4. Policies to speed convergence

Poland has made substantial progress towards establishing a vibrant economy, where private entrepreneurs are able to pursue opportunities with growing support from legal institutions and in an environment where regulatory and administrative burdens are declining. The private-sector now produces some 75 per cent of GDP; there are over 1.7 million active independent firms and the Polish stock market is the most active and largest in Central Europe. The transition to a market economy has been facilitated by major changes to laws governing capital and product markets, and efforts to improve the regulatory framework. However, despite substantial accomplishments over the past decade and a half, problems persist. Investment levels, though rising rapidly in recent years, are low relative to other emerging economies and have been declining, productivity levels are low and a large and stagnant agricultural sector represents a persistent drag on the economy. All these factors raise costs, lower activity and limit aggregate demand for labour. As a result, policies aimed at improving the investment environment, speeding up productivity growth and restructuring of the agricultural sector should be seen as complementary to the labour – market reforms described in Chapter 3, in that they increase the long-term demand for labour and should, therefore, speed the transition to higher employment rates. The first section of this chapter focuses on factors affecting the attractiveness of Poland as a site for investment, a second on policies susceptible to speed productivity growth and a third which deals with issues more directly related to rural development.

Policies to improve the environment for investment

The attractiveness of an economy as a site for investment depends on a wide range of factors: the productivity of its labour force, wages and other labour costs, the tax treatment afforded to business activity, predictability of the regulatory environment, administrative burdens associated with business activity and the extent to which existing laws and their execution enforce property rights. This *Survey's* special chapter on the labour market (Chapter 3) deals with a number of factors affecting labour productivity and labour costs that are relevant in this regard, not least among these payroll taxes, employment protection legislation

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and the minimum wage. This section deals with those affecting product markets more directly.

Improving the economy's capacity to attract high quality foreign direct investment and to direct domestic savings towards productive projects is among the most important challenges facing the Polish economy. Raising investment levels will serve to increase potential output in general. Foreign direct investment, in addition to serving as a complement to domestic savings in the financing of investment, is often associated with enhanced global economic integration and accelerated productivity growth as a result of transfers of technology, skills and know-how. Indeed, over 50 per cent of Polish exports are produced by firms with foreign participation. While the government has an important role to play in the funding and organisation of investment in public goods (see below), the private-sector is the source of the bulk of investment in Poland, as indeed is the case in every OECD country. Here, the government's role is to create framework conditions in terms of infrastructure, labour force quality, and legal and regulatory environments that make investors – both foreign and domestic – want to undertake projects in Poland.

Investment performance

Poland is the largest and the most geographically and industrially diversified economy of the emerging former-communist OECD countries. Nevertheless, because of similar comparative advantages – especially *vis-à-vis* more developed OECD countries – Poland competes very naturally with other emerging economies as an investment destination – both as concerns foreign and domestic investors. It shares with them a number of weakness – principally, low stocks of quality physical capital and know-how, an underdeveloped services sector and a relatively weak institutional structure. However, it also shares with them a number of strengths, including membership in the European Union (as of May 2004), a well educated and relatively inexpensive labour force, and strong commercial links with the markets of both the former Soviet Union and the EU.

As discussed in Chapter 1, while investment and foreign direct investment were very strong in the mid-1990s, they have since weakened considerably. Moreover, even in the good years Poland's performance on a GDP or per capita basis was less strong than in other emerging economies. The remainder of this section discusses a series of policy initiatives that together can be expected to improve the investment climate in Poland and, as a result, boost productivity growth and the speed of convergence. Issues discussed include policies required to improve the effectiveness of the banking-sector and other financial markets in channelling private-sector saving towards the most effective investment projects; policies to improve the enforcement of property rights; tax policies; and investment promotion policies.

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Making more productive use of domestic savings

Financial markets play a critical role in supporting investment activity and productivity growth by channelling domestic and foreign savings towards worthy investment projects. While Poland's banking sector is generally considered to be stable and poses no systemic risk, having received favourable evaluations recently by the IMF and enjoying positive ratings from private-sector agencies, it does not perform this critical intermediation function very well. Only 17 per cent of corporate investment spending is bank financed in Poland as compared with 42 per cent in the Euro zone and bank-financing of current operations is similarly weak. Overall, total loans represent only 28 per cent of GDP (NBP, 2003), about a quarter of the OECD average and lower than the intermediation rates observed in other OECD emerging economies (Figure 4.1). Moreover, 21 per cent of loans are classified as substandard[1] and 11 per cent are non-performing.[2] As a result, the extent of disintermediation is even greater, with active loans representing less than 25 per cent of GDP as compared with deposits of 37 per cent of GDP.

To a certain extent weak banking-sector intermediation reflects transitional issues common to the banking sector in all emerging economies. Pre-existing banks tended to be over-staffed and excessively specialised, resulting in weak competition in sub-markets and high costs. Client markets tend to be characterised by many very small and, therefore, risky domestic firms or very large international firms with easy access to financing from external sources. Finally, property and creditor rights and their enforcement tend to be weak, adding to the risks inherent in lending. Taken together, risky clients, high costs and a lack of competition have been reflected in large interest-rate spreads between deposits and loans and low loan volumes. While initial conditions varied across transition countries and the paths they have taken since then have diverged, the Polish banking-sector lies behind others in the region in terms of: intermediation, privatisation, interest-rate spreads and the quality of loan portfolios.

In order to speed progress, efforts need to concentrate on reducing bank costs on the one hand and increasing competitive pressures on the other. For the moment the sector remains relatively fragmented with the five largest banks holding less than half of assets as compared with much higher concentration ratios in other emerging economies.[3] While the large number of active banks reflects easy entry conditions during the beginning of the transition, the small size of most of them may be preventing the exploitation of potential economies of scale. Indeed, the financing of even medium-size projects frequently requires establishing a syndicate of banks. Unfortunately, the State's apparent reluctance to exit the sector may be preventing any single private-sector lender from achieving the necessary critical size that would provoke a wider-scale restructuring. Banking-sector privatisation in Poland lags progress in other emerging economies[4] and the 25 per cent of banking assets still controlled by the State exercise an important influence on

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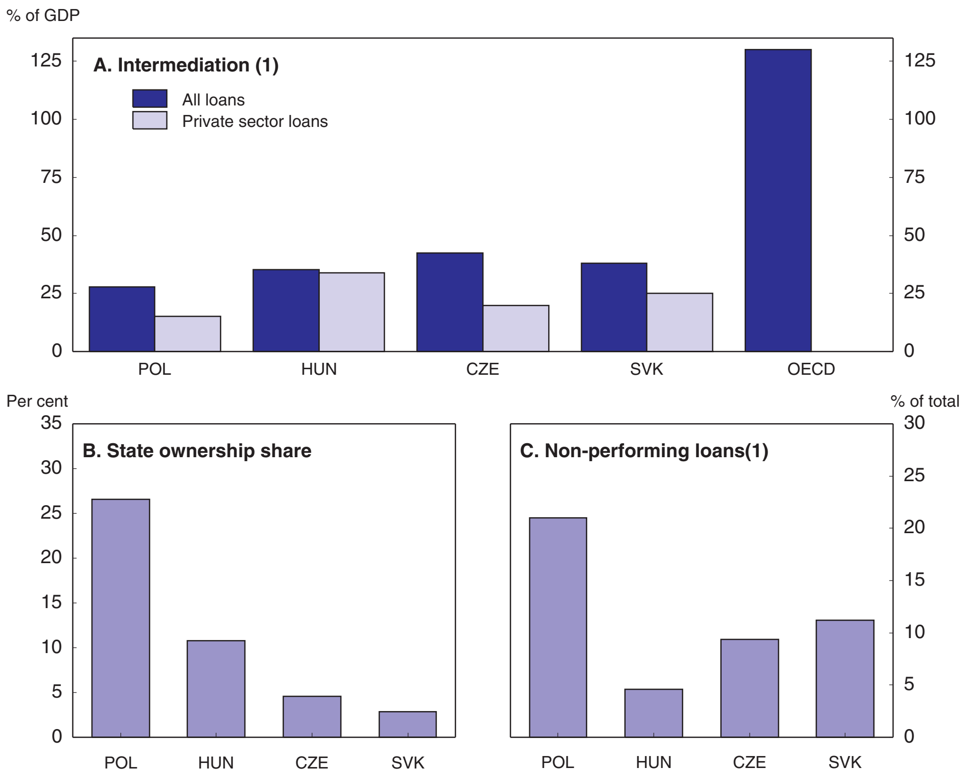
Figure 4.1. **Banking sector: comparative statistics**



1. Financial sector data for Poland concern 2003 and were provided by the NBP. Data for other countries concern 2002 and were taken from (EBRD, 2003) except for total loans (OECD, 2003).

Source: EBRD, Transition Report 2003, NPB (2003) and OECD (2003).

the overall market. Moreover, uncertainty over the final ownership structure of the sector may be slowing consolidation as strategic owners of smaller banks wait to see whether their aspirations to gain market share can be met through future privatisation deals.

For the moment, the State has only limited plans for further privatisation in the banking sector (Box 4.1), preferring to retain majority stakes in the three largest banks that it owns so as to keep control of their activities, which are concentrated in the retail banking and rural finance fields. A more aggressive privatisation strategy could be expected to reduce costs more rapidly and lower real lending rates by increasing competitive forces, which would likely result in higher levels of investment.

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Box 4.1. Banking-sector privatisation

Currently, the State owns or controls 7 banks,[1] representing about 25 per cent of the sector's assets. Two of these provide standard commercial banking services: PKO *Bank Polski*, (PKO BP), which is one of the country's leading retail banks, and Bank Pocztoy (BP), which is operated by the post office, providing retail banking services. *Bank Gospodarki ywnociowej* (BGZ) is a more specialised bank, with a strong position in the rural market. *Bank Gospodarstwa Krajowego* (BGK) is a state bank, which acts as a clearing house for payments between the state and the private sector.

The authorities intend to retain control over PKO BP and BGZ. They hope to float minority stakes in PKO BP and BGZ via public offerings on the Warsaw Stock exchange during the course of 2004. Prior to any sale, the restructuring of BGZ will need to be completed. The hope is to transform BGZ into a universal commercial bank, providing services to agriculture and food processing industry. In recent years, the bank has encountered significant difficulties and does not currently meet PNB minimum reserve and capitalisation requirements. In October 2002, a restructuring plan was adopted,[2] which if executed, would require BGZ to increase its shareholders' equity by 1 billion zloty, in two tranches, one to be concluded by 30 June 2004 and the second a year later. To this end, the Ministry of Treasury would like to attract a strategic investor who would inject capital in the amount of 1 billion zloty. Moreover, it is felt that the entrance of a strategic investor would increase interest in an eventual share offering on the Warsaw Stock exchange.

1. PKO *Bank Polski* (PKO BP), *Bank Gospodarki ywnociowej* (BGZ), and *Bank Gospodarstwa Krajowego* (BGK) (which has the status of a state bank), BankPocztowy S.A. (controlled by Poczta Polska, the national postal service), *Bank Ochrony rodowiska* (BOS). And *Bank Inicjatyw Spoeczno-Ekonomicznych* (BISE).
2. "Program for the Development of BG S.A. as a Universal Commercial Bank and Program for Increasing the Bank's Shareholders' Equity". The Banking Supervision Commission signed off the Program and passed Resolution No. 366/KNB/02 amending Resolution No. 74/KNB/2001 of 6 August 2001, changing the dates and amounts of external recapitalisation to the benefit of BG S.A.

Partly as a result of this ownership structure and notwithstanding some progress towards bringing them down, costs remain high. This may reflect the restrictions that were placed on private-sector purchasers in terms of labour force adjustments may have limited the extent to which they have been able to lower costs, thereby contributing to high spreads. Operating costs represent 54 per cent of gross interest income and over 109 per cent of net interest income (Table 4.1). Expressed as a share of assets and notwithstanding low wages, labour and other costs are about double the rates observed in the euro zone. As a result, the spread between lending and borrowing rates exceeds 10 percentage points in the retail market and 6 percentage points in the corporate

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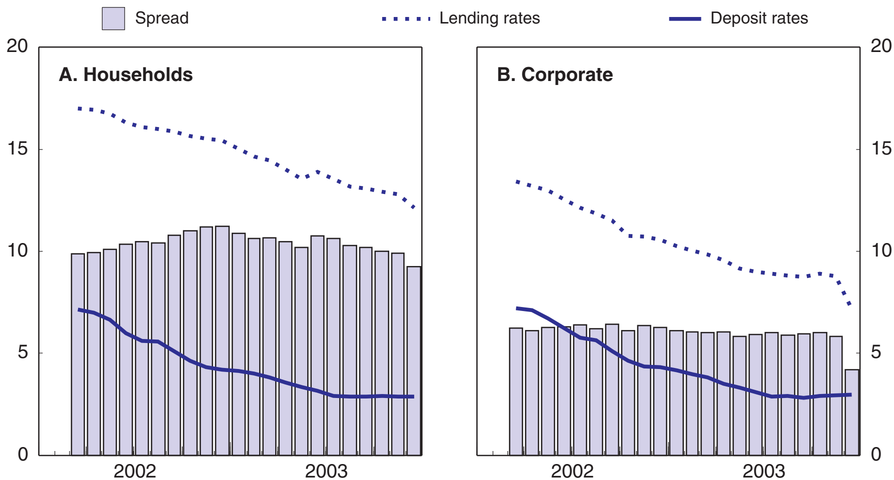
Table 4.1. **Key bank performance indicators, commercial banks**

	Dec. 1998	Dec. 1999	2000	2001	2002	June 2003
Number of banks analysed	79	75	73	66	60	56
	Per cent of average total assets					
Earning assets	83.4	86.9	87.6	82.1	86.3	87.1
Performing assets	82.4	85.0	74.9	78.9	82.4	82.8
Interest received	14.7	11.2	12.9	11.7	7.7	5.9
Interest paid	10.0	7.1	8.8	8.3	4.4	2.9
Net interest income	4.7	4.1	4.0	3.3	3.3	3.0
Net income from core activity	6.6	6.0	6.2	6.0	5.9	5.3
Operating costs	3.7	3.6	3.7	3.5	3.4	3.2
Pre-tax earnings	1.7	1.7	1.5	1.4	0.8	1.3
ROA (net earnings)	0.7	1.0	1.1	1.0	0.5	0.9
ROE (net earnings)	9.2	14.2	14.5	12.9	5.3	10.3

Source: National Bank of Poland, OECD calculations.

