

3. Poland- Transition since 1989

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Poland- Summary

- Over the last 25 years, Poland lived through a unique experience of transformation which may serve as a useful case study for many countries.
- An economic crisis in the 1980's led to an initial period of radical political and economic transitions which began in **1989**.
- It then entered a period of accelerated modernization which, since 2004, was supported by its membership of the European Union.
- The country's recipe for success could be explicated as a mixture of several far-sighted stabilization and structural reforms taken over time as well as appropriate sequencing of these reforms:
 - (i) from the “**shock therapy**” at the beginning of transition in 1989,
 - (ii) through a “**big bang**” introduction in 1999 of four major reforms once the situation had stabilized,
 - (iii) to the EU accession reforms of 2004; and
 - (iv) to the “**incrementalism**” after 2009 to fine-tune areas of reform.

Poland – Economic Situation during the 1970s.

- Under a communist government, from 1970 to 1975, Poland contracted large **foreign loans** which permit it to improve living standards based on imported goods.
- This ended in the late 1970s when Western banks no longer provided Poland with loans due to **deterioration in its creditworthiness**.
- As the supply of imported goods fell, living standards also fell.
- Furthermore, **local prices** had to be increased, as Poland was forced to divert output to exports, particularly food and coal, in order to service its massive debt, which reached US\$23 billion by 1978.
- By 1978, high foreign debts, food shortages, and an outmoded industrial base forced the government to increase prices again.
- But these price increases set off **protests across the country**, especially in the Gdańsk and Szczecin shipyards.
- Labor turmoil in Poland during 1980 led to the formation of the informal but independent trade union, **Solidarity**, led by Lech Wałęsa.

Lech Walesa was an electrician at the shipyards in Gdansk in northern Poland (he was also a communist informant in the 1970s)



Economic Situation during the 1980s.

- Under the Gdańsk Agreement of 1980, the communist government was forced to **grant legal status to Solidarity** and to concede the right to strike.
- But this was opposed by the Communist Party, which changed the government in 1980, with the new authorities **outlawing Solidarity** and introducing martial law shortly thereafter.
- In 1980 **Janos Kornai** published his theory on the Economics of Shortage. Kornai argued that the shortages seen in Eastern Europe in the 1970s were not the consequences of planners' errors, but rather **systemic flaws**: the unchallenged bureaucratic administration of state firms and prices lead to **prices that cannot bring market equilibrium**, even by chance. The incentive system would lead to large output of **military goods** (desired by the nomenclatura) and shortage of **consumer goods**.
- Furthermore, access to imports from the West became even more restricted as Western governments applied economic sanctions to express in protest to the government's repression of the opposition

.....Economic Situation during the 1980s.

- Nevertheless, since 1981, Poland progressively moved the **distribution of products onto a market basis and accorded greater autonomy to firms.**
- In addition, most agricultural producers were private.
- This combination of decentralization with limited private ownership resulted in **self-management within firms.** Some 70 percent of Polish firms became self-managed.
- Furthermore, Gorbachev's Glasnost policy of 1985 had encouraged openness and later on, he encouraged Eastern Europe to seek their own course to improve socialism. This was called Gorbachev's "Sinatra Doctrine" in a reference to the Frank Sinatra song "My Way" (this doctrine led Poland to approach the IMF/World Bank for support in 1986).
- But these **partial changes were not successful** in improving efficiency and the economic crises continued during the 1980s as the government had to use most of its foreign currency to pay its foreign debt.

.....Economic Situation during the 1980s.

- In 1985, the Polish government requested World Bank support: during my visit to Poland in 1986 (as the World Bank's Division Chief for Industry), I could see that rationing and queuing was widespread, with ration cards necessary to buy even basic consumer staples such as milk. The very low efficiency of large state enterprises made clear that these firms could not compete internationally. But there was no agreement on required reforms and no support was given by the Bank.
- **The economic crises continued in the late 1980s** and in response, the government, which controlled foreign trade, continued to maintain highly **artificial foreign exchange rates**.
- The exchange rate worsened distortions in the economy at all levels, resulting in a **growing black market**, with illegal “street-corner money changers” throughout the country.
- To escape the economic and political pressures during these years, thousands of **Polish workers** sought work in Western Europe (particularly West Germany), North Africa and the Middle East.

.... Economic Situation during the 1980s.

- **After several years of failure** to improve the economic situation, despite government's unsuccessful attempts to try various schemes to improve the economy (such as placing military personnel to control work in the factories), the government **reluctantly accepted pressures to liberalize the economy**.
- In particular, the government introduced a series of small-scale reforms, such as allowing more small-scale private enterprises to function.
- But this was rejected by the population: as Janos Kornai told me in 1986, **“reforms at the margin are bound to fail, since it is like asking a few car drivers in a city with heavy traffic to drive on the other side of the street, in order to find out if that alternative traffic system is better”**.
- The government also felt that it did not have the population support to carry out any large-scale reforms, which would cause large-scale social dislocation and economic difficulties for most of the population.
- The only way to carry out such changes without social upheaval would be to **get support from the opposition**.

.....Economic Situation during the 1980s.

