World Bank Group – Poland Partnership Program Snapshot

April 2015

WORLD BANK GROUP

RECENT ECONOMIC AND SECTORAL DEVELOPMENTS

Recent Economic Developments and Outlook

Growth

Strong domestic demand, in particular a significant rebound in fixed investments, strengthened economic growth in Poland from 1.7 percent in 2012 to 3.3 percent in 2014. Domestic demand became the main driver of growth amid slowing export activity, which was related to the lackluster recovery in the Eurozone combined with the impact of rising geopolitical tensions, sanctions, and the slowdown in Russia's economy. Investment rebounded strongly amid favorable financing conditions and improved business confidence, while private consumption benefited from significant improvements in employment and real wages. On the production side, the services sector—in particular, retail trade, transport, and financial services—grew strongly, reflecting a robust rebound of private consumption.

Resilient domestic demand within a challenging external environment will stabilize economic growth slightly above 3 percent per year over the medium term. GDP is expected to grow by 3.2 percent in 2015 and 3.3 percent in 2016. Domestic demand is expected to remain the main driver of growth, backed by strong consumption and investment growth. Private consumption growth is forecasted to reach 3.1 percent on the back of strong employment growth, leading to a reduction in the unemployment rate. In addition, the scaling up of some social expenditures—notably, an increase in the child tax credit for families and the pensions indexation—will further support the growth of real household incomes. Investment will also benefit from the rollout of new projects financed by European Union (EU) Structural Funds and the ongoing recovery of credit growth to enterprises. The recent upgrade of the outlook in Germany as well as low oil prices should be conducive to economic growth going forward; however, heightened risks in the Eurozone and the recent escalation of tensions between Russia and Ukraine raise uncertainty, which could dampen consumer confidence and private sector investment.

Risks to the macroeconomic outlook remain balanced. Downside risks include further instability in the Eurozone, protracted low growth among Poland's main trading partners, an upsurge in financial market volatility as the U.S. Federal Reserve and the European Central Bank (ECB) implement divergent monetary policies, and geopolitical tensions related to Russia and Ukraine. Poland also remains vulnerable to external debt deleveraging through parent bank funding of local subsidiaries, which may slow credit growth. The recent appreciation of the Swiss franc (CHF) may dampen private consumption of households with CHF-denominated or linked mortgages and affect some banks with large CHF exposure. Domestically, the risk of continued deflation remains elevated. On the upside, lower oil prices should support an increase in consumption, as Poland is a large net importer; however, given Poland's high reliance on coal, the impact is likely to be modest. Better growth performance in the Eurozone, triggered by the quantitative easing of the ECB and the launch of the so-called Juncker Plan, and the depreciation of the Polish zloty (PLN) may also increase Poland's growth prospects.

Shared Prosperity and Poverty

Poland's transition since the 1990s is widely seen as very successful. Since 1989, Poland has become the European growth champion, more than doubling its GDP per capita in that period. Its economy is modern, diversified, centered on industry and services (around 30 and 65 percent of GDP, respectively), and deeply integrated into the EU, especially within German supply chains. In 2009, Poland was the only EU country to avoid a recession (thanks to the size of its domestic economy, a floating exchange rate regime, limited imbalances at the onset of the crisis, and a fiscal stimulus in part financed through EU Structural Funds). In spite of the Eurozone turbulences, economic growth has remained solid by EU standards since 2010. In 2015, GDP growth is projected to exceed 3 percent, and living standards are gradually converging to EU averages.

This fast growth has also translated into significant progress for the lowest-earning 40 percent of the population. During 2005–11, the share of the population with incomes below the US$5 per day threshold decreased from 14.8 percent to 4.9 percent (extreme poverty, defined as income per capita below US$1.25 per day, was below 0.3 percent of the population in 2011). At the same time, the lowest-earning 40 percent of the population saw their incomes grow during 2006-11 relative to both the mean growth rate and most other countries in the region. Yet, the at-risk-of-poverty rate remains high, particularly among the unemployed and the inactive, as well as among youth, families with several children, and households in small towns and rural areas. There is also a relatively large cohort of the working poor; at 10.7 percent in 2013, the at-risk-of-poverty rate among employed people is the fourth highest in the EU.

