POLAND: ACCELERATING GROWTH WITH INCLUSION
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Summary

Poland has grown rapidly over the last 25 years, which has translated into significant welfare gains across the entire income distribution. While the ‘catch-up’ phase to converge with the rest of the European Union (EU) may be almost over, a coherent set of policies are needed to respond to current challenges and opportunities, including managing one of the fastest aging societies in Europe and leveraging technological change. To accelerate inclusive economic growth requires policies that put people at the center of government strategy.

Such a strategy would include a greater focus on raising productivity and decreasing the country’s reliance on cheap labor and foreign financed investment for growth. Productivity will increasingly be driven by efficiency gains within individual firms and through innovation. This can be supported by promoting policies to increase investment in people to raise skills and improve health outcomes, enhance the dialogue with the private sector, and continue to upgrade infrastructure and public services to better support needs of people and firms.

This note explores four policy areas that would help achieve the objective of inclusive growth in Poland, through: putting people first; creating the right environment for business and innovation; making the state more efficient and responsive to citizens; and investing in, and leveraging, infrastructure. These policies would help to promote greater productivity as well as enhancing the effective use of Poland’s assets, including its people.
Poland’s challenge: accelerate inclusive growth with an aging society

Figure 1: An inverting pyramid: Poland’s population is shrinking and aging


1. **Poland’s recent economic growth has been driven by strong productivity growth and capital accumulation.** Productivity growth and investment have been the main drivers of economic growth over the past 20 years. The accumulation of human capital and conventional physical capital accounted for about one-third of total economic growth between 1995 and 2014, while increases in total factor productivity (TFP) and firms’ adoption of new processes and information and communication technologies (ICT) accounted for almost two thirds. This structural transformation and reallocation of resources to more productive sectors was supported by reforms that encouraged economic liberalization, the commercialization and privatization of state-owned enterprises, and an opening up to international trade and capital flows (World Bank, Savings Country Economic Memorandum, 2014).

2. **Poland’s economy has been transformed through integration into the global economy and sound macroeconomic management.** In the past decade, Poland’s exports experienced significant gains in global market shares, driven by the development of dynamic
supply chains within Europe. This process has led to substantial technological transfer and increased sophistication, with positive implications for productivity, competitiveness, and growth. Important factors in Poland’s economic upgrading have been the improvements in the business environment, its well-educated population, and improvements in infrastructure, which have been supported by the use of EU funds. Growth has also been supported by sound public finances, the capacity of institutions to regulate and supervise key sectors, such as financial markets, and an independent judiciary and respect for the rule of law.

3. However, Poland’s population is declining and aging rapidly, which is not only a challenge to growth, but raises questions of how to ensure that national income is shared between generations. In Poland and its neighbors, economies have grown since the early 1990s, while populations have shrunk, impacted by rapidly falling fertility and waves of outmigration. While people are generally living longer healthier lives, a significant gap in life expectancy remains in Poland compared to much of Western Europe, which means that the share of the very elderly (age 80+) in the population is comparatively low. Poland’s population pyramid is inverting: In future the share of the working-age population, measured at the share of the population aged 15 to 65, is projected to decline from 70 percent to 64 by 2030 and to 58 by 2050. Of the working-age population, a third will be 50 years old or older by 2030 (World Bank, Golden Aging, 2015).

4. Aging-related spending is set to grow significantly and needs to balance concerns over affordability with adequate levels of social protection. While pensions are likely to be a big driver of aging related spending, they also play an important role in reducing poverty. While the reform of 1999 made the pension system financially more sustainable, and linked individual pensions to a person’s contributions, this came at the cost of a substantial drop in the amount pensioners finally receive (the average replacement rate). This is likely to lead to many future pensioners having incomes below the statutory minimum. Health care costs will also be driven by technology and the rise in the number of older people with demand for long-term care as the population ages and fewer people are available for “informal” caregiving.

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5. **Strong economic growth has translated into significant welfare gains across the entire income distribution, but benefits have not been shared equally.** While Poland weathered the 2008 global financial crisis better than its neighbors, per capita income growth for the bottom 40 percent has fallen behind the growth rate for the entire population. Moreover, convergence with the income levels in other parts of the EU has been more limited and a significant number of people are vulnerable to changes in economic circumstances. In recent years, Poland has also seen a moderate increase in the extreme poverty rate, which reached 7 percent in 2014. There is also a clear regional divide, with eastern and central sub regions characterized by higher poverty than western sub regions, while big cities, on the other hand, are areas with the lowest levels of poverty, providing scope to address poverty in lagging regions.