- However, this opposition support was not given since the communist government still believed that **they should retain real power**, and only allow the opposition limited, **advisory** participation in the running of the country.
- Although during most of the 1980s, Solidarity existed only as an underground organization, **by 1988**, it became sufficiently strong to organize opposition to government attempts of marginal reforms.
- **The nationwide strikes in 1988** (caused by further price increases) forced the government to open dialogue with Solidarity in January 1989.
- Also in 1989, the Soviet Union had repealed the **Brezhnev Doctrine** of armed intervention in Eastern Europe in favor of **non-intervention** in the internal affairs of its Warsaw Pact allies.
- **In March 1989, the government and Solidarity agreed (under the Round Table Agreement) to the formation of a bi-cameral parliament.** The existing Sejm became the lower house with its 460 members. A new upper house (the Senate) would have 100 senators. They would be elected by the people. The presidency was given more powers. Solidarity was legalized.

.....Economic Situation during the 1980s.

- By June 1989, Solidarity won overwhelmingly the parliamentary elections and by September 1989 a Solidarity-led government took power in Poland, led by **Tadeusz Mazowiecki**, an anti-Communist journalist (the Soviet Union voiced no protest, despite calls from hard-lines to intervene militarily).
- **Leszek Balcerowicz**, a respected Polish economist, was appointed Deputy Prime Minister and Minister of Finance.
- On 29 December 1989 the Sejm amended the constitution to change the official name of the country from the People's Republic of Poland to the Republic of Poland. The communist Polish party dissolved itself in 1990.
- In December **1990, Lech Walesa, the Solidarity leader**, was elected President of Poland.
- Walesa's inauguration as President is considered to be the formal end of the Communist People's Republic of Poland and the beginning of the modern Republic of Poland under as a Western-style democracy.
- The Warsaw Pact was dissolved in July 1991 and the last Russian troops left Poland in 1993.

Reforms from 1989 to the Present

- **After 1989, four sets of reforms were carried out by the new authorities: in 1989, in 1999, in 2004 and in 2009.**
- **First**, the reforms of the Mazowiecki government in **1989** were led by a team of economists headed by Leszek Balcerowicz. These “**shock therapy**” reforms set the Polish economy on the transition path from a centrally planned to a market economy.
- These reforms included macroeconomic stabilization, price liberalization and import liberalization. They also included the privatization of small/medium enterprises and also facilitated the establishment and operations of enterprises, unleashing the entrepreneurship and creativity of new small and medium private firms.
- They forced many managers of state-owned enterprises to face “Hard Budgets” and to engage in “deep restructuring” to survive, i.e. to alter the production process, to change the mix of the firm’s output, to engage in marketing and to shed unproductive labor.
- These positive effects of the reforms on firm behavior were the main drivers for the positive growth that the Polish economy exhibited since 1992.

Reforms from 1989 to the Present

- However, the agricultural sector remained handicapped by structural problems, surplus labor, inefficient small farms, and a lack of investment.
- The **second “big bang”** block of reforms was implemented in **1999**, when reforms of public administration, pension plan, health system, and education were enacted. These second phase reforms aimed at improving institutions, which still retained communism features and were not conducive to improve efficiency. These reforms however resulted in substantial pressures on government finances.
- The **third** block of reforms are those taken in the run up to EU accession, around **2004**. They included reforms to improve the functioning of the financial/banking sector, privatization, reforms of labor market, reform of the corporate and personal income tax system, and improved legislation regarding the health and the pensions reforms, with a view to modernized their finance.
- The **fourth** set of reform followed the financial crisis of 2009

1. The Initial 1989 “Shock Therapy” Reform Program

The 1989 program had three elements: (1) Monetary/price stabilization; (2) Structural adjustment; and (3) Foreign economic assistance and reduction of foreign debt.

1. Monetary and Price Stabilization

The five elements of the stabilization program were as follows:

- A **first** element of the stabilization strategy was to balance the government **fiscal budget**. The principal tool to control the deficit was a deep cut in subsidies to State Enterprises which fell from 15% of GDP in 1989 to 6% in 1990. It also allowed State Enterprises to declare bankruptcy.
- **Second**, the Central Bank implemented a very **restrictive monetary policy**, limiting domestic credit expansion, cancelling preferential credits to state enterprises and forbidding the Central Bank from financing fiscal budget deficits.
- The **third** element of the program was **price liberalization**. By January 1990, all administrative price controls were removed with a few exceptions, allowing them to be dictated by the market instead of the Central Statistical Office.
- The **fourth** element of the stabilization program was the imposition of a unified **exchange rate**, which was based on the black market rate.
- The **fifth** element in the stabilization program was a **tax-based incomes policy**, which involved a tax surcharge on wages growing above a certain norm.

The Initial 1989 Reform Program: Structural Adjustment

2. Structural Adjustment

The main elements of the structural adjustment facilitated the growth of the private sector and exports.