Despite this remarkable progress, Poland faces a number of challenges going forward. There remain significant disparities of income between Warsaw (by far the wealthiest part of the country), the western provinces (typically with strong entrepreneurship and better infrastructure), and the eastern provinces (relatively backward and poorer). Youth unemployment remained high at 22 percent in the fourth quarter of 2014. The labor force participation rate for the 15–64 age group is below the EU average (67 percent in 2013). There are also persistent, although declining, gender gaps in labor force participation (60 percent for women vs. 74 percent for men) and earnings. While the gender pay gap for full-time workers fell from 15.2 percent in 2007 to 6.2 percent in 2013, the pay gap for part-time employment increased from 9.2 percent to 13.5 percent during the same period. The country is also rapidly aging; the share of the population over 65 is projected to increase from 13 percent in 2010 to 23 percent in 2030, while the fertility rate stands at 1.3.

Inflation

Despite the solid pace of economic activity, inflation has decelerated sharply over the past two years. Inflation remains well below the National Bank of Poland's (NBP) 1.5–3.5 percent target range, affected by strong declines in food and energy prices. The headline inflation rate has been negative since July 2014, and prices fell 1 percent in December 2014 compared to one year earlier. This reflected a combination of factors, predominantly low imported inflation from the Eurozone trading partners and declining global food and energy prices. Twelve-month core inflation stood at 0.5 percent in December 2014, while inflation expectations for the next 12 months hovered around 0.2 percent.

The NBP's Monetary Policy Council (MPC) resumed its easing cycle in late 2014. In October 2014, the MPC reduced its key interest rate by 50 basis points (bps) on the back of low domestic inflation and an expected slowdown in Poland's growth. An additional cut of 50 bps was delivered in March 2015 as an adjustment of the exceptionally high real rates in Poland to the new environment set by the January ECB decision to scale up its quantitative easing.

Declining prices in the Eurozone will continue to weigh on price movements, which together with low energy and food prices are damping prospects for inflation. Inflation is expected to reach the lower bank of the NBP's tolerance band in the second half of 2017.

Trade and Capital Flows

The current account deficit has narrowed, and the external position is consistent with medium-term fundamentals. Strong exports to the EU, combined with EU Structural Funds and moderate import growth, have helped reduce external imbalances. The current account deficit narrowed to 1.3 percent of GDP in 2013 from a deficit of over 5 percent of GDP in 2010–11. Preliminary data for 2014 point to a further moderation in the current account deficit to some 1.2 percent of GDP. The improvement stemmed from strong export growth, especially to traditional trade partners from the EU: Germany, the Czech Republic, and Italy. Net foreign direct investment (FDI) inflows remained subdued, reflecting the prolonged period of low investment in Europe, and the current account deficit was largely financed from EU Structural Funds. External debt stabilized at around 70 percent of GDP, over 10 percentage points higher than in the pre-crisis period, largely reflecting increased government indebtedness. The share of short-term debt in total external debt remains broadly stable at around 20 percent, while the ratio of short-term debt to official reserves stood at 70 percent. International reserves account for the equivalent of 5.3 months of imports of goods and services.

Over the medium term, the current account deficit is expected to stay below 3 percent of GDP as exports and imports pick up modestly, in line with the gradual recovery. The current account deficit is projected to be financed mostly by FDI inflows and EU transfers. External debt peaked at around 73 percent of GDP in 2012 before falling below 70 percent in 2015 and declining over the medium term.

Fiscal Performance

Fiscal consolidation has continued at a reasonable pace. The fiscal deficit narrowed to some 3.2 percent of GDP in 2014 from 4 percent in 2013. The good fiscal performance stemmed from shorter-than-expected revenue collection, as recovering domestic demand pushed up the value added tax (VAT). In addition, changes to the second pillar pension have effectively reduced the government's social contributions. Expenditures are also expected to have turned out lower than in 2013, in particular due to the limited growth of public investments because of the transition to the next EU perspective, the continued freeze on public sector wage levels, and some savings on interest payments. The public debt stock declined to 48.8 percent of GDP in 2014 from 55.7 percent in 2013, after the reform of the second pillar pension reduced the debt stock by some 8.5 percent of GDP as government bonds were returned to the government balance sheet.

