits.
- ***Fiscal surplus over the next 15 to 20 years due to a large reduction in pension benefits relative to wages.*** This surplus is brought about by the decline in future pension benefits relative to wages. According to the World Bank's PROST model, benefits could fall from currently close to 70 percent of net average wages to less than 30 percent of net average wages over the next thirty years. In view of the aging of the population, there is no need for the pension system to accumulate a long run surplus.
- ***Reforms of the funded system.*** In addition, legislation identifying the principles on how the funded system would pay out benefits for those retiring between 2009 and 2013 was issued in 2008, but vetoed by the President. An annuity law that defines the payout provisions for the lifetime pension from the funded pillar was presented and adopted by the Parliament in December 2008, but then vetoed by the President. The legislation specified a temporary pension and a lifetime pension (annuity) as two types of pensions. While legislation would be desirable now, it is not urgently needed, and it will not be essential until cohorts with a significant balance of accumulated savings in their private retirement accounts begin to retire in 2014.
- **Integration of special schemes within the pension system.** Poland still maintains a number of separate occupational schemes, such as those for farmers, the military, and police. While integrating these occupations into a national scheme is difficult in most countries because of occupational limitations, labor market flexibility is sacrificed by maintaining many separate schemes.

Source: World Bank PER 2010.

Box 13: Impact of the Financial Crisis on Returns of Pension Fund Assets

Losses in asset values over the last 12 months reported by pension funds have been considerable. As of September 30, the real year-on-year return on mandatory pension funds amounted to -17 percent. This compares to losses in other countries with funded systems from 8 percent to 50 percent. While the losses are disturbing to plan members over the short term, they should not be taken as an indicator of the overall longer term performance of the funds which is the relevant perspective for any pension system. Indeed, since its inception through to 2007, mandatory pension funds in Poland experienced an annual real rate of return of 9 percent, compared to 6 percent for other countries with funded systems. In addition, the proportion of pension wealth that is supported by funded individual account assets is still small.

Source: Adopted from World Bank 2009c.

Health

42. **A major accomplishment of the Polish system has been the almost universal coverage of the population by health insurance.** There has been a steady and substantial reduction since 2000 in the percentage of respondents citing financial problems as a reason for not seeking needed services. Poland is successfully providing protection from catastrophic medical costs for inpatient care, use of which is almost even across consumption quintiles with very low out-of-pocket expenses. It has also succeeded in delivering a fairly high level of satisfaction with general practitioner services and has been whittling away at out-of-pocket costs as public funding has increased. Following years of incremental improvements since 2000, the health system has been transformed. Problems remain in access to specialist and dental services, out-of-pocket expenses for drugs, queues in hospitals for "planned" (as opposed to "urgent") care, and hospital debt.

43. **The Government's health policy is centered on implementing recent reforms to improve the incentives for better economic and medical performance of health providers.** The agenda includes the definition of a basic care package to be financed by NHF, encouraging private insurance coverage to finance services not covered by the NHF package; the transformation of hospitals organized as independent public institutions into companies regulated under the Commercial Companies' Code; the creation of a single Patient's Ombudsman (already completed); a new legal framework for accreditation; a new legal framework for health professionals; and a shift to hospital reimbursement via diagnosis related groups (already completed) (Box 14). In September 2009, the Parliament approved revisions to the algorithm for the distribution of NHF financial resources across voivodships. The allocation of funds is now related only to demographics, epidemiologic factors, and the provision of highly specialized medical services. The modifications in the formula increased the share of resources accruing to poorer voivodships.

44. **A key step in the process has been the adoption of the new law on financing health services in July 2009**. It defines the basic health package that is provided to the insured citizens. In terms of coverage, the law is almost a direct adaptation of the decrees of the President of NHF. Initially over 4,000 activities are covered, encompassing virtually all that NHF has financed historically. It increases the stability in the health system, and opens up the possibility of prioritizing the scope of health services financed

by the NHF in the future. One use envisaged by the Ministry of Health is, rather than limiting services financed for beneficiaries, to help define the minimum providers must deliver under NHF, freeing them to provide additional services for other payers and thus use available resources more extensively to provide a larger total volume of services.

Box 14: Reform Agenda for Health Financing

- **The spectre of cost escalation.** From 1989 to 2005, Poland struggled to pay the bills, caused by a combination of low fiscal effort for health and an expensive and unaffordable endowment of inappropriate infrastructure and excess personnel. 2005 seems to have been an inflection point when, through a combination of higher incomes and a higher NHF tax rate, resources flowed into the system in volumes sufficient for hospitals to incur less debt for operations and for NHF to start experiencing surpluses. Yet health care expenditures around the world are highly income elastic, rising faster than incomes. Inevitably this will happen in Poland, and the challenge will be how to manage pressures for costs and expenditures to escalate. Two important policies, the corporatization of hospitals and the adoption of DRGs, have been put in place that will help manage these pressures in the future. Starting in 2010, NHF should be able to start analyzing DRG data to understand efficiency characteristics of hospitals and to formulate future reimbursement policies to encourage attentiveness to costs by hospitals. The Ministry of Health also seeks higher State funding to raise the fiscal effort above 5 percent of GDP.
- **Quality.** The government's package of reforms includes changes to the accreditation regime for the medical sector, which up to this point has been voluntary. Despite initial expectations, the proposed law does not offer any immediate benefits for accredited units. Yet, if combined with competitive contracting by NHF, accreditation would create a financial benefit for medical institutions to become accredited and improve basic standards of care. A quality improvement function within NHF could use comparative data and the power of its purse to encourage constant improvement of quality.
- **Patient Subsidies.** Since approximately 2005, Poland has succeeded in driving down out-of-pocket expenditures for everyone, even as incomes have grown substantially. An alternative in the future is to provide higher subsidy rates (drug purchases would be an obvious focus) for specific groups – such as for the poorest 40 percent of the population, or age-related subsidies for drugs purchased by the elderly – which would target additional subsidies to the most vulnerable at lower cost than the across-the-board approach taken during the last five years.
- **Health Outcomes.** Many argue that health systems do not have much effect on general indicators of health (such as life expectancy). All agree that Poland has done very well over the past 20 years to improve life expectancy, and this improvement is probably due to a combination of income growth, education, behavior, and improved health care. However, for specific diseases, there is no question that public awareness, changes in behavior, better health services, and targeted interventions can make a difference. Poland lags the pre-2004 EU by five years of life expectancy. The difference is primarily due to excess mortality among adults, and 84 percent of that excess mortality is estimated to come from cardiovascular disease. Many countries have experienced declines of 30 percent in mortality due to cardiovascular disease over a ten-year period, with about two-thirds of the decline due to a reduction in risk factors (obesity, smoking, etc.) and one-third due to better treatment.

Source: World Bank PER 2010.

Education

45. **The Government has advanced the reform of the education system.** Education decentralization started in 1990 and over time the tasks of maintaining and managing preschools, primary schools and finally secondary schools were gradually transferred to local self-governments in gminas and poviats. In 1999, the Government of Poland stepped up reforms of secondary education. They improved the integration of

general secondary and vocational education and delayed the vocational training track in order to expand students' exposure to general secondary curricula. These reforms helped to provide young people with flexible skills and improved their ability to absorb and generate new knowledge and technology. Overall, Poland's education system is remarkably efficient and equitable. While the achievements are impressive, there remain important challenges in the area of kindergarten and pre-school education, adjusting the education system to demographic change, and reforming tertiary education (Box 15).

46. **Over the last year, the Ministry of Education has taken steps to bolster pre-school education.** It has introduced mandatory pre-school education of 5 year-old children from 2011/12 onwards, and mandatory school education of 6 year-old children from 2012/13 onwards (PL3 prior action). In addition, the Government has started to roll out the new syllabus. In the school year 2009/2010, the reform covered kindergartens and the first grades of primary and middle schools. The syllabus reform will be completed in secondary and vocational schools by 2015, in secondary technical schools and artistic secondary schools by 2016, and in complementary secondary schools by 2017.

47. **The Ministry of Science and Higher Education is preparing a new law on higher education**. Within the framework of tertiary education reform, the financial support for graduate and post-graduate students from poor households is set to increase. The Council of Ministers adopted the assumptions of a new law to shift a larger share of public stipends for tertiary education onto a needs basis on October 28, 2009. At present, higher education facilities have to allocate no less than 50 percent of the financial subsidy to support low-income students. Under new rules, this threshold is set to go up to 75 percent.[10] The law is expected to become effective by October 2010. In addition, the Government has endorsed the higher education reform plan that includes higher funds for elite universities starting on 2011; limits tuition-free studies to one degree (only the top 10 percent of students will have the right to pursue a second tuition-free degree); and defines a common list of free services on public and non-public universities including examinations, final examination, submitting and reviewing of the thesis.

[10] Income thresholds for social stipend will also be raised. Currently, all students with income below PLN351 are entitled to get material support from the university. This lower threshold will be increased to PLN438.75, and the upper threshold from PLN602 to PLN752.5. In addition, students with income exceeding PLN351 but less than PLN602 may also receive support pending decisions of the Head of University and Students' Association. This upper threshold will be increased to PLN752.5.

Box 15: Reform Agenda in Education

- ***Increase access to and diversity of preschool education.*** International experience indicates that early childhood education has high payoffs in improving the ability of children to learn and in generating equitable educational outcomes. In addition to expanding public preschools, expanding the involvement of non-public institutions with low per-capita costs and creative staffing and management arrangements can help to diversify service delivery.
- ***Adjusting the pupil/teacher ratio to demographic trends.*** While Poland's student population in primary and secondary education continues to fall, the number of teachers has not declined in proportion to the demographic shift of the student population. Inflexibilities in the management and deployment of teachers make this adjustment difficult. Local governments have inadequate incentives to adjust the teaching force to demographic changes by consolidating schools and classrooms. As a result, there is scope to use resources more effectively within education.
- ***Financing of tertiary education.*** While the growing role of private institutions and financing in Poland's tertiary education has been an important factor in expanding coverage, public financing of higher education can be made more equitable and fiscally sound. Currently, subsidies for tertiary education are based on merit alone, which tends to cause a regressive distribution of public subsidies (favouring better-off families).

Source: World Bank PER 2010.

3.4. PURSUING STRUCTURAL REFORMS

48. **As stagnation gives way to recovery, Poland can shift attention to strengthening the foundations of inclusive growth with productive jobs.** With the crisis still unfolding, much of the policy makers' attention is understandably on addressing immediate needs. Yet, the crisis has been a reminder of the need to build the foundations for sustainable growth. Advancing structural reforms to safeguard the achievements of transition and put the economy back on track for convergence remains vital.

Private Sector Development

49. **Poland has continued to make gradual progress in improving the business environment.** The 2010 Doing Business Report recognizes four recent reforms, making Poland the most active reformer among the EU10 countries (Box 16). In the 2008 Doing Business Report, Poland ranked 74 out of 178 countries; in 2009, 72 out of 181 countries, and in 2010, 72 out of 183 countries. Overall, Poland improved from the 42^{nd} percentile to the 39^{th} percentile.

50. **The Government recognizes the need to accelerate reforms of the business environment.** Staying internationally competitive in a world of reduced capital flows and discriminating financial markets reinforces the importance of an enabling business environment. First, following on the two previous business liberalization acts, so called "Economic Freedom" acts, adopted in September 2008 and March 2009, the Government is in consultation with stakeholders regarding a new business liberalization law to further decrease barriers to firm registration, cut red tape, including through limiting the need for administrative affidavits, and improve access to e-government. The new law, which

would change more than 100 existing laws, ranging from business inspections to business registration, is scheduled to come into force in January 2011. Third, the Government is cooperating closely with the Bank on Doing Business reforms. The Bank will provide technical assistance focused on five major reform areas identified in the 2010 Doing Business report (starting a business, closing a business, providing construction licenses, paying taxes, and registering a property). Fourth, on December 8, 2009, the Council of Minister submitted to Parliament an act on delivery of services in Poland, aimed at enhancing this sector, which accounts for 56 percent of GDP, in line with the EU Service Directive (PL3 prior action). Finally, the Ministry of the Economy is developing a Public Private Partnership (PPP) Policy and Implementation Framework based on international best practices. The objective is to increase the number of PPP projects following the new PPP act which entered into force in February 2009.

Box 16: Reform Agenda for Doing Business

The 2010 Doing Business Report highlights four recent reforms in Poland:

- *Starting a Business*: Business start-up was eased by reducing the minimum capital requirement from PLN 50,000 to PLN 5,000 and consolidating applications for company registration and registrations with the tax, social security, and statistics authorities.
- *Closing a Business*: Poland eased the process of dealing with distressed companies with an amendment to its bankruptcy law introducing the option of pre-bankruptcy reorganization for companies facing financial difficulties.
- *Paying Taxes*: Social security taxes were cut for businesses, and the value added tax (VAT) law was simplified.
- *Getting Credit*: Access to credit was improved by allowing all legal persons (including foreign entities) to hold or grant security interests.

The 2010 doing business ranking points to three areas stand out where Poland lags behind peer economies: construction permits (164), paying taxes (151), and starting a business (117).

- Poland has made a huge jump in this year's ranking on starting a business, from 145 to 117, due to the reduction in the minimum capital required. One remaining bottleneck is the time it takes to file at the national court register for company registration (28 out of the 33 days).
- The number of tax payments due are fairly high (40) and a significant amount of time is spent processing in particular social security payments (222 hours out of 395 hours overall).
- Obtaining a construction permits takes 30 steps and 308 days. One key bottleneck is to obtain the building permit, which takes 180 days alone.

Source: Adapted from 2010 Doing Business Report.

IV. BANK SUPPORT TO THE GOVERNMENT'S PROGRAM

4.1. LINK TO THE COUNTRY PARTNERSHIP STRATEGY

51. **The PL program is central to the Bank's engagement in Poland, as emphasized in the 2009-13 Country Partnership Strategy (CPS) approved by the Board on June 30, 2009, together with the PL2 operation.** The overarching goal of the CPS is to support Poland's convergence towards EU living standards. The CPS aims to situate the Bank's engagement in Poland firmly in the context of the activities of other external partners and focuses on niche areas of engagement where the Bank can add value.

52. **The policy lending series provides an anchor for the strategic dialogue between the Bank and the Polish authorities.** The Bank's strategic partnership with Poland is based on four pillars: (i) Growth and Competitiveness; (ii) Public Sector Reform; (iii) Social and Spatial Inclusion; and (iv) Regional and Global Public Goods. Public financial management reform, private sector reform, labor market efficiency and social sector reform, supported by the PL series, are key elements of the first three pillars. Beyond the current series, the Bank will continue focusing on supporting high, sustainable growth through the improved competitiveness of firms and regions, increased employment, and strengthened social cohesion. The Bank is also engaged in energy sector reforms and climate change challenges, and is reaching out to subnational governments to sustain broad-based, sustainable and inclusive growth. The Bank will support Poland in implementing the fiscal development and consolidation strategy and in advancing structural reforms of the Government's Vision 2030 and of the EU's Europe 2020 strategy.

4.2. COLLABORATION WITH THE IMF AND THE EUROPEAN COMMISSION

53. **The Bank has collaborated closely with the IMF and the European Commission on this program.** The staffs of the Bank and the Fund are working closely together on Poland, with frequent exchanges on macroeconomic, fiscal and structural reforms. The measures under the proposed PL program have been discussed with both the IMF and the EC to ensure that they reinforce and complement their support to Poland.