- The **Act on New Rules of Taxation**, introduced common taxation for all companies and abolishing special taxes that could be applied by means of administrative decision.
- The **Act on Economic Activity of Investors**, allowed foreign companies and private people to invest in Poland and transfer their profits abroad.
- The **Act on Foreign Currencies**, abolished the state monopoly in international trade and introduced internal exchangeability of the zloty
- The **Act on Customs Law**, created a uniform customs rate for all companies.
- The **Act on Employment**, regulating the duties of unemployment agencies.
- **Act on Special Circumstances for Workers** protected workers of state firms from being fired in large numbers and guaranteeing unemployment grants and severance pay.
- **The privatization of retail and small shops** occurred rapidly. But the expansion of private sector employment was driven by new private firms entering the market. They were responsible for job creation in a large fashion with new private firms in the manufacturing sector in 1991 being responsible for 20 percent of job creation whilst their employment share was only 4 percent.
- **The Privatization of 512 large state enterprises was left for the future**, since it was felt that high inflation had wiped out most of the savings of domestic investors and selling the companies to foreigners was politically not feasible.

The Initial 1989 Reform Program: International Support

3. International Support

- The third pillar of the “big bang” reforms was support by the Bretton Woods institutions and by the governments of the OECD countries.
- This support had two pillars.
- First, both the **IMF and OECD governments provided USD 1 billion each** for a stabilization fund. Given the low level of foreign reserves, this stabilization fund was deemed necessary by the Polish government and the IMF to be able to defend the zloty against a speculative attack. With this large fund at its disposal the government was credible in its defense of the zloty and no speculative attack occurred. Thus the stabilization fund was never used.
- The second pillar was **the write-off of part of Poland’s external debt**. The Polish government asked the IMF to facilitate negotiations with the aim to cancel 50 percent of the debt given by official creditors. In March 1991 a deal was struck between the Polish government and its official creditors to write off 50 percent of USD 30 billion. A similar deal was struck later with the commercial creditors of Poland’s remaining external debt of USD13 billion. **These write-offs were of vital importance for the budget**, since the resulting interest payments could be paid without driving the government deficit out of control. **An additional USD 500 million structural adjustment loan provided by the World Bank was an important financial source for improvements in the infrastructure of state administration.**

Results of the Initial 1989 Reform Program

- The reforms drastically limited the state's influence over the economy.
- In the short term, the reforms **contained hyperinflation** (but continued at high but declining rates for several years), ended food shortages, restored goods on the shelves of shops and halved the absence of employees in the work place.
- However, the reforms also caused many **state companies to close at once**, leaving their workers unemployed and generating a decline in GDP. Government statistics show that unemployment rose from 0.3% to 6.5% during 1990. The shrinking in the GDP was 9.8% in the first year and 7.0% in the second year.
- **In the long term**, the reforms paved the way for economic recovery, with the GDP growing steadily to about 6%–7% between 1995–7, falling to a low of 1.2% in 2001 before rising back up to the 6%–7% region by 2007. Growth was led by small and medium businesses which had been suppressed by the Communist government.
- **However, despite GDP indicating prosperity for Poland, the unemployment rate continued to rise steadily**, peaking at 16.9% in July 1994 before falling down to a low of 9.5% in August 1998 and rising again to 20.7% in 2003.
- During the early years, the unemployment rate is believed to have been lower due to fact that many of those claiming unemployment were in fact working in the grey (informal) economy, although this can account for no more than 5% of the unemployment rate.