Continued fiscal consolidation will allow Poland to exit from the EU's Excessive Deficit Procedure (EDP) in 2016. The consolidated general government deficit is set to decline to an estimated 2.8 percent of GDP in 2015, in line with the European Commission's (EC) deadline for reducing the fiscal deficit. The main adjustment comes from limiting aggregate expenditure for the general government in line with the recently introduced expenditure rule. The Government has taken discretionary measures to adjust the structure of public expenditures within the binding expenditure limit by continuing the freeze on public sector wages, the abolishing early retirement schemes, increasing the retirement age, and streamlining administrative costs.

These saving measures have created fiscal space for increasing spending on selected social programs. Programs include the extension of maternity leave, more generous pension indexation, and the expansion of child tax credits. On the revenue side, the main adjustment comes from reducing the transfers to the second pillar pension funds, freezing personal income tax (PIT) thresholds, and abolishing various forms of tax relief, as well as instituting measures to increase tax compliance and the effectiveness of tax administration. The introduction of the child tax credit will reduce PIT revenues, but the loss will be fully compensated for by the aforementioned revenue-raising measures.

The public debt-to-GDP ratio is expected to remain below 50 percent of GDP over the forecast horizon. Changes to the pension system, associated with a transfer of pension fund assets to the government, and the change in the European System of Accounts? (ESA) methodology resulted in a reduction of the debt-to-GDP ratio from 55.7 percent of GDP in 2013 to an estimated 48.8 percent in 2014. Continued fiscal consolidation and a favorable differential between projected GDP and the real interest rate will help keep public debt at levels close to 50 percent of GDP over the horizon period. This would ensure that public debt remains below the Maastricht ceiling of 60 percent of GDP and key national debt thresholds, as calculated according to the national methodology. The public debt sustainability analysis suggests that the debt path is highly sensitive to a growth shock, but it is not expected to put the level of public debt above the threshold of 60 percent of GDP.

Financial Sector

The banking sector is well capitalized, liquid, and profitable, with stable credit growth. Capital adequacy is strong (at 15.4 percent in September 2014, 90 percent of which is Core Tier 1 capital) and liquidity is high. In 2014, the net profit of the banking sector exceeded PLN 16.2 billion (US$4.2 billion), a historical record. The deleveraging of Eurozone banks has stabilized and the fall in foreign funding was offset by rising domestic deposits. Private sector credit grew by 7 percent in 2014, including a welcome pickup in credit to the corporate sector.

Selected Sectoral Policies for Economic Growth

Poland's challenge is two-fold. In the short term, Poland ought to further mitigate the impact of a difficult external environment and support a rapid recovery of economic activity. Beyond this horizon, Poland needs to avoid a decline in its long-term growth potential as a result of both the aging of society and the diminishing returns of its current "catching up" growth model. This will require action on a multiplicity of fronts, including but not limited to: mitigating the effects of the aging process, enhancing the business environment, increasing innovativeness, and further strengthening public finances.

Business Environment

Substantial efforts are under way to improve the country's business environment. Poland has made the largest progress in *Doing Business* (DB) reforms among the EU and Organisation for Economic Co-operation and Development (OECD) countries since 2005. It is ranked 32nd worldwide in *Doing Business* 2015, above the EU28 average and ahead of all new EU member states in Central Europe. Based on the strengths of the most recent reforms, it may advance to the top 30 in *Doing Business* 2016. However, the business climate still has weaknesses, including in starting a business, dealing with construction permits, and paying taxes. These are priority areas for government action in the coming year. The World Bank has provided technical advice to the insolvency law, streamline construction permits, and improve contract enforcement. The World Bank has also provided support to enhance financial reporting through advisory services financed by the Swiss Agency for Development and Cooperation (SDC).

Innovation

Poland's current growth model may be gradually approaching its limit. Over the past two decades, Poland's growth has been driven by simple "post-transition" reserves in terms of productivity growth and capital accumulation. Yet, as income per capita increases, Poland will need to further move up the value chain and achieve productivity gains through innovation and additional structural reforms. Poland remains one of the least innovative economies in the OECD according to the rankings and still needs to make efforts to best equip its workers for the needs of a modern economy. In 2014, total research and development (R&D) spending amounted to 0.9 percent of GDP, below most peers and below the EU average of 2 percent of GDP. Increasing R&D spending will require a combination of steps to foster more effective "ecosystems" for innovation (and in particular, links between research, entrepreneurs, and financiers) to strengthen public support for innovation; enhance the quality and relevance of general, vocational, and higher education; and further develop skills and entrepreneurship.