4.3. RELATIONSHIP TO OTHER BANK OPERATIONS

54. **The PL series constitutes the bulk of new lending in the early years of the CPS.** In addition, two non-sovereign operations are under preparation, each of which could amount to about EUR300-400 million, although the operations are at risk due to issues related to sovereign guarantees and negative pledge clauses. The first is a line of credit to support SMEs. The second is an investment loan to the City of Warsaw to support municipal infrastructure development. The reforms supported in the program will also benefit from prior Bank financed assistance at the local level. The Post Accession Rural Support Project (PARSP), approved by the Bank in 2005, provides assistance to rural *gminas* to enhance the capacity of local governments to identify, plan, and execute social protection strategies through a Social Inclusion Program. The project

is implemented in 500 rural *gminas*, where it has helped to increase the capacity of local governments as well as to engage communities – by emphasizing participation and building on social capital – in monitoring the use of resources and social transfers. As the reforms supported by the program of policy lending help to put more decisions into the hands of local authorities, the capacity created with support of the PARSP will become critical. The Bank has also provided support to the agricultural insurance fund (KRUS) reform to improve the efficiency of the KRUS Agency by strengthening its administrative and analytic capacities, its management, and its decision-making processes.

4.4. LESSONS LEARNED

55. **The Bank has played an important role in Poland since 1990, the beginning of the transition period.** The Bank has supported the economic transformation efforts of successive governments through policy dialogue, technical assistance related to project preparation, capacity building and institutional strengthening, and financing. In the first half of this decade, the EU accession provided an important anchor for structural reforms. Following EU accession, a range of other financing sources were available to the Polish authorities, including grants from the EU and loans from regional institutions and development banks. Several changes of government made it difficult to engage in a continuous dialogue on core policy issues.

56. **The PL series incorporates a number of lessons from the Bank's previous engagements, and from Bank work with other middle-income countries.** First, the program focuses on areas of strategic relevance where the Bank has an established track record of strong technical capacity and ample cross-country experience. Rather than seeking to cover an extensive list of measures, this program has sought to concentrate on core aspects of public financial management, labor market efficiency, private sector development and social sector expenditures. Second, these engagements are grounded in a strong analytical basis. Analytical work is crucial for selecting the reform areas to be supported with policy lending and informing the design of particular policy reforms. Third, in order to implement a lending program that best addresses Poland's needs as a creditworthy middle income country, the program's focus should be adjusted flexibly to respond quickly to changing circumstances. This is especially important in the context of the global financial crisis. An anti-crisis program cannot solve all problems a country faces, but should be tailored to address urgent issues, while leaving some structural reforms for the post-crisis phase. Fourth, Government ownership is crucial for the success of reforms. The concentration on critically important reform steps facilitates the political ownership of the program, and thereby made the process easier for the authorities to initiate and to pursue. The proposed operation effectively responds to the Government's own priorities and commitments as reflected in the fiscal consolidation and development strategy, the convergence program and Vision 2030.

4.4. ANALYTICAL UNDERPINNINGS

57. **The Bank has undertaken extensive analytical work in the areas covered by the proposed operation, with a number of recent or ongoing activities.** The Bank team prepared in 2009 the first Public Expenditure Review since Poland's accession to the EU in 2004 (Table 7). This was a key element in the analytical assistance agreed in the negotiation of the first lending operation. It provides a comprehensive assessment of Poland's policies in the areas of social sector, public wages, and performance-based and medium-term budgeting. The report lays out options for reforms in support of Vision 2030, and simulates the medium-term fiscal impact of these reforms.

58. **In addition, several pieces of technical assistance have been completed or initiated to inform the policy dialogue in PL-related areas.** To analyze the impact of the global financial crisis, the Bank team is collaborating with DEC and PREM on country case studies of the growth and distributional dimensions as part of the Bank's knowledge agenda. In the area of public financial management, the Bank finalized end 2009 a EU10 study on recent reforms in performance-based and medium-term budgeting frameworks, will complete by April 2010 a subnational PER on the Mazowieckie voivodship, and has launched work on tax expenditures. In the area of private sector development, the Bank is collaborating with the Ministry of the Economy in fee-for-service technical assistance to improve the business regulatory environment, enhance the quality and effectiveness of state control institutions providing oversight over the private sector, and developing a PPP policy and implementation framework. In the area of labor markets, the Bank has engaged with the Government on the reform of unemployment insurance and active labor market programs. In the area of pensions, the Bank conducted in February 2010 a workshop on the Bank's pension simulation toolkit for Government staff, and discussed Poland's experience as part of an ECA study on the implications of the global financial crisis on mandatory pension systems. In the area of health, the Bank conducted workshops on the fiscal implications of demographic change on long-term care in Poland and public-private partnerships in health with the Mazowieckie voivodship, and continues a close dialogue with the Ministry of Health on the health policy agenda. In the area of education, the Bank collaborated with the Government on higher education reform through participation in two regional conferences, expert advice on linkages between science curricular practices and the development of human capital for research, science and technology. Policy notes on enhancing teacher performance and assessing the quality of educational services at higher education institutions are in preparation. In the area of social assistance, the Bank is updating the incidence of social assistance spending using the 2008 household survey data, undertaking qualitative field research to compare gminas where social assistance performance has improved with those where it has deteriorated over recent years. The Bank is also supporting the preparation of the Government's plans to encourage and regulate child care facilities for children under the age of 3. This collaboration entails a case study of existing child care facilities in Poland and a review of international experience with policies to increase labor force participation of women through an expansion of child care facilities.

Table 7: AAA Work in PL Areas in 2009 and 2010

Area	AAA work	Link to PL Agenda	Status
Financial crisis	• Country case study on medium term growth prospects • Country case study on distributional impact	• Protect priority infrastructure investments for recovery • Strengthen targeted social assistance programs	• Ongoing • Ongoing
Public financial management	• Public expenditure review on PFM, public wages and social sectors • EU10 fiscal study on performance-based, medium-term budgeting • Public expenditure review on Mazowieckie voivodship • Technical assistance on tax expenditures	• Strengthen fiscal framework through expenditure ceilings • Implement roadmap for performance-based, medium-term budgeting • Adopt fiscal consolidation measures at the local level • Strengthen tax collection in efficient and equitable manner	• Completed • Completed • Ongoing • Ongoing
Private sector development	• Fee-for-service TA to improve the business regulatory environment, enhance state control institutions, and developing PPP policy and implementation framework	• Implement roadmap for business regulatory environment and state control institutions	• Ongoing
Labor market	• Policy advice on strengthening active labor market policies	• Improve monitoring and evaluation framework	• Ongoing
Pensions	• Policy paper on the implications of the global financial crisis on mandatory pension systems in ECA • Government training on World Bank simulation tool for pension reform	• Strengthen the multi-pillar pension system • Strengthen the multi-pillar pension system	• Completed • Completed
Health	• Paper on fiscal implications on demographic change on long-term care • PPP workshop in Mazowieckie voivodship	• Strengthen the fiscal sustainability of long-term health care • Expand public-private partnerships to strengthen health care	• Completed • Completed
Education	• Regional conferences on higher education reform • Policy advice on linkages between science curricular practices and the development of human capital for research, science and technology • Policy notes on enhancing teacher performance and assessing the quality of educational services at higher education institutions	• Ensure equitable access to higher education • Make science curricular relevant job market • Monitor and evaluate quality of educational services	• Ongoing • Ongoing • Ongoing
Social assistance	• Qualitative field research on coverage and leakage in social assistance • Assessment of plans to encourage and regulate child care facilities for children under 3 years of age to improve incentives for women to participate in the labor market	• Reduce coverage gap in social assistance • Simplify legal provision for child care facilities	• Ongoing • Ongoing

V. THE PROPOSED POLICY LOAN

5.1. OPERATION DESCRIPTION

59. **This is the third lending operation supporting a policy program aimed at accelerating Poland's convergence with EU living standards** (Figure 1). The first policy loan (PL1), prepared in summer 2008, focused on structural reforms central to the convergence agenda. This included strengthening the quality and efficiency of public finances, increasing the supply of relevant and skilled labor, and strengthening the business environment. The second policy loan (PL2), prepared in early 2009, continued to support reforms in public financial management, labor markets, pensions, and private sector development. However, from autumn 2008 to spring 2009, the external economic environment changed dramatically, leading to a sharp slowdown in Poland's growth rate. The Government responded to the weakening of revenue collection by strengthening fiscal balances through a supplementary budget in July 2009. At the same time, the Government stepped up its efforts to mitigate the social cost of the economic slowdown and to protect priority programs and up-front fiscal costs of structural reforms in the sectors of education, health and social assistance. Consequently, PL2 expanded its focus to these additional social sectors. PL3 maintains the focus of PL2. It will continue to support the Government's reform agenda in the seven sectors of public financial management, labor markets, pensions, private sector development, education, health, and social assistance. The measures supported by PL3 are critical for achieving the three main objectives of the PL series:

- mitigating the social cost of the economic slowdown;
- strengthening public finance; and
- pursuing structural reforms.

60. **The PL series has supported a number of policy reforms crucial to maintaining Poland's convergence process on track.** According to recent Eurostat data on GDP per capita in purchasing power standards, Poland is projected to continue the convergence to EU levels between 2008 and 2011 from prior to the crisis, while the other nine EU member states from Central and Eastern Europe are expected to see a moderate reversal in the convergence process over this period. Policy reforms supported by the PL series have contributed the Government's successful policy response over the last year and a half. In particular, they have:

- strengthened the resilience of the private sector (improvements in the business environment through the reduction in minimum capital requirements for business start-ups (PL1); the amendments of the law on freedom of business operations (PL2); and the enactment of the law on delivery of services (PL3));
- protected vital social and labor market reforms (reduction in the tax wedge (PL1); phasing out of bridging pensions (PL2); hospital corporatization (PL2 and PL3); universal primary education at 6-years of age (PL2 and PL3); and
- contributed to the robust social outcomes in the face of the economic slowdown (provision of budget reserve for the vulnerable (PL2); better targeted family benefits and greater flexibility in working hour adjustments (PL3)).

Figure 1. Schematic illustration of Poland's PL program

	PL1	PL2	PL3
Mitigating Impact of Slowdown*			
1. Layoff Disincentives			1
2. Social Assistance		1	1
Strengthening Public Finance			
3. Public Financial Management	1	2	2
4. Pensions	1	1	1
5. Health		2	1
6. Education		1	2
7. Work Incentives	2	1	
Pursuing Structural Reforms			
8. Private Sector Development	2	2	1
Total Prior Actions	**6**	**10**	**9**
Notes: * Pillar added in PL2 and PL3. Cell entries give the number of prior actions.			

Source: World Bank

61. **The remainder of this section will present the policy areas and prior actions supported by the proposed operation.** Table 8 explains the revisions to PL3 triggers as indicated in the PL2 program document and summarizes the status of the PL3 prior actions. Some of the prior actions supported by PL3 were adjusted in order to ensure that PL3 addresses adequately Poland's needs in the context of the global financial crisis. While the Government has continued to advance structural reforms, it has tailored its efforts to address the crucial issues of mitigation and recovery, which has led to some delays in structural reforms for the time when the recovery is more firmly under way. The proposed operation effectively responds to the Government's own priorities and commitments as reflected in the fiscal consolidation and development strategy and convergence program.

	PL3 Triggers as of June 2009	PL3 Prior Actions	Comments
Health			
	6. Adequate budget proposed in 2010 to finance hospitals to be liquidated or corporatized through December 2010 (estimated to be approximately 80 hospitals).	6. The Borrower has allocated adequate resources for financing the hospital corporatization program through the enactment of the Budget Law for 2010 of January 22, 2010 (Journal of Laws of the Republic of Poland No. 19 of 2010, item 102).	Reworded
Education			
	7. Adequate budget to finance educational programs for 5 and 6 year-olds enacted in 2008 and implemented in 2009. The Government will finance preparatory activities in local government for 5-year-olds by supporting Gminas to adopt diversified supply options including non-publicly managed institutions.	7. The Borrower has allocated adequate resources for the financing of educational programs for five (5)- and six (6)-year olds through the enactment of the Budget Law for 2010 of January 22, 2010 (Journal of Laws of the Republic of Poland No. 19 of 2010, item 102).	Reworded
	8. Shift government subsidies in the student loan program to a sliding scale to increase the subsidy for poorer students. Introduce legislation to reorient Government higher-education subsidies for students to the material situation of students.	8. The Borrower has adopted the Resolution of the Ministry of Science and Higher Education of May 18, 2010 (Journal of Laws of the Republic of Poland No. 87 of 2010, item 560) to introduce a means-based sliding scale in subsidized student loan programs.	The trigger covered two separate policies linked to separate legal instruments. The first part of the trigger related to the student loan program is reworded. Regarding the second part of the trigger, the Government clarified that it would take until autumn 2010 to finalize the preparation of legislation to reform student subsidies. Hence, the Government advice that meeting the second part of the trigger was not feasible within the PL3 timeline. The Government remains committed to this reform, which is part of its fiscal development and consolidation strategy. The preparations are on schedule to make the law effective by October 2010.
I. PURSUING STRUCTURAL REFORMS			
Private Sector Development			
	9. Adopt Government strategy for the rationalization of inspection processes in Poland, set-up high-level inter-ministerial task force set up, and initiate implementation by Council of Ministers.	9. The Borrower has enacted the Law of March 4, 2010 on Delivery of Services in the Republic of Poland (Journal of Laws of the Republic of Poland No. 47 of 2010, item 278) on Delivery of Services in the Republic of Poland, thereby enhancing international competition in services in line with the EU Services Directive.	While the Government remains committed at the highest level to rationalize the inspection regime, the formulation of the strategy has been delayed due to a Government reshuffle and broadening the scope of the PSD reforms to administrative changes within state control institutions and the doing business agenda. While preparations of the inspection regime reforms are proceeding, the Government advised that the adoption and implementation of the strategy within the PL3 timeline is no longer feasible. The Bank team agrees with the proposal of the Ministry of Economy to replace this prior action with the new prior action regarding the enactment of the law on delivery of services. By enhancing the growth potential of the service sector, which contributed 56 percent of GDP in 2008, this act enhances Poland's medium-term growth prospects.

PL3 Triggers as of June 2009	PL3 Prior Actions	Comments
Health		
6. Adequate budget proposed in 2010 to finance hospitals to be liquidated or corporatized through December 2010 (estimated to be approximately 80 hospitals).	6. The Borrower has allocated adequate resources for financing the hospital corporatization program through the enactment of the Budget Law for 2010 of January 22, 2010 (Journal of Laws of the Republic of Poland No. 19 of 2010, item 102).	Reworded
Education		
7. Adequate budget to finance educational programs for 5 and 6 year-olds enacted in 2008 and implemented in 2009. The Government will finance preparatory activities in local government for 5-year-olds by supporting Gminas to adopt diversified supply options including non-publicly managed institutions.	7. The Borrower has allocated adequate resources for the financing of educational programs for five (5)- and six (6)-year olds through the enactment of the Budget Law for 2010 of January 22, 2010 (Journal of Laws of the Republic of Poland No. 19 of 2010, item 102).	Reworded
8. Shift government subsidies in the student loan program to a sliding scale to increase the subsidy for poorer students. Introduce legislation to reorient Government higher-education subsidies for students to the material situation of students.	8. The Borrower has adopted the Resolution of the Ministry of Science and Higher Education of [INSERT DATE] (Journal of Laws of the Republic of Poland No. [INSERT NUMBER], item [INSERT NUMBER] to introduce a means-based sliding scale in subsidized student loan programs.	The trigger covered two separate policies linked to separate legal instruments. The first part of the trigger related to the student loan program is reworded. Regarding the second part of the trigger, the Government clarified that it would take until autumn 2010 to finalize the preparation of legislation to reform student subsidies. Hence, the Government advice that meeting the second part of the trigger was not feasible within the PL3 timeline. The Government remains committed to this reform, which is part of its fiscal development and consolidation strategy. The preparations are on schedule to make the law effective by October 2010.
III. PURSUING STRUCTURAL REFORMS		
Private Sector Development		
9. Adopt Government strategy for the rationalization of inspection processes in Poland, set-up high-level inter-ministerial task force set up, and initiate implementation by Council of Ministers.	9. The Borrower has enacted the Law of March 4, 2010 on Delivery of Services in the Republic of Poland (Journal of Laws of the Republic of Poland No. 47 of 2010, item 278) on Delivery of Services in the Republic of Poland, thereby enhancing international competition in services in line with the EU Services Directive.	While the Government remains committed at the highest level to rationalize the inspection regime, the formulation of the strategy has been delayed due to a Government reshuffle and broadening the scope of the PSD reforms to administrative changes within state control institutions and the doing business agenda. While preparations of the inspection regime reforms are proceeding, the Government advised that the adoption and implementation of the strategy within the PL3 timeline is no longer feasible. The Bank team agrees with the proposal of the Ministry of Economy to replace this prior action with the new prior action regarding the enactment of the law on delivery of services. By enhancing the growth potential of the service sector, which contributed 56 percent of GDP in 2008, this act enhances Poland's medium-term growth prospects.