Results of the Initial 1989 Reforms

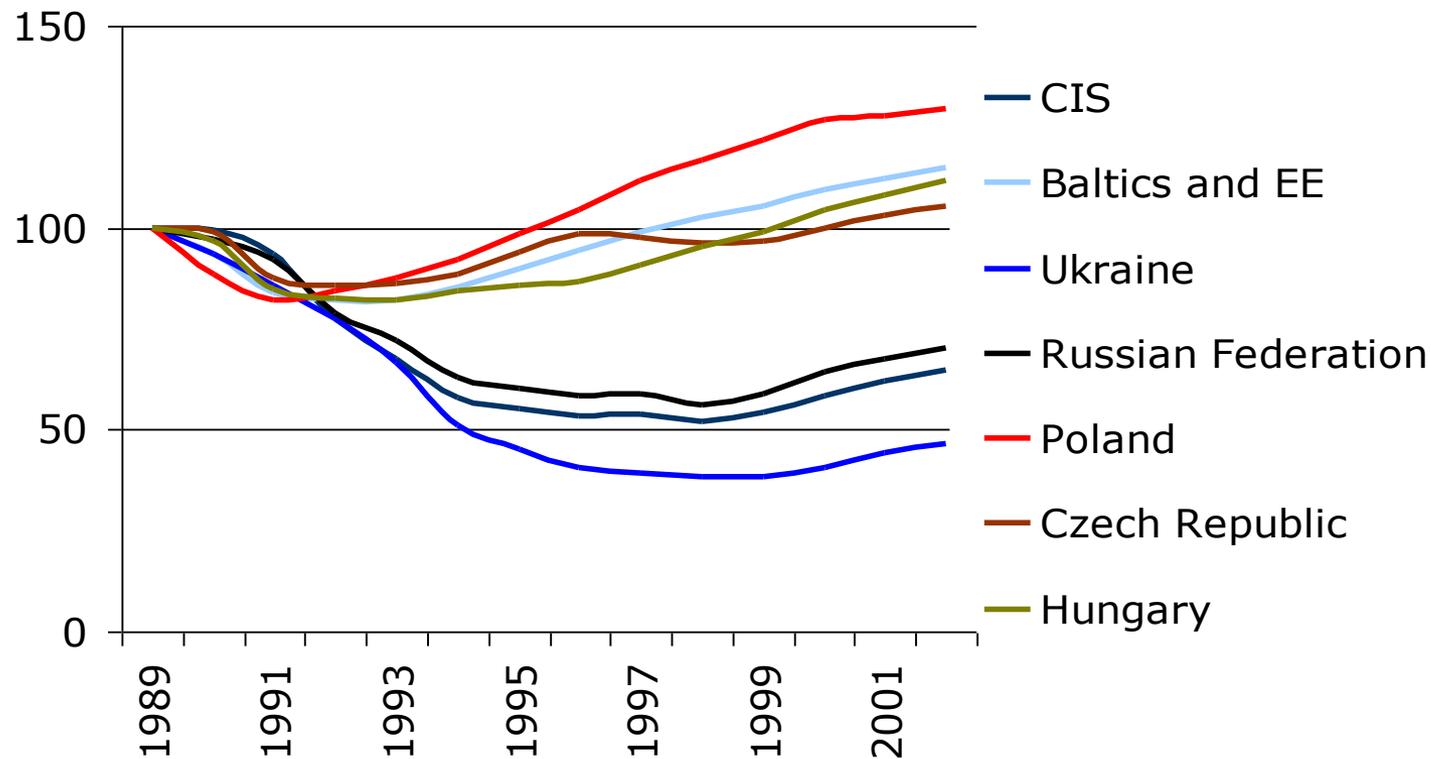
- **By 1992, more than 600,000 new private companies had been set up,** principally small shops, providing jobs for approximately 1.5 million people.
- The long-term results of shock therapy point to a rise in living standards. Ownership of consumables (cars, TVs, washing machines, refrigerators, computers, etc.) boomed, as did consumption of fruit, vegetables and meat.
- The reforms were successfully implemented in the years 1990 and 1991 in spite of pressures from workers and firms demanding that some of the stringent conditions of the reform policies be relaxed.
- But since these reforms **had produced visible benefits to the Polish population in the form of rising GDP and incomes and reducing inflation** in a relatively short period of time, a majority of voters found that economic reforms had improved their lives and thus were willing to let the government pursue further reforms.
- This support facilitated the implementation of the **second set of reforms at the end of the nineties**, namely the reforms of public administration, and the health, pension and educational systems.

Dynamics of GDP (according to PPP in USD) in selected countries

<u>Year</u>	<u>Poland</u>	<u>Hungary</u>	<u>Czech</u>	<u>Russia</u>	<u>Ukraine</u>	<u>Belarus</u>	<u>Finland</u>
1990	-9,68%	-6,67%	-1,20%	-3,00%	-3,60%	-1,90%	+0,01%
1991	-7,02%	-11,90%	-11,61%	-5,00%	-8,70%	-1,40%	-6,39%
1992	+2,51%	-3,06%	-0,51%	-14,50%	-9,90%	-9,60%	-3,81%
1993	+3,74%	-0,58%	+0,06%	-8,70%	-14,20%	-7,60%	-1,24%
1994	+5,29%	+2,95%	+2,22%	-12,70%	-22,90%	-11,70%	+3,94%
1995	+6,95%	+1,49%	+5,94%	-4,10%	-12,20%	-10,40%	+3,45%
1996	+6,00%	+1,32%	+4,16%	-3,60%	-10,00%	+2,80%	+3,79%
90-96	+6,61%	-16,11%	-1,94%	-41,94%	-58,55%	-34,29%	-0,75%