More than €10 billion will be made available to support private sector–led innovation under the new 2014–20 EU financial perspective. Both the national and subnational governments have developed "innovation and smart specialization strategies" to provide a framework for using these resources effectively. The World Bank Group has supported these efforts by carrying out a review of public support to the innovation system and helping develop innovation strategies at both the national and subnational levels. The World Bank Group continues to provide support to the Polish authorities to further increase the efficiency and effectiveness of the innovation system, including through a trailblazing project on engaging the private sector in innovation policy making as part of the entrepreneurial discovery process (EDP).

Poland is also stepping up its participation in the digital economy, in particular by expanding broadband access to isolated areas (possibly with the involvement of the private sector) and gradually moving toward e-government services. This is facilitated by the provision of large resources under the EU financial perspective. Yet, despite recent progress, access to the Internet is below the EU average and is of low speed. Hence, further improvement in building a modern information and communications technology (ICT) sector is indispensable to increasing competitiveness, economic growth, and job creation in Poland.

Effective Public Finance

The Government has taken significant steps to improve the public financial management system. In late 2009, the Parliament enacted the new *Public Finance Act*, which significantly strengthened the transparency and efficiency of the budgetary process in Poland. The new legislation introduced, among other measures, a medium-term fiscal framework and performance-based budgeting, enhanced debt safety procedures, strengthened control and internal budget audit, and increased budget transparency through the consolidation of some budgetary units and the establishment of a separate budget for EU funds. To accompany the ongoing fiscal consolidation effort, the Government carried out further reforms aimed at strengthening fiscal rules and institutions and improving the quality of expenditure and public sector effectiveness, including in the social sectors and health. The Bank has been actively engaged in this area through successive Development Policy Loan (DPL) series and technical assistance in the areas of spending reviews, management of a public sector wage bill, and local government fiscal management horizontal fiscal equalization transfers, in close cooperation with the EC and the International Monetary Fund (IMF).

Selected Sectoral Policies for Equity and Inclusion

Action in this area is critical to ensure that the lowest-earning 40 percent of the population can enjoy the full benefits of economic growth, including in terms of accessing economic opportunities as well as benefiting from efficient social services. This is a multitiered agenda, where specific support is needed for each of the various groups that altogether constitute the lowest-earning 40 percent of the population, in particular, the unemployed (inclusive and effective labor market), those living in lagging regions (balanced regional development), and the older/less healthy people (strengthened health care and health prevention in an aging society).

Labor Market

The labor market, which deteriorated in 2012–13 on the back of weaker economic growth, recovered in 2014. Unemployment fell 2 percentage points to 8.1 percent in the fourth quarter of 2014, and employment rates in the private sector grew by nearly 3 percent compared to the previous year, largely through temporary contracts. The number of vacancies also increased robustly (29 percent).

Beyond the short-term gains, however, a number of structural labor market issues remain that more active social policies could try to address. Increased participation in the labor market is critical to Poland's growth as well as for social inclusion, particularly among people over 50, the lower skilled, and beneficiaries of social assistance. The Government is making efforts to improve the employment rates of these groups through the introduction of a new suite of activation policies in labor offices, which will continue to need to support improved effectiveness. The ongoing deregulation of professions (supported by, among other actions, the Bank DPL) is also likely to provide increased employment opportunities for the medium- and high-skilled unemployed, including the youth. Lastly, the significant gap in employment conditions between those whose work is regulated by civil (freelance) contracts and those covered by better protected labor contracts is partially being addressed through aligning contributory obligations on civil contracts, though more could be done to reduce the cost of hiring workers on labor contracts. The Bank has provided input into the Government's thinking in these areas.

Regional Development

The process of national convergence within the EU has been accompanied by increased internal divergence among and within Poland's regions. Several of the country's 16 regions have made significant progress in terms of growth and living conditions, but five of them (those located in the eastern part of the country) have experienced a relative loss. These regions remain among the 20 poorest regions of the EU27. In addition, disparities within each region have been on the rise (typically with large cities faring relatively well and rural areas and small towns falling behind) and now rank among the highest in the OECD. Poverty and the risks of economic marginalization have a significant territorial component, due to accessibility constraints, the mixed quality of public services, and initial resource endowments. The challenge is to help people living in the poorest parts of the country escape a vicious cycle of impoverishment and low investment and private sector activity.