Figure 4.2. **Interest-rate spreads**

Per cent



Source: National Bank of Poland.

sector (Figure 4.2) – much higher than in other transition countries. As a consequence, banking deposits lack appeal as compared with other instruments, such as low-risk government debt, and loans are prohibitive for borrowers, with the result that domestic lending tends to get crowded out.[5] Indeed, subsidised

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agricultural loans by the State-owned BGZ bank represents as much as 54 per cent of all corporate lending (EBRD, 2002). In an effort to improve bank profitability and allow a reduction in spreads, the authorities recently reduced reserve requirements and as of 1 May 2004 have begun remunerating reserves. Nevertheless, they may wish to do more, perhaps by bringing reserve requirements down to levels in the Eurosystem.

To a certain extent the high costs of Polish banks also reflect very tight prudential regulations. Until the end of 2003, banks were obliged to provision up to 100 per cent of loans that were as a little as 90 or more days past due (there were classified as loss loans). While such rules have helped to ensure overall stability, the sector has likely achieved sufficient maturity so that a relaxation of rules would not place stability at risk while allowing banks to provide more financing at lower cost. As of January 2004 provisioning rules were relaxed and harmonized with international practice. As a result, loans now fall into *loss* category and require 100 per cent provisioning only after 360 days of arrears (180 days for consumer loans). Similarly, Polish loan classification rules have been brought closer into line with international norms, which should reduce the share of loans recorded as classified. Moreover, a revision to the tax treatment of non-performing loans should incite banks to right them off more quickly, further helping to make Polish data on non-performing loans more internationally comparable.

Enforcing property rights and facilitating restructuring

The difficulties that creditors have experienced in securing assets offered as collateral for loans represents another important factor contributing to low intermediation rates and high spreads. On average it takes 18 separate legal procedures and more than 3 years to recover a debt in Poland (World Bank, 2003), which compares unfavourably with average recovery periods of 1¼, 1 and ¾ of a year in Slovakia, Hungary and the Czech Republic respectively. These long delays, which result from lengthy and administratively heavy procedures, have reduced significantly the value that creditors are able to recover from liquidated companies. In so doing, they have contributed to the overall low level of intermediation in the economy and indirectly denied financing to fast-growing high productivity firms – with negative impacts on overall growth. Moreover, the absence of an effective work-out law has effectively precluded viable firms facing short-term liquidity problems from restructuring their debt and re-emerging as healthy firms. The problem extends beyond the banking sector because similar difficulties in executing legal judgements for intercompany debt have made firms reluctant to extend credit to Polish clients (or suppliers), thereby slowing the pace with which activity expands. Moreover, the additional uncertainty concerning payments, both in terms of getting legal judgements and executing them once rendered, represents an independent factor contributing to entrepreneur's reluctance to invest in Poland.

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The introduction of a new bankruptcy law in October 2003, replacing the previous law that dated from the 1930s, represents an important step in redressing these shortcomings. The new legislation, which is inspired by current best practices, recognises insolvency as a natural outcome in a competitive market economy and seeks to simultaneously better protect creditor's rights and ensure as efficient as possible reallocation of assets from less to more productive uses within the economy. It includes "Chapter 11"-like provisions[6] that enable debtors to restructure their debt before they actually default, as well as allowing for pure bankruptcies that can end either in an insolvency arrangement or liquidation. Moreover, the new law includes provisions for the resolution of international bankruptcy, including those set out under EU law.[7] These changes represent a major improvement over previous rules and should help improve investors' confidence both by offering a more familiar legal treatment of debt recovery and by harmonising treatment of international bankruptcies.

Notwithstanding these very welcome legal changes, the extent to which these reforms will improve the resolution of bankruptcies will depend importantly on its implementation. Raising awareness and capacity building among judges and insolvency professionals, including through adequate training programmes, will help. The ability of the court system to adapt to a less interventionist role is another issue that needs to be addressed. In particular, how effective the reform is in maximising the value that creditors are able to extract from a defunct firm will depend on whether the courts take advantage of the additional flexibility provided for in the legislation to speed the process. Thus, while the new law allows creditors to play a larger role in bankruptcy and liquidation cases, it also allows the courts considerable latitude in determining the form that administration takes. To the extent court-appointed administrators continue to be the most common form of administration the reform may fall short of its potential. Indeed, in the past, court-appointed administrators were largely responsible for very slow debt recovery periods and loss of firm value. In this regard, provisions that require the administrator in liquidation cases to attempt to sell a bankrupt enterprise as a whole rather than breaking it up into pieces that maximise its value should be revoked. Such provisions are likely to slow the restructuring process, reduce creditors' returns and, perhaps cause the firms' value to deteriorate further, ultimately resulting in greater job loss than would have occurred had restructuring begun immediately.

Uncertainty over the credit worthiness of borrowers is also a major factor limiting lending. With more than 2 million companies in Poland, most of which have existed less than 10 years, most firms do not have adequate credit histories to guide banks in their lending decisions. The creation of a central registry of borrowers, an initiative of the Polish Banking Association, for both individuals and corporate borrowers, will as information is built up help to overcome this problem. Similarly, the creation of a central registry of real-estate transactions – including

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information on sale prices should help banks better evaluate the value of proposed collateral and increase loan volumes.

Improving the land registry

The rising share of mortgage-backed loans in total lending likely reflects both improvements to the land and mortgage registration process and legal changes facilitating access to such loans and relaxing restriction on the use that banks can make of pledged collaterals.

Significant recent efforts to improve the speed with which the land registry is updated have likely helped promote lending by reducing uncertainty surrounding the ownership of offered collateral. Considerable progress has been made towards introducing a computerised registry in the 15 per cent of registry divisions that cover major urban areas. Although this work will not be completed until the end of 2005, positive impacts are already being felt as the average time to settle a land or mortgage registration has fallen from 3.8 months in 1999 to about 2 months in the middle of 2003. Similarly, an abstract from the registry can now be retrieved within 10 days. As a result, uncertainty over ownership arising from incomplete or out-of-date registers, which in the past resulted in instances of mortgages being taken out on land that had already been sold or multiple sales of the same property, should be greatly reduced. Notwithstanding the improvements already made, progress needs to be continued. Delays remain problematic in large centres, such as Warsaw, Wroclaw, Poznan and Bydgoszcz. Moreover, as discussed in the section on rural development (see below), as much as one third of agricultural land has never been registered and ownership is therefore unclear.

By the same token, recent efforts to relax restrictions on the use that banks can make of pledged collateral have likely contributed to reducing banking costs, lowering spreads and thereby increasing lending and investment. For mortgage banks in particular, the value share of a given property that could be mortgaged was increased from 80 to 100 per cent in 2002, while for a bank's whole portfolio the loan-to-value ratio was raised from 63 per cent of the value of the mortgaged property plus 10 per cent of additionally pledged collateral to 60 per cent plus 30 per cent of the additional collateral. Mortgage banks have also been provided with greater freedom to securitise mortgage-backed loan portfolios, allowing them to hedge foreign currency denominated loans and tripling the pre-existing limit on the emission of mortgage-backed securities to a maximum of twice the banks own capital. Recent amendments have also permitted mortgage banks to grant loans to local government institutions (if they are endorsed or guaranteed by these institutions), allowing them to offer loans prior to the termination of mortgage registration proceedings. These moves may have eased access to credits to borrowers with established credit records. However, it is unlikely to improve access for new borrowers because banks run the risk that a mortgage reg-

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istration will be refused. To extend the benefits of this reform to all potential borrowers, the mortgage-registration process will need to be streamlined and land-registry problems resolved.

Increasing the efficiency of capital markets

Although the Warsaw Stock exchange (WSE) is the largest in the region[8], the Polish capital market plays only a limited role as a source of enterprise financing. The market capitalisation of the WSE is equal to only 21 per cent of GDP and most shares are relatively illiquid. Global disillusionment with capital markets and reduced interest in capital market financing have played a role in limiting the markets growth.[9] Nevertheless, market capitalisation is expected to increase over time as assets held in Poland's funded insurance and pension schemes rise. While these currently represent less than 6 per cent of GDP, they are projected to increase to some 210 per cent by the middle of the century (EU, 2003). Moreover, the accession experience of other EU countries suggests that joining the union will result in important inflows of capital. In order to facilitate portfolio inflows, the authorities have moved to improve the integration of the Polish and European markets. An agreement was signed granting cross-membership and cross-access agreement to members of the WSE and the *Euronext* stock exchange (the entity created following the merger of the Paris, Amsterdam and Brussels exchanges). This should reduce transaction costs for foreign traders seeking to take a position in Poland and facilitate the floating of shares on the WSE by international firms with important operations in the region.

Efforts have also been extended to improve transparency and reliability in Polish capital markets. The WSE has adopted a written code and compulsory set of Corporate Governance Principles[10] (see the previous *Survey*) and plans regulatory changes to strengthen disclosure requirements.[11] In addition, draft legislation has been prepared re-enforcing prohibitions on insider-trading, market manipulation and introduces rules governing conflicts of interest. It also provides clearer definitions of price manipulation, rules governing firms' buy-back of their own shares and better codifies issuers' rights and obligations *vis-à-vis* the exchange.[12] These steps should increase transparency and reduce perceptions of risk that might be associated with investing in an emerging economy market. In this regard, the authorities might wish to implement rules prohibiting firms from hiring the same audit and consulting firms as well as requiring a more regular rotation of auditors.

In order to expand the role that quasi-public funds can play in developing the capital market, the authorities are seeking to widen the range of assets that investment-fund societies and pension funds may hold. Thus for open investment funds, the scope of permissible investments has been expanded to include money market instruments and bank deposits, and the permissible range and

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Box 4.2. Open Pension Funds

The so-called Open Pension Funds (OFE) manage the accumulated contributions of Polish workers under the compulsory fully-funded defined-contribution component of the country's multi-tiered pension system. The Polish authorities consider the contributions to these funds an element of central government finance and the range of investments the OFEs are authorised to make is restricted by law in order to ensure the preservation of future pensioners' principal assets. As of June 2003, there were 16 open pension funds operating in Poland, which reflects a substantial consolidation following several mergers and acquisitions. Contrary to initial expectations, the market is heavily concentrated with the four largest funds managing over 73 per cent of net assets. The net assets of OFE amounted to 41.6 billion zloty (5 per cent of GDP) as of 30 September 2003 and are projected to rise to some 160 billion zloty by 2010. Pensions will only begin to be paid out as of 2009, by which time a legal basis for governing of the payments will have to be created. Initially the scale of disbursements will be small and the growth rate of fund assets should not decrease substantially. The system is expected to reach maturity in 2034, when all new retirees will be covered by the new multi-tiered system.

extent to which derivatives, including non-standardized derivatives, can be used by open funds has been expanded. Moreover, restrictions on funds that emulate market or bond indices have been relaxed.

Finally, the authorities have recently passed legislation expanding the range and share of assets that Open Pension Fund managers could place in more profitable albeit riskier instruments such as equity markets and private bond portfolios (Chapter 5 presents a wider analysis of the Polish pension system, focussing on its long-term sustainability). Concerns that competition among fund managers was inadequate, lowering their handling fees led the authorities to introduce rule charges. While such a measure may increase returns to fund holders in the short-term, it is likely to dissuade managers from competing on the basis of returns. Indeed, existing performance rules, which punish firms whose quarterly returns deviate form the average of all funds may already be provoking management firms into following very similar strategies. In addition since November 2003, the State has assumed the liability arising from the delayed transfer of contributions to the various Open Pension Funds by the Social Insurance Agency (ZUS) mostly caused by technical problems during the introduction of the new system. The assumed debt has been financed by 10-year floating interest-rate government bonds.

Given the size of the assets that the Open Pension Funds are to be called upon to manage in the future, the extent to which they impact positively the

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behaviour of the firms in which they hold shares may have important consequences on overall corporate governance. Here the relative passivity, both in Poland and elsewhere in the OECD, of institutional investors, such as pensions funds, that hold shares on behalf of others could contribute to weaken overall performance. A regime that requires institutional investors to disclose their overall corporate governance policies, as well as how they vote shares they hold, could contribute to them taking a more active and positive role. In addition, corporate governance rules for such funds should require fund managers to indicate explicitly how they manage their own conflicts of interest.

Tax administration and tax policy

Taxes and tax administration form an important part of the overall regulatory environment. Indeed, as discussed in the previous *Economic Survey* there is substantial scope for reducing the extent to which the tax system and its administration impinge negatively on enterprise profitability, investment behaviour and public finances. In this regard, the authorities could go a long way to reducing the scope for arbitrary decision making and thereby increase the certainty with which firms make investment decisions as well as tax compliance by setting up a centralized tax authority to which firms could refer for binding or at least exculpatory *ex ante* tax rulings. For the moment, although tax offices offer opinions, these are not binding nor does the fact of having received a favourable *ex ante* ruling affect the penalties imposed if it should be subsequently overturned. Not only does this make it difficult for entrepreneurs to determine the future profitability of investment projects, but honest firms that receive a favourable *ex ante* tax ruling only to have it overturned subsequently are found guilty of "tax fraud" and lose their credit-rating. A proposed law that would oblige the authorities to provide, free of charge *ex ante* and binding tax rulings as well as similar rulings (for a fee) on issues of transfer pricing would, if enacted, help firms evaluate the potential after tax profitability of projects, an important first step towards reducing investment uncertainty. To ensure that the new rule has the maximum positive effect, it will be important that a national registry of such rulings be established to act as jurisprudence. In addition, while such a registry would help, it might be necessary for a central office to be given responsibility for making rulings in order to prevent firms shopping around among local tax offices for more favourable rulings.