GDP Growth Rates

Depth of the transition recession

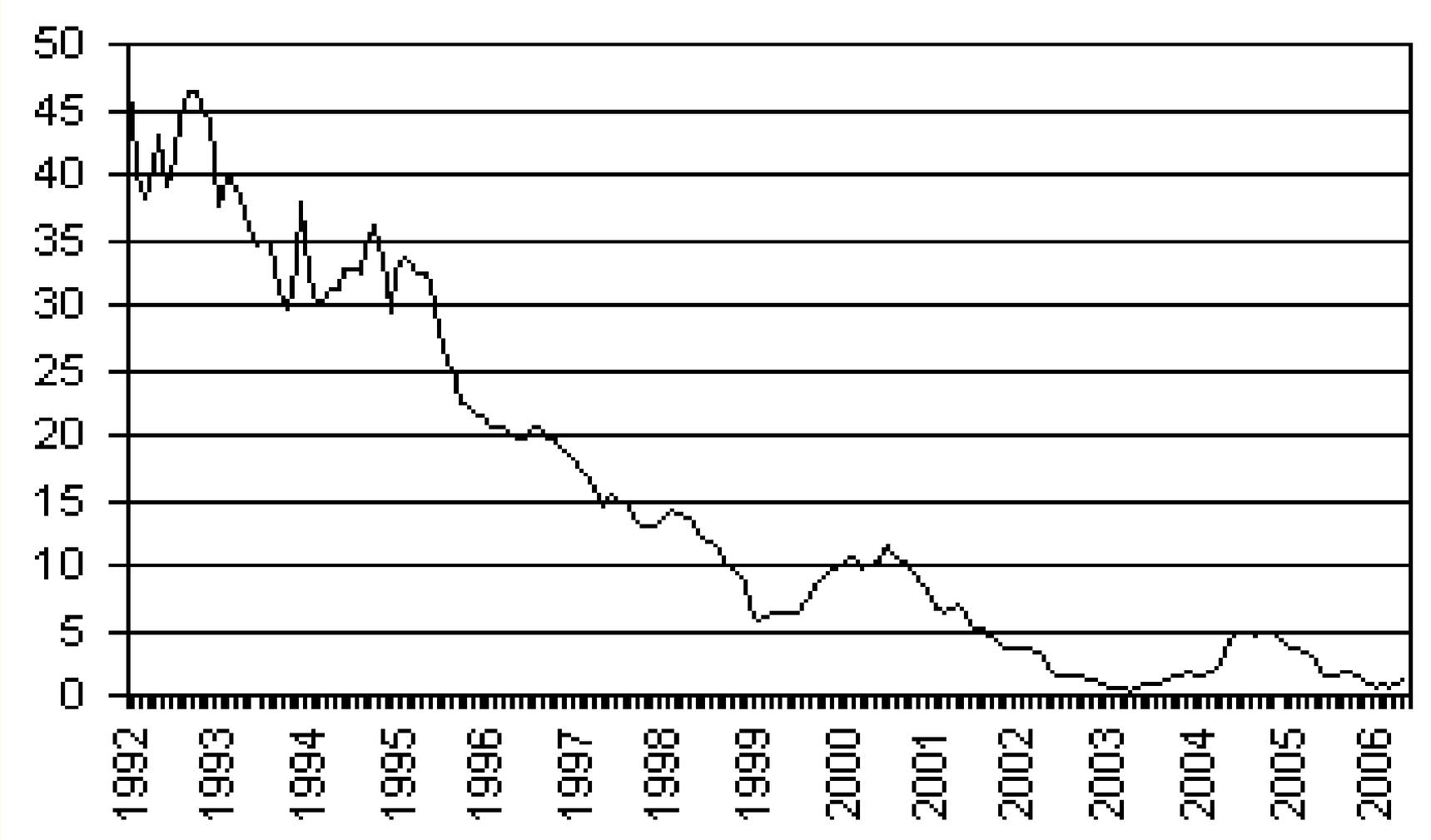


Inflation at the end of year in selected countries

<u>Year</u>	<u>Poland</u>	<u>Czech</u>	<u>Slovakia</u>	<u>Hungary</u>	<u>Bulgaria</u>	<u>Romania</u>
1989	640,0%	1,5%	1,5%	18,9%	10,0%	0,6%
1990	249,0%	18,4%	18,4%	33,4%	72,5%	37,6%
1991	60,4%	52,0%	58,3%	32,2%	339,0%	222,8%
1992	44,3%	12,7%	9,2%	21,6%	79,0%	199,2%
1993	37,6%	18,2%	24,8%	21,1%	64,0%	295,5%

Note: Poland's inflation in 1988 was 250% pa. It went down to 16% by 1996.

Polish Inflation



Unemployment rate in selected countries

<u>Year</u>	<u>Poland</u>	<u>Hungary</u>	<u>Czech</u>	<u>Slovakia</u>	<u>Bulgaria</u>	<u>Finland</u>
1991	12,2%	6,1%	3,8%	9,6%	8,5%	6,6%
1992	14,3%	11,8%	2,6%	10,6%	14,3%	11,7%
1993	16,4%	12,9%	3,2%	13,9%	15,7%	16,3%
1994	16,0%	10,9%	3,2%	14,5%	13,4%	16,6%
1995	14,9%	10,9%	3,1%	14,8%	14,1%	15,4%

Unemployment Rates

Unemployment rate in Poland, EU28 and the Eurozone 1997-2014



Source: Eurostat

Criticisms about Shock Therapy

Discussions have exaggerated the possible role of shock therapy or gradualism as a cause of recession – either way.

The shock of **raising prices to market clearing levels** at the outset was absolutely essential – even to make the old system work.

Many other things also had to be **done instantaneously**: legalising private property and enterprise, giving free access to foreign trade to all agents, eliminating quantitative trade restrictions, unifying exchange rates and allowing current account convertibility. All these changes can and should be done at a stroke.

Many other changes take time and must be allowed all the time they need: introducing legislation, establishing jurisprudence, setting up financial markets, establishing reputation and trust. It is pointless, indeed counter-productive, to pretend otherwise.

A choice between “shock therapy” or “gradualism” exists only in a handful of areas:

- (1) trade liberalization,
- (2) the elimination of subsidies,
- (3) privatization,
- (4) capital account convertibility and, especially,
- (5) dis-inflation.