6. **Continued growth in Poland, shared by all Poles, is not guaranteed in the absence of policy change.** While Poland has garnered a long and positive track record for a growing economy, both prior and subsequent to the 2008 crisis, multiple challenges exist beyond a rapidly aging population, such as rising external and public debt, relatively low levels of participation in the workforce, a recent trend of diminishing productivity and low levels of research and development spending, high-levels of bureaucracy and regulation, and a declining availability of EU funds, which have to date bolstered public investment.
The solution: promoting productivity and effective use of Poland’s assets

Figure 2: Poland’s growth model is changing and will need focus more on promoting productivity

7. **Poland’s challenge is to accelerate growth and make sure it is inclusive in the context of rapid population aging and accelerating technological change.** The response to both challenges is to focus on policies to both boost productivity and enhance the opportunities for people to work. Investing in people, promoting a dynamic and innovative business environment, building supportive infrastructure and strengthening public sector institutions are important and mutually reinforcing ingredients. Investing in people, if done right, will help safeguard growth while the population ages, and ensure the benefits are shared among all citizens.

8. **Aging and population decline need not be a drag on growth, as long appropriate policies are in place to encourage firms and individuals to act appropriately.** Investing in people’s health and skills should raise employment and enable people to work for longer and more productively and, therefore, age in an economically secure way. Poland has significant room to further enhance people’s health and skills, and to create the enabling environment for more productive employment. The policy response can exploit win-wins: For example, an expansion of
quality child care can help boost the skills of the next generation and simultaneously raise the number of people that continue working into their later years, especially women. Longer employment, if productive and appropriately remunerated, will contribute to pension and health system sustainability, even as the population ages. Investing in people will also help ensure that more people benefit from the proceeds of economic growth and could, over the longer-term, stem outward migration and boost fertility.

9. **The ability of firms to innovate will be increasingly important for job creation and growth.** Good macroeconomic performance and strong productivity growth have microeconomic foundations in vibrant and competitive firms. While Poland’s structural transformation and the reallocation of resources from less productive activities to more productive ones is largely completed (i.e. the patterns of productivity in Poland are now approaching those in other advanced EU countries), continued productivity improvements will rely increasingly on individual firms innovating to become more efficient. To take advantage of the opportunities in an era of accelerating technological change globally, this process can be aided by support for research and development (including improving the links between the private sector, research institutes and academia), venture capital and access to financing for small and medium enterprises (SMEs) and startups, and continued investment in supportive infrastructures like Information and Communication Technologies (ICT).
Putting people first

Figure 3: Poland’s employment rates for prime age workers are on par with the EU28, but below for younger and older workers, especially women.


10. A better employed population would reduce the negative effect of labor market duality, while encouraging participation. Fast and sustained economic growth in Poland over the past decade has delivered strong job creation and falling unemployment. At the same time, while employment among prime age workers in Poland is on par with EU28 averages, there are gaps for younger and older workers and for women (Figure 3). New jobs have come largely through temporary labor and “civil law” contracts, which offer more limited protection against being laid off or having ones hours reduced. These contracts often do not lead to more permanent stable jobs, and they can also reduce the likelihood that firms will invest in training their staff, which may reduce long term productivity.

11. The result has been the growth of dual labor markets, where terms vary widely depending on the type of labor contract. Reducing the negative aspects of labor market duality entails a strategy that strikes a better balance by reducing the relative cost and complexity associated with labor contracts (including dismissal procedures), tightening the requirements for civil law contracts and strengthening worker protection during transitions. Low labor participation rates also suggest that good quality public and private child- and long-term care are constraints for many potential workers. Helping to address this challenge, while helping firms adapt to an aging
workforce, including reviewing incentives for early retirement, will be important to boost employment. Benefits and taxes should also be designed to better support low-wage workers.