5.2. POLICY AREA I: MITIGATING THE SOCIAL IMPACT OF THE SLOWDOWN

Labor Markets

Prior Action 1: *The Borrower has enacted the Law of July 1, 2009 on Alleviation of Implications of the Financial Crisis for Employees and Entrepreneurs (Journal of Laws of the Republic of Poland No. 125 of 2009, item 1035), thereby introducing a temporary measure to allow entrepreneurs to redistribute working hours over twelve (12) months instead of between one (1) and four (4) months during the period between August 22, 2009 and December 31, 2011.*

62. **The new law on "Mitigating the effects of the economic crisis for employees and entrepreneurs" came into force in July 2009 as temporary, crisis-related legislation until end 2011.** This measure is expected to help stabilizing the employment rate, including of elderly workers. This law gives employers the possibility to reduce working hours during periods of low demand and increase them during periods of high demand, provided that the total number of working hours within 12 months is unchanged and the work week does not exceed 48 hours. Moreover, employers are not required to pay an overtime premium as long as the total yearly amount of work hours is not exceeded. The law provides businesses with a cost-effective tool to manage the slowdown in the economic cycle through adjustments in working hours rather than layoffs. Workers would face a lower risk of job loss and unemployment during the period of downturn.

Social Assistance

Prior Action 2: *The Borrower has passed the Regulation of the Council of Ministers of August 11, 2009 on the Amounts of Family Income and Student Income Used as the Basis for the Provision of Family Allowance and on the Amounts of Family Benefits (Journal of Laws of the Republic of Poland No. 129 of 2009, item 1058), thereby increasing the means-tested child benefits by on average forty (40) percent.*

63. **The changes to family benefits became effective as of November 2009.** This measure is expected to improve the effectiveness of social assistance in alleviating poverty. In spite of the tight fiscal envelope, the Government approved a nominal increase of about 42 percent of the monthly child benefits, or by about 38 percent in real terms, in order to improve livings standards of vulnerable households with children. This constituted the first increase in child benefits since 2004. It also improved targeting by leaving the income threshold unchanged. The amount of family support was increased for a child less than 5 years of age by 42 percent (from PLN48 to PLN68); for a child aged 5 to 18 by 42 percent (from PLN64 to PLN91); and for a child aged 18 to 24 by 44 percent (from PLN68 to PLN98). To limit the fiscal impact of the revision, supplementary family benefits, including the PLN80 top-up for every third and fourth child, remained constant in nominal terms. Since supplementary family benefits account for about 50 percent of spending on family benefits, overall family benefits increased by close to 20 percent in real terms. The increase in child benefits was required to meet the provision from the 2004 family benefit law that the amount of core family benefits has to be no lower than 40 percent of food expenditures of a child.

5.3. POLICY AREA II: STRENGTHENING PUBLIC FINANCE

Prior Action 3: *The Borrower has enacted the Budget Law for 2010 of January 22, 2010 (Journal of Laws of the Republic of Poland No. 19 of 2010, item 102) in line in form and substance with the provisions of the Law on Public Finance (Journal of Laws of the Republic of Poland No. 157 of 2009, item 1240).*

64. **The 2010 state budget, approved by Parliament on December 18, 2009, and effective from January 1, 2010, mitigates the impact of the global financial crisis by supporting economic growth and bolstering social expenditures.** As stated in the justification to the 2010 budget act, the 2010 budget act was based on the new law on public finance. In particular, it includes for the first time a separate budget for the EU funds and is subject to the enhanced debt safety procedures if public debt exceeds 55 percent of GDP (Box 2). As discussed in Section III.2.2, the general government fiscal deficit is projected to decline moderately from 7.2 percent of GDP in 2009 to 6.9 percent of GDP in 2010. The large fiscal deficit reflects pension and labor tax wedge reforms, the decline in revenues due to the economic slowdown, and the Government's commitment to bolster social and infrastructure expenditures to support the recovery. State budget expenditures on pensions, education, health and social assistance are projected to increase by 0.3 percent of GDP, mainly due to the rise in the state budget subsidy to fund first pillar pension benefits (Table 9).[11] Social benefits of the general government are set to reach 17.0 percent of GDP 2010, compared to 17.2 percent of GDP in 2009. Capital expenditures are planned to increase from 5.7 percent of GDP in 2009 to 7.1 percent of GDP.

Table 9: Selected Social Expenditures of the State Budget (% of GDP)

	2009 Projected	2010 Plan
Subsidy to FUS	2.2	2.7
Subsidy to KRUS	1.2	1.1
Special Pensions	1.2	1.2
Education Subvention	2.5	2.5
Other Education and Science	1.0	1.0
Health	0.3	0.2
Social Assistance Transfer to Voivodships	0.9	0.9
Overall	9.4	9.7

Source: Ministry of Finance, World Bank staff.

Prior Action 4: *The Borrower has adopted a fiscal strategy to initiate medium-*

[11] The decline in the budget of the Ministry of Health is due a decentralization of paramedical services to local government. In 2009, FUS, the general social insurance fund, projects receipts of PLN30 billion as state subsidy, PLN22.2 billion as compensation for transfers to the second pillar OPFs, and PLN4 billion as loans. In 2010, FUS projects receipts of PLN38 billion as state subsidy, PLN22.5 billion as compensation for transfers to the second pillar OPFs, PLN4 billion as loans, and PLN7.5 billion from the demographic reserve fund. Overall, non-contributory sources, including for OPF transfers, increase from PLN56 billion to PLN72billion. Out of the increase of PLN16 billion, about PLN10 billion are needed due to lower revenues in light of the economic slowdown, and PLN6 billion due to higher expenditures.

term fiscal consolidation as part of Convergence Program Update approved by its Council of Ministers on February 8, 2010.

65. **The Government adopted the fiscal development and consolidation plan for 2010 and 2011.** Laying out the Government plan for the second two-years of its term of office, this plan embeds fiscal consolidation in structural and institutional reforms. As discussed in Section III.2.2, the objectives are to consolidate public finances in the next few years and lay the foundations for a competitive economy. The Government aims to adopt the legal changes for the implementation of the proposed reform by the end of 2010. The main targets are to:

- reduce the fiscal deficit from 7.2 percent of GDP in 2009 to 3 percent of GDP in 2012 (or 2013 if economic performance is more modest)
- limit the rise in public debt according to national methodology below 55 percent of GDP in 2010 and beyond
- maintain the structural public deficit at no higher than 1 percent of GDP, Poland's medium-term objective of the Stability and Growth Pact, from 2012 onwards, and
- maintain general government spending below 40 percent of GDP over the long-term.

Pensions

Prior Action 5: *The Borrower has enacted the Law of June 26, 2009 on Amending the Law on the Organization and Operation of Pension Funds and on Amending the Law Amending the Law on Pension Funds and Other Laws (Journal of Laws of the Republic of Poland No. 127 of 2009, item 1048), thereby reducing the cap in contribution fees earned by fund managers by half.*

66. **The law reducing fund management fees was adopted by Parliament and went into force on January 1, 2010.** This measure is expected to increase the accumulated savings balances workers can rely on at retirement. Together with the scale economies of centralized revenue collection arrangements, the measure will ensure that Polish pension funds continue to operate with low costs by comparison with other reforming countries at a time when the cost-effectiveness of the funded pillar is under close public scrutiny. The legislation advanced from 2014 to 2010 the reduction in the cap on contribution fees from 7 percent to 3.5 of the second pillar. All but one fund manager charged in 2009 the maximum contribution fee in spite of a fairly conservative asset structure dominated by government bond holdings. In addition, a cap on the management fee was imposed at PLN15.5 million per month once a fund reaches PLN45 billion in assets. Currently, the assets of all OPFs with the exception of one OPF are below this limit. In line with the requirements, all OPFs submitted a revision of their status to the Financial Supervision Commission and introduced caps on their fees.

Health

Prior Action 6: *The Borrower has allocated adequate resources for financing the hospital corporatization program through the enactment of the Budget Law for 2010 of January 22, 2010 (Journal of Laws of the Republic of Poland No. 19 of 2010, item 102).*

67. **The 2010 state budget provides adequate financing for the voluntary program of hospital corporatization.** Hospital corporatization (shifting from SPZOZ

status – state corporation – to NZOZ status – commercial code corporation – under Polish law) can help to ensure that hospitals have incentives to control costs and to check the accumulation of debt, which national and local government budgets have in the past paid off periodically at high cost. Hospital corporatization was initiated in 2009. The program was authorized by the Council of Ministers on April 27, 2009, but a tripartite agreement among the Ministry of Health (MoH), the National Health Fund (NHF), and Bank Gospodarstwa Krajowego (BGK) to implement the program was not signed until July 7, 2009. Under implementation, the program has taken several routes:

- *Leveling the Playing Field for Local Governments.* Prior to 2009, about 10 percent or 70 hospitals had been shifted to NZOZ status unilaterally by local governments. They assumed all the debt of the SPZOZ upon its liquidation, with no help from the MoH. Obviously these first movers have had an incentive to seek assistance under the current program from the MOH to resolve some of this debt on terms similar to what is available today. Seventeen of these local governments (mainly counties) so far have applied for a subsidy from the state budget for an amount of PLN 65.6 million. As of January 26, 2010, one hospital has completed the process. The MoH expects a high proportion of these municipalities to seek relief from the program.

- *Liquidation.* One hospital in Bytów has been liquidated completely and a new hospital in the form of a limited liability enterprise was established in its place.

- *Full Process.* The full process of corporatization begins with an application by the local government to BGK using templates available on its website. BGK uses templates available on its website. BGK prepares an assessment of its 5-year business plan using a set of estimated ratios (current assets/liabilities, debt/EBITDA, gross profit margin, and net profitability ratio). If positively evaluated, the assessment is sent to NHF for acknowledgement of the revenue projections for healthcare provision. After approval, the local government provides the voivodship with its application, which sends it to the MoH with recommendation to include it into the transformation program. Twenty-five additional applications were received by the end of 2009, and BGK expects that it will receive approximately 30 more in the first half of 2010.

68. **For all three routes, the MoH estimates a total of 80 hospitals will be processed in 2010.** The total estimated cost to the State Budget in 2010 is expected to be PLN350 million. Compensation by the State includes unpaid social insurance contributions and a PLN 1-for-1 matching of any reductions in arrears to suppliers that the local government is able to negotiate. The target of the program is to have 30 percent, or about 210, hospitals corporatized by the end of 2011, when the program is projected to end.

Education

Prior Action 7: *The Borrower has allocated adequate resources for the financing of educational programs for five (5)- and six (6)-year olds through the enactment of the Budget Law for 2010 of January 22, 2010 (Journal of Laws of the Republic of Poland No. 19 of 2010, item 102).*

69. **The 2010 state budget provides adequate financing for ensuring mandatory pre-school education for 5-year olds in 2011/12, and mandatory school education for 6-year olds in 2012/13.** This measure is expected to increase school participation rates among young children. The Ministry of Education has confirmed that this program is adequately financed in the 2010 budget through a number of initiatives. First, local governments are receiving larger education subventions to cover the cost of schooling for 6-year olds.[1] Second, on September 1, 2009, a new ordinance on the types of other forms of pre-school education came into force in order to ensure equal educational opportunities for children aged 3-5 from various backgrounds. Since 2008, 1,159 other public and non-public forms of pre-school education have been established. In addition, 484 new public and non-public kindergartens and 1383 pre-school branches in elementary schools have been set up. These activities are supported through funding of PLN 243 million including contributions from the European Social Fund, with currently 480 ongoing projects. Third, complementary activities supporting this reform include: promoting pre-school education with an extensive media coverage on Polish public TV and commercial stations, the distribution of a brochure with 1.8 million circulation, and the setting up of a dedicated pre-school website; improving the professional abilities of pre-school teachers, including through a new regular occupation training course for future pre-school and elementary education teachers; defining rules and regulations on the voluntary diagnosis of school readiness of five-year-old children and related training; and developing new core curriculum for pre-school and general education. Finally, on 7 July 2009, the Government adopted the "happy school" program over PLN2.4 billion to upgrade school playgrounds and equip schools with teaching aids for school playtime areas. The program is expected to support 14,000 public and non-public elementary schools and 1st degree music schools with children in grades 1-3.

Prior Action 8: *The Borrower has adopted the Resolution of the Ministry of Science and Higher Education of May 18, 2010 (Journal of Laws of the Republic of Poland No. 87 of 2010, item 560) to introduce a means-based sliding scale in subsidized student loan programs.*

70. **The Government approved in May 2010 a new resolution on the principles, modes and criteria for granting, repaying and amortizing student credits and loans.** This measure is expected to make the student loan system more equitable. The targeting of student loans will be improved so that students from poor households will receive a higher proportion of subsidies by way of, among others, introducing a more transparent method to calculate per capita income in students' families with regard to applying for loans, introducing the option to suspend payments in the event of lack of means or a new regulation of the option to lower the monthly repayments for students of limited means to 20 percent of their income.

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[1] In the school year 2009/2010, some 15,000 6-year olds started education at schools (about 5 percent of the age cohort). According to preliminary data, local governments received in 2009 funds over PLN24 million through the education subvention to cover the related school expenses for the period of September 2009 to December 2009. Another PLN77 million of additional education subvention will be provided to cover expenses in the period from January 2010 to December 2010. This amount will be further adjusted within the budget year to include 6 year-olds, who will start school education in September 2010.

5.4. POLICY AREA III: PURSUING STRUCTURAL REFORMS

Private Sector Development

Prior Action 9: *The Borrower has enacted the Law of March 4, 2010 on Delivery of Services in the Republic of Poland (Journal of Laws of the Republic of Poland No. 47 of 2010, item 278) on Delivery of Services in the Republic of Poland, thereby enhancing international competition in services in line with the EU Services Directive.*

71. **Parliament adopted the new act on March 4, 2010; the Law will become effective on April 9, 2010.** Its objectives are to (i) align Poland's legislation with the EU Services Directive, (ii) reduce barriers to delivery of services by both domestic and EU-based firms and (iii) increase product market competition through opening Poland's service sector to EU competition. This measure is expected to increase Intra-EU trade in services increased and improve the quality of the business environment. By removing legal and administrative barriers to trade in the services sector, this act streamlines procedures and increases transparency for SMEs and consumers when they want to provide or use services in the single markets. By enhancing the growth potential of the service sector, which contributes 56 percent of GDP in 2008, this act enhances Poland's medium-term growth prospects. The act simplifies procedures and formalities that service providers need to comply with, including by facilitating establishment of businesses and cross-border provision of services. It also sets up points of single contact through which service providers can obtain relevant information and deal with administrative formalities without the need to contact several authorities. The points of single contact have to be accessible at a distance and by electronic means.