Key success factors

- Shock therapy + strong personality of the leader (Balcerowicz).
- Social support including the 'Solidarity factor'.
- Shock therapy vs. gradualism. In Poland – deep macroeconomic imbalances called for a radical approach. In general terms, the choice of transformation strategy should take into account the initial conditions including the command economy legacy.
- Sequencing of the reforms – depends on initial conditions. However, complexity is required to create the ‘critical mass’ of the reforms and make them irreversible. If, like in Poland, deep macroeconomic disequilibrium is pervasive, the shock therapy is advisable while institutional reforms make take more evolutionary course (nevertheless, they should be implemented in full complexity to ensure positive synergy).
- The role of the ‘EU factor’ or “external anchor” – crucial at later stages of transition.
- Relative openness of the country since 1956 – exposure to Western culture and ideas, with most universities offering market-oriented economic studies.
- Communist government decision in 1970 to open the borders - primitive accumulation of capital (including human) - explosion of small private entrepreneurship since 1989.
- Relevance of historical traditions. Hence, the design of transformation strategy and accompanying economic policies should be compatible with national ‘identity’.
- Consistent economic policy after 1989 despite changing governments.
- Selected pre-war institutions (e.g. Commercial Code, universities) on place.

2. Reforms of 1998: Administrative Reform

- **Decentralization** was the key feature of the Polish PA reform of 1999.
- The major problems that triggered Polish PA reform were the following:
 - highly **centralized decision-making** with direct central government participation in decisions on a variety of local level issues,
 - the **central administration was also involved in the control** of “decentralized” local entities through a broad range of regulations,
 - a highly centralized system of **public finance** that envisaged financing of all budget-funded entities out of state budget;
 - **unclear delineation of responsibilities** between different levels of government; with conflicting priorities of state and local authorities;
 - low **public participation in the process of policy** formulation;
 - low **accountability** of public administration to the public;
 - huge **network of public administration bodies** that sometimes contradicted the principles of territorial differentiation;
 - **weak delivery of public services.**

2.....Poland Administrative Reform

- **The major public administration reform of 1999 made the central ministries responsible only for policy and strategy, with decentralization of service delivery to territorial self-governments** (the Act on Branches of the Government Administration of 1999).
- Functional and operational reviews eliminated complicated administrative regulations and procedures at various levels of government.
- They also reformed the system of **public finances**, with local governments receiving own-source revenues, shared taxes and general transfers from the center.
- The monolithic structure of the state administration was replaced by a decentralized model that **clearly separated** local/regional affairs from national affairs of “countrywide character”.
- The main principle of decentralization was that the resolution of all social problems should be done by **committees of local communities** based on territorial, cultural and economic ties.
- The central government intervened in situations when the problem could not be solved in the community, due to the problem of scale or problem of coordination with other communities.

2.....Poland Administrative Reform

- In the 1990's, about 100,000 central staff were fully transferred to local governments. Nevertheless, the **central government still retained** some authority over these staff, including appointment rules.
- The outcome of decentralization was a public administration that looks like a classical pyramid: **the basic tiers** are in charge of everyday matters focusing their activity on the delivery of basic social services to the public; and **the top tiers** of administration were concentrated on policy, strategic, and general problems of the country's development.
- **Local affairs with their local budgets based on independent revenue generation** were entrusted to 2,500 **municipalities** ("Gminas"), the basic and the most important level of public administration.
- It was here that the most important collective needs of local communities were met: they are responsible for local transportation, social welfare, water and sewerage, public health, nurseries, sports, primary education, libraries and culture, housing, parks, fire protection, etc.

2.....Poland Administrative Reform

- 370 **Provincial governments** (Powiats) are responsible for secondary education and other services that extend beyond the municipality borders.
- 16 **Regions** (Wojewodztwa) are in charge of Regional affairs. They are the largest administrative unit at the sub-national level. The Executive bodies of the Regions are responsible for university education, major hospitals, regional roads, maintaining public order and environmental protection within their jurisdiction.
- The Provinces and Regions have independent budgets & revenue sources.
- Administrative units at all levels are run by democratically elected officials & councils which established management boards with executive powers.
- The **Central government** retained responsibilities to decide on national policy and strategic matters.
- Decentralization has moved ahead, **but checks have been put in place:** fiscal budget decentralization is considerable, but program standards place restrictions on how the money is spent; staff have been devolved, but the interests of unions have been preserved through appointment rules. **Some of these restrictions have created political tensions between govt. levels.**

2. Reforms of 1998: Health Care Reform

- This reform covered three aspects.
- The first aspect is related to **financing methods**. Along the line of German insurance agencies, **regional health insurance companies** were set up and financed from a national health insurance surcharge. These health insurance companies then **bought health services from doctors and hospitals**. In addition, some financing for health services was provided by the state for highly specialized treatment. Another source of financing the reform foresaw private payment by patients for services not covered in the list of health insurance companies.
- The second aspect concerned the further **decentralization of health administration** having the decision making located at the province (powiat) level and not at the regional level (województwo level) as it was before.