The lack of a centralised jurisprudence means that frequently two separate local offices interpret and apply the tax law in a different manner. Given the local tax authorities' power to immediately freeze firm's financial assets and the extended time required for courts to reach decisions, a less arbitrary mechanism is required to deal with such disputes. In the area of value added taxes, the need for such a mechanism appears particularly acute. The complexity of VAT rules coupled with the discretion allowed local tax offices means that VAT filings are partic-

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ularly prone to error. Penalties (30 per cent) may be large for some firms and are asymmetric, overpayment is not refunded but credited, while payments are due immediately. Moreover, a lack of clarity concerning VAT liabilities in the case of the sale of an enterprise has been cited as a factor inhibit restructuring (PKPP, 2004), although because following EU entry firms can now refer to EU case law in such instances, the issue may have become less problematic.

Finally, firms' ability to plan and evaluate investment projects would be greatly enhanced if tax law were enacted in a more timely manner. Currently the lags between the passage of legislation and its entering into force can be very long, in many cases extending to several years. As a result, firms do not always know what tax law will apply – a factor that can make the difference between going through with a project or not.

Efforts at reducing the cost of tax compliance have concentrated on increasing the firm-size threshold for simplified payroll taxes (see above) and the introduction of a new category of a small taxpayer[13] who may submit their monthly tax return forms and VAT accounts on the basis of non-accrual method on a quarterly rather than monthly basis. In addition, several changes to the personal income tax system were introduced in 2003 with the aim of creating favourable conditions for rapid economic development. These include allowing owners of new start-ups to be exempted for a period of one year from: the obligation to submit a monthly tax return, paying income tax advances (or the lump-sum tax) and, in the case of natural persons, from the requirement that they combine their income from business operations with income from other sources. The unpaid tax is to be repaid over the following 5 years. Moreover, purchasers of new investment goods can apply accelerated depreciation rates to these goods as long as they respect the minimum depreciation periods set out in the applicable regulations. While many of these reforms go in the right direction, the main thrust of reform has been towards the harmonisation of the Polish law with the EU legislation and exempting smaller firms from complicated provisions. More effort needs to be expended towards reducing administrative complexity and compliance costs for all tax filers. By the same token, substantial progress remains to be made in terms of reducing the costs to the public purse of administering the tax system, both in terms of foregone revenues from poor compliance and a poorly organised and costly administration. In this regard, there is likely significant economies to be made by merging the ZUS and personal income tax collection systems.

While tax administration can be an important source of uncertainty and as such alter the balance in firms' investment decisions, so can tax policy and tax rates themselves. In this regard, the decision to reduce the corporate income tax rate from 27 to 19 per cent should go a long way to improving the relative attractiveness of Poland-based investments. The new rate aligns Polish tax treatment of corporate earnings with that of other transition countries[14] and brings it substan-

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tially below that of the Czech Republic (31 per cent). The revised law also includes provisions allowing individual entrepreneurs to file under a flat 19 per cent personal income tax regime, although given that tax reductions reduce average personal income tax rates to less than 10 per cent for most individuals, the attractiveness of this regime is uncertain.

Towards modern foreign direct investment promotion strategy

On a legal basis Poland foreign and domestic firms are on an equal footing. However, the complexity and unpredictability of the legal and regulatory environment for business puts outsiders in a disadvantageous position (OECD, 2001b). Among the most frequently cited obstacles to investing in Poland are the lack of transparency and consistency of the legal system as well as weak law enforcement at the local level precisely among the most important factors in determining a healthy investment environment (OECD, 2001a). While the authorities should continue efforts to improve the execution of business law so as to reduce uncertainty (see above), if Poland wishes to enjoy the success of its neighbours in terms of attracting investment projects it should offer more pro-active assistance to firms or entrepreneurs seeking to invest so as to allow them to find their way through the existing system (OECD, 2001a).

In particular, Poland should seek to reinforce existing foreign investment structures so as to develop a comprehensive framework for investment promotion and servicing. OECD (2003b) outlines a number of principles that should be followed.[15] Currently, funding and responsibility for promotion services are dispersed among several authorities and legal and financial constraints prevent the national investment promotion organisation (PAIiIZ) from fulfilling a role similar to that of the Czech investment promotion agency. The Czech agency offers one-stop-shop services where potential foreign investors are advised free-of-charge as to potential investments, choices of local suppliers and are helped with recruitment and evaluation of the skills of the local workforce as well as with immigration procedures for their foreign staff. While PAIiIZ does provide information concerning opportunities and principles surrounding 14 special economic zones (Box 4.3), it does not maintain a database of current investment opportunities, nor of local economic and legal conditions for investment. Moreover, its role with respect to the economic zones is limited to directing prospective investors towards them. The overall effectiveness of the agency would be enhanced if it were able to make binding offers of support to potential investors. Currently, any such incentive proposal can be made but responsibility for approval lies with various Ministries. Moreover, investment incentives are only approved once the investment has been made. As a result, uncertainty as to whether aids will be forthcoming poses a serious problem for investors. Investment agencies in other countries are able to make binding offers, which places PAIiIZ (and Poland) at an important competitive

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Box 4.3. **Special economic zones**

National legislation provides for the creation of special economic zones, of which there are currently 14. These zones are operated autonomously and provide specific services to potential investors in the form of assistance with formalities. Moreover, they offer a wide range of national and regional investment incentives such as exemptions from PIT, CIT and real estate tax, equipped investment sites offered at attractive price, investment grants as well as grants for employee training and job creation.

Firms investing in these zones and receiving these incentives are obliged in return to follow an agreed business plan specifying employment and investment levels for a period of at least 5 years. Since enabling legislation was passed 10 years ago, the special economic zones have attracted more than 13 billion zloty worth of investment (1.6 per cent of GDP) and 50 thousands jobs.

disadvantage. Recent efforts within the government to delegate to PAIiIZ some of the decision making power as regard specific aids should be reinforced.

The authorities may also wish to examine more closely the overall effectiveness of the investment incentives that are being offered. Here, OECD (2003a) provides a checklist for government in assessing the cost effectiveness of tax and other incentives. In general, tax incentives run a particularly high risk of generating significant deadweight losses – *i.e.* being granted to firms that would have undertaken an investment anyway. Overall, associated tax expenditures are estimated by the Ministry of Finance to equal 0.7 per cent of GDP. These resources might be more usefully employed in improving the overall investment climate especially given the risk of high deadweight losses. In particular, while tax holidays and other reliefs can cause an investor to favour one site over another, research suggests that these are rarely the major determinants of firms' location decisions. Rather, the quality of local infrastructure and human capital, market access, administrative burdens and the overall stability of the business environment are determining factors (Ernst & Young, 2002)

Policies to improve productivity and profitability

OECD's product-market indicators suggest that Poland has the most restrictive set of business-sector regulations among member countries. Reducing these administrative burdens could generate substantial savings both directly in terms of reduced compliance costs, but also indirectly. Fewer regulations and a more predictable regulatory regime would help to reduce the incidence of corrup-

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tion and associated business costs [Poland is estimated to have the highest incidence of corruption among OECD countries (Transparency International, 2003)]. Indeed, the existence of such costs represents incentives for firms and individuals to participate in the underground economy, which is already estimated to represent 15 per cent of GDP. To the extent that streamlined administrative procedures helped bring firms and individuals back into the formal economy, it could generate an important virtuous circle. More formal employment and activity would generate more tax revenues, leaving open the possibility of reducing tax rates, which would tend in turn to further reduce underground activity, generating more employment and activity.

Policy can also contribute to increasing the growth potential of the economy by making a given level of capital stock more productive. While policies that promote innovation and technological change can play an important role in this regard, in an emerging economy such as Poland, much can be achieved via regulatory reforms that reduce the costs of doing business; by putting into place a productive infrastructure that enhances private-sector firms' profitability; and by increasing competitive conditions within the economy. Moreover, such moves, by reducing the costs of doing business, make investment opportunities more attractive. These new investments, both foreign and domestic, often embody with them improvements in the technology of production but also, just as importantly, improvements in terms of know-how and management technique that can significantly enhance domestic productivity.

In order to facilitate the creation of new companies and jobs and to increase survival rates of those already established, the authorities have included a number of initiatives within the overall "*Entrepreneurship First*" package with a view to reducing administrative burdens for both new and existing firms. Recognising that burdensome administrative procedures are an impediment to investment and, more generally, entrepreneurship in Poland, the plan enumerates a legislative agenda, covering among other reforms, a simplification of administrative procedures, a simplification of the social insurance system and a reform of the tax system.[16] Already a number of elements of the overall programme have been implemented.

Among the initiatives underway is a new draft *Law on the freedom of business operations* adopted by the government in October 2003. In addition to proposing a number of specific measures designed to improve the business environment, the bill is viewed as a framework law for entrepreneurship, setting-out for the first time an explicit public-sector obligation to support entrepreneurial activities. While largely a symbolic gesture, it is nevertheless important especially because the administration continues to exercise substantial powers and institutions of public accountability are, as yet, underdeveloped. Some of the most important initiatives of the draft law are aimed at restricting the possibility for the abusive or

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even corrupt exercise of public power. Recognising that multiple, time consuming and activity-paralyzing controls by often incompetent but still powerful public offices can lead to undue financial losses or even bankruptcies of firms, the bill proposes limiting the frequency of controls that can be made on a given firm and the number of separate ones that can be conducted simultaneously.

So as to streamline the firm creation process and thereby spur job-creation, a new "One-Stop Shop" enterprise register is to be created to replace the current 12 separate procedures, a number that compares unfavourably with other OECD countries (ten procedures for other emerging member countries and 7 for the OECD group as a whole). It is hoped, that these changes will reduce the time required to register a firm by almost two thirds from some 58 days now to about 20 days. For existing firms, the most important initiative involves raising from 5 to 20 employees the size limit for firms operating under simplified labour-market administration rules (see Chapter 3) – a step which could have important positive impacts for new and smaller firms who are least able to amortise the fixed costs associated with excess regulations.

In addition to broader regulatory reforms aimed at reducing the administrative burden on SMEs, the government is pursuing its programme to facilitate their access to external financing. The programme "Capital for Entrepreneurs 2002-2006" offers loan guarantees and actual loans and is being modified to take advantage of EU structural funds. Such programmes can play an important role in helping small firms access capital. However, care must be taken to ensure that such guarantees do not entirely eliminate the risk to lenders. Here, a system of interest rate subsidy or partial loan guarantee might be more effective and may help leverage the lending institutions' own self-interest in ensuring that prospects for loan repayment are acceptable.

Infrastructure

As indicated above, the overall business environment and the available infrastructure are among the most important factors influencing business location decisions. Moreover, by facilitating the transport of merchandise and the flow of information, a high-quality infrastructure can drastically reduce transaction costs – thereby contributing to higher productivity. Not only is Poland's infrastructure underdeveloped, as indicated in Chapter 1, but Poland is only investing between 0.5-0.7 per cent of GDP in infrastructure, less than half the average rate for other OECD economies (between 1-2 per cent of GDP).

Transportation

Investment decisions and the productivity of firms depend importantly upon the speed, reliability, and cost-effectiveness with which products can be brought to market and with which supplies can be brought to production facilities.

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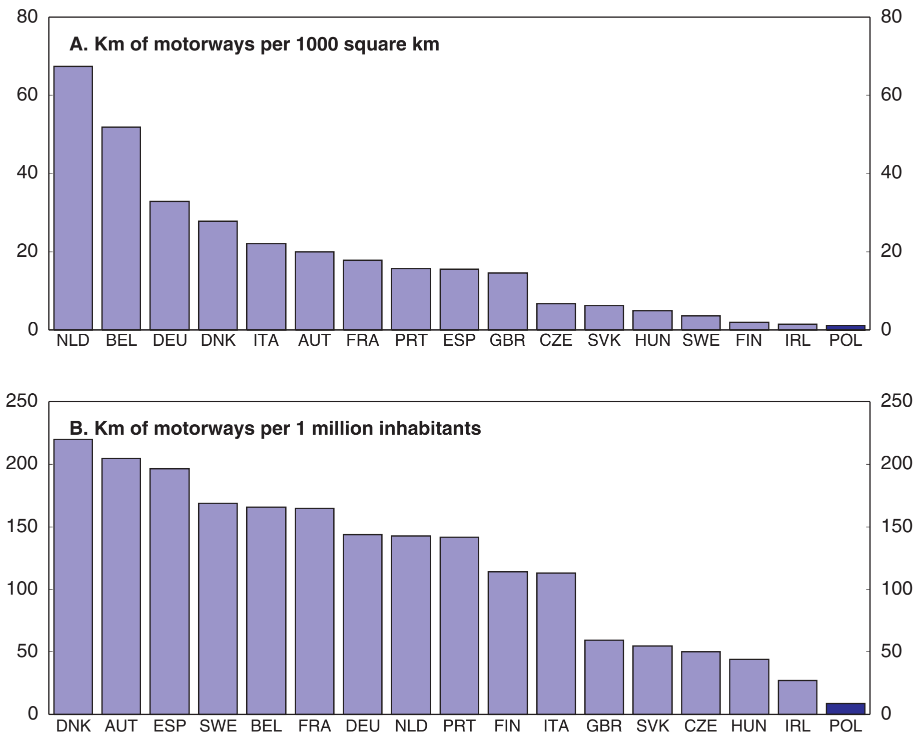
As discussed in the previous *Economic Survey*, the poor quality of the road system in Poland and its Warsaw-centric orientation represents a real deficiency. It prevents Poland from reaping the benefits of its favourable geographical location in the centre of the main transport corridors between Western and Eastern Europe and between Scandinavian countries and Poland's landlocked neighbours to the South. Indeed, in a country with an area of 313 thousand square kilometres, there are only some 600 kilometres of high-quality roadway[17], with both the density of motorways per square kilometre and per inhabitant substantially less than in any other European Union or accession member country (Figure 4.3). Furthermore Poland's position has been deteriorating as other countries have made more rapid

Figure 4.3. **Motorway densities**
2002[1]



1. Except for Ireland (2001), Portugal (2000) and Spain (1999).
Source: European Conference of Ministers of Transport and World Bank.

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progress.[18] Finally, the uneven market access that Poland's poor roadway system gives to different regions contributes to a large extent to regional development differences (OECD, 2002a). In both the Czech Republic and Hungary, the development of motorways with efficient connections to markets in western Europe has been a critical element in the success of different regions.