VI. OPERATION IMPLEMENTATION

6.1. POVERTY AND SOCIAL IMPACT[13]

72. **The two prior actions in the policy area of mitigating the social impact are likely to support poverty reduction significantly.**

- In labor markets, the flexible working hours arrangements contribute to limit the increase in unemployment, which is an important correlate of poverty. As of mid-January 2010, over 500 agreements on extending the calculation period for working time mostly in large companies were in place. By in effect paying firms to hoard workers, Poland has slowed the rise in joblessness and helped to support consumer confidence and demand. At the same time, this measure will be phased out by end-2011 and hence does not constraint adjustments in job structure away from sectors with excess capacity to more promising ones over the medium-term.
- In social assistance, the increase in family benefits improves the household income of vulnerable households, as large families are prone to poverty. Simulations suggest that the rise in family benefits reduces poverty by about 0.5 percentage points in 2010 compared to 2009. Maintaining the income threshold constant ensured that the increases in child benefits accrued mostly to poor families and families vulnerable to

[13] To be updated with the PSIA on the distributional impact of the crisis in Poland during negotiations.

poverty. The income threshold remains 20 percent above the relative poverty line defined according to EU standards. For example, for a 4-member family (2 parents, 2 children), the relative poverty threshold according to the EU in 2008 was PLN1,676 per month, which equals 60 percent of the national equalized median income. By comparison, the monthly family benefit income threshold was PLN2,016 (4*PLN504).

73. **The prior actions in the policy area of public finance are likely to support poverty reduction and social inclusion.** In 2010, the Government is pursuing countercyclical policies to boost economic growth, sustain employment, and limit the rise in non-performing loans. According to estimates of the European Commission based on ESA95 methodology, social expenditures are projected to increase slightly from 24.6 percent of GDP in 2008 to 25.3 percent of GDP in 2009 and 25.5 percent of GDP in 2010. Beyond 2010, the proposed operation supports medium-term fiscal consolidation, which will be critical for a sustainable recovery of growth. This in turn will facilitate employment creation and poverty reduction over time.

- In pensions, the reduction of contribution and management fees for the second pillar is expected to increase the accumulated savings at retirement for contributors. According to Government estimates, this measure will reduce fees by PLN700 million in 2010 alone.
- In pre-school education, introducing mandatory enrolment for 5-year olds is a cost-effective way to improve equitable opportunities in education. It contributes to increasing the knowledge of literacy, mathematics and other basic subjects and ensure access to a range of better paying vocations and professions.
- In higher education, the uptake of the student loan program among poor students is small, in part because commercial banks require physical collateral to approve the loans. Limited access to loans is one of the reasons for low enrollment rates in higher education among individuals aged 19–26 from low-income families. Household Survey data show that only 9 percent of private-day-school students come from households within the first quintile of per capita consumption, while 40 percent come from households from the last quintile. International experience suggests that making the loan scheme more affordable will expand its reach with little risk to repayment given that the students' human capital and associated future income are perhaps the strongest guarantee of repayment.
- In health, hospital corporatization is expected to reduce cost overruns in the hospitals, and thereby improve the allocation of resources to programs that would be more effective in improving the health of the population. Access of poor households to health services will be maintained, as Poland has developed a robust and adequately financed health insurance program that protects citizens from the adverse consequences of health costs, particularly for hospital care and for access to a general practitioner. In some cases hospital corporatization may involve the reduction in hospital staff and lay-offs. Hospital workers who lose their jobs are likely to experience temporary unemployment and associated income reduction. However, the poverty impact of hospital corporatization is expected to be minor. First, the number of involuntary lay-offs is expected to be limited, as normal attrition provides flexibility in adjusting the number of hospital staff. Second, most hospital workers have skills that are sought after by employers. Specifically, the private health care

sector is large and growing. In addition, the labor market was rather mildly affected by the downturn and job opportunities remain relatively good. The majority of the affected workers can be expected to find new jobs relatively quickly, without experiencing long unemployment spells. Finally, Poland has in place a developed income protection mechanism. Laid-off workers receive severance payments and are eligible for unemployment benefits for up to one year. Those who become long-term unemployed are eligible to participate in active labor market programs (e.g. retraining, hiring subsidies), and those whose income falls below the income threshold are eligible for social assistance.

74. **The prior action in the policy area of structural reforms is also likely to benefit poverty reduction.** In private sector development, the act on service delivery is expected to generate employment growth, especially for SMEs. According to EU estimates, the EU service sector directive is estimated to increase EU growth by at least 0.8 percent, increase EU net employment by 0.3 percent, and increase the real average wage by 0.4 percent.

6.2. ENVIRONMENTAL ASPECTS

75. **The specific policies supported by the third policy loan in the program are not likely to have significant effects on Poland's environment, forests, and other natural resources.** Unanticipated and unintended risks of adverse effects to the environment and natural resources are minor, although acknowledged. However, Poland has adequate environmental controls in place. Poland's environmental legislation and regulation is reinforced by EU environmental directives, including the EU's guidelines on adoption of environmental assessments at the planning and programming level (June 2001) and the EU's Environmental Liabilities Directive setting out liability for damage to properties and natural resources (April 2007). Pre-privatization environmental audits are required to determine the existence and scope of any liabilities of companies in state hands, manifested as contamination on real property or other conduits. The quantification of such liabilities is then used as part of the overall valuation of the state enterprise for purposes of negotiating a fair purchase price with the private party. Private sector bidders of enterprises will be subject to the environmental provisions embodied in Polish and EU law once they acquire previous state assets in the process of ownership transfer.

6.3. CONSULTATIONS

76. **All legislative measures - particularly social sector reforms - in Poland are subjected to a demanding consultation process with social partners and groups likely to be impacted by particular proposed reforms.** The consultation process is an important institutional feature of Poland's process of government. The reforms supported by this operation have been subject to extensive stakeholder consultations. Regular parliamentary procedures ensure careful scrutiny during consideration by Parliament, and hearings and debate in Parliament receive large coverage by the news media.

77. Specific examples of social sectors consultations concerning the program supported by the policy loan include:

- The Government carried out an extensive information campaign on mandatory pre-school education of 5 year-olds and mandatory school education for 6 year-olds. Up to June 2009, the education reform agenda was discussed by government representatives in 16 regional debates with more than 7,000 participants. The Ministry of National Education received more than 200 reviews of the proposed reform program. During the legislative process, the amendment to the law on the education system was consulted with 25 social partners.
- The multi-year program "Support for regional and local self-government units with regard to activities that stabilize health care system" has been widely consulted with relevant stakeholders. The assumptions of the program were presented to the public in February 2009. The Ministry of Health organized three workshops with representatives of local governments, representatives of trade unions and management of hospitals to discuss the proposed changes. In addition, the Ministry of Health launched a dedicated website (www.ratujemyszpitale.pl) for this program.
- The resolution on increasing family benefits was consulted with a tri-party committee of trade unions, employers, and government in May 2009.
- The law on "Mitigating the effects of the economic crisis for employees and entrepreneurs" from July 2009 was agreed jointly by trade unions, employers' associations and government representatives. It was endorsed at the meeting of a tri-party committee on May 25, 2009.

6.3. IMPLEMENTATION, MONITORING AND EVALUATION

78. **The Bank continues to work closely with the MOF, PMO and sector Ministries to monitor and assess reform progress and impacts during the course of the program.** Monitoring and evaluation will be supported by the various Ministries as well as budgetary, legislative and economic data provided by the authorities and verified in official disclosures, directives and regulations. Baseline and updated data are provided by the respective specialized agencies for the pertinent functions and tracked according to the indicators and outcome measures as shown in the Monitoring and Results Framework.

6.4. FIDUCIARY ASPECTS AND PROCUREMENT

79. **The fiduciary risk to this operation arising from Poland's public financial management system and use of budget resources is low.** As part of its accession process to the EU, Poland has achieved significant progress in reforming its public financial management system (PFM). [14] It has upgraded its legislative framework, in line with the EU acquis, introduced an internal audit function, and prepared for the EU accreditation process of fund-managing agencies. Poland has also made significant

[14] The status of the PFM was derived from the World Bank's ongoing monitoring of PFM reform and diagnostic works conducted by the Bank and external organizations including: The World Bank 2009 report – "Poland Public Expenditure Review: From Welfare State to Workforce Society", The World Bank 2009 publication "Current Issues in Fiscal Reform in Central Europe & the Baltic States 2008 – Performance-Based Budgeting and Medium-Term Expenditures Frameworks in Emerging Europe", IMF report dated October 16, 2009 – "Republic of Poland - The Staff Report for the Review Under the Flexible Credit Line Arrangement", IMF report dated July 17, 2009 – "Republic of Poland - Staff Report for the 2009 Article IV Consultation".

improvements related to the public availability and coverage of fiscal information, particularly the adequacy of accounting and reporting standards and regularity of reconciliations of bank accounts.

80. **The PFM reform agenda supported by this program will enhance budget transparency, predictability and performance-orientation over the medium term.** The new law on public finance adopted in September 2009 enhances budget transparency, predictability and performance-orientation (Box 11). A key challenge is the implementation of the reform at the operational level, as emphasized in a recent EU10 fiscal study on PFM reforms (World Bank 2009). The introduction of performance-based budgeting (PBB) involves a number of technical challenges like changes in the financial control framework; updated and compatible budget classification, accounting and reporting systems; and an integrated financial management information system. The authorities are aware of the required changes. They have followed a well-defined implementation roadmap, and, with EU support, put strong emphasis on building the required skills and capacity at MOF and other agencies. The development of monitoring and evaluation systems, with well-specified key performance indicators, the harmonization of accounting and reporting practices, and the designing of the IT system are ongoing. In mid-2010, the medium-term financial plan will be prepared in PBB format. The state budget in PBB format is expected to be operational from 2013, in parallel with the traditional line-item budget.

81. **Other areas of ongoing reform include *cash management*.** This includes the introduction of a single treasury account (TSA) system, computerization of all cash transactions and central monitoring of commitments and liabilities. The State Budget TREZOR computerized system includes all tier State budget holders. In 2005, the TREZOR system gained an ability to communicate with the National Bank of Poland's accounting system, allowing direct coordination of pending payment orders and State Budget cash availability, improving internal controls. The next phase of system upgrading commencing in 2010 includes rolling out paperless procedures for applications of budget funding.

82. **In the area of *external audit*,** Poland is advanced in relation to availability of the audit reports to the public, independence of the Supreme Audit Institution (NIK) from the executive, and control of the NIK budget, providing a well functioning public financial accountability and assurance mechanism for the legislature and the public. The amended Law on Public Finance introduced a requirement for the independent external audits of the annual financial statements prepared by large local governments.

83. **The National Bank of Poland is part of the European System of Central Banks, and it has upgraded its accounting and reporting policies in accordance with the guidelines of the European Central Bank.** Its financial management and operations are transparently disclosed and presented on its website. The NBP's annual financial statements are regularly audited. The most recently available audit reports (for 2004-2008) have unqualified audit opinions and were approved by the Council of Ministers. The IMF safeguard assessment of central banks is not available for Poland. Overall, the fiduciary risk to this operation arising from Poland's public financial management system and use of budget resources and its foreign exchange environment as controlled by the Central Bank is low.

84. **Finally, Poland has made significant progress in reforming its public procurement system.** Adoption of a new law in January 2004 made Poland a pioneer in Central and Eastern Europe in setting up a sound public procurement system that met the requirements of the EU. In April 2006 and April 2007 the Public Procurement Law was further amended to implement the provisions of the EU directives 2004/18/EC and 2004/17/EC, on the (i) coordination of procurement procedures for the award of public works, supply, and service contracts and (ii) coordination of procedures of entities operating in the water, energy, transport and postal services sectors. The latest amendments to the Public Procurement Law entered into force in October 2008 in order to further adjust the Law to the EC directives but also to enhance and streamline the implementation of procurement procedures. Improvements and further simplifications of the public procurement system were also a result of the development and upgrading of e-government procurement tools. In 2009 two major amendments were approved: one in response to the current economic slowdown with the overall objective to limit the financial burden posed on contractors participating in public tenders, and the second one incorporating the provisions of the new Directive 2007/66/EC of the European Parliament and the Council regarding increasing of effectiveness in appeal procedures in public procurement. Other areas of ongoing reform in public procurement relate to: (i) increasing the effectiveness of public expenditures; (ii) strengthening competition in public procurement; (iii) facilitating access of SMEs as bidders; (iv) improving the quality of procured goods, works, and services; and (v) promoting innovative and ecological solutions in public procurement.

6.5. DISBURSEMENT AND AUDITING

85. **As with the first and the second loan in the program, loan proceeds will be disbursed in one single tranche to the foreign currency national budget account at the National Bank of Poland (Central Bank).** This account forms part of the foreign currency reserves of the country. Disbursement will be made upon declaration of loan effectiveness and submission of a withdrawal application to IBRD. At the request of the MOF, IBRD will deposit the proceeds of the loan into the foreign currency national budget account indicated by the Government that forms part of the budget management system of the country. The proposed loan will follow the Bank's disbursement procedures for development policy lending. Disbursements will not be linked to specific purchases, thus no procurement requirements will be necessary. The Government shall maintain accounts and records with respect to the deposit of loan proceeds in the NBP. If the loan proceeds are used for ineligible purposes as defined in the loan agreement, IBRD will require the borrower to refund the amount directly to IBRD.

86. **No additional fiduciary arrangements will be required.** The Bank will not require an audit of the Deposit account but will require the Government to provide confirmation to the Bank in the form of an official letter from the Ministry of Finance on the amounts deposited in the foreign currency account within 30 days of receiving the funds.

VII. RISKS AND RISK MITIGATION

87. **In view of Poland's deep market integration in the region, a recovery in Europe is needed to support exports, spur credit growth, and strengthen job prospects in Poland.** However, Europe's recovery from the global financial crisis, which triggered a sharp and synchronized contraction, could be sluggish or followed by a 'double-dip'. This could undermine growth in Poland, would jeopardize fiscal outcomes and might give rise to pro-cyclical expenditure cuts. Mitigating factors include low inventory levels, some pent-up demand, low interest rates and stepped-up utilization of EU funds. In addition, the authorities' solid track record over the last years has assured good access to financial markets, which should provide adequate access to credit to borrow through any further slowdown or downturn, as long as credible commitment to medium-term fiscal and structural reform is documented.

88. **In spite of the recent improvements in global financial markets, heightened financial strains could return, especially if policy support is withdrawn prematurely or policy coordination deteriorates.** Banking stresses still persist. A renewed deterioration of macroeconomic conditions could lead to a further increase in non-performing loans and additional credit tightening by banks. The authorities may need to respond with additional confidence-restoring and liquidity-enhancing measures. Mitigating factors include the strong initial condition of Poland's financial system, and the strong credibility in the conduct of monetary policy by the country's central bank and the regular stress-tests undertaken by the financial supervisor KNF.

89. **A prolonged deterioration of economic prospects could undermine public support for the Government reforms.** This could reduce the Government's ability to implement the needed structural reforms. Improvements in productivity depend on successful structural reforms in areas such labor markets, education, and business climate. Without such reforms, the remaining rigidities in the labor and product markets and the large public sector in Poland could become a drag for future growth. Mitigating factors include the Government's strong commitment to the fiscal development and consolidation strategy and Vision 2030, and the broadly recognized need for a reduction in the fiscal deficit in view of the constitutional public debt limit of 60 percent of GDP and Poland's commitments under the Stability and Growth Pact.