2.Reforms of 1998: Health Care Reform

- The intention of this decentralization was to bring health services closer to society since persons living in a province could now vote for the local authorities responsible for the decisions made about their health services.
- **The third leg was the independence of all health care providers.** This independence was particularly relevant in financial terms as the health providers could decide autonomously about their budgets and received legal status that made them independent from the regulations of budgetary law.
- The health care reform thus had good modernizing intentions trying to **set the financing on a sounder footing, giving more autonomy to health care providers and increasing the involvement of local citizens in the running of the system.**

2. Reforms of 1998: Pension Reform

- The traditionally pay-as-you-go pension system was unsustainable.
- The new system was conceived as a **multi-pillar system**. The **first pillar** was still based on the pay-as-you-go principle, while the **second pillar** was funded through investments. Both these pillars were mandatory for workers born in 1949 or later. **The third funded pillar was voluntary.**
- The two mandatory pillars were based on the defined contribution principle, with benefits linked to accumulated lifetime contributions and returns based on financial returns (second funded pillar) or the growth of the wage bill (first pillar).
- From the individual future pensioner's point of view the pension reform achieved two aims: **first** it provided actuarially fair pension benefits since benefits were linked to an individual's contribution. **Second** it diversified risk since the first pillar was tied to developments in the labor market while the second & third pillars are tied to capital markets.

3. Reforms of 2004 for EU accession

- The **third** block of reforms undertaken by Poland since 1989 are those taken in the run up to EU accession, around **2004**.
- They included reforms to improve the functioning of the financial/banking sector, privatization of state enterprises, reforms of labor market, reform of the corporate and personal income tax system, and improved legislation regarding the health and the pensions reforms, with a view to modernized their finance.
- **Banking Sector Reform:** The entrance of Poland to the EU meant that Poland became a part of the single European banking system and branches of a any EU credit institution could start operations in the Polish banking sector without requesting additional authorization from the Polish Financial Supervisory Authority. For this purpose, banking regulations were strengthened. These more stringent regulations led to a large consolidation and restructuring of banks.

3..... Reforms of 2004 for EU accession

- **Privatization of State Enterprises:** After years of inaction, in 2004, the government downsized its portfolio by outright sales, divestment of government shares in viable enterprises and liquidation of some unviable firms. Nevertheless, the government still retained ownership of a number of state enterprises.
- **Labor Market Reform:** By 2002, unemployment was still high at 20%, caused principally by “structural factors”. These include **labor market rigidities** such as “**high labor taxes**, a regionally non-differentiated **minimum wages**, regulatory obstacles to the renewal of fixed-term contracts, and mismatches between skills offered and required”. In 2003 the government enacted labor legislation to address these issues, **liberalizing the labor markets**.
- **Income Tax Reform:** Included the introduction of **a single-rate for personal and corporate income**. The simplification of the tax system reduced distortions and lowered compliance costs.
- **Health and Pension Finance:** Included the partial commercialization of the health care system and the streamlining of the pension system by eliminating **some early retirement options**.

4. Reforms since the 2009 Financial Crises

- Since the global recession of 2009, Poland's GDP continued to grow.
- In 2009, at the high point of the crisis, the GDP for the European Union as a whole dropped by 4.5% while Polish GDP increased by 1.6%.
- As of November 2013, the size of EU's economy remains below the pre-crisis level, while Poland's economy increased by a cumulative 16%.
- The major reasons for its success appear to be a business friendly investment climate supported by the economic reforms implemented after the fall of communism
- A large internal market (in terms of population is sixth in EU) also played a role.
- Between 1989 and 2007 Poland's economy grew by 177%, faster than other countries in Eastern and Central Europe.
- Another factor which allowed the Polish economy to avoid the financial crisis was its low level of public debt, at about 50% of GDP, below the EU average (around 90%).
- Strict financial regulation also helped to keep household and corporate debt low.
- Furthermore, unlike many other European countries, Poland did not implement austerity in 2009, but rather boosted domestic demand through a policy of tax cuts, and foreign-assistance which funded public spending.
- An additional reason for its success lay in the fact that Poland is outside the Euro zone. The depreciation of the currency, the złoty, increased international competitiveness and boosted the value of Poland's exports (in złotys).

...The Economy since the 2009 Financial Crises

Although Poland has done well with a GDP growth rate of 4% since joining the EU in 2004, there are still some pending reforms, principally due to the recent loss of the Russian market due to the invasion of Russia to Ukraine.

According to a recent OECD report, the country ought to raise productivity by (1) liberalizing the labor market, (2) privatizing state-owned enterprises, (3) cutting red tape, and (4) making agriculture competitive.

- (1) Despite progress, participation in the labor market remains limited. This problem will deepen as the working-age population shrinks. Poland's birth rate is low and emigration, especially of the young and skilled, remains high. The OECD recommends that men and women should retire at the same age and that Poland should raise the pension age to 67 by 2030 rather than by 2040, as planned. It could boost female employment by improving child care and care for the elderly. The jobseekers' allowance needs to become more conditional. A law that prevents firms laying off an employee in the last four years before retirement should go, as it discourages firms from hiring older people.

.... The Economy since the 2009 Financial Crises

- (2) State ownership remains a vestige of the communist regime. Several hundred largish companies are still in the hands of the state; the government has a tendency to declare them “strategic” when they are, in fact, just big. Poland’s largest bank, PKO Bank Polski, is state-owned as is KGHM Polska Miedz, a mining firm, several chemical producers, as well as LOT, the national airline.
- (3) Red Tape. Public procurement works poorly, partly because of Poland’s history of corruption. Civil servants have become so fearful of being thought biased that in a public tender they almost always choose the lowest bidder. “That works for an order of 100,000 pencils, but not for motorways, where they should opt for the best value for money,” says an analyst. Bureaucracy remains a scourge—which explains why Poland ranks 45th, behind countries such as Colombia and Montenegro, in the World Bank’s ease-of-doing-business index.