Enabling legislation was passed in 2003 to increase the financing options available for new roadways. An amendment to the Motorway Act creates a Motorway Fund that will be funded from excise duty on fuel toll fees and loans taken by the General Directorate for National Roads and Motorways. The Fund is to provide grants and interest-free loans to private-sector firms that will build roads, whose ownership will remain with the state, in exchange for an operations concession. Concessionaires are to repay their loans from their profits. The authorities expect that by the end of 2006 an additional 630 kilometres of high-quality motor, 481 kilometres of improved roads and 35 ringroads totaling 177 kilometers in length will be built. Given Poland's past record in organising road construction this is a very ambitious target. If achieved, it would represent a doubling of the existing stock of improved roadways, but also more than a quarter of the 2 000 kilometres of improved motorway that Poland plans to complete by 2015. The work is to be partially funded via EU structural funds and will seek to connect the country's major cities, with one road planned from the German border to Krakow, and further to Tarnow and Rzeszow, and a second motorway from Swiecko (on the German border) to Warsaw through Poznan.[19]

The rail system also represents a source of concern. Notwithstanding its extensiveness, poor maintenance and other inefficiencies conspire to make rail transport expensive in Poland. Overall less than 25 per cent of track is in good condition and long transit times, as much as two weeks, and high costs have been cited as a factor that reduces the competitiveness of the Polish coal mining sector. Demand for rail transport between main agglomerations is relatively high and improvements to infrastructure on these lines could be economically viable if the transit times were lowered and quality of service improved. In contrast, local lines are in very bad shape and, given low demand, may be economically unviable. Here some steps at liberalisation are helping, including the privatisation of some branch lines and the legal separation of the State rail company into separate entities managing the fixed and rolling stock. The Railways Transport Office was created in June 2003 with a mandate to provide oversight of a more competitive and efficient sector.

The authorities' strategy appropriately concentrates on the modernisation of both rolling and fixed stock on 12 000 km of lines of national importance. In this regard the European Union has been participating in improving rail routes, reducing the Warsaw-Berlin link to some 4¼ hours and with plans to upgrade the link between Katowice and Brno in the Czech Republic. More generally a restructuring

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programme is underway that seeks to increase speeds, lower costs and increase the competitiveness of rail transport, with a particular eye towards improving sea-rail connections. Financial responsibility for operating trains on the remaining 9 000 kilometres of lines of local importance is to be left with subnational governments. Such subsidiarity should help rationalise decision making concerning local lines by internalising costs. However, given the size and political importance of the rail system's labour force, it is not clear to what extent the authorities will succeed in delegating decision making to the local level.

Progress in developing air transport has been better although Poland's aircraft departure per inhabitant ratio is still 50-60 per cent lower than in the Czech Republic and Hungary who have opened up their markets to low cost operators. The construction of a new airport terminal at the Warsaw airport as well as planned future construction of new airports should considerably extend the capacity. Nevertheless, the benefits of these investments can only be fully realized if the monopolies within the Polish aviation sector are broken up, prices of connections are lowered and the range of available services is extended.

ICT *technology investment and infrastructure*

Information and communications technology is recognised as an important driver of technological progress in all OECD countries. While Poland lags in most indicators, this reflects to a large extent low income levels and a weak starting point. Thus, although there are only 31 fixed lines per 100 inhabitants the mobile-phone sector had developed relatively quickly with 45.1 numbers per 100 inhabitants. Official policy seeks to increase access to telephony throughout the territory and has placed a particular emphasis on expanding access to telephone and internet services to rural areas including a recent decision to maintain a VAT free policy for internet services. The fixed-line market remains dominated by the historic monopolist, TPSA – majority owned by France Telecom and although there have been a number of complaints and ruling concerning unfair competition, the independent regulator and overall regulatory environment have generally succeeded in promoting competition in the sector.[20]

Housing

In order to promote labour force mobility the authorities should expand programmes that help create and maintain low-cost rental housing. Currently, there are 308 inhabited dwellings[21] per 1 000 persons giving Poland a relatively low housing density. Official estimates indicate a housing shortage of about 1.5 million units. Moreover, as many as 1 million existing units could be destroyed for safety reasons during the next six years. As indicated in Chapter 3, overall internal mobility rates are very low – a factor generally attributed to the lack of a rental market and large regional differences in owner-occupied housing prices.

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To date, the bulk of State assistance has come in the form of interest subsidies on home-owner loans and tax expenditures equal to 0.6 per cent of GDP to offset owner-occupied housing expenditures. While this programme has been successful in promoting the creation of owner-occupied units (new starts have increased by almost 60 per cent since 1995), they have done little to promote the construction of low-cost rental housing. Indeed, the share of rental housing in the overall stock has declined from 52 per cent in 1990 to less than 28 per cent, mainly reflecting a policy of privatisation of rental and cooperative housing at favourable prices but also a system of rent controls[22] and strong tenants' rights which makes private investors (and municipalities) reluctant to invest in tenant housing (Zawislak, 2002). In particular, the combination of regulations that prevent landlords from evicting tenants who fail to pay if there is no state-supplied replacement housing available and a severe shortage of such housing makes private investors (and even municipalities) very reluctant to invest in rental housing.

The authorities intend expanding the supply of such temporary shelter and eliminating administrative barriers to their construction. While such moves are a step in the right direction they need to be complemented by a rebalancing of tenant-landlord rights in favour of the latter so as to increase the private supply of low-cost rental housing. The recent decision to delay the planned elimination of rent controls on accommodations subject to such rules until 2008 is unfortunate. The proposed draft goes part of the way to liberating the market by allowing new contracts to be free of controls. While this should increase incentives to invest in rental accommodation, the co-existence of free market and rent controlled units will likely result in serious distortions. Moreover, such a partial reform only delays and increases the price adjustment that will eventually have to be made. In order to accelerate liberalisation, the process of raising controlled rents towards market levels should begin immediately. Such a step should help to make rental accommodation a more attractive alternative for both investors and potential renters and should thereby contribute to the progressive revitalisation of the commercial real-estate sector. As the stock of such housing rises, renting would increasingly become a viable low-cost and low-risk alternative to still expensive owner-occupied housing and should thereby help promote labour mobility (see Chapter 3).

Given the relative supply of rental and owner-occupied housing, the authorities might also wish to consider reassessing the structure of aids – perhaps affording similar kinds of subsided loans to individuals and firms investing in rental properties. In particular, the authorities should extend to lower-income individuals the housing support offered to middle and upper income individuals through tax expenditures. This could be accomplished indirectly by reducing such expenditures and creating new incentives for the private production of low-cost housing in areas of relatively high labour demand. Such a solution would have the advantage over the alternative of direct subsidies to the construction of state-owned housing because it would harness private savings to speed the construction process. Indeed,

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rental and co-operative housing co-financed by the National Housing Fund (a programme introduced in 1995) now constitutes approximately 10 per cent of the total output of housing construction. At a minimum, income-tax reliefs currently afforded to home owners should be transformed from tax deductions to capped tax credits so as to eliminate the current bias in favour of wealthier individuals.

Privatisation and restructuring

Privatisation *per se* does not guarantee better economic performance. However, in generalprivatised firms outperform state-owned firms, partly because whereas unproductive and loss-making private-sector firms go out of business or are taken over, such State-owned firms too often continue to be propped up by their public-sector owner both lowering average productivity and preventing resources from moving to more productive activities. Indeed, up to 15 per cent of privatisation revenues are used in this way (Ministry of Treasury, 2003). Moreover, in a low-productivity country such as Poland, privatisation (especially to a strategic international investor) can often lead to substantial technological and know-how transfers. This can generate significant positive externalities, as parent firms train their locally hired workforces, share production and quality control techniques with local suppliers and produce demonstration and competitive emulation effects (OECD, 2001a). Indeed, to some degree it is precisely such factors that help explain the large productivity gains and innovations observed in, among others, the banking, car manufacturing, furniture production and air transportation sectors.[23] Finally, in countries such as Poland, where public finances are an issue, the State may be unable to muster the funds necessary to take full advantage of the potential of a company. In these cases, privatisation creates a channel through which domestic and foreign private-sector savings can be brought to bear.

While the privatisation process in Poland is well advanced, progress to date lags behind that observed in other central European member countries over a wide-range of indicators (Figure 4.4). Nevertheless, the Polish authorities are committed to pursuing the privatisation process. In particular, the 2004 Budget calls for a doubling of revenues. More generally, they indicate that they intend to reduce the State's ownership share in the economy from 25 per cent currently to between 10 and 15 per cent by 2006. At this stage they indicate that they would consider the core of the privatisation process complete – in part because by their estimation this represents the average level of state-ownership within the European Union. Nevertheless, even after completion of this next planned phase, the Polish State would still control three or four times as much of the overall economy as in other transition member countries such as Hungary and the Czech Republic. Moreover, given plans to proceed with further privatisation in most major European countries, even if today's objective were achieved, Poland would likely remain with a larger than average State-owned sector.

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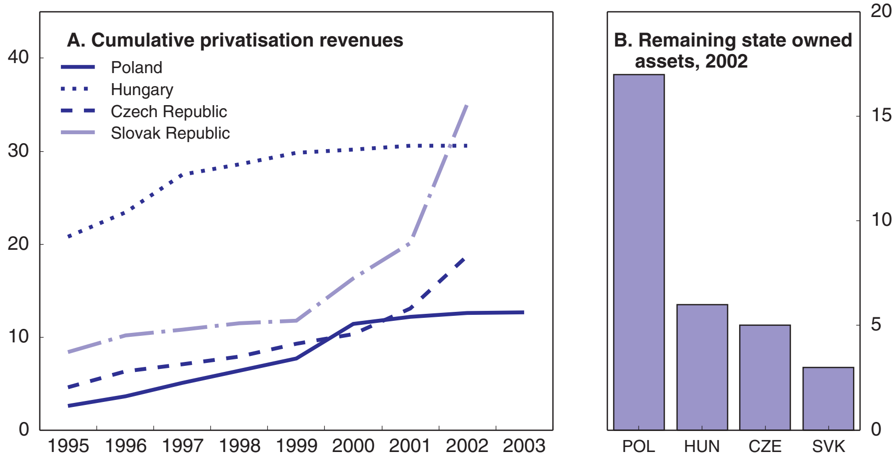
Figure 4.4. **Privatisation progress in selected transition economies**
Per cent of GDP



Source: EBRD, Transition Report 2003 and OECD.

Notwithstanding the modesty of official privatisation goals, meeting them will call for a substantial acceleration in the process, requiring a tripling or quadrupling in the pace of privatisation over the period 2004-2006.[24] To a large degree the relatively slow pace of privatisation in Poland reflects an uneven process, with privatisation in several sectors nearly complete but with progress having been particularly slow in others (notably, the mining, steel, defence industry, heavy chemical and rail transport). Overall, the State continues to have stakes in some 3 000 firms (Table 4.2) of which controlling positions in some 1 100 firms (13 per cent of the total value of firms in 1990). Moreover, since 2001 Poland has made very little progress in closing the gap with other central European member countries, with total sales consistently undershooting objectives by as much as two thirds. The authorities have enumerated specific privatisation programmes for firms operating in the mining, energy and heavy chemical sectors (Box 4.4). In addition, they hope to float minority stakes in two of the seven banks that they directly or indirectly control (see above). Longer-term objectives have been laid out for progress in the pharmaceutical and defence industry. In general, privatisation plans are to be preceded by a sectoral consolidation involving the agglomeration of profitable firms and units into a larger company with significant market power. This larger entity would then be privatised with purchasers undertaking various commitments as concerns future investment and employment levels.

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Table 4.2. **State-owned and controlled enterprises**

	1990	2002	2003[1]
Total Joint-stock companies with state ownership	8 453	1 630	1 716
100 per cent state-owned		417	475
50-100 per cent state owned		99	109
25-50 per cent state owned		420	449
Less than 25 per cent		694	683
Undergoing bankruptcy or liquidation		783	689
State-owned enterprises not yet approved for privatisation		603	531
Total firms with State participation		3 016	2 936
Total (with controlling interest including ongoing liquidations)		2 322	2 253
Total (with controlling interest less ongoing liquidations)		1 539	1 564

1. Data pertain to September 2003, except for the number of joint-stock firms in which the state share is less than 25 per cent, where data concern 28 October 2003.
Source: Ministry of Treasury.

Accelerating the transformation to a smaller state-presence will require a less rigid approach to privatisation. In the past, the process placed a strong emphasis on sales to strategic investors, with the state retaining substantial minority stakes in many companies and on limiting the short-term social disruption caused by the transfer of ownership. Thus, prospective purchasers have been obliged to undertake extensive obligations in terms of investment and employment plans and have had to negotiate their approval with unions in the to-be-privatised firm. These requirements, plus the authorities desire to maximise revenues from sales have slowed and on more than one occasion resulted in the abandonment of sales. Most recently, such considerations caused the authorities to refuse an offer for a 75 per cent stake *Rafineria Gdanska*, a large refinery that they have been attempting to sell for several years.[25] While in the case of the PKO BP bank a variety of such factors have led the authorities to re-launch the search for a privatisation advisor 5 separate times.

In contrast, a more flexible attitude taken as regards the sale in 2003 of the steel conglomerate, PHS (a company created in 2002 by the merger of four large loss-making steel mills). The firm was sold for 1.8 billion zloty,mainly in the form of the discounted purchase of existing debts. In addition to the relatively low sale price, the deal was reached more quickly than in the past partly because it was confirmed notwithstanding the fact that the purchaser had not agreed a social package with trade unions.[26] While care must be taken to ensure that sales continue to be characterised by transparency, more realistic expectations as concerns revenues and fewer restrictions on the behaviour of firms would help both to speed privatisation and to improve aggregate productivity performance.

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Box 4.4. The status of privatisation and restructuring in the industrial sector

As indicated in the previous survey the relatively slow pace of privatisation in Poland reflects the authorities' conscious decision to restructure some state-owned firms before proceeding with their sale. Over the past few years, restructuring has, in several instances, taken the form of merging existing firms into larger entities that the authorities hoped would have sufficient economic weight as to be economically viable, even though their component parts had been loss-making. In addition, firms have been generally obliged to agree investment and business plans as well as agree social plans restricting layoffs for a significant period. Most recently the authorities have sought to sell minority stakes, on the Warsaw Stock Exchange, in an apparent effort to retain control of firms whose capital is opened in this manner.