Significant EU resources are available in the current 2014–20 programming period to finance investments directly at the subnational level, where local governments have a solid track record for disbursing such funds (€31.28 billion will be invested at the regional level, which represents 40 percent of the total EU envelope for Poland).

The challenge is twofold: to maximize results (beyond disbursements), especially with regard to reducing the inequality of opportunities across and within regions, which stand in the way of creating shared prosperity; and to ensure the sustainability of these investments (in particular by strengthening local public finance to free up resources for cofinancing, operations, and maintenance). An additional objective for Poland is to leverage public resources by private contribution, primarily by developing public-private partnerships and raising the number of hybrid projects. Over the past years, the Bank has worked in close cooperation with the EC, providing a range of knowledge services and developing solid relationships with several key counterparts at both the national and subnational levels.

Aging and Health

In an aging society, the Government has engaged in several successive reforms of the pension system. The system, adopted in 1999, rested on a defined-contributions scheme based on a multi-pillar system: (i) a mandatory pay-as-you-go scheme based on notional defined contribution (NDC) accounts and run by the State Social Insurance Institution (ZUS) ("first pillar"); (ii) a mandatory, fully funded, and defined contribution scheme run by the Open Pension Funds (OFEs) ("second pillar"); and (iii) a voluntary private pension scheme ("third pillar"). In 2012, the pension age was raised to 67 (from 60 for women and 65 for men), and the mandatory length of service for "uniformed services" (military, border security, etc.) was increased from 15 to 25 years. In late 2013, the Government adopted a reform of the pension system, including: (i) the transfer of Government bonds held by OFEs to the ZUS and the banning of any further investment by OFEs in Government bonds; (ii) the introduction of a clause making contributions to the second pillar voluntary, with the default option being nonparticipation; and (iii) the transfer of OFE funds to the ZUS over a 10-year period ahead of a contributor's retirement. The changes have resulted in a significant downsizing of the second pillar in terms of both assets and participants.

The low level of replacement ratios and the subsequent impact on pension adequacy remain the central issue faced by the Polish pension system. The "dependency ratio" is projected to dramatically increase in the decades to come for demographic reasons. As a result, pensions could drop to as low as 30 percent of pre-retirement incomes, presenting the risk that a large share of the older population would fall into poverty (especially in the absence of strong family support networks). Measures are needed to ensure the adequacy and sustainability of pension benefits, such as: (i) aligning special pension systems to the general system (in terms of duration of contributions, retirement age, and levels of benefits); (ii) reviewing the disability systems (to cover only the disabled); (iii) considering a further increase in the retirement age as may be needed based on actuarial data; (iv) developing instruments to encourage voluntary long-term individual savings; and (v) ensuring that minimum pensions remain at or above subsistence level. The Bank has been engaged in analytical support of the Government's policy agenda related to aging through a regional aging project and the "Saving for Growth and Prosperous Aging" Country Economic Memorandum (CEM).

A growing elderly population is also associated with increased health care service utilization as well as with increased risks of old-age exclusion. Poland's objective in the health sector is to develop an effective care system that can deliver quality services and cope with demographic changes in a fiscally constrained environment. Achieving this will in particular require strengthening the spatial planning for health service delivery to account for the health needs of an aging population, streamlining hospital infrastructure, and developing less hospital-centric care practices. This will also include developing measures to limit the growth of long-term care needs by prevention and rehabilitation and by expanding the capacity of independent living. Significant reforms have already been implemented, in particular the transfer of responsibility for hospital management (and financial losses) to subnational governments, which heightens the pressures for consolidation and restructuring.

Selected Sectoral Policies for Climate Action

Poland's economy is among the least emissions efficient in the EU. The consumption of energy equal to one ton of oil equivalent generates 3.4 metric tons of CO_2 compared to an

EU average of 2.5. This largely reflects the dependence on coal, especially in the power sector; very high rates of emission growth in the transport sector; and an energy-efficiency performance that remains below EU averages. Action is needed in a number of areas related to climate-informed policy making, climate change adaptation, and climate change mitigation.