12. **A healthier population is essential for inclusive growth.** Despite major progress in life expectancy, Polish citizens are still facing life expectancy gaps compared to the EU15, especially among males, as well as poor financial protection and poor responsiveness of the health system, as evidenced by long waiting lists and poor outcomes. While life expectancy gaps and morbidity in part reflects unhealthy lifestyles, poor efficiency of health services (especially hospitals) and the overall poor coordination of health services delivery is a major barrier to improved health outcomes. There is scope to strengthen the capacity to purchase and finance health services in a coordinated way to improve the efficiency and quality of the hospital sector and promote primary care (including prevention, the most cost-effective way to reduce health risks stemming from unhealthy life styles). Three opportunities stand out for short-term action: accelerating the implementation of hospital reform, strengthening primary and ambulatory care through revising the ambulatory care payment systems and moving towards a targeted approach for financing long-term care.

13. **Building skills matter for jobs in advanced economies and in the context of rapid technological change.** Three dimensions of skills include: cognitive skills, socio-emotional or behavioral skills, and technical skills. Skills are built along the life cycle, with cognitive and socio-emotional beginning to build early in life and providing a foundation for subsequent technical skills to be built throughout adulthood. Employers globally attach high importance to cognitive and socio-emotional skills. In the 21st century labor market, the demand for technical skills is rapidly evolving in line with technological progress – requiring strong cognitive and socio-emotional skills foundations to adjust technical skills through lifelong learning.

14. Through a series of reforms in the late 1990s and early 2000s – which included starting schooling a year earlier, revamping the curriculum and delaying the streaming of children into specialized education tracks – Poland has achieved major success in raising cognitive skills, as measured by reading, mathematics and science competencies among 15-year-olds in the Program for International Student Assessment (PISA). Aggregate PISA scores and performance across all groups have surged, although 15 year-olds perform relatively poorly in problem solving and there is scope for the education system to become more equitable to reduce significant gaps in cognitive skills between well-off and poor students. Progress will come with changes in classroom practices
to foster advanced cognitive skills like problem-solving and socio-emotional skills. Further expansion in child care for children aged 0-3, especially from poor backgrounds, and accompanying measures to work with parents and students can help make the system more equitable and boost cognitive and socio-emotional skills early in life.

15. On technical skills, Poland’s challenge is one shared by many countries: how to build systems in higher education and vocational training that are more responsive to labor market signals. Some policy options include building systems that better capture, and anticipate, information on the skills needed by the economy and linking this to the quality of education and training programs, with adequate incentives. Poland’s universities have opened up to the business community by involving representatives on Boards of Trustees, but could go further in connecting with business on teaching and research, for example by improving timely information flows on emergency skill requirements.

16. **More could be done to ensure all citizens share in economic growth.** Remaining equity gaps point to a need to help disadvantaged children. Actions to promote better opportunities for all through policies for people at all ages, starting with children—such as interventions to support *at-risk families*, early childhood and child care programs, strengthened social safety nets and professional social work as well as effective employment programs—would help. This requires strengthening the strategic focus and effectiveness of the local delivery system for social assistance benefits and more coordinated social and employment services for the poorest and most vulnerable citizens.

17. Poland’s labor offices are over-burdened, face capacity and budgetary constraints to manage resources and programs, and continue to operate under limited pressure to be accountable for results. This compromises their ability to provide necessary support to disadvantaged job seekers. Boosting capacity in labor offices to deliver better quality services would require: stronger program monitoring and evaluation, a revised profiling of workers, a greater emphasis on skills development, better use of performance-based outsourcing, and expanded partnership with employers.

18. **Poland’s demographic transition is expected to bring an unfavorable shift in the ratio of retirees to workers.** The challenge for Poland is to find the right balance between ensuring the financial sustainability of the pension system and the adequacy of pension benefits
for retirees. Poland has taken important steps since 2010, including scheduled increases and equalization of retirement ages, which have been critical to improve sustainability, and decreased expected pension expenditures as a share of the expected future economy. However, the future adequacy of retirement benefits remains at risk. Poland’s replacement ratios at retirement are likely to decline sharply in the future because the Notional Defined Contribution (NDC) arrangements provide lower benefits than the pre-1999 system and are designed to adjust replacement ratios down over time to contain costs as Poland’s population ages. Moreover, while Poland has a minimum pension it requires 25 years of contributions (men) and 20 (women) and is near the subsistence level of income, and is likely to become lower relative to the national average wage in the future.