The energy generation sector remains largely in state hands and recent progress has been slow, overall. Despite several firms having been on the privatisation agenda for several years, relatively few generation, distribution or thermal-electric plants have been sold. Within the generation and distributions sectors, the authorities are merging existing firms into larger vertically and horizontally integrated entities before proceeding further with a sale of a miniority stake in the Warsaw Stock Exchange, At the same time, they seek to separate out the energy trading system and other non-core activities from PSE, the Polish Power Grid operator. Such a move is to be combined with a recapitalisation of PSE by transferring to it shares in other State-owned firms, which it is hoped will allow the firm to borrow under more favourable terms. Privatisation of PSE will not begin before 2005 and will require finding a solution to the stranded cost problem arising as a result of long-term contracts that have left the firm with an uneconomic cost structure. A draft law proposing annulling the contracts, and compensating suppliers with a one-time payment equal to the difference in the market value (as calculated by the energy regulator) of the firms before and after the annulment of the contracts. The problem is particularly complex as many of the loans in the sector were secured by these contracts.

The restructuring of the coal sector has been an ongoing problem, involving substantial financial and technical assistance from the World Bank and European Union among others. While large reductions in capacity and employment in the sector have been achieved, the sector continues to be characterised by excess supply and an uneconomic cost structure, which for exports is influenced by excessive transportation costs.* Some privatisation initiatives are currently underway and, as in other sectors, coal sector restructuring has also sought to create a market-dominating producer. In 2003, the authorities combined 23 mines into the conglomerate *Kompania Weglowa* S.A and intend folding-in a further 5 profitable pits in 2004 prior to an eventual privatisation.

* Transportation costs average 12-13$ per tonne from mine to port (World Energy Council *www.worldenergy.org/wec-geis/publications/reports/current_cls/ClsCOAL.asp*).

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Box 4.4. **The status of privatisation and restructuring in the industrial sector** (*cont.*)

Restructuring plans in the heavy chemical sector are at the earliest stages. A restructuring strategy has been adopted by the government. Here too, the strategy proposes merging existing firms into a larger entity that will be sufficiently large to be economically stable and able to compete in international markets. Existing non-core activities are to be spun off as independent business units, which are to be privatised at some future date and unused plant sites transformed into industrial parks that are to help spawn the establishment of local businesses in a supplier relationship with the larger chemical firms. Plans are contingent upon ensuring that the new conglomerate can get access to natural gas at competitive prices and include the possibility of merging a gas production company or a company having access to natural gas deposits to the new concern so as to provide it with security of supply.

The previous *Economic Survey* made several recommendations (Chapter 4, OECD 2002a) to accelerate the privatisation and speed the process by which private capital, market incentives and foreign expertise can be brought to bear in terms of productivity gains to firms and sectors that for the moment remain relatively unexposed to market pressures. These recommendations remain relevant and include:

- Reducing the influence of special interests (management and staff) within the privatisation process, by giving them less of a decisive role in approving sales.
- Streamlining the decision-making process by reducing the number of governmental institutions with responsibility over privatisations. In particular, the important role played by the Ministry of Economy, Labour and Social Policy and the Ministry of Infrastructure, which are also responsible for re-structuring programmes, leads to a natural bias that favours a necessarily slower strategy of restructuring firms prior to sale.The authorities' insistence on restructuring prior to sale can only make sense if it is presumed that they are in a better position to restructure these firms than a private-sector owner would be.[27]
- Being more proactive in direct privatisations. Currently, these generally occur at the initiative of management or local governments, who in many cases have no economic incentives to increase profitability and limited access to private-sector capital. As a result firms fail to take advantage of

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the market opportunities and fail to grow, which translates into slower productivity and employment growth, lower taxes and more demand for social expenditures.

- Freeing privatisation deals from industrial policy goals that complicate and slow sales. The repeated delays in the privatisation of the coal, steel and defence sectors at least partly reflect efforts by the authorities to attach conditions to these sales designed to create market-dominating firms – despite the negative consequences that such structures may have for competition. A simpler strategy would involve relieving firms of their accumulated debts and other contingent liabilities and then proceeding with their sale. Experience in other countries indicates that private sector operators are willing to come in under such conditions even if the firm remains loss making.
- Reducing the constraints imposed on purchasers' ability to manage their labour force, by making greater use of strengthened active-labour market measures (see Chapter 3) and, where appropriate, an enhanced social assistance system. Job retention contracts merely raise the cost of buying a firm and delay the inevitable job losses. Moreover, if not compensated for by a reduction in the purchase price they can be deal breakers.

While speeding the privatisation process should help productivity in the medium-term, attention nevertheless needs to be paid to improving the governance of those firms that the authorities intend retaining, those that have yet to be sold and the more than 900 partially privatised firms in which the State retains a controlling stake (a 25 per cent or larger share).[28] As indicated in the previous Survey, the authorities' apparent reluctance to allow private-sector partners to increase their participation in the capital of such firms, and thereby infringe upon the State's ability to influence corporate policy, defeats one of the main objectives of privatisation – enabling domestic firms to harness world savings so as to expand their activities and take fullest advantage of Poland's comparative advantages. Moreover, the very public disputes that have arisen,[29] including the decision to annul long-term energy contacts, risk jeopardising other privatisations by creating doubts about the authorities' willingness to relinquish their controlling interests and respect contracts freely entered into. Rather than second-guessing the decisions and strategies of its private-sector partners, the State should relinquish its remaining shares and concentrate its energy and resources in creating the kinds of framework conditions that would incite firms to undertake the kinds of activities that policy makers desire.

More recently, the State has indicated that it will proceed with the sale of a minority block of share on the Warsaw Stock Exchange in the case of a number of large companies, while retaining a majority or controlling state interest. Such a strategy runs the risk of saddling firms sold in this manner with a weak corporate

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governance structure. Indeed, it forgoes the significant advantages of selling to a strategic investor whose interests would be clearly linked to those of the firm. It also risks creating a defused ownership structure dominated by State, employee and management interests – a structure that, in emerging markets, tends to under perform ones dominated by a single investor.

Rural development[30]

In order to spur more rapid productivity and income growth, the authorities will need to provide a framework for faster restructuring in the agricultural sector. Unlike most OECD countries, a substantial proportion of the Polish population continues to live on the farm. Indeed, official statistics indicate 40 per cent of the population and 35 per cent of the working-age population live in rural areas. Moreover, between 16 and 25 per cent of the total work force[31] is employed on private farms, where they produce less than 3 per cent of GDP (Figure 4.5). Even adjusting this for part-time work, rural productivity remains low.[32] While many Polish forms achieve productivity levels comparable to those in western Europe, the vast majority are too small and over endowed in terms of labour – reflecting in part widespread hidden unemployment. Overcoming this very low productivity performance will be key to reducing poverty and joblessness among the rural population and by extension within the economy as a whole. The seriousness of the problem is only exacerbated by the size of the sector and the fact that in contrast to other transition countries within the OECD, agricultural productivity has not been improving. The lack of any significant adjustment in the agricultural employment since 1993[33] stands in stark contrast to the sharp fall in the sector's share in GDP and, more substantial restructuring in terms of the output of the sector.

The lack of urban rural mobility and the resulting poor agricultural productivity reflects several factors:

- the relatively low cost of living in rural areas, which makes low productivity farm-based activity relatively attractive;
- a preponderance of small and uneconomic farms, and a lack of consolidation among such holdings;
- substantial government transfers (a significant share of which are farm-specific) that interfere with market adjustment mechanisms, supporting a low-productivity poverty trap;
- land-ownership rules and transfer-based financial incentives that have prevented the consolidation of uneconomic small holdings;
- underdeveloped institutions to support a market for agricultural land;
- poor educational outcomes for rural students; and
- poor infrastructure.

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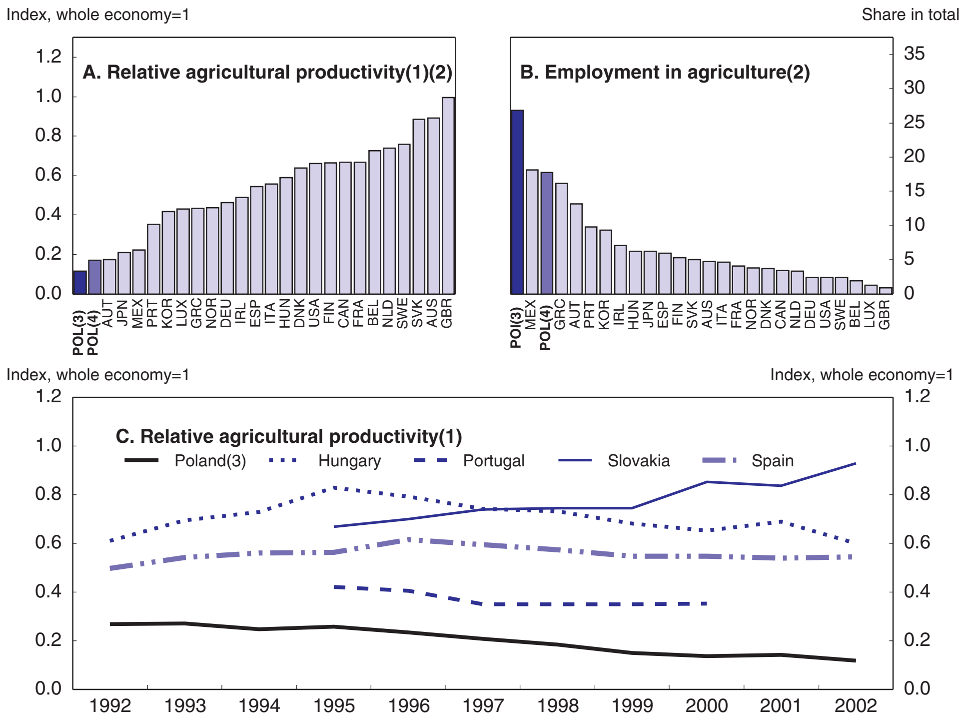
Figure 4.5. **Indicators of rural development**



1. Agricultural value-added per agricultural worker divided by whole economy value-added divided by total employment.
2. Data concern 2002, except for Australia, Belgium, Ireland, Japan, Mexico and USA: 2001; Canada and Portugal: 2000.
3. Based on national accounts data including all agricultural workers.
4. Based on Agricultural census data, including only those agricultural workers whose primary activity is farming.

Source: OECD.

The farmers' social security system and small-farm consolidation

In order to promote restructuring in agriculture, the authorities need to reform the special farmers' social security system (KRUS, for more on the labour market implications of this system see Chapter 3). As compared with the general system, ZUS, the KRUS system offers three important advantages: 1) contribution scales are substantially lower than for ZUS but offer comparable benefits (contributions only cover 5 per cent of expenditures); 2) all members of a farmer's household are entitled to coverage and in particular, all receive health insurance coverage, whereas under the ZUS system only beneficiaries (retirees and the disabled) and contributors (the employed and self-employed and their dependents)

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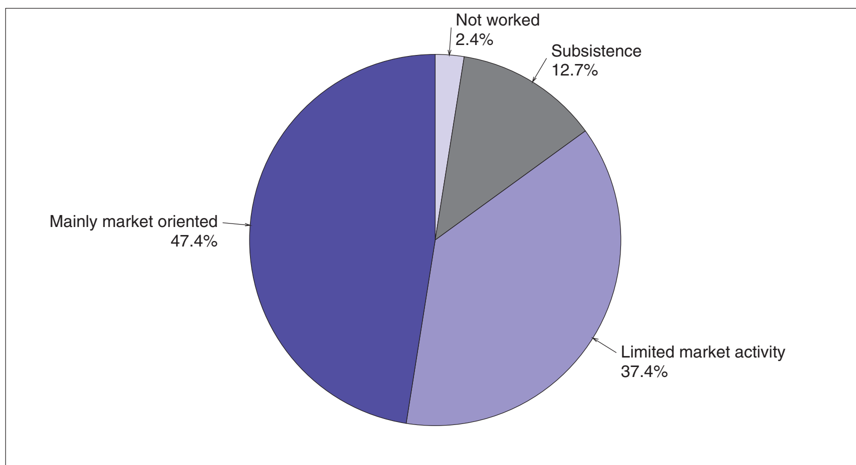
have health insurance coverage; 3) contributions do not rise with incomes. These features constitute a substantial implicit subsidy (95 per cent) to the KRUS system and represent a real financial incentive to remain in a rural environment and under the KRUS umbrella.

Access to the system is restricted by several eligibility criteria, most relevant of which are the need to own at least 1 hectare of agricultural land. This, plus a second condition providing unemployment benefits to KRUS householders that lose a non-farm job if their farm is smaller than 2 hectares contribute to a very high incidence of uneconomically small farms. Partly as a result, subsistence farms represent a substantial proportion of all Polish farms and less than half are significantly engaged in market activities (Figure 4.6). Moreover, because of the implicit KRUS subsidy, the necessary process whereby small unproductive farms are consolidated into larger ones has not been occurring. Indeed, while there has been an increase in larger farms at the expense of medium-sized ones, both the share and absolute number of small uneconomic farms have been increasing (Table 4.3). Twenty per cent of all farms produce only for own-consumption. For 70 per cent of these households, farming represents only 10 per cent of their total income (inclusive of own consumption). However, for 5 per cent of subsistence farmers, agricultural activity represents 90 per cent of household income. Even among households

Figure 4.6. **Market orientation of Polish farms**



Source: Ministry of Agriculture.