ANNEX 1: GOVERNMENT'S LETTER OF DEVELOPMENT POLICY

REPUBLIC OF POLAND
Minister of Finance
Jan Vincent-Rostowski

DZ/912/BVJ/741/2010

Warsaw, May 14, 2010

Mr. Robert B. Zoellick

President

The World Bank

1818 H Street, NW
Washington, D.C. 20433
United States of America

Dear Mr. President,

Let me express my appreciation of the continued efforts of the staff of the International Bank for Reconstruction and Development towards the successful performance of our joint projects and mutually beneficial cooperation. The prime example of this is the Development Policy Loan (DPL), aimed at supporting Poland's economic and social reforms. Currently, representatives of the Polish public administration are working in close cooperation with the Bank's Warsaw Office on the preparation of the third and final loan within the designed EUR 3 billion DPL envelope.

In light of the above, I would like to request that the International Bank for Reconstruction and Development deliver the third loan under the Development Policy Loan envelope, including the associated technical cooperation program, in the amount of EUR 1 billion.

The Employment, Entrepreneurship and Human Capital Development Policy Program encompasses a set of actions towards the objective of accelerating Poland's convergence with the living standards of the European Union, continuing the activities included in the scope of the second loan of the series. The loan proceeds are to be utilized to strengthen the measures implemented with the aim of mitigating the effects of the economic crisis and boosting the somewhat languishing recovery through carefully targeted expenditure. In addition, a number of key structural reforms are supported under the program in the fields of public financial management, labour markets, social assistance, pensions, healthcare, education, and private sector development.

Public financial management

Among the key activities supported are crucial improvements to the efficiency of public finance management, outlined in the latest Convergence Program, geared towards the broader goal of achieving financial stability and sustainability. Our Plan for the Development and Consolidation of Public Finances 2010-2011 contains steps to attain the structural deficit consistent with the medium-term budgetary objective.

Labour markets

With relation to a difficult situation on the labour market, in August 2009, thc Anti-crisis Package was implemented, elaborated in cooperation with trade unions and employers, in order to help companies affected by the crisis. The Package mitigates the effects of crisis for entrepreneurs and employees, by creating additional labour market instruments limiting unemployment, supporting human resources development and creating a mechanism of financial support for mortgage payers who lose their jobs.

Social assistance

As part of our efforts to strengthen the social assistance system, we have increased child benefits in 2009 while leaving eligibility criteria unchanged. This measure will contribute to project vulnerable families during the economic slowdown.

Pensions

The Plan for the Development and Consolidation of Public Finances proposes a reform of the social security system for uniformed services for officers and soldiers starting their service from 2012. The Plan also assumes that a debate on the gradual increase and equalization of the retirement age of women and men, which would allow the retirement age to be adapted to ongoing demographic changes and increase the value of retirement benefits. Higher retirement benefits would also mean the lowering of required extra payments to minimum retirement benefits, which would lower state budget expenditure. The debate will concern the methods of including farmers in the labour market while conducting an evolutionary reform of the pension and retirement system of this professional group.

Healthcare

In line with the organizational changes in the health services, adopted in April 2009, we continue our efforts to create economically stable entities providing health services as part of the health protection system. This program, which includes financial support for founding authorities of facilities under transformation, will be executed until end 2011.

Education

In education, activities aimed at lowering the school starting age to 6 years, modernization of vocational and life-long education are being carried out. Moreover, we are taking steps to increase the effectiveness of the education financing model, implement a new model of higher education financing and ensure the universality of pre-school education.

Private sector development

Our activities are aimed at facilitating the operation of companies, by removing red tape and abolishing some requirements for businesses, including in the services sector. As part of the liberalization of the economy, activities aimed at eliminating unnecessary administrative procedures, developing e-administration and improving the relations of citizens and business with administration will be carried out.

It is my firm conviction based on the outcome of our cooperation thus far that the support by the World Bank, comprising providing financing as well as expertise, may prove pivotal to the attainment of the objectives set forth in the Polish government's reform agenda. The successful conclusion of the program shall serve to reinforce the Bank's position as a leading provider of comprehensive support for the emerging countries and further highlight its vital role to the Central and Eastern Europe region, particularly in the current period of economic unrest.

Yours sincerely,

Jan Vincent-Rostowski
Minister of Finance

ANNEX 2: POLICY MATRIX

Prior Actions under PL1	Prior Actions under PL2	Prior Actions under PL3	Indicator and baseline value	Target (2010)
MITIGATING THE SOCIAL IMPACT OF THE SLOWDOWN				
		Labor Market		
		CHALLENGES: Mitigating the impact of the economic slowdown on labor market outcomes through anti-crisis employment measures		
		LONG-TERM OBJECTIVE: Labor market emerges robustly from the slowdown ensuring that long-term objectives – the Lisbon target of 70% employment rate and reducing the incidence of long-term unemployment are on track.		
		EXPECTED OUTCOME: Employment rate maintained during downturn.		
		The Borrower has enacted the Law of July 1, 2009 on Alleviation of Implications of the Financial Crisis for Employees and Entrepreneurs (Journal of Laws of the Republic of Poland No. 125 of 2009, item 1035), thereby introducing a temporary measure to allow entrepreneurs to redistribute working hours over twelve (12) months instead of between one (1) and four (4) months during the period between August 22, 2009 and December 31, 2011.	(i) 57% employment rate in 2007	(i) 58% employment rate in 2010

Prior Actions under PL1	Prior Actions under PL2	Prior Actions under PL3	Indicator and baseline value	Target (2010)
MITIGATING THE SOCIAL IMPACT OF THE SLOWDOWN				
	Social Assistance			
	CHALLENGES: The effectiveness of social assistance is weakened through "leakage" of benefits to non-poor groups.			
	LONG-TERM OBJECTIVE: Increase the efficiency of public spending on social assistance for the poorest households.			
	EXPECTED OUTCOME: Social assistance benefits are more effective in alleviating poverty.			
	Provision for a reserve in the 2009 budget to protect the vulnerable affected by the economic downturn.	**The Borrower has passed the Regulation of the Council of Ministers of August 11, 2009 on the Amounts of Family Income and Student Income Used as the Basis for the Provision of Family Allowance and on the Amounts of Family Benefits (Journal of Laws of the Republic of Poland No. 129 of 2009, item 1058), thereby increasing the means-tested child benefits by on average forty (40) percent.**	(i) 31.3% of social assistance benefit going to the poorest quintile in 2007	(i) 38% of social assistance benefit going to the poorest quintile

Prior Actions under PL1	Prior Actions under PL2	Prior Actions under PL3	Indicator and baseline value	Target (2010)
STRENGTHENING PUBLIC FINANCE				
Public Financial Management				
CHALLENGES: Ensuring continued gradual reduction in the fiscal deficit and improving the quality of public finances through reducing the tax burden in sustainable manner and implementing institutional reforms in public financial management.				
LONG-TERM OBJECTIVE: To improve the quality of public finances through a gradual, medium-term reduction in the fiscal deficit and increased emphasis on productive spending and institutional reforms to make the budget more transparent, predictable, and performance-oriented over the medium term.				
EXPECTED OUTCOMES: Reduction of fiscal deficit and tax burden in a sustainable manner. Improved transparency and predictability of fiscal policy. Increased effectiveness and efficiency of public spending. Public debt maintained below national public debt levels and budget process enhanced.				
Implementation of 2008 budget on track and 2009 budget bill in line with Convergence Program and including PIT reform	**Satisfactory continued implementation of the 2009 budget in light of the changed economic outlook.** **Submission to Parliament of amended Law on Public Finance.**	**The Borrower has enacted the Budget Law for 2010 of January 22, 2010 (Journal of Laws of the Republic of Poland No. 19 of 2010, item 102) in line in form and substance with the provisions of the Law on Public Finance (Journal of Laws of the Republic of Poland No. 157 of 2009, item 1240).** **The Borrower has adopted a fiscal strategy to initiate medium-term fiscal consolidation as part of Convergence Program Update approved by its Council of Ministers on February 8, 2010.**	(i) PIT rates 19%, 30% and 40% in 2007 (ii) General government deficit 2% of GDP in 2007) (iii) No multi-year financial plan of the State in 2007 (iv) General government public debt 45% of GDP in 2007	(i) PIT rates 18% and 32% (ii) General government deficit reduced to 6.9% of GDP in 2010 from 7.2% in 2009 (iii) 4-year financial plan of the State by 2011 (iv) General government public debt 53.1% of GDP

Prior Actions under PL1	Prior Actions under PL2	Prior Actions under PL3	Indicator and baseline value	Target (2010)
		STRENGTHENING PUBLIC FINANCE		
		Pensions		
CHALLENGES: Reforming some of the incomplete components of the NDC pillar of the pension system and increasing the efficiency of the funded pillar through reducing disincentives for early withdrawal from the labor force and improving saving balances of pensioners at retirement.				
LONG-TERM OBJECTIVE: To reform some of the incomplete components of the pension design, specifically oriented toward lowering pension expenditures, reducing or eliminating disincentives for early withdrawal from the labor force, and generating additional revenue by making the pension system more attractive to workers and employers. To limit the excessive profits by PTEs and to make the funded part of the pension system more attractive to workers and employers.				
EXPECTED OUTCOMES: Reduction in number of pensioners below the normal retirement age. Reduction in number of disability pensioners. Pensioners successfully retiring and receiving pensions from funded system. Increased choice with regards to accumulation portfolios and payout options under the funded system.				
Tightened eligibility conditions for disability, resulting in a decline of newly disabled from 86,000 per year in 2001 to 50,000 per year in 2007.	**Enactment of the Law on Bridging Pensions which reduces the number of people eligible for early retirement from 1.7 million to 300,000, while safeguarding the base level of pensions for those affected by the change.**	**The Borrower has enacted the Law of June 26, 2009 on Amending the Law on the Organization and Operation of Pension Funds and on Amending the Law Amending the Law on Pension Funds and Other Laws (Journal of Laws of the Republic of Poland No. 127 of 2009, item 1048), thereby reducing the cap in contribution fees earned by fund managers by half.**	(i) Percentage of new pensioners receiving early pension 82% in 2007 (ii) Average contribution fee charged by PTE to OPF members 6% in 2008	(i) Percentage of new pensioners receiving early pension 70 % (ii) Average contribution fee charged by PTE to OPF members 3.5%

Prior Actions under PL1	Prior Actions under PL2	Prior Actions under PL3	Indicator and baseline value	Target (2010)
STRENGTHENING PUBLIC FINANCE				
	Health			
	CHALLENGES: Limiting expenditure growth, increasing efficiency, and permitting reallocations to higher impact health interventions.			
	LONG-TERM OBJECTIVE: Reduce absolute amount spent on hospital care to accommodate reallocation to primary and preventive services. Eliminate hospital debt for ongoing operations, reserving debt for capital expenses. Improve resource allocation in the health sector and among hospitals. Encourage cost-saving technical change in hospitals and improved response to payment incentives.			
	EXPECTED OUTCOME: Hospitals completing the corporatization process will emerge without major debt and with 5-year restructuring plans that will be monitored annually by the MOH, NHF, and BGK Bank. DRG system in place and generating data for the NHF. Analysis underway and institutional capacity developed in NHF to use analysis in setting reimbursement policy and rates.			
	Approval of an implementation plan for the participation of public hospitals in a voluntary program that would convert them into corporate entities operating under the Commercial Code. **Adopt DRG-based payments system for 90% of all payments from NHF to hospitals.**	**The Borrower has allocated adequate resources for financing the hospital corporatization program through the enactment of the Budget Law for 2010 of January 22, 2010 (Journal of Laws of the Republic of Poland No. 19 of 2010, item 102).**	(i) 0 hospitals undergoing the process of corporatization in 2009 completed the COM-approved program, while 25 hospitals submitted applications (ii) 0% of hospitals covered by DRGs in 2007	(i) 60 hospitals corporatized under COM-approved program (ii) 90% of hospitals covered by DRGs

Prior Actions under PL1	Prior Actions under PL2	Prior Actions under PL3	Indicator and baseline value	Target (2010)
STRENGTHENING PUBLIC FINANCE				
	Education			
	CHALLENGES: Low pre-primary education enrollment in Poland of 52% for 3-5 year old (pre-school aged children). Merit-based public subsidies of tertiary education tend to support better off students.			
	LONG-TERM OBJECTIVE: To improve the quality of education and begin instruction at an earlier age, increase the relevance of education to the labor market, and develop general knowledge and skills needed for a flexible workforce able to renew its skills and knowledge over a lifetime.			
	EXPECTED OUTCOME: Increased pre-school participation rates among children aged 3-5 years. Equity of the student loans system improved through increased loans for poor students.			
	Pass a law to initiate a compulsory pre-primary program for 5 year-old children (Grade 0) starting from 2011/12 and begin implementing it on a voluntary basis in 2009/10. The same law initiates a compulsory school program for 6 year-old children from 2012/13.	**The Borrower has allocated adequate resources for the financing of educational programs for five (5)- and six (6)-year olds through the enactment of the Budget Law for 2010 of January 22, 2010 (Journal of Laws of the Republic of Poland No. 19 of 2010, item 102).** **The Borrower has adopted the Resolution of the Ministry of Science and Higher Education of May 18, 2010 (Journal of Laws of the Republic of Poland No. 87 of 2010, item 560) to introduce a means-based sliding scale in subsidized student loan programs.**	(i) Primary school at age 6 in 2007 (ii) 52% enrollment rate for 3-5 year olds in 2007 (iii) 10.2% of students who submitted loan application, met the criteria but failed to obtain the loan due to lack of collateral in 2007	(i) Primary school at age 5 in 2012/2013 (ii) 60% enrollment rate for 3-5 year olds (iii) 7.5% of students who submitted loan application, met the criteria but failed to obtain the loan due to lack of collateral

Prior Actions under PL1	Prior Actions under PL2	Prior Actions under PL3	Indicator and baseline value	Target (2010)
STRENGTHENING PUBLIC FINANCE				
Labor Market				
CHALLENGES: Low labor force participation and low employment rate, especially among older (55-64), which translates into lower output and incomes.				
LONG-TERM OBJECTIVE: To improve the utilization of labor resources, including reaching the Lisbon target of 70% employment rate and reducing the incidence of long-term unemployment in order to foster income growth and combat social exclusion.				
EXPECTED OUTCOME: Labor force participation rate of 55-64 year-old increased.				
The disability pension contribution rate was lowered by 7 percentage points, from 13 to 6 percent of payroll. **Work permits abolished for workers from neighboring countries employed on a temporary basis**	**Implementation of the government program to increase labor force participation of older workers, known as "50+"**		(i) 13% disability rate contribution in 2007 (ii) 29.7% employment rate for population aged 55-64 in 2007	(i) 6% disability rate contribution (ii) 33% employment rate for population aged 55-64

Prior Actions under PL1	Prior Actions under PL2	Prior Actions under PL3	Indicator and baseline value	Target (2010)
PURSUING STRUCTURAL REFORMS				
Private Sector Development				
CHALLENGES: Improving the quality of business environment and enhancing competitiveness of the enterprise sector through reduction in regulatory barriers to enterprise start-up and operations, privatization of state-owned enterprises, and reduction in legal and administrative barriers to cross-border operations in services sector.				
LONG-TERM OBJECTIVE: To improve the quality of business environment, increase cross-border operations, and enhance corporate competitiveness to stimulate long-term growth.				
EXPECTED OUTCOMES: The cost of business regulatory compliance for registration and start-up of a business as well as for obtaining licenses is reduced by at least 20 percent, based on the pre-costing estimates by enterprises of such procedures and the subsequent removal of the identified government requirements. By the end of the privatization cycle, the assets of state enterprises transferred to private ownership represent an estimated value equivalent to at least 20% of the initial asset value of those SOEs or shares thereof offered to the market.				
A bill of presented to Parliament that sharply reduces minimum capital requirements for business start-ups. **Government approval of a privatization program comprising 740 enterprises to be sold (of which some 2-300 minority stakes) and 350 to be liquidated or wound down.**	**Amendments to the Law on Freedom of Business Operations that unify and coordinate business inspection procedures, scheduling and duration among all inspection authorities.** **Offer for sale on the market (through stock exchange or by auction) or via competitive tenders the first 80 public sector enterprises in the program (or those constituting 10 percent of aggregate asset value).**	**The Borrower has enacted the Law of March 4, 2010 on Delivery of Services in the Republic of Poland (Journal of Laws of the Republic of Poland No. 47 of 2010, item 278) on Delivery of Services in the Republic of Poland, thereby enhancing international competition in services in line with the EU Services Directive.**	(i) Minimum capital requirement for limited liability company is PLN 50,000 in 2007 (ii) 740 state-owned enterprises or state shares in enterprises announced for sale in 2008, (iii) Poland's share in total intra-EU trade in services is 2.2% in 2008	(i) Minimum capital requirement for limited liability company reduced to below PLN 10,000 (ii) At least 200 state-owned enterprises or state shares in enterprises have received private investor offers (iii) Poland's share in total intra-EU trade in services larger than 2.5%

ANNEX 3: PUBLIC INFORMATION NOTICE OF THE ARTICLE IV MISSION OF THE INTERNATIONAL MONETARY FUND FROM MAY 10, 2010

On May 7, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Poland.[15]

Background

Poland is the only EU economy to have escaped a recession in 2009. Similar to its regional peers, it experienced spill-overs from the crisis through real and financial channels, as an abrupt slowdown in capital inflows caused a credit crunch and a sharp decline in investment. However, consumption held up relatively well, and the trade balance began to contribute positively to growth from the onset of the crisis. This reflected Poland's large domestic market and attendant modest reliance on exports; a flexible exchange rate policy; and, not least, significant fiscal stimulus and monetary easing, as policymakers took advantage of the room for maneuver afforded by Poland's contained external and internal imbalances on the eve of the crisis.