19. Three priorities stand out to address these trends: (i) assuring minimum benefit adequacy for Polish elderly following retirement, particularly for vulnerable groups; (ii) equalizing and increasing retirement ages for men and women in line with life expectancy to improve benefit adequacy following retirement as contributions grow, especially for women; (iii) continuing reforms to the disability pension system to assure it adequately protects those who lose income due to disability and assists those who can to become productive members of the workforce again.
Creating the right environment for business and innovation

Figure 4: Easing business regulations can help firms to grow and create jobs


20. **Boosting productivity is essential for Poland to sustain its impressive growth.** In the last 20 years productivity growth and investment in ICT and capital infrastructure were the main sources of economic growth. While Poland has largely caught up with EU contemporaries’ with respect to productivity the country has yet to reach its full potential in manufacturing and exports, with scope to move into more dynamic global markets and rely less on being a low cost producer. Polish firms can innovate more, by not only adapting existing techniques but by creating new methods and products, while continuing to integrate more fully into global value chains. Improving infrastructure for connectivity would also provide small and medium sized firms better access to international markets. Finally, low levels of digital interaction also threaten to leave the economy lagging behind regional counterparts.

21. **Despite much progress in recent years, Poland can go further in improving the business environment to make it easier for firms to grow and create jobs.** Thanks to an ambitious reform program, Poland has steadily climbed in international competitiveness rankings. The 2016 Doing Business survey ranks Poland 25th among 189 economies, higher than the EU average and a significant improvement from a few years ago. However, performance remains uneven: on half of the 10 areas surveyed, the business environment lags the EU average. Poland ranks 27th in the EU with regard to the ease of starting a business and is ranked in the bottom third globally with regard to the time it takes to issue a construction permit (a key element in
starting and growing a business). Despite a shared national legislative framework, the World Bank's subnational Doing Business survey also highlighted marked differences in the ease of doing business among cities due to the varying efficiency levels of public agencies, increasing the scope for more balanced development by sharing good practices across the country. For example, it is easier to start a business in Poznań, deal with construction permits in Bydgoszcz, register property in Białystok, and enforce a contract in Olsztyn, while no single city did equally well on all indicators.

22. **Continued growth needs a system that encourages innovation and better enables firms to create value and jobs.** Readily available access to finance and world class infrastructure are critical to achieving this objective. While the private sector needs to be in the driver’s seat, Government can play an important role in creating an environment that encourages active innovation in the private sector. The public innovation support system could strengthen links between science and business, introduce policies based on a close dialogue with the private sector, and open up the innovation system to world class ideas and talent. This requires strengthening the capacity of the public support institutions and making better use of public support, including around €10 billion available from EU funds. This could play a catalytic role in transforming Poland into a creator of new knowledge and spurring private sector lead growth.

23. **Despite recent improvements, Poland would benefit from following the EU Digital Single Market Strategy and developing a facilitating environment for ICT development.** Fixed broadband availability is low (Poland ranked 28th in the EU in 2015) and active eGovernment use remains relatively low, with 21% of Internet users returning filled in forms to the public administration. Poland can improve access for consumers and businesses to digital goods and services through cross-border e-commerce, enforcing consumer protection, fast product delivery, restricting geo-blocking (site access denial or re-rerouting based on consumer location), enforcing competition and copyright laws, and reducing the administrative burden of doing business online. Poland would benefit in particular, from supporting the development of broadband networks and public e-services at a central level.
Making the state more efficient and responsive to citizens

Figure 5: Both the perception and quality of public services can be enhanced

Source: OECD 2015

24. **A public sector that is responsive to citizen’s needs, business-friendly, and accountable is necessary to deliver an ambitious reform agenda.** This would require going beyond a system focused on compliance with rules and regulations to improve the the performance of public services and regulation. According to OECD, Poland’s satisfaction and confidence across public services remains well below OECD averages, except in education. Those Institutions which are meant to deliver a more inclusive society, notably health and legal systems and labor offices, are doing relatively poorly in the public’s view and need strengthening. Poland also rates poorly among its peers in terms of producing open, useable information about public spending. Such information could not only be used to hold government more accountable for policy decisions, but many countries have developed user-friendly, interactive government portals, set public service standards in many areas and introduced spending reviews, which all help make the delivery of government policies more responsive and effective for citizens.
MAKING THE STATE MORE EFFICIENT AND RESPONSIVE TO CITIZENS

25. **The international financial crisis underlined the need for governments to maintain sound budget finances.** Citizens and businesses require economic stability and sufficient information about economic developments in order to be able to invest and make sound decisions. Poland has put in place new budget rules to help limit the overall deficit and gradually reduce public debt, which is helping reinforce Poland’s track record for prudent economic management. However, these efforts could be strengthened with improvements in the availability and quality of information about public finances, notably incorporating the public sector’s assets and liabilities, which would also allow a better understanding of future opportunities and risks.