Table 4.3. **Number of private farms by size**
1990-2000

	1990	1995	2000	2002	2002/1990
	Thousands				Per cent change
Size of farm (in hectares)					
1-2	378	428	448	517	36.8
2-5	750	690	613	629	–16.1
5-7	319	274	224	217	–32.0
7-10	319	272	224	210	–34.2
10-15	242	219	186	183	–24.4
15+	130	164	186	196	50.8
Total	2 138	2 048	1 881	1 952	–8.7
	Share in total, per cent				Change
1-2	18	21	24	27	8.8
2-5	35	34	33	32	–2.9
5-7	15	13	12	11	–4.0
7-10	15	13	12	11	–4.0
10-15	11	11	10	9	–2.0
15+	6	8	10	10	4.0
Memorandum items					
5 or less	1 129	1 118	1 061	1 146	1.5
Average size	6.3	6.7	7.2	7.4	17.5
Arable land	10 941	11 722	11 845	11 485	5.0
Privately-held agricultural land	14 228	15 205	15 456	14 858	4.4
Total arable land	1 4228	15 205	15 456	15 734	10.6
Total area of plots larger than 1 ha[1]	13 469	13 722	13 543	14 445	7.2
Total area of plots less than 1 ha[1]	759	1 483	1 913	1 289	69.9
Share of land owned by State	24.0	18.3	16.1	16.1	–33.1

1. OECD estimates based on data from Central Statistical Office.
Source: Central Statistical Office.

producing mainly for the market, agricultural activity represents less than 10 per cent of total income.

The potential productivity returns from farm consolidation are large (see Chapter 1). Data suggests that farms smaller than 15 hectares cannot support a household and that returns to labour are close to zero for farms of up to 30 hectares – implying that more than 90 per cent of Polish farms are overmanned. Because of low productivity, farmers have not been in a position to invest in their farms and as a consequence the sector has suffered from years of underinvestment. This, plus farmers' generally low-level of educational attainment, partly explains their failure to make effective use of technology. Polish farmers employ only one third the level of fertilisers used elsewhere in the EU and one seventh the level of pesticides (Lisztwan and Dalton, 2001). Consolidation of small scale

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farms could yield increases of 12 to 25 times as much output per worker (on a full-time equivalent basis). As indicated in Chapter 1 economy-wide returns from agricultural restructuring could yield an increase in potential output growth as high as 1 per cent per annum for a period of several decades or more.[34]

Notwithstanding the importance of the KRUS system as an explanation for the slow pace of rural restructuring, before consolidation can be expected to progress significantly, much needs to be done to clarify property rights in the agricultural land market, reduce transaction costs and eliminate ownership restrictions. Indeed, while Poland has made substantial progress in its transition towards a market economy, institutions in the agricultural land market have lagged behind. Dale and Baldwin (2000) estimate that, as of 1998, Poland had made only about one third of the progress to reach levels observed in developed market economies.

In this regard, efforts should be made to spur farm consolidation by eliminating the 5 per cent land-transfer tax, lowering the costs of land registration and eliminating other impediments to land purchase. Currently the 5 per cent land-transaction tax and fees associated with registering and transferring of land ownership combine with notary fees to raise sales costs to as much as 12.5 per cent of the total sale price for small holdings.[35] The problem is particularly acute for the 30-40 per cent of agricultural land, mainly small plots, that is not yet registered (registration is only obligatory at the time of sale). By making land-registration obligatory but free, at least during the transition period when the remaining stock of land is brought into the registry, the authorities would help to make the agricultural land market more liquid, thereby increasing the likelihood of consolidating purchases being concluded. Moreover, once the registry is completed, there appears to be substantial scope for simplifying and streamlining the process, which should contribute to reduced costs and lower fees even in the long run.

Completing the registry would also help clarify property rights and would, in combination with a recent decision to raise the priority of mortgage claims from 6th to 3rd during foreclosure procedures (after outstanding wages and taxes), increase the willingness of financial institutions to extend credits to farmers. Indeed, over 50 per cent of non-farm business investments are financed from private savings, and only 17 per cent are intermediated by banks and cooperative banks. Here, recent changes raising the share of land's value that can be mortgaged and the recent reform of the bankruptcy law (see above) may help to increase both land consolidation efforts but also investments that could promote rural employment and productivity.

In addition to helping speed the restructuring of the agricultural sector, such steps would also likely improve rural wealth. Currently, Polish land prices are one fifth of the levels in eastern Germany and one tenth those in western Germany. Moreover, land prices in Poland have been stagnant in real terms – in contrast to prices in other transition countries with more liberal regimes. A thin

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land market, poor land productivity and ownership restrictions (see Box 4.5) keep land prices low. While this benefits young Poles who might wish to enter the market, it deprives those that are in it (and their children) from deriving the maximum value from their land should they wish to leave and as such slows consolidation. Contrary to popular thinking, in the context of functioning credit markets, a generally higher price level would not reduce opportunities for purchasing because it would increase the value of the purchaser's existing assets and those that he purchases, both of which could be used to secure credits. Moreover, higher rural land prices would make the purchase of an apartment in an urban area more affordable, thereby increasing urban-rural mobility.

Privatisation of the remaining 16 per cent of agricultural land held by the State (down from 25 per cent in 1990) would also help develop the market for agricultural land. Although collectivisation was less pervasive in Poland than in other former communist countries, the process of restitution and privatisation of state-owned lands has been slow, mainly because of multiple claims on the same property

Box 4.5. Ownership restrictions on agricultural property

Polish law requires that a purchaser of agricultural land have "practical and theoretical agricultural qualifications", either vocational secondary vocational or tertiary training or be resident on a farm. The Ministry of Treasury can prevent a sale if following the purchase the new owner would have more than 500 hectares of land; if he does not live in the commune where the purchase is being made; or does not declare that he will work the land himself.

Beyond these regulations, foreigners are not legally prohibited from owning agricultural land. However, for a period of 12 years following EU accession in order to make a purchase foreigners must apply for and receive approval from the Ministries of the Interior, Defence and Minister of Agriculture and Rural Development. Leases do not require permits. Moreover, a foreigner having leased land for between 3 and 7 years (depending on the region) may purchase it on the same basis as a Polish citizen. A recent amendment to the act on the management of State Treasury Agrarian property only allows individual or firms that are already in agriculture or who are repatriates or who fulfil the requirements of the agricultural settlement programme from participating in tenders for the sale or lease of agricultural land (Chaplin, 2001).

In the context of EU accession, Poland has been able to preserve these restrictions for a period of between 3 and 7 years, depending upon the region.

All told, the Agricultural Property Agency has sold an estimated 39 000 hectares to foreigners since 1990 and leased 114 000 hectares to foreigners and a further 60 000 ha to companies with foreign participation.

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arising from the manner in which land was initially collectivised. Rather than privatise under uncertainty, the State has opted to lease land[36] in about equal proportion to local farmers and private companies.[37] In order to get around the problem of multiple claims on the same land, a restitution/privatisation plan that gave individuals with valid claims a share of the total revenues (or land) rather than a specific plot would allow progress to be made more quickly. More generally, the leasing of State land has had a positive impact on agricultural productivity. On average parcels of leased land are 15 hectares in size and farms including some leased land are on average more than three times as large as those without. Among private owners, leasing is much less common, 83 per cent of farmers do not lease land and those that do tend to be older farmers, who rent out significant parts of their land because they are no longer able to farm it. Taken together, these facts suggest that a significant proportion of larger farms in Poland are in fact ones either operating wholly or significantly based on leased land State land.

Rural income transfers

Official statistics indicate that the per capita income of farming households is only three quarters of the economy-wide average. However, this does not take into consideration the consumption of own-production goods, estimated to equal 9 per cent of total rural household income[38] or the generally lower cost of living in rural areas, which Paci and Sasin (2003) estimate to be 13 per cent lower than in urban areas. A special rural household income survey conducted by the World Bank suggests that non-farm wage income may be higher than recorded in the household budget survey. On the basis of this data, per capita farm incomes uncorrected for rural prices are only 8 per cent lower than the national average (Table 4.4). Independent of which data source is used, the low cost of living in rural areas combined with substantial sources of non-earned income makes low-productivity rural activity a viable alternative to looking for better-paid work in an urban environment. This is a factor, which in addition to the difficult labour market situation in urban areas helps explain why, notwithstanding very low rural productivity levels, rural out migration has declined from 113 000 per annum in 1990 to only 9 000 in 1998 and actually had reversed itself in 2002 with some 18 000 individuals net moving from urban to rural areas. Farming households are heavily reliant on government transfers for their income, with on average one third of total revenue coming in the form of government transfers, one third from off-farm work and only one third from farming itself. Among smaller farms, the share represented by farm income in total income is even smaller and that of transfer income larger.

Recognising the problem, the authorities are proposing to substantially reduce incentives to stay in rural-based low productivity work by requiring farmers to pay contributions to the KRUS system more in line with their incomes and at

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Table 4.4. **Sources of farm household income by farm size**

	0-1 ha	1-7 ha	7-15 ha	15+ ha	Average	Farmers[1]	Whole economy[1]
				Zlotys			
Household annual income	20 140	18 189	18 621	53 198	28 313	23 160	22 855
Per capita	6 794	4 381	4 734	11 751	6 737	5 472	7 326
Net farm income	2 189	1 295	8 203	39 034	13 577	16 716	
Net income from non-farm business	348	1 773	183	4 757	2 134		
Non-farm wage income	8 609	7 839	4 116	3 057	5 706	382	
Income from transfers	9 300	6 949	5 622	5 776	6 428	5 280	2 295
KRUS	2 827	2 842	3 851	4 580	3 560		
ZUS	4 937	3 418	1 372	815	2 343		
Other	694	333	497	574	468	782	
				Per cent of national average earnings[2]			
Household annual income	88	80	81	233	124	101	100
Per capita	93	60	65	160	92	24	32
				Per cent of household earnings[3]			
Net farm income	11	7	44	73	48	73	
Net income from non-farm business	2	10	1	9	8		
Non-farm wage income	43	43	22	6	20	2	
Income from transfers	46	38	30	11	23	23	10
KRUS	14	16	21	9	13		
ZUS	25	19	7	2	8		
Other	3	2	3	1	2	3	

1. Data are taken from Table (207) Central Statistical Office (CSO) (2002), *Statistical yearbook of Poland*, monthly average data multiplied by 12.
2. World Bank rural household survey data divided by CSO whole economy data.
3. World Bank rural household survey data divided by World Bank Rural household survey data.

Source: OECD, calculations using data from World Bank (2001), CSO (2002).

rates closer to those that would be paid by participants in the general system (ZUS). While likely to be unpopular, such a reform is essential if market incentives to move to higher productivity work are to be effective in promoting migration. To be most effective, this initiative should be supplemented by a reform of the way in which individuals' qualify for health insurance. Under the current system, all members of a KRUS enrolled farmers' household qualify for health insurance even if they have no income. The same is not the case for ZUS households. Here, given the severe financial difficulties experienced by the healthcare system a better solution might be to make access to the healthcare system universal and transfer its financing to general revenues. This would have the simultaneous advantages of: allowing for a reduction in payroll taxes, with beneficial impacts for the labour

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market; providing for clearer governance of the healthcare system (see OECD, 2002a); and making individuals indifferent (at least from the point of view of healthcare) as between working inside and outside of the farming sector.[39]

Rural development projects

At least some of the net savings generated from making benefits and contributions in the two systems more similar should be used to enhance current efforts to promote regional development. Here an augmented agricultural outreach programme that emphasises the possibilities and benefits from small farm consolidation should be considered. Indeed, while the current emphasis on helping teach farmers how to apply for EU funding may help restructuring in the long run by providing successful farmers with the resources to finance consolidation, in the short-run it will be counterproductive to the extent it encourages farmers to see EU funding as a further source of unearned income support.

There seems to be opportunity for refocusing the assistance already given. Milczarek (2003) argues that too much money is going to production subsidies in the form of subsidised loans and not enough to infrastructure development. The Agency for Reconstruction and Modernisation of Agriculture (ARMA) spends about 0.2 per cent of GDP on rural development, with almost 70 per cent of that amount going to cover subsidised interest payments. Less than one tenth of the total goes to rural infrastructure and human capital enhancing projects (Table 4.5).[40] By value, more than 30 per cent of expenditures is made in the form of interest subsidies for loans covering operating costs (purchases of agricultural inputs and the storage of surpluses). In volume and presumably administrative effort, these represent 78 per cent of all loans.[41] Not only does such support not contribute to improving agricultural

Table 4.5. **Expenditures of the Agency for reconstruction and modernisation of agriculture**

	1995	2000	2002
	Share in total, per cent		
Subsidised loans:			
For investments	25.1	59.0	41.3
For working capital	52.2	31.6	27.2
Co-financing technical infrastructure development	12.7	0.7	0.0
Job-creation loans	2.4	1.3	2.6
Vocational qualifications and on-the-job training programmes	1.4	0.5	1.1
Other (of which SAPARD loans)	6.2	7.0	27.7
Total Zloty, 1995 prices	597 718	832 715	808 503

Source: Ministry of Agriculture, OECD calculations.

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productivity, research suggests that it is also ineffective as an anti-poverty measure (Milczarek, 2003) – mainly because it is only better off farmers producing for the market that qualify for loans (85 per cent of loans go to farms larger than 7 hectares). Very little money is spent on human capital improvement spending. The fast growth in spending the "other" category reflects loans to support agricultural and rural development (SAPARD) (see Box 4.6).

Efforts at upgrading infrastructure may have an important effect on contributing to improved rural productivity. The EBRD (2002) reports that improvements to the quality of rural roadways can generate social returns in excess of 35 per cent and are beneficial to rural communities because they both improve market access for rural products and they reduce costs of goods sold in outlying areas. Similarly, efforts at improving the distribution network for farm goods and supplies can have important positive effects. The creation of a central Warsaw market helped improve transparency by bringing sellers and buyers together, thereby ensuring that sellers received a fair price but also forcing them to compete more effectively in terms of quality and price.

Finally, as indicated in the Chapter 3 rural educational outcomes are low (44 per cent of the rural population has less than basic vocational education) and

Box 4.6. **The Special Accession Programme for Agriculture and Rural Development – (SAPARD)**

In the case of Poland the SAPARD programme has fixed itself two principal objectives: 1) improving the efficiency of the agri-food sector (30 per cent of funds will go towards supporting the processing and marketing of agricultural products and 15 per cent towards bringing beef an dairy operations into line with EU *acquis*) and 2) improving the conditions for economic development and job creation (around 30 per cent of funds to go towards infrastructure development, 15-20 per cent towards to support diversification of farm incomes and collective marketing efforts). A final 3 per cent of the funds are destined to provide technical support to the programme.