.... The Economy since the 2009 Financial Crises

- (4) Agriculture is subsidized and hence too big. Measures to improve agricultural efficiency need to be implemented. KRUS, the farmers' national-insurance system, is a burden on the state and needs reform. But it will be unpopular. As with other unpopular reforms, it is unlikely to happen soon.
- In Summary, while the Polish economy's fundamentals are still good, the country's poor demography will soon bite.
- Even today some employers cannot find the workers they are looking for. Before the financial crisis struck, Ireland managed to lure back talented émigrés. Poland should be aiming to do the same.

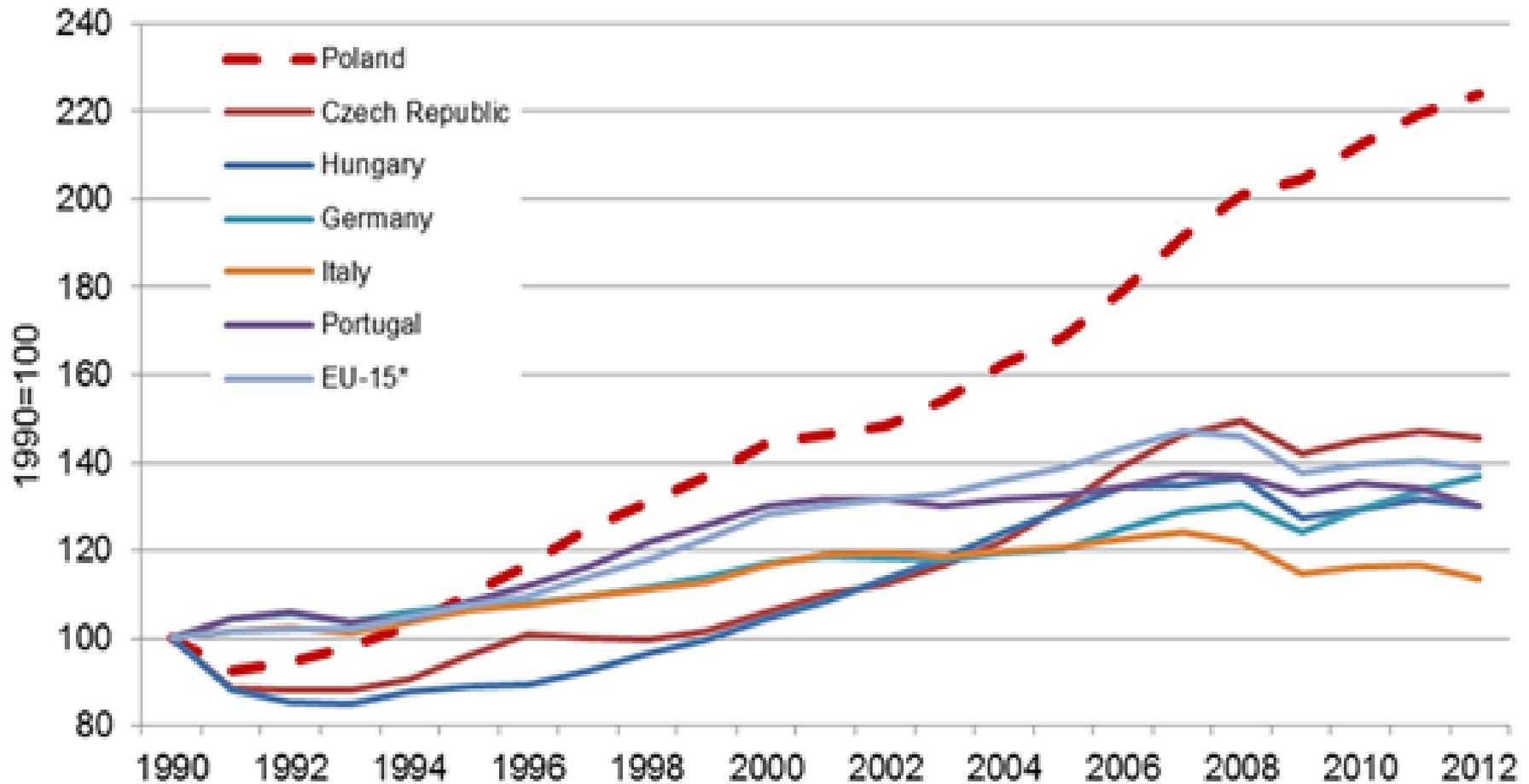
How to measure the success of economic transformation?

Poland:

- Average salary: \$20 in 1989, \$100 in 1990, \$1000 in 2009, \$1200 in 2015
- Unemployment rate: 12% in 1991, 15% in 1995; 9.8% in 2015
- GDP growth rate: 3.5%pa in 1995-2015 one of the highest in the EU (GDP growth rate about 2 times EU average)

probably the only EU member country to experience GDP growth in the 2009 financial crises, estimated at 1.2%

Change in GDP per capita (1990 = 100)



The Old Town during the World War II



Old Town rebuilt after the war



The Royal Castle square in Warsaw



Modern Warsaw