Climate Change Policy

The EU climate change and energy package, or the "20-20-20" targets, requires comprehensive action by EU members to achieve, by 2020, a 20 percent reduction of greenhouse gas (GHG) emissions below 1990 levels; a 20 percent level of EU energy consumption from renewable resources; and a 20 percent improvement in energy efficiency. The 20-20-20 package requires Poland's energy-intensive sectors to contribute to the EU-wide target while allowing the emissions from the country's other sectors to increase by no more than 14 percent compared to 2005. A World Bank study showed that the transition is expected to generate economic costs in output and employment until 2020 that are higher than the costs for the average EU country, but that the shift toward low emissions through better fuel efficiency, energy efficiency, and other measures would eventually boost Poland's economic growth in the long term.

In October 2014, the European Council adopted an ambitious climate policy framework, setting a target for the EU to reduce GHG emissions by 40 percent below 1990 emission levels by 2030. Some decisions on how to share the mitigation burden inside the EU are still to be negotiated between the EU member states and the EC. The 2030 target is in line with the Intergovernmental Panel on Climate Change's (IPCC) suggestion for developed countries to reduce GHG emissions by 80–95 percent below 1990 levels by 2050.

The Polish Government is keenly interested in developing a better understanding of the implications of energy and climate change policy decisions on the overall economy, especially with regard to the impact on growth prospects and relevant macroeconomic aggregates, so as to be able to analyze policy options and trade-offs. In recent years, the World Bank Group has carried out analytical work and provided technical assistance. The Bank has successfully supported the Polish Government by providing technical expertise and by building institutional capacity to develop a comprehensive modeling toolbox for energy and climate change policy analysis. The Bank stands ready to continue building analytical capacity for climate policy analysis inside the public administration structure, in particular in sectoral economic models for energy, transport, and agriculture.

Adaptation: Protection against Floods

Climate change is expected to heighten flood risks, to which large parts of the country are already exposed, especially in the basins of the two main rivers (the Odra and the Vistula). Effective protection requires a combination of infrastructure investments (e.g., dikes, reservoirs, etc.) and adequate arrangements for coordination among the various entities in charge of administering the river basins. The Government has developed a comprehensive program to enhance flood protection along the Upper Odra River (which was affected by a devastating flood in 1997) and is now preparing similar plans for the Lower Odra River and the Upper Vistula River. Over the last period, the Bank has supported these efforts by providing financing and technical leadership and by mobilizing other financiers (the EC and the Council of Europe Development Bank [CEB]) to implement the Odra River program.

Mitigation: Resource-Efficient Infrastructure

In close cooperation with the EC, Poland is making efforts to gradually strengthen its low carbon infrastructure systems, including for transport (railways, urban transport) and energy (energy efficiency, alternatives to coal). This is especially important in the context of a growing economy, with increasing trade with EU partners and a growing demand for mobility, including North-South and East-West transit. Yet, this has proven a challenging endeavor, and in several key sectors (railways, for example) the authorities are facing some difficulties in absorbing the corresponding EU funds. Over the last period, the World Bank focused on knowledge exchange and assistance in making urban transport an attractive alternative to individual car transport, and continued an ongoing dialogue and support to institutional reforms and government capacity to implement the multi-sectoral National Road Safety Program 2020.

POLITICAL DEVELOPMENTS

Poland has become a major actor within the EU. With a population of about 38.2 million and a GNI per capita of US$13,080 (2013, Atlas method), Poland has the largest economy in Central Europe. Since joining the EU in 2004, the country has made remarkable progress in catching up with the core of the EU in terms of economic development and living standards (GDP per capita in purchasing power standards [PPS] has risen from 51 percent to 68 percent of the EU average).

The year 2015 is a crucial one in Polish politics, as there will be two major elections, the presidential poll in May and the parliamentary election in October that will determine the shape of the political scene for several years. The coalition formed in late 2007 by the Civic Platform (PO) and the Polish Peasants Party (PSL) is expected to remain in power until the end of its second term in late 2015. Current opinion polls put the ruling Civic Platform led by Prime Minister and the leader of the party Ewa Kopacz in the lead, although the actual outcome of the October parliamentary election is yet to be seen. At the same time, the presidential campaign has already been launched, with President Bronislaw Komorowski leading in the polls. So far, 12 candidates have declared their intention to stand, including from the main opposition party Law and Justice (PiS) and the Democratic Left Alliance (SLD).