Limited funding (only 170 million euros over seven years, 2000-2006) means that the programme will be able to affect only a small portion of all enterprises in target areas, (¼ of dairies and less than 10 per cent of dairy farms. Moreover, the net benefit of the programme will depend importantly on the quality of programmes it finances. Because the financing is to be made as a complement to national programmes, to be effective these programmes will need to be better targeted in the past so as to ensure that they do not just displace private investment that would have occurred anyway.

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have been for sometime.[42] While the steps outlined there to improve resources at the local level and to make curricula in non-academic streams more appropriate should be helpful, effort also needs to concentrate on practical adult education. Here making smallholders more aware of opportunities for expanding their holdings or of leasing would be useful. Moreover, as indicated by Leiprecht (1999), labour mobility is strongly correlated with educational attainment. For future generations this is important, although for those currently on the land there is no obvious policy solution.

Summing up

Increasing investment rates and raising productivity growth rates must be critical elements of any strategy to raising the incomes of Polish workers to the level of individuals in other more developed OECD countries. Both investment and productivity are the result of a complex series of economic decisions and actions and neither can be directly influenced by government policy. Nevertheless, as outlined above, government can influence investment and productivity developments by pursuing a set of policies that seek to lower the barriers to bank lending, spur privatisation and private ownership, streamline the functioning of the judicial system as it applies to firms, remove roadblocks to firm activity and invest in the fundamental public infrastructure that facilitates business activity. Table 4.6 summarises the recommendations of this chapter and updates implementation efforts in other areas addressed in earlier *Surveys*. Progress in these areas coupled with the kind of reforms liberating effective labour supply and demand outlined in Chapter 3, would go a long way to creating the kind of dynamic and sustainable growth needed to rapidly reabsorb the vast pool of currently unemployed individual in Poland.

Rural restructuring and the freeing up of labour currently occupied in low-productivity, low income agricultural and rural activities has a central role to play in the process. For that potential to be realised will require that a number of difficult reforms be launched, principally aimed at those features of the farmers pension scheme that serve to block farm consolidation on the one hand and labour mobility on the other. While such a reform is likely to impose costs on some parts of society, doing nothing is not an option. The past 15 years suggest quite clearly that with existing institutions the sector will not evolve and that human and productive potential will continue to be wasted. Here, how the funds made available following Poland's adhesion to the European Union are used will play an important role in determining the future course of rural restructuring. While these could be used to help improve the level education, develop infrastructure to both upgrade the rural economy and facilitate communication with urban centres, there is a risk that they will become another income transfer that further increases the opportunity cost of leaving the farm, thereby slowing the necessary and inevitable transformation of the rural economy.

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Table 4.6. **Structural surveillance**

Issues/previous recommendations	Recent action taken	Assessment	Follow-up recommendation
Panel A: Labour markets			
Chapter 3 deals with labour market issues in detail and a summary of its recommendations is presented in Box 3.8			
Panel B. Product and financial markets			
Sectoral restructuring			
Coal-mining Reconsider the balance of costs and benefits from merging mines. Enhance surveillance to ensure competition in the sector.	Remaining mines were consolidated into three holdings, output and the workforce were reduced further: financial restructuring and injection of additional capital were pursued. Some privatisations are planned for 2004.	Despite considerable downsizing the sector remains unprofitable. Merged mines could create monopolistic rents and cross-subsidise unproductive mines to the detriment of the competitiveness of customers that are dependant on coal.	To ensure low prices for consumers, the competition authority will need to follow developments closely.
Iron and steel Reconsider plans to merge steel mines, if proceeded with reinforce regulatory surveillance.	Four largest steel producers (80 per cent of production) were merged and sold. Consolidation within product groups and financial restructuring of the remaining entities is underway.	The privatisation of the consolidated steel producer may represent a model for faster sales, but market dominance remains an issue.	Reinforce competition vigilance.
Gas Proceed with sale of regional distributors. Widen scope for competition from imported gas.	Sales of regional distributors continue to be stalled.	Restructuring of the gas sector is proceeding too slowly. Import opportunities for foreign market players need to be expanded. The non-competitive gas market impedes the liberalisation of the electricity and coal sectors.	Implement previous recommendation.
Defence sector Implement privatisation plans.	The government created 2 holdings and plans to contribute the shares of a number of remaining companies after their restructuring. The remaining companies will be sold following restructuring.	The sector remains weak and plans to consolidate disparate firms may not bring the desired privatisation revenues.	Proceed with privatisation, but reconsider the consolidation-before-privatisation approach.

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Table 4.6. **Structural surveillance** (*cont.*)

Panel B. Product and financial markets			
Electrical sector: Reconsider the balance of costs and benefits from merging power plants.	The new amended strategy (April 2002) plans to merge three major power plants; a lignite-fuelled power plant with its supplier mine; and several regional distributors. The role of PSE, the national operator, to be restricted to transmission alone. Distributors' monopolies in local power supply will be terminated. Privatisation of PSE will not begin before 2005.	The envisaged reduction of the role of PSE and the increased exposure of the regional distributors to competition in the retail market are welcome. Recent progress has been slow, due to plans to merge firms before privatisation.	If the merger of the lignite-fuelled power plant with its supplier mine is implemented and if other such mergers will follow, ensuing privatisation deals should not include provisions prohibiting the unbundling of the mines and the power stations.
Electrical sector:*Stranded costs* Attempt to adopt the compensation payment system and increase the openness of the sector to imports.	Long term contracts were declared void by law, with proposed compensation equal to the difference of the value of firms before and after liquidation of contracts. Estimates of compensation to be made energy Regulator and financed by securities emitted by PSE.	The liquidation of long-term contracts allows competition to influence domestic prices. However, if the proposed compensation is not seen as fair, the process could be viewed negatively by markets.	Both for equity reasons and to maintain investor confidence, the proposed compensation must do justice to companies that have made investments based on the long-term contracts.
Banking sector Expand the plans for privatisation in the sector.	A restructuring plan of BGZ has been adopted in October 2002, including plans to increase shareholders' equity through partial privatisation on the Warsaw Stock exchange.	A large State presence in the sector contributes to low efficiency and may distort resource allocation.	Instead of a partial sale of BGZ shares, the bank should be sold to a strategic investor.

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Table 4.6. **Structural surveillance** (*cont.*)

Panel B. Product and financial markets

Privatisation			
Accelerate privatisation in a transparent and predictable manner.	Progress in 2003 has been disappointing. 4.5 billion zloty in privatisation revenues were raised. 3 000 companies still remain in State hands. The 2004 Budget anticipates 8.8 billion zloty in privatisation revenues.	Privatisation process is excessively cumbersome, complicated and costly. Current process places too large an emphasis on sales price.	Reduce the number of governmental institutions with responsibility over privatisations; avoid complicated social clauses and instead providing direct social and labour market assistance to affected workers. Adopt a more pragmatic and active approach placing less emphasis on the sale-price and more on the total cost/benefit.
Actively promote the sale of small firms and minority stakes using the expertise of an investment bank.	Some small firms have been bundled recently and sold to an investment bank for subsequent sale.	The pace of sales remains very slow.	Implement the previous recommendation and extend the use of bulk sales.
The State should accelerate its withdrawal from firms in which it holds a controlling or minority stake.	The State continues to hold controlling or significant minority stakes in the vast majority of formerly wholly state-owned companies.	Plans to sell minority stakes on the stock exchange risks creating a weak corporate governance structure and denying firms access to necessary capital and guidance from a strategic investor.	Implement the previous recommendation.

Panel C: Regulatory reform

Regulatory framework			
The competition authority should criticise more openly government decisions with which it disagrees. It is especially important for it to play an active watch dog role over market conditions where market dominating firms are being created.	No specific actions.	The competition authority needs to be more publicly critical of government positions with which it disagrees.	Implement the previous recommendation.

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Table 4.6. **Structural surveillance** (*cont.*)

Panel C: Regulatory reform			
Introduce clear rules governing the protection of minority shareholders in the case of conflicts with firm management and on majority owners.	Voluntary corporate governance codes based on OECD guidelines were made compulsory for listed firms.	This development is welcome. However, temporary exemptions allowing companies in which Treasury is a shareholder to hold extra special voting shares and issue non voting shares, introduces undue special rights and is difficult to justify on either economic or equity grounds.	Government should consider the immediate suspension of temporary privileged voting rights conceded under the new Code.
Improve the efficiency of capital markets.	Signature of agreement between WSE and Euronext stock exchange of conferring on each mutual trading rights. Increased instruments available to Open Pension Funds and the share of assets in risky instruments.	Efforts have reduced transactions costs for foreign traders, improved the reliability in Polish capital markets. However, the Polish market remains thin.	Continue efforts to expand liquidity on Polish markets.
Improve infrastructure.	Enabling legislation for motorway construction and financing passed; creation of the "Railways Transport Office" in June 2003; plans to upgrade rail access between major urban centres; creation of a new airport.	Poland's infrastructure remain underdeveloped, which impedes investment and curbs productivity growth.	Increase expenditures in infrastructure, taking advantage of EU funds. Speed up privatisations in the transport sector so as to improve its competitiveness.
Expand housing rental market.	Plans to eliminate rent controls by the State in 2005.	Lack of rental housing limits opportunities for labour mobility; excessive tenants rights and rent controls are among the most serious problems.	Include rental housing in home renovation and construction loan programmes; eliminate rent controls; improve the balance between tenant and owner's rights.

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Table 4.6. **Structural surveillance** (*cont.*)

Panel C: Regulatory reform			
Specific measures			
Extend the electronic registry system to form a one-stop business registration system.	Proposals have been floored to create of a one-stop shop enterprise register and further reduce administrative burdens.	If implemented, these changes can be expected to facilitate the conduct of business and improve transparency and confidence with which economic agents enter into agreements.	Continue efforts to simplify red tape. The effectiveness of the new business registry would be reinforced by adding all existing businesses as rapidly as possible.
Eliminate impediments to real-estate transactions.	Time to register property has been reduced. A computerised registry that covers major urban areas has been created.	Institutions in the agricultural land market lag behind the urban property market impeding land sales and purchases. Lags in updating registries remain large in some large urban centres.	Rural land registration should be made obligatory and free, including the temporary suspension of the land transfer tax. Existing restrictions on land purchases should be liquidated. Real-estate remaining in State hands should be fully privatised.
Be more proactive in promoting FDI.	The national investment promotion organization (PAIiIZ) was strengthened.	The effectiveness of PAIiIZ would be enhanced if it were given authority to negotiate binding *ex ante* agreements and if it were able to offer one-stop shop services to investors.	Offer more pro-active assistance to firms seeking to invest by creating a one-stop shop investment agency maintaining an up-to-date investment site database, able to make binding offers and providing more comprehensive administrative help.
Reduce uncertainty in the tax system.	A draft law, if passed, would oblige the tax authorities to provide free of charge *ex ante* exculpatory tax rulings.	This proposal is welcome as tax administration is a major source of uncertainty that curbs investment. However, the problem of different interpretations at local tax offices remains.	Implement the proposed reform and set up a centralised authority for *ex ante* tax rulings; reduce the lag between the passage of a tax law and its enactment; reduce administrative complexity and compliance costs for all tax filers.

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Table 4.6. **Structural surveillance** (*cont.*)

Panel C: Regulatory reform			
Lower the overall tax rate faced by enterprises and streamline tax and regulatory frameworks.	Corporate income tax has been reduced from 27 per cent to 19 per cent. Submission of tax documents has been simplified for smaller firms, social security rebates for newly hired graduates and tax holidays for newly established youth entrepreneurial activities have been introduced.	The introduced changes should support Polish competitiveness but the tax system remains very complex.	Simplify tax and regulatory environment.
Streamline bankruptcy procedures.	Introduction of a new bankruptcy law in October inspired by current best practices.	The new law should contribute to the strengthening of creditor rights, reduce the potential for debtors to delay restructuring and speed court procedures. Execution remains a serious problem.	Improve the quality and efficiency of judicial processes; make use of potential in law to speed bankruptcies and give a greater role to creditors; reconsider provisions that require the administrator to attempt to sell a bankrupt enterprise as a whole rather than breaking it up.
State aid, both direct and indirect, should address specific market failures and avoid distorting competition by introducing rules and minimise moral hazard and adverse selection risks.	The new State aid law sets out clear conditions for admissibility and defines the rules for granting and supervising state aid to entrepreneurs.	The new law brings Poland closer to international standards in this area; however, too often loan guarantees are exempted from the rules.	Evaluate the ability of the new state aid regulations lower tax and social security arrears. The usefulness of the competition authority's annual report on state aid would be enhanced if it were submitted earlier in the budget process.

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Table 4.6. **Structural surveillance** (*cont.*)

Panel D: Sustainable development			
Ensure effective integration of environmental considerations in sectoral policies by including environmental priorities into the regulatory framework.	The 2001 2nd National Environmental Policy provides the basis for integrating environmental concerns into policies at national, regional and local levels and within this context it includes special Action Programmes for air, water and waste.	New effort is welcome, insofar as it can be expected to contribute to re-orienting policies towards a sustainable approach.	Continue to monitor and update programmes as their implementation proceeds.
Provide the legal basis for tradable emission permits; develop regulatory framework for domestic emission trading systems.	A draft law for tradable permits has been completed and the phasing in of the new system started in January 2002.	Though a step in the right direction, much more needs to be done to increase the monitoring capacity at the *voivodship* and *poviat* level and to establish an efficient system of communication between them.	Improve training concerning tradable emission permits and the extent of communications between relevant staffs.
Formulate a strategy for phasing-out Environment Funds.	While several actions have been taken to make the activities of the Funds more transparent, their phasing out is not part of the government's agenda.	As the availability of market-based sources of financing for environmental protection increases, fund-based subsidises to polluters are less justified.	Implement previous Survey recommendations.
Panel E: Healthcare reform			
A new law on healthcare is needed to consolidate the weak elements of recent reform (definition of a minimum package of benefits, improvement of payment arrangement, enforcement of a hard budget constraint on regional funds).	The government envisages integrating the existing 17 healthcare funds into a single fund and strengthening central influence on service providers.	Though a detailed plan remains to be outlined, integration of funds should help assert control over the system.	In order to ensure that further reform does not destabilise the system, implementation of any significant change in the system should be undertaken carefully and in consultation with stakeholders.