The rapid contraction in the trade balance resulted in a decline in the current account deficit from 5 to about 1½ percent of GDP in 2009. Foreign direct investment has declined notably, although higher retained earnings have cushioned the fall. Portfolio inflows have performed particularly well, especially since the middle of last year, driven by renewed external appetite for zloty-denominated assets, especially government debt. As a result, after its initial sharp fall, the zloty has been recovering steadily.

Fiscal policy has provided significant counter-cyclical stimulus, with discretionary relaxation estimated at 1¾ percent of GDP in 2008 and 2½ percent of GDP in 2009, mainly due to tax cuts enacted in 2007 but coming into effect with a delay. While the government initially intended to offset revenue shortfalls to the extent needed to maintain the state budget deficit below the limit of zloty 18 billion in 2009—through what would have been highly pro-cyclical expenditure cuts—it appropriately altered such plans at mid-year. As a result, the general government deficit increased from under 2 percent of GDP in 2007 to over 7 percent of GDP in 2009.

The Monetary Policy Council continued to cut rates through the first half of 2009, to 3.5 percent. It maintained a loosening stance until October 2009, when it changed its informal bias to neutral, reflecting an improved outlook and renewed concern about inflation. Nevertheless, helped by subdued wage growth and commodity prices, and renewed appreciation of the zloty, inflation has recently fallen from around 4 percent in mid-2009 to well within the National Bank of Poland's tolerance range of 1½- 3½ percent. Core inflation followed a similar path, declining to around 2 percent in recent months.

The banking system has withstood the crisis relatively well, while facilities for exceptional liquidity support have been phased out. Capital adequacy ratios have risen to over 13 percent at end-2009, from 11 percent a year ago. Moreover, profits remained robust in 2009, reaching about

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[15] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

two thirds of the record-high level of the preceding year. While nonperforming loans rose from around 4 percent in 2008 to about 7½ percent in 2009 as economic activity declined, their growth appears to be slowing. Banks' balance-sheet restructuring is coming to an end. They have recently started to ease lending policies for housing loans and short-term corporate credits and resumed foreign-currency lending, especially for Euro-denominated mortgages.

Executive Board Assessment

Executive Directors expressed their deepest sympathy to the people and authorities of the Republic of Poland for the death of their President, his wife and many senior country officials in the recent airplane crash.

Directors commended the authorities for their swift and timely response to the global crisis. Anchored in a strong macroeconomic framework and financial system, and buttressed by access to the Flexible Credit Line, this response enabled Poland to escape a recession in 2009.

Directors noted that economic growth is set to increase gradually as the global environment improves, banks' risk appetite reemerges, and the inflow of EU funds accelerates. Given the still fragile recovery and surrounding uncertainties, the timing and manner of the withdrawal of fiscal and monetary stimuli will have to be carefully managed.

Directors considered that policy interest rates should not be raised at this stage, in view of the contained outlook for inflation and the excess capacity in the economy. If increased capital inflows put persistent upward pressure on the zloty and inflation remains subdued, interest rates could be further cut, possibly complemented by transparent foreign-exchange interventions. Directors welcomed the authorities' commitment to euro adoption, while not setting a target date at this juncture. This will allow them to continue to take all the steps, including on the structural front, for successful euro adoption at an appropriate time, while preserving exchange rate flexibility in the face of external shocks.

Directors stressed the need to gradually start withdrawing the fiscal stimulus while carefully balancing short-term cyclical priorities and longer-term objectives. They welcomed the steps already taken by the authorities to reduce the deficit and called for further measures, including reform of entitlement programs and revenue enhancements, to meet the deficit target of 3 percent of GDP. A number of Directors endorsed the authorities' intention to achieve this target by 2012, noting that although ambitious, this would be achievable. A number of other Directors, however, were of the view that a somewhat more gradual consolidation would be preferable so as not to stifle the incipient recovery. In order to help anchor confidence in fiscal policy, Directors recommended introducing a permanent fiscal rule with a deficit or debt anchor consistent with the authorities' medium-term targets.

Directors considered that, although the financial sector has been well buffered, continued vigilance is necessary. They welcomed the Polish Financial Supervision Authority's recent recommendations aimed at strengthening lending standards for household loans.

Directors noted that the renewed appetite for foreign-exchange lending could pose risks. They encouraged the authorities to ensure that such lending is funded and hedged on a longer-term basis as well as to raise capital requirements on foreign-exchange-denominated mortgages to reflect higher credit and valuation risks. Directors also underscored the importance of cross-border cooperation in this area.

Directors stressed that despite Poland's strong fundamentals, raising its exceptionally low labor participation rate remains critical to boosting long-term growth. They encouraged labor supply-enhancing reforms with complementary measures such as equalizing and gradually increasing the retirement age and merging special pension schemes with the general scheme. This, together with vigorous pursuit of the ambitious privatization agenda, would help to enhance the economy's flexibility and bolster its long-run potential.

Republic of Poland: Selected Economic Indicators, 2006-10

	2006	2007	2008	2009 Est.	2010 Staff Proj.
Real economy (change in percent)					
Real GDP	6.2	6.8	5.0	1.7	2.7
CPI (end of Period)	1.4	4.0	3.3	3.5	2.3
Unemployment rate (in percent)	13.8	9.6	7.1	8.0	9.5
Public finances (percent of GDP)					
General government balance 1/	-3.6	-1.9	-3.7	-7.2	-7.5
Public debt 2/	47.8	44.8	47.0	49.9	52.8
Money and credit					
Private sector credit (12-month change)	22.9	29.5	36.3	10.0	...
Broad money (12-month change)	16.0	13.4	18.6	8.1	...
Money market rate (eop)	4.1	5.6	5.8	4.2	...
Balance of payments					
Current account balance (percent of GDP)	-2.7	-4.8	-5.1	-1.6	-2.8
Official reserves (billion U.S. dollars)	48.5	65.7	62.2	79.6	88.2
Total external debt (percent of GDP)	49.6	55.0	46.1	61.5	59.0
Exchange rate					
Exchange rate regime			Floating		
Present Exchange rate (April 21, 2010)			PLN 2.89=US$1		
Zloty per US$, period average	3.10	2.77	2.41	3.12	...
Zloty per Euro, period average	3.90	3.79	3.55	4.09	...
Real effective exchange rate (INS, CPI based)3/	139.4	144.7	159.3	133.7	

Sources: Polish authorities; and IMF staff estimates.

1/ ESA95 definition

2/ National definition

3/ Annual average (1995=100)

ANNEX 4: STATUS OF BANK GROUP OPERATIONS IN POLAND

Poland: Planned and Actual Deliveries, FY05-09

A. Lending Deliveries

FY	CPS Plans	US$mln	Actual	US$mln
FY05	Hard Coal Mine Closure 1/	100.0	Hard Coal Mine Closure 1/	126.0
	Road Maintenance & Rehab. II	130.5	Road Maintenance & Rehab. II	130.5
	Subtotal FY05	*230.5*	*Subtotal FY05*	*256.5*
FY06	Road Maintenance & Rehab III	195.0	Road Maintenance & Rehab III	180.2
	Post-Accession Rural Support	65.0	Post-Accession Rural Support	88.8
	Odra River Basin Flood Protection	130-190		
	Subtotal FY06	*390-450*	*Subtotal FY06*	*269.0*
FY07	None		Odra River Basin Flood Protection	184.0
			Subtotal FY07	*184.0*
FY08	None		None	-
FY09	None		Development Policy Loan (DPL)	1,250.0
			Subtotal FY09	*1,250.0*
	Total FY05-09	***620.5-680.5***	***Total FY05-09***	***1,859.5***

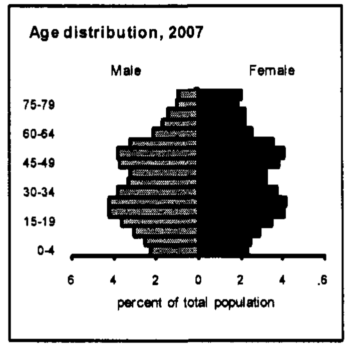
1/ Approved on July 1, 2004, prior to the CPS. The operation was included in the previous CAS

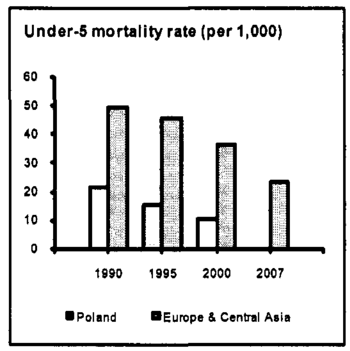
B. Non-Lending Deliveries, FY05-08
(excluding Regional Studies)

FY	CPS Plans	Actual
FY05	Corporate Governance ROSC Update	Actual, FY05
	Accounting & Auditing ROSC Update	Actual, FY05
	Financial Services Development (Policy Notes)	Actual FY06
	Influence of the Legal System on the Financial Market	Actual FY06; Converted to: Barriers to Contract Enforcement
		Additional Actual Products:
		Education Policy TA
FY05-06	Health Reform Implementation Dialogue	Actual, FY05
	Railways Reform Implementation Dialogue	Actual, FY05
	Public Administration Reform TA	Actual, FY06
	Policy Dialogue on National Development Plan 2007-13	Actual, FY06
	Second Generation PPP in Roads	Actual, FY06
	CGE Model Building	Actual, FY0x
	Public Environmental Financing	Dropped (work suspended in FY06)
	Energy Policy Dialogue	Dropped
	IDF Accounting and Auditing Reform	Actual, FY05-08
FY06	Renewable Energy	Dropped
		Additional Actual Products:
		FSAP Update
		Transition Brief
		Anti-corruption Update
		Country Financial Accountability Assessment (CFAA)
		Directions in Regional Policy
FY07	None	Ownership Policy for SOEs
		Hard Coal Sector Dialogue
FY08	None	Performance Based Budgeting Conference
		Insolvency and Creditor Rights ROSC

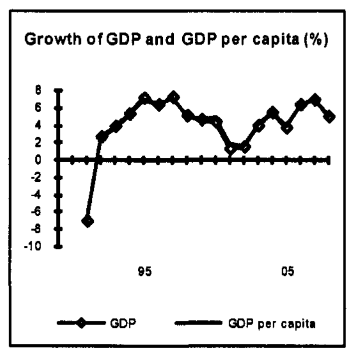
ANNEX 5: POLAND AT A GLANCE

Key Development Indicators	Poland	Europe & Central Asia	Upper middle income
(2008)			
Population, mid-year (millions)	38.1	446	824
Surface area (thousand sq. km)	..	23,972	41,497
Population growth (%)	0.0	0.2	0.7
Urban population (% of total population)	..	64	75
GNI (Atlas method, US$ billions)	447.1	2,697	5,854
GNI per capita (Atlas method, US$)	11,730	6,052	7,107
GNI per capita (PPP, international $)	*15,500*	11,262	12,072
GDP growth (%)	5.0	6.9	5.8
GDP per capita growth (%)	5.0	6.7	5.0
(most recent estimate, 2003–2008)			
Poverty headcount ratio at $1.25 a day (PPP, %)	<2	4	..
Poverty headcount ratio at $2.00 a day (PPP, %)	<2	9	..
Life expectancy at birth (years)	..	70	71
Infant mortality (per 1,000 live births)	..	21	21
Child malnutrition (% of children under 5)	..	..	..
Adult literacy, male (% of ages 15 and older)	100	99	95
Adult literacy, female (% of ages 15 and older)	99	96	93
Gross primary enrollment, male (% of age group)	..	98	112
Gross primary enrollment, female (% of age group)	..	96	109
Access to an improved water source (% of population)	..	95	95
Access to improved sanitation facilities (% of population)	..	89	83





Net Aid Flows	1980	1990	2000	2008 [a]
(US$ millions)				
Net ODA and official aid	..	1,320	1,396	*1,524*
Top 3 donors (in 2007):				
European Commission	..	289	838	*1,101*
France	..	2	197	*197*
Austria	..	27	124	*83*
Aid (% of GNI)	..	2.4	0.8	*0.6*
Aid per capita (US$)	..	35	36	*40*



Long-Term Economic Trends	1980	1990	2000	2008	1980–90	1990–2000	2000–08
					(average annual growth %)		
Consumer prices (annual % change)	..	*70.3*	10.1	4.2			
GDP implicit deflator (annual % change)	..	*55.2*	7.2	3.0			
Exchange rate (annual average, local per US$)	..	0.9	4.3	2.4			
Terms of trade index (2000 = 100)	..	104	100	102			
Population, mid-year (millions)	35.6	38.1	38.5	38.1	0.7	0.1	-0.1
GDP (US$ millions)	..	58,976	171,276	527,866	..	4.7	4.4
		(% of GDP)					
Agriculture	..	8.3	5.0	4.5	..	*0.5*	1.3
Industry	..	50.1	31.7	30.8	..	*7.1*	5.7
Manufacturing	..	..	18.5	17.3	..	*9.9*	8.5
Services	..	41.6	63.3	64.6	..	*5.1*	3.7
Household final consumption expenditure	..	48.0	63.1	60.4	..	5.2	3.7
General gov't final consumption expenditure	..	19.3	18.5	19.4	..	3.7	4.2
Gross capital formation	..	25.6	24.8	23.9	..	10.6	6.4
Exports of goods and services	..	28.6	27.1	39.8	..	11.3	10.2
Imports of goods and services	..	21.5	33.5	43.5	..	16.7	9.4
Gross savings	..	*15.9*	18.8	18.3			

Note: Figures in italics are for years other than those specified. 2008 data are preliminary. .. indicates data are not available.
a. Aid data are for 2007.

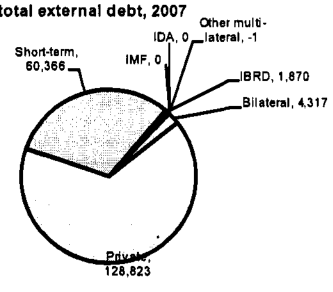
Development Economics, Development Data Group (DECDG).