Poland and Development Cooperation

Poland is aspiring to play an increasingly stronger role in the international arena, in line with its demographic weight, economic performance, and political capacity. The Government is aware of the potential importance of development cooperation in Poland's foreign policy in helping to raise the country's profile and influence in selected areas and to contribute to the stability and development of its neighbors and partners. Poland is also playing an increasingly strong role in a broad range of international forums. From an economic angle, the authorities are keen to support the internationalization of Polish firms and to develop links with the Polish diaspora and with Poles living abroad to help promote Poland's interests in the world.

Poland has significant experience to share with other countries on economic transition and sectoral reforms. Yet, resources for development cooperation remain very limited, and there are substantial aid effectiveness issues. The aid budget of US$474 million in 2013 included a mandatory contribution to the EU budget and other multilateral organizations (of about US$355 million in 2013), and a relatively small bilateral program (about US$119 million in 2013) focused on microprojects implemented by Polish nongovernmental organizations (NGOs) (in the Eastern Partnership countries and in selected International Development Association [IDA] countries). Poland's contribution to the IDA17 amounted to US$10 million.

THE WORLD BANK GROUP PROGRAM IN POLAND

The World Bank Group's engagement in Poland aims to support shared prosperity. The International Bank for Reconstruction and Development (IBRD) program is well aligned with the Government's strategy and with EU priorities (the "smart, sustainable, and inclusive growth" EU 2020 agenda), and follows a "niche" strategy. The International Finance Corporation (IFC) has not had any significant operation in Poland for several years, but is now considering a modest reengagement. The Multilateral Investment Guarantee Agency (MIGA) has no significant activity at present.

The current four-year Country Partnership Strategy (CPS), presented to the Board of Executive Directors on August 6, 2013, sets out the country context, country development program, and envisaged World Bank Group program for Poland for the period 2014–17. Poland has indicated its interest in continuing to benefit from the World Bank's financial and technical support (and its intent not to seek graduation in the near future). The CPS' two-fold aim is: (i) to foster sustainable income growth for the bottom 40 percent of the population (within the context of Poland's economic convergence with the EU), and (ii) to support Poland's emerging role as a global development partner. The program rests on four strategic engagement areas: (i) economic competitiveness (business environment, innovation, public finance); (ii) equity and inclusion (labor market, regional development, health, aging); (iii) climate action (climate policy, flood protection, resource-efficient infrastructure); and (iv) Poland as a global development partner. The strategy foresees two series of two DPLs each and a number of investment lending (IL) programs over the period (including in health, flood protection, and social inclusion).

The previous lending program was anchored around successive programmatic DPL series in support of the Government's reforms in public finance, the labor market, and the social sectors, as well as in private sector development. The new series is focused on resilience and growth, with the first operation of €700 million approved by the Board on July 1, 2014 and the second scheduled for the Board by end-FY15. The investment portfolio consists of one project under implementation (on flood prevention along the Odra River) and a follow-up operation on flood prevention along the Odra and the Vistula Rivers, planned for the Board on July 2, 2015.

Analytical and Advisory Assistance (AAA) Program. The World Bank program is largely based on "knowledge products"—analyses and advisory services, in part reimbursed by the Government. The authorities value their partnership with the World Bank as a way to access global knowledge in specific technical "niches" (e.g., on a bank resolution framework, innovation and competitiveness, climate change modeling, infrastructure financing, etc.). This serves several purposes, including to inform policy debates and to facilitate the design or implementation of technical reforms. Examples of such work include: (1) support on *Doing Business*, which is provided across several ministries (on insolvency, contract enforcement, access to electricity, etc.), including Subnational *Doing Business* conducted in 18 Polish cities; (2) dialogue on innovation and smart specialization, with a series of engagements with the Ministry of Infrastructure and Development, the National Center for Innovation and Development, the Ministry of Economy, and some regional authorities; (3) support to the development of a macroeconomic model to assess the economy-wide impact of climate change–related policy decisions; (4) analytical work on aging (healthy, active, and prosperous aging) and on savings and growth (in a context of aging); (5) support to the Ministry of Finance on issues such as forecasting for subnational governments and macroeconomic analysis as part of preparing for an eventual adoption of the euro and improving the process for spending reviews; (6) development of financial instruments in the energy efficiency and waste management sectors; (7) analytical support to public transport development, including green transport and road safety; and (8) financial reporting in the private and public sectors (funded by the Government of Switzerland).