26. **Poland’s tax system is also seen as increasingly outdated as piece-meal changes have undermined its integrity, fairness, efficiency and sustainability.** The tax administration could be modernized through a unified tax authority that is more client-focused, innovative and risk-based while tax policy simplified to make it easier for individuals and companies to pay (and to reduce tax avoidance and evasion). The tax and benefit systems could also be better integrated and more progressive to protect the poorest and most vulnerable members of society. This would also help Poland respond to challenges from a changing world, including future demographic changes, technological improvements, highly mobile investment and greater labor mobility, as well as improving the fairness of the system and reducing the burden on businesses and individual taxpayers.

27. **Strengthening capacity and public finances at the local level is needed to further improve service delivery.** With the majority of core public services delivered by subnational government, the framework for sharing resources needs to be adjusted to be more in line with public demands to deliver the appropriate level of services, in contrast to equalizing funds, without jeopardizing overall fiscal sustainability. While improving how resources are shared between the different levels of government, and between regions, is important, local governments also need to invest in their capacity to deliver those services more efficiently and effectively, and respond to users’ needs. This will involve investing in local administrative capacity and developing new ways to put users at the heart of local services, for example using IT systems to help services adapt to feedback from users.
Investing in and leveraging infrastructure

Figure 6: There is significant scope to enhance the quality of infrastructure

Source: World Economic Forum 2015

28. **Poland needs a long term approach to plan and manage transport infrastructure and finance investment beyond the current period of high EU financing.** While Poland has implemented many successful infrastructure investments and modernized the transport sector over the last 15 years, with substantial EU funding, a new approach to planning is needed to address funding and policy challenges and accelerate gains over the medium-term as EU funding declines. The goal should be to continue to improve services and rebalance demand between different types of transport. Poland could improve revenues from road (e-tolling) and rail transport infrastructure, and attract alternative sources of infrastructure financing, including creating conditions to crowd-in private finance, both for infrastructure maintenance and development. Transport services could also be better organized in many urban areas, with better linkage between types of transport. There are also opportunities to strengthen road safety, which is still an acute problem in Poland’s.

29. **The private sector is a key technical and financing partner in helping improve infrastructure.** As EU funds are anticipated to diminish after 2020, Poland will also need new sources of financing for infrastructure spending in waste, water and will continue to have large
energy production needs. This calls for greater efficiency in infrastructure planning, provision and financing which can combine private, EU and public money. A key priority until 2020 would be to utilize financial instruments, effectively 'lengthening' the availability of EU funds and taking a more integrated approach to infrastructure asset management.

30. **As Poland plans for the next wave of infrastructure development, an integrated, whole-of-life-cycle approach to infrastructure asset creation and management in partnership with the private sector is vital.** Selection of the appropriate financing vehicle is therefore key to enhancing efficiency of infrastructure development. Public private partnerships (PPPs) and private finance concessions can be considered as a way to reduce the public sector’s risk and to leverage private financing and know-how for infrastructure. The private sector can help cushion the financing burden for these investments and also provide technical expertise. The assets managed by the public sector also need to follow a ‘whole of life cycle approach’ with a realistic approach of public sources of financing when private funds are not available.

31. **Poland has considerable scope for a major energy transition through the adoption of greener energy.** Due to the high carbon intensity of the Polish economy, with a predominantly coal-based structure of the energy sector, the economic adjustment costs for energy-intensive sectors covered by the EU Emissions Trading Scheme are expected to be high, as Poland has a large potential for cost-efficient reduction in emissions. Indeed, the targets set out in the EU suggest significant effective reductions in greenhouse gas emission by 2030. The scale of additional climate action needed to reach the overall reduction targets means that Poland needs to carefully assess (and manage) the associated economic costs of present and future policies. A successful low-emission strategy for Poland requires an integrated, in-depth knowledge of abatement costs for each sector of the economy to help plan and manage long-term investments and to establish the appropriate regulatory incentives for this transition.
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