Balance of Payments and Trade	2000	2008
(US$ millions)		
Total merchandise exports (fob)	31,729	165,647
Total merchandise imports (cif)	49,023	195,906
Net trade in goods and services	-10,904	-19,233
Current account balance	-10,343	-28,921
as a % of GDP	-6.0	-5.5
Workers' remittances and compensation of employees (receipts)	1,726	*10,496*
Reserves, including gold	27,466	62,180

Central Government Finance		
(% of GDP)		
Current revenue (including grants)	38.1	39.1
Tax revenue	19.8	22.8
Current expenditure	38.2	37.7
Overall surplus/deficit	-3.0	-3.7
Highest marginal tax rate (%)		
Individual	40	*40*
Corporate	28	*19*

External Debt and Resource Flows		
(US$ millions)		
Total debt outstanding and disbursed	64,834	218,022
Total debt service	10,156	57,188
Debt relief (HIPC, MDRI)	–	–
Total debt (% of GDP)	37.9	41.3
Total debt service (% of exports)	..	..
Foreign direct investment (net inflows)	..	..
Portfolio equity (net inflows)	..	..

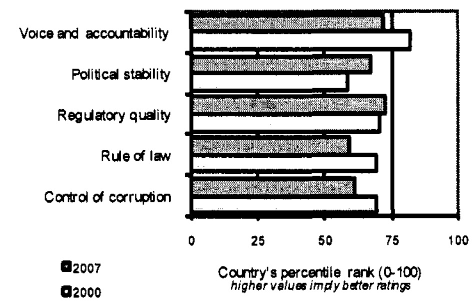
Composition of total external debt, 2007



US$ millions

Private Sector Development	2000	2008
Time required to start a business (days)	–	31
Cost to start a business (% of GNI per capita)	–	18.8
Time required to register property (days)	–	197
Ranked as a major constraint to business	**2000**	**2007**
(% of managers surveyed who agreed)		
Tax rates	..	*57.5*
Access to/cost of financing	..	*50.7*
Stock market capitalization (% of GDP)	18.3	48.7
Bank capital to asset ratio (%)	7.1	7.4

Governance indicators, 2000 and 2007



Source: Kaufmann-Kraay-Mastruzzi, World Bank

Technology and Infrastructure	2000	2007
Paved roads (% of total)	68.3	*69.7*
Fixed line and mobile phone subscribers (per 100 people)	46	136
High technology exports (% of manufactured exports)	3.3	3.8

Environment		
Agricultural land (% of land area)	60	*52*
Forest area (% of land area)	30.6	..
Nationally protected areas (% of land area)	*9.6*	..
Freshwater resources per capita (cu. meters)	*1,402*	1,406
Freshwater withdrawal (billion cubic meters)	16.2	..
CO2 emissions per capita (mt)	7.8	*7.9*
GDP per unit of energy use (2005 PPP $ per kg of oil equivalent)	5.1	*5.7*
Energy use per capita (kg of oil equivalent)	2,325	*2,562*

World Bank Group portfolio	2000	2007
(US$ millions)		
IBRD		
Total debt outstanding and disbursed	2,229	1,870
Disbursements	349	3
Principal repayments	199	261
Interest payments	122	89
IDA		
Total debt outstanding and disbursed	–	–
Disbursements	–	–
Total debt service	–	–
IFC *(fiscal year)*		
Total disbursed and outstanding portfolio	111	46
of which IFC own account	91	46
Disbursements for IFC own account	8	0
Portfolio sales, prepayments and repayments for IFC own account	21	10
MIGA		
Gross exposure	2	0
New guarantees	0	0

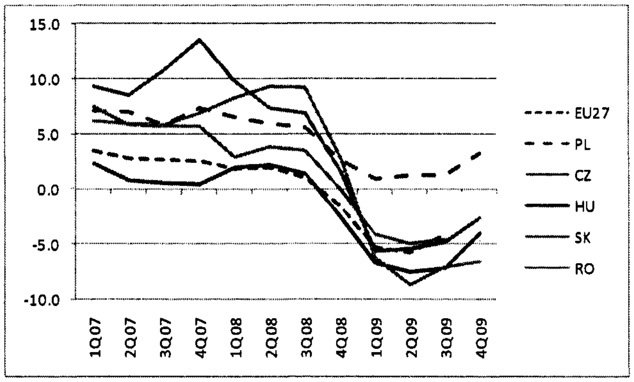
Note: Figures in italics are for years other than those specified. 2008 data are preliminary. 11/6/09
.. indicates data are not available. – indicates observation is not applicable.

Development Economics, Development Data Group (DECDG).

ANNEX 6: SELECTED CHARTS

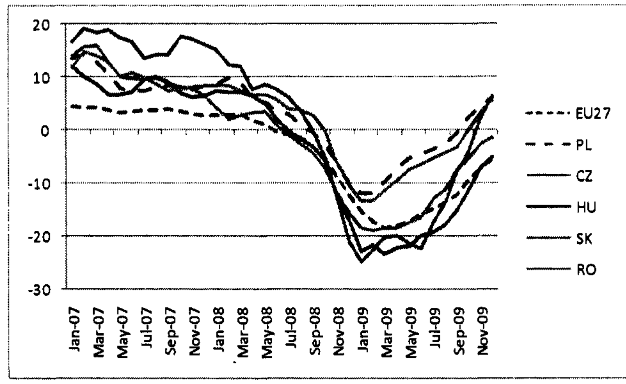
I. Recent Developments in the Real Sector

Figure 2. GDP growth, percent, year-on-year, nsa



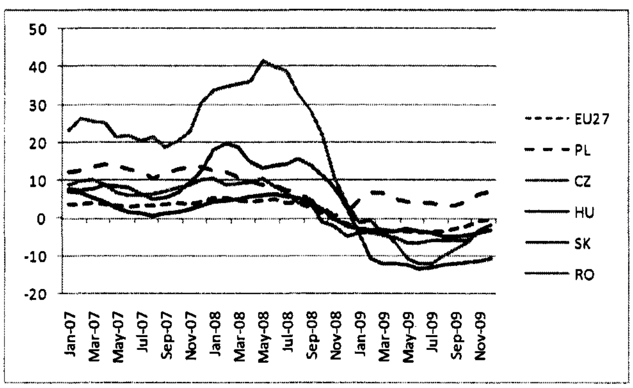
Source: Eurostat, World Bank staff calculations
Note: 4Q data are preliminary

Figure 3. Industrial production growth,3mma, data adjusted by working days, year-over-year



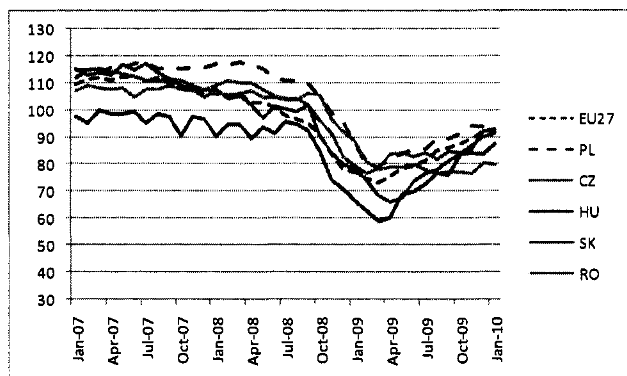
Source: Eurostat, World Bank staff calculations

Figure 4. Retail sales growth, 3mma, data adjusted by working days, year-over-year



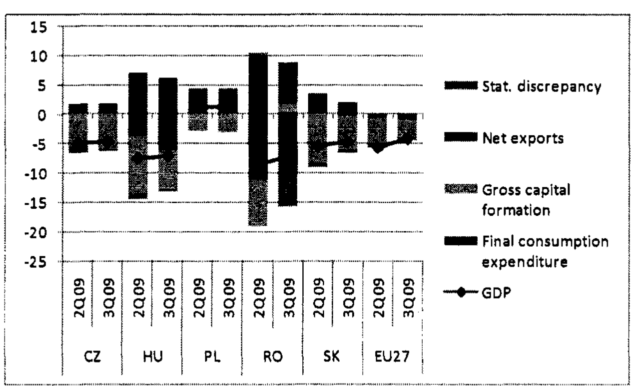
Source: Eurostat, World Bank staff calculations

Figure 5. Economic sentiment indicator (long term average = 100)



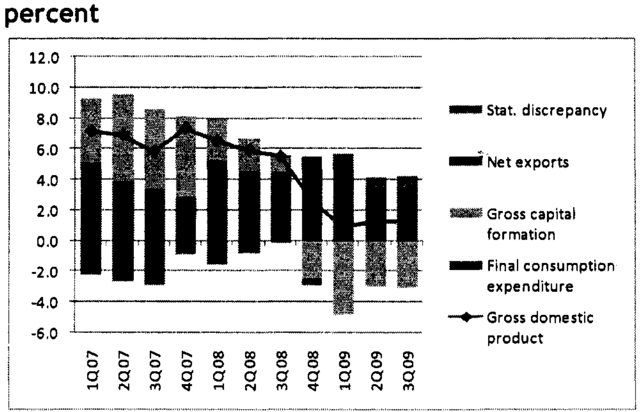
Source: European Commission, World Bank staff calculations

Figure 6. Contribution to GDP growth, percent



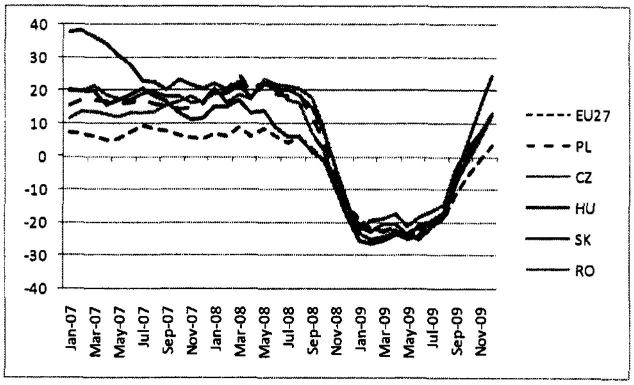
Source: Eurostat, World Bank staff calculations

Figure 7. Contribution to GDP growth in Poland, percent



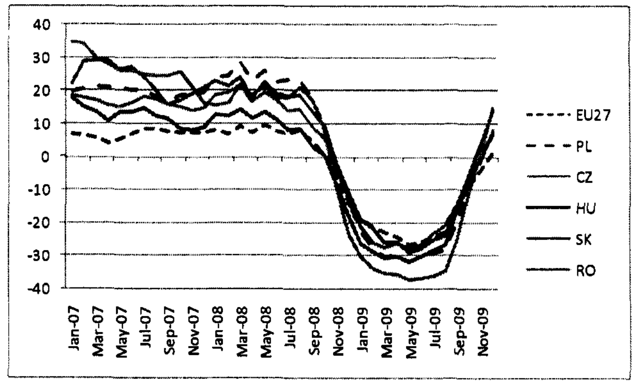
Source: Eurostat, World Bank staff calculations

Figure 8. Exports performance, 3mma, percent, year-on-year



Source: Eurostat, World Bank staff calculations

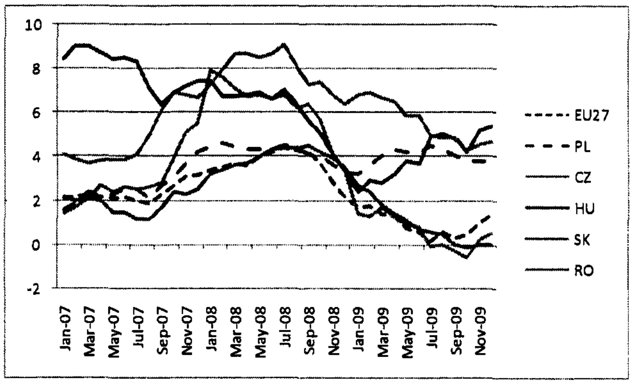
Figure 9. Imports performance, 3mma, percent, year-on-year



Source: Eurostat, World Bank staff calculations

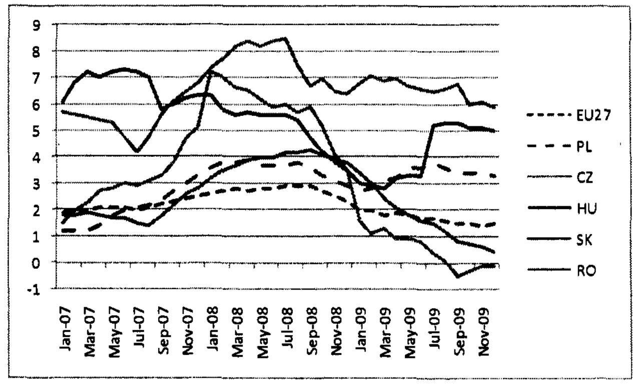
II. Recent Developments in the Monetary and Financial Sectors

Figure 10. HICP[16] overall index, annual rate of change, percent



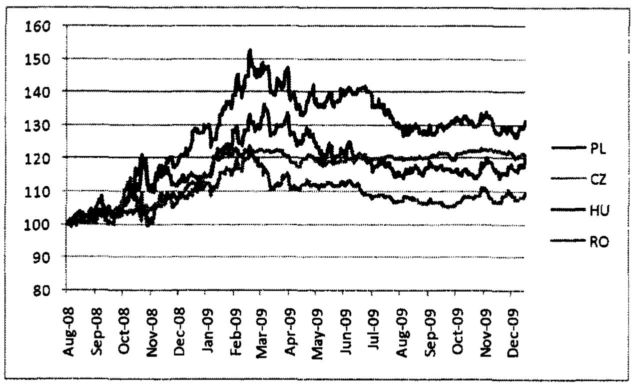
Source: Eurostat, World Bank staff calculations

Figure 11. HICP core[17] index, annual rate of change, percent



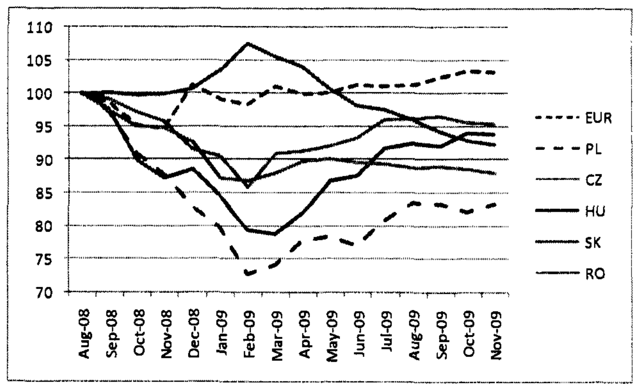
Source: Eurostat, World Bank staff calculations

Figure 12. Exchange rates vs. Euro for countries with floating exchange rate system, August 2008=100