POLAND: ODRA RIVER FLOOD PROTECTION PROJECT (ORFPP) - *Project 086768*

Key Dates:

Approved: March 21, 2007

Effective: July 9, 2007

Closing: December 31, 2017

Financing in million Euro:

Financier	*Financing*	*Disbursed ***	*Undisbursed*
Government of Poland	30.0	57.5%	17.25
World Bank	140.1	69.57%	69.687.9
Council of Europe Dev Bank	204.9	57,10%	117.0
European Union	172.5	75.44%	98.1
Total Project Cost	**547.5***	**55.15***	**301.95***

***As per Dec 31, 2014 Progress Report**

**** Per December 31, 2014 Project report for the second quarter of 2014 and World Bank records as of March 5, 2015.**

The Odra River Flood Protection Project (ORFPP) will better ensure the protection of the population in southeastern Poland (Lower and Upper Silesia) and in particular, the economically crucial city of Wrocław, from loss of life and damage to property caused by severe flooding. These areas are heavily affected by recurrent devastating floods, most recently in 1997. As the final total cost is likely to be close to US$1 billion, this project is among the Bank's largest engagements in the Europe and Central Asia (ECA) region. The project is cofinanced by the Council of Europe Development Bank (CEB) and European Union (EU) Cohesion grants. The project has three main components:

- **Rehabilitation and modernization of dikes and river embankments in and around Wrocław,** as well as the widening of bridges and weirs and the dredging and improvement of the floodwater by-passing capacity;
- **Construction of a flood retention dry polder (reservoir) near Racibórz** upstream of Wroclaw; and
- **Improvement of flood forecasting and flood management capabilities.**

The project is being implemented in three phases. First, the implementation structure was established and staff trained; the implementation involves several ministries (notably the Ministries of Home Affairs, the Environment, and Regional Development) and four project implementation units (PIUs) inside the four regional Implementing Agencies. Teams of experts (technical assistance, contract engineers) were recruited to assist these agencies. This first phase was completed at end-2009. In the second phase, land was acquired and all permits obtained, in particular for the construction of the 24 kilometer-long dikes for the dry polder in Racibórz—critical protection for downstream Wroclaw. An area of 1,260 hectares was acquired for the dry polder dikes; the total polder area is 26 square kilometers. Furthermore, 202 households are being resettled. Forty-seven households have opted to move into the new town Nowy Nieboczowy; the first 25 houses are under construction with the (relocated) church and community center completed and other village infrastructure (e.g., wastewater, electricity) in process. In these areas, culturally significant archeological fragments have also been found, including the *Silesian Venus*. The third phase, now in full operation, concerns all the construction flood works. This phase will last from early 2013 through 2017. Most works are progressing reasonably well, though technical and managerial challenges remain. Environmentally significant areas, such as Natura 2000 sites, receive protection or are compensated.

The Bank's finance will have leveraged about 5–6 times the non-Bank funds, mostly EU Cohesion Funds. It will also have built administrative and policy capacity within the Government to carry out complex large infrastructure works of a national strategic nature, involving numerous national and local agencies. This rich engagement (both on the technical and policy aspects) has resulted in interest from the Government for a follow-on project on the neighboring Vistula River (which suffered from flooding in 2010, unlike in the project areas).

Expected Results:

(i) Improved protection for about 2.5 million people in the Wrocław area, as well as other urban centers and towns upstream of Wrocław, against severe flood episodes, such as the 1997 flood.

(ii) Improved flood forecasting to allow for better prevention of flood damage and the minimization of damages.

Key Partners: The main partners are the Ministries of Home Affairs and of the Environment; Water Management Boards; the Institute of Meteorology and Water Management (IMGW); and Voivode and local governments. In addition, financial partners are the European Commission (EC) and the Council of Europe Development Bank (CEB).