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Table 4.6. **Structural surveillance** (*cont.*)

Panel F: Efficiency and sustainability of public expenditures			
Make the annual Budget process more comprehensive by integrating into it the activities of the extrabudgetary funds.	The Ministry of Economy, Labour and Social Policy has been made responsible for administering the Labour Fund.	Including extrabudgetary funds in the Budget would ensure a better adequate control and monitoring of central government programmes.	The Labour Fund should be integrated into the State Budget and the Health Fund could be as well.
Adopt a medium term budgetary framework with an explicit expenditure rule.	A "Medium-term growth and fiscal strategy" is produced regularly. Officials talk of an expenditure rule for the State Budget but it is not binding.	These medium-term projections are only very weakly integrated into the budget process. The expenditure rule is not respected and only concerns the State Budget.	Implement the recommendation.
Increase the transparency of public finance at local and central government level.	To support enhanced local government powers, a larger share of personal and corporate income tax revenues are being transferred to sub-national levels of government, partially offset by reduced cash transfers.	This reform is an important step in the process of decentralisation. However, because transfer formulae are based on costs not ability to pay, services in low income regions are underfunded.	Local-level budgetary reporting needs to be improved. Financing rules for sub-national levels of government should take into consideration their capacity to pay co-financed programmes such as education.
Panel G: Encourage rural development			
Reform rural income transfers.	Planned reforms would reduce the extent to which the farmers' social security system is subsidised as compared with the general system.	A 95 per cent subsidy rate creates a significant dependency trap, impeding labour mobility and keeping individuals in low-productivity work in rural areas.	Harmonize fully the benefits and contributions of the two systems, while augmenting social assistance support for the poorest farmers.
Eliminate land-ownership requirements in the farmers' social insurance system.	No measures planned.	Most Polish farms are uneconomically small and consolidation is not occurring, because access to the farmers' pension system is contingent on holding at least 1 hectare of farm land.	Harmonising benefits as suggested above would render land-ownership rules irrelevant.

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Table 4.6. **Structural surveillance** (*cont.*)

Panel G: Encourage rural development			
Eliminate ownership restrictions on rural land.	No measures planned.	Ownership restrictions on farm land depress prices and farmers' wealth – indirectly slowing land consolidation and rural-urban migration.	Implement this new recommendation.
Promote rural restructuring by improving infrastructure.	Current programmes designed in cooperation with international agencies seek to promote infrastructure development and improvements in rural educational outcomes.	Poor infrastructure and high transportation costs, reduces rural profitability and incomes. Education outcomes are low.	Focus on improving infrastructure (quality of rural roadways).
Improve educational outcomes in rural areas.	No specific measures planned.	Rural educational outcomes are poor, partly due to funding mechanisms and excessive streaming.	Make educational funding reflect local governments' ability to pay not just costs. Reduce the extent of streaming in rural education.

Source: OECD.

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Notes

1. These loans are provisioned and therefore pose less risk to the financial system than the numbers would suggest. Moreover, the Polish classification system is more stringent than that in other countries.
2. In the Polish classification system, prior to 1 January 2004, loans were classified as substandard if payments were between 30 and 90 days overdue or the financial condition of the borrower was in doubt. They were classified as doubtful if payments were between 3 and 6 months overdue or the financial condition of the borrower had deteriorated substantially. They were classified as loss loans if payment was 6 or more months overdue or the financial condition of the borrower was so deteriorated as to preclude repayment.
3. In 2000, the share of assets held by five largest banks in Poland at 46.7 per cent is significantly lower than in Hungary (66.7), the Czech Republic (59) or Slovenia (62.5). As of 2003, this ratio has increased to 53 per cent in Poland.
4. Of the 56 commercial banks operating in the Polish market 43 are foreign controlled and 7, representing 25 per cent of assets, remain state owned. In addition, there are some 601 co-operative banks, virtually all associated with one of three affiliating banks, which together represented only 5 per cent of banking assets and activity.
5. As of June 2003, government securities represented 19 per cent of banks overall assets as opposed to a 41 per cent share for loans.
6. Under the voluntary restructuring provisions of the new law a firm upon realising that it is illiquid, although not yet in default, can petition the court for protection from its creditors (similar to US Chapter 11 protection). It then is granted a period to continue operations while it determines a restructuring deal. During this period, creditors may not foreclose on debts and the debtor may not take on new debts or new encumbrances on existing assets. Once a restructuring deal is arrived upon, it is to be presented to creditors and will be accepted if a majority of them representing ⅔ of the debt agrees to it. The court then will be called upon to approve the agreement. If an agreement is not reached the court must order bankruptcy or liquidation procedures to be undertaken.
7. The new law ensures that if an EU firm whose principal business activity lies in an EU country other than Poland files for bankruptcy under the provisions of this second country, then the bankruptcy proceedings of the Polish assets will be governed by the laws of the other EU country. Similar provisions exist for bankruptcies initiated in non-EU countries, but here the recognition of the foreign bankruptcy law is not automatic. Moreover, a decision to recognise a foreign process can be revoked if the grounds for its granting are subsequently found to not exist. Finally the recognition of a foreign

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bankruptcy procedure does not preclude the initiation of a Polish procedure for the assets located in Poland.

8. Market capitalization in 2003 was almost equal to the combined market value of the next three largest stock emerging-market exchanges in the region (the Budapest, Prague and Ljubljana exchanges).
9. The value of public offerings decreased by 40 per cent between 1999 and 2001.
10. All WSE issuers are required to observe the Principles since July 2003. They define best practices in the area of the operation of listed companies and their governing bodies (management boards, supervisory boards, general shareholders' meetings), thus strengthening ownership supervision over public companies.
11. Major envisaged changes for 2004 include ensuring higher investor security and improving supervision over capital market, introducing new solutions in the procedure for admitting securities into public trading (mutual recognition of prospectuses by EU member states), launching new trading instruments and platforms (alternative trading system and internal transactions), as well as expanding investment options for investment funds, launching new types of funds and implementing principles for mutual recognition of companies managing UCITS funds.
12. In particular, the draft contains provisions on the mutual recognition in the case of parallel offers; provides the issuers with recourse before the courts if the PSEC refers them access to the exchange; renders more explicit the regulations prohibiting the disclosure of restricted information by the exchange; and refines the definition of the scope of such restricted information.
13. Firms whose sales and exports of goods and services may not exceed the EUR 800 000 in the preceding fiscal year. Special pensions already allow very small submitters to file on a quarterly basis.
14. Hungary's corporate tax rate is 18 per cent and since January 2004 Slovakia's is 19 per cent.
15. The Strategic Guidelines on Investment Promotion, developed in the context of the South East Europe Stability Pact, among other things propose the following priority areas for policy action: *i*) ensure consistency of other government policies with agreed FDI policy so that efforts to attract FDI are not undermined or obstructed by conflicting laws and regulations; *ii*) establish an investment promotion agency with a clear legal structure and powers to carry out its mandate; *iii*) ensure that the mandate of the agency is clear, transparent and modifiable only by government decision; *iv*) ensure that all management and staff are appointed based on industry experience, skills and personal qualities; and *v*) Identify administrative barriers to FDI and undertake regular reviews of the investment climate in the country.
16. The whole package comprises five thematic blocks, including: simplification of the tax system; reduction of the costs of labour; increased labour relation flexibility; simplification of the social insurance system and simplification of administrative procedures.
17. Comprised of 400 km of double-laned highway and 200 km of so-called "express ways", two-lane roads with a third passing lane.
18. Despite the lowest initial density of motorways as compared to other Central European markets (1/5th of the Czech Republic level), Poland road investment performance has lagged other central European countries. While road densities in the Czech Republic, Slovakia and Hungary increased by 45, 51 and 69 per cent respectively between 1994 and 2002, in Poland they increased by only 37 per cent.

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19. 25 September issue of *Rzeczpospolita*, p B3 reported in Polish News Bulletin 2003, September, 25.
20. The regulatory environment reflects best practices, with full competition in the provision of long distance services (Summer 2003), liberalisation of local loop provision, definition of universal service and number transferability. Since 1st January 2002, potential operators may freely apply for permits enabling them to provide local and long-distance telephone services and, since 1st January 2003, the market of international connections has also been liberated.
21. Including owner-occupied and rented apartments, detached and semi-detached dwellings.
22. Rents cannot exceed 3 per cent of the market value of a dwelling.
23. Smaller direct privatisation deals also resulted in efficiency gains and high company survival rates, see Annex IV in OECD (2001a).
24. For instance, for State-owned enterprises share in GDP to reach French levels, Poland would have to sell about half of its assets (or about 8 per cent of GDP) over the next three years, approximately twice the amount sold during the period 2001-2003.
25. The authorities now indicate that they will merge the refinery with some other smaller ones before attempting to sell it again.
26. Following this merger a special privatisation procedure, bypassing the normal public procedures, was initiated which terminated with a decision to enter into exclusive negotiations with the LNM Group of India in July 2003 and the reaching of a tentative privatisation agreement, contingent on LNM agreeing a social plan with PHS unions. The privatisation agreement requires the purchaser to increase the company's capital, purchase its outstanding debt (following debt equity swaps), to respect the investment and business plan created by the government and submitted to the European Union and provide the Polish company with bridge financing. The State Treasury intends maintaining a 25 per cent stake in the company, which the investor will be permitted to purchase by the end of 2007.
27. The argument that pre-privatisation restructuring is necessary to maximise the sale price of the firm appears to abstract from the costs (both in terms of direct expenditures, lost market value and opportunity costs) incurred by the government during the restructuring process. In the case of the coal sector, the authorities annual "investment" approaches 1 per cent of GDP in unpaid tax and social security payments, loan guarantees and other associated contingent liabilities.
28. Under the Commercial Company Code, the approval of all decisions involving a change in the company's statute is contingent upon gaining the support of 75 per cent of the voters attending the shareholding meeting.
29. The privatisation process has also been disturbed by a number of litigations brought against the Ministry of Treasury by purchasers of state-owned firms following what they interpret as arbitrary changes to privatisation agreements. In the case of PZU, an insurance company, the strategic investor (eureko) initially purchased 30 per cent of the company. It was subsequently prevented from exercising its right, as per a second agreement with the government, to purchase a further 21 per cent of the company's stock because it failed to acquire the required permit from the Ministry of the Interior. The case is now in arbitration, with Eureko requesting to be allowed to complete its purchase of the company. A similar case involves, Hachette Distribution Services, which claims the right to purchase 40 per cent of Ruch SA, Poland's largest press distribution company. In each case, the Ministry of Treasury appears to have backed of initial agreements to sell to the strategic investor a subsequent tranche of shares that

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would allow it to become a majority owner. Instead, it has argued that offering these shares on the Warsaw stock exchange affords the firms in question the possibility to acquire the shares and therefore respects the original agreements.

30. This section draws heavily on the World Bank (2001) special report *Poland: The functioning of the labor, land and Financial markets: Opportunities and constraints for farming sector restructuring.*
31. Official national accounts data indicate that in 2002 25 per cent of workers were involved in agriculture, including those whose main job was not in agriculture. In contrast, the labour force survey places this raito at about 20 per cent based on a person's main job. Most recently a new rural census suggests that in 2003 17.4 per cent of the work force was employed in agriculture.
32. Lisztwan and Dalton (2000) report that on average14.2 per cent of rural farmers work 2 or fewer hours, 26.4 per cent work between 3 and 5 hours, 29.1 work 6-8 hours and 30 per cent work 8 or more hours. On this basis, full time equivalent employment levels in agriculture are about ¾ of nominal employment levels. Similar data are not available for the whole economy.
33. Agricultural employment fell sharply between 1990 and 1993 but then actually picked up between then and 1995 after which it has been broadly stable.
34. Microeconomic studies of Polish agriculture indicate that land productivity is constant – independent of the amount of labour applied to it – for farms between 1 and 30 hectares in size (World Bank, 2001). Assuming consolidation led to average relative productivity levels in agriculture, some 25 per cent of the labour force would be freed up. Assuming the process occurs gradually and that liberated workers found productive employment at the minimum wage, potential GDP and incomes would increase by about 12 per cent. Of course, if the value added generated by these workers were higher then the impact on potential output would be higher. At the opposite extreme, if none were to find work then the impact on potential output would be zero.
35. These values were taken from a real transaction for 3 hectares of land, with a sale price of 9 000 euros (World Bank, 2001).
36. In many instances, lease agreements are conditional on lessees employing a certain number of workers or contain special employment-related rebate clauses (Chaplin, 2001).
37. Precise data as to who the State leases land is not available. However, in 1997 it owned 2.6 million hectares more than it farmed and 1.2 million hectares were leased by private companies. As leasing of land by private individual sis relatively rare, this suggests that this land was leased from the state.
38. World Bank cited in EBRD (2002).
39. Work that looks at the link between migration and unemployment suggest a weak positive correlation. Data cited in World Bank (2001) indicates that between 20 and 31 per cent of rural workers are employed in urban areas, although on average commuting distances are moderate averaging between 12 and 19 kilometres.
40. Of subsidies to support capital expenditures, 34 per cent support land purchases, 30 per cent the purchase of agricultural machinery and 25 per cent covers the modernisation of livestock buildings.
41. Alinska (2001) reports that 42 per cent of loans extended to farming households are used to finance the day-to-day operation of the farm and that interest payments on 93 per cent of these loans are subsidised.
42. In 2002, 44 per cent of the rural population had less than basic vocational education, an additional 30 per cent had basic vocational qualifications, 22 per cent had a secondary education and only 4 per cent had a tertiary degree.

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Glossary of acronyms

BGK	National Guarantee Bank
EC	European Commission
EU	European Union
FDI	Foreign Direct Investment
FUS	Social Insurance Fund
GDP	Gross Domestic Product
GFS	Government Financial Statistics
GSM	General Shareholders Meeting