Source: Reuters, World Bank staff calculations

Figure 13. Real effective exchange rates, CPI deflated, August 2008=100



Source: IMF IFS, World Bank staff calculations

Figure 14. 3M interbank rates spreads over 3M Libor EUR, basis points

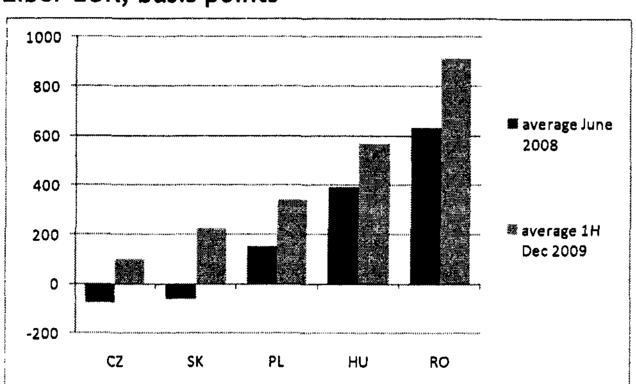
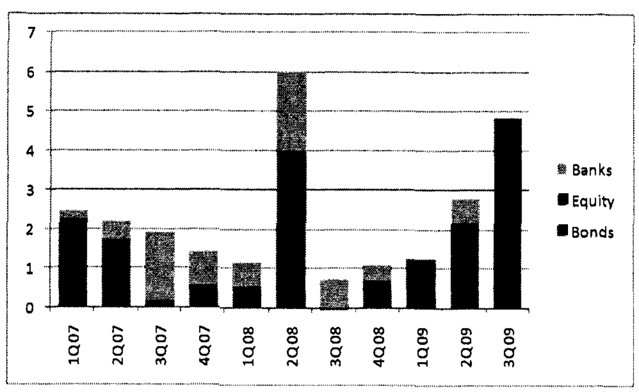


Figure 15. Capital inflows to Poland, USD billions

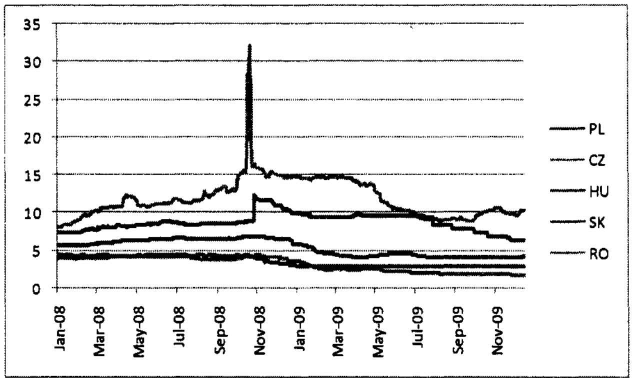


[16] HICP is a harmonized index of consumer prices.
[17] HICP core is overall HICP index excluding energy and unprocessed food

Source: Reuters, World Bank staff calculations

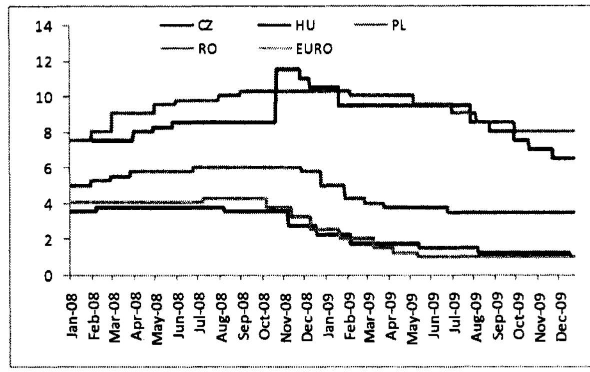
Source: World Bank DEC PG, Staff calculations

Figure 16. 3M interbank rates, percent



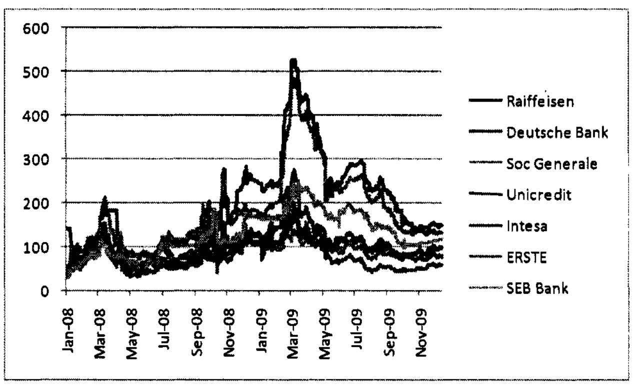
Source: Reuters, World Bank staff calculations

Figure 17. Policy interest rates, percent



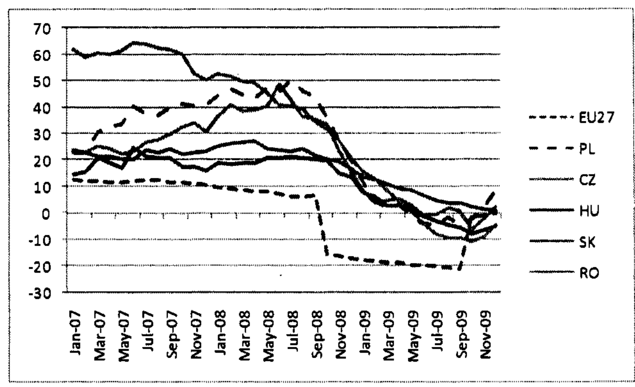
Source: Central Banks, Staff calculations

Figure 18. 5Y CDS spreads for selected parent banks (basis points)



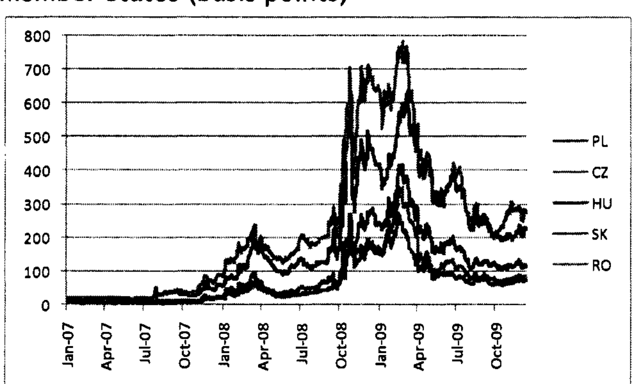
Source: Reuters, World Bank staff calculations

Figure 19. Credit growth to private sector, percent, year-on-year



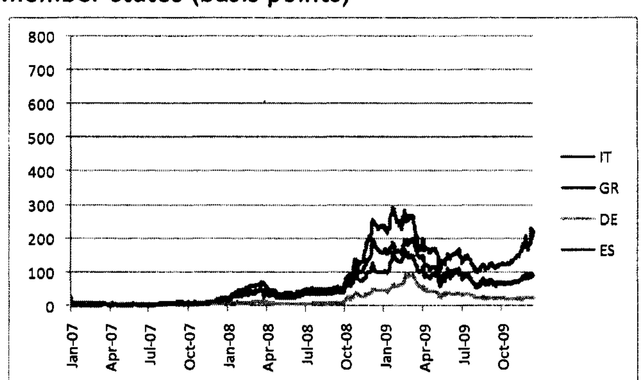
Source: European Central Bank, World Bank staff calculations

Figure 20. 5Y CDS spreads for selected New Member States (basis points)



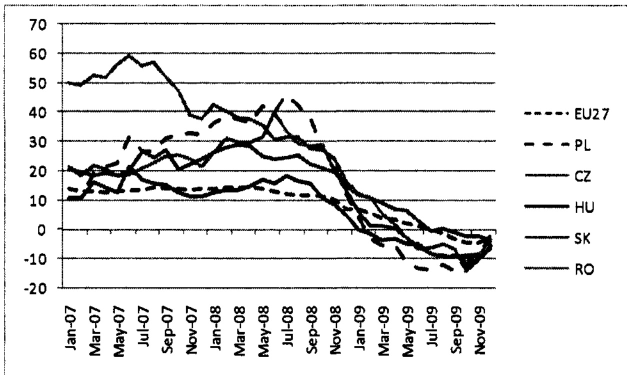
Source: Reuters, World Bank staff calculations

Figure 21. 5Y CDS spreads for selected Euro Area member states (basis points)



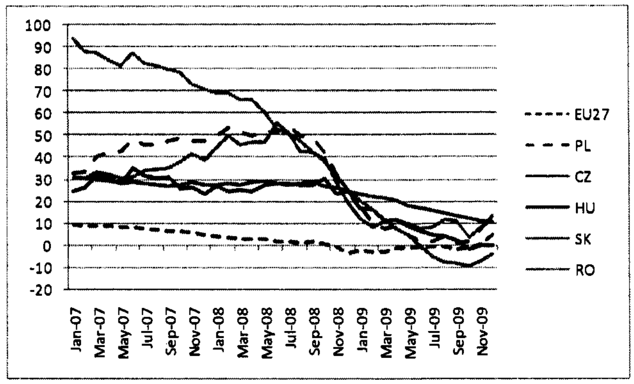
Source: Reuters, World Bank staff calculations

Figure 22. Credit growth to non-financial enterprises, percent, year-on-year



Source: European Central Bank, World Bank staff calculations

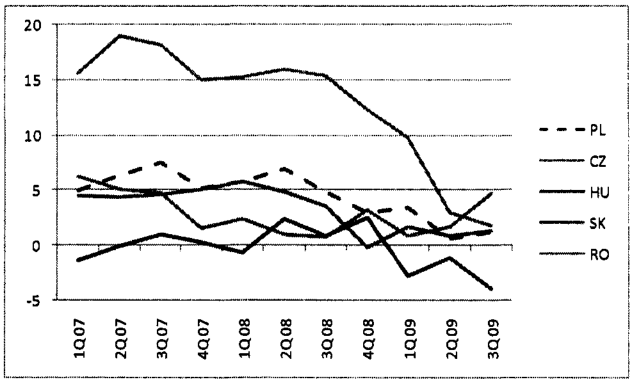
Figure 23. Credit growth to households, percent, year-on-year



Source: European Central Bank, World Bank staff calculations

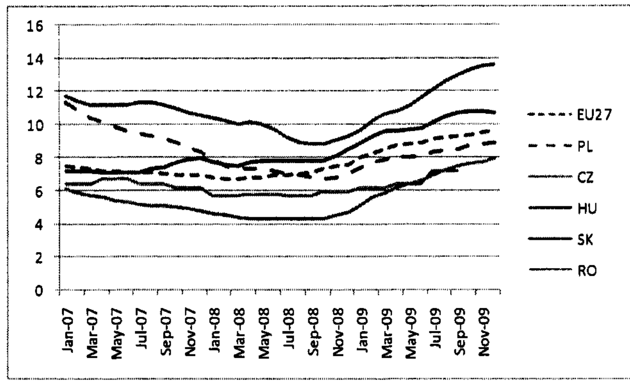
III. Recent Developments in Labor Markets

Figure 24. Real growth of wages, year-over-year



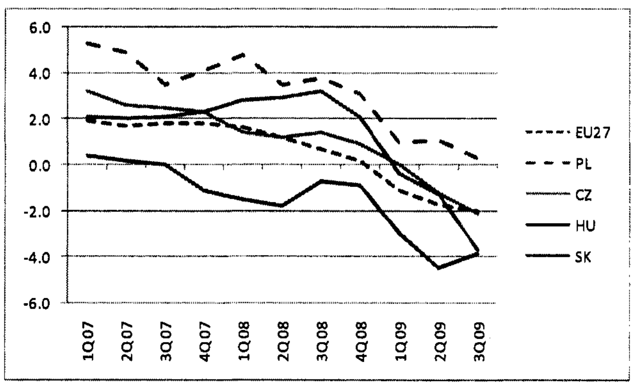
Source: Central Statistical Offices, World Bank staff calculations

Figure 25. Harmonized unemployment rates



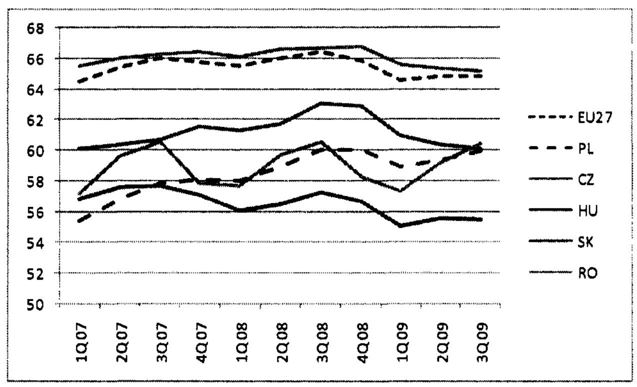
Source: Eurostat, World Bank staff calculations

Figure 26. Employment growth, year-over-year



Source: Eurostat, World Bank staff calculations

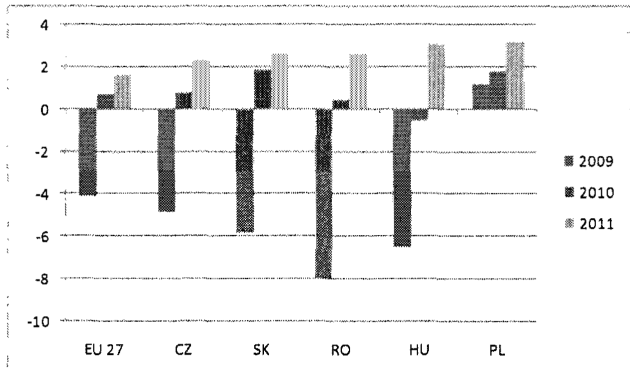
Figure 27. Employment rates (15-64)



Source: Eurostat, World Bank staff calculations

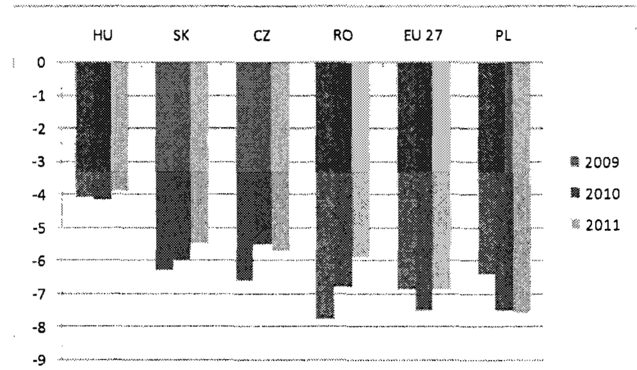
IV. Macroeconomic Outlook

Figure 28. European Commission's GDP growth forecasts



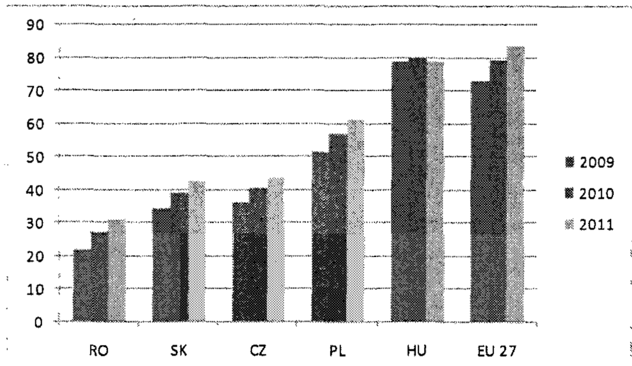
Source: EC Autumn Forecasts 2009, World Bank staff

Figure 29. European Commission's fiscal balance forecasts



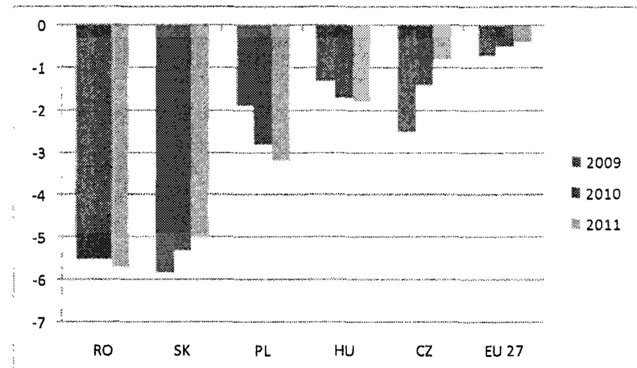
Source: EC Autumn Forecasts 2009, World Bank staff

Figure 30. European Commission's public debt forecasts



Source: EC Autumn Forecasts 2009, World Bank staff

Figure 31. European Commission's current account balance forecasts



Source: EC Autumn Forecasts 2009, World Bank staff

Map Section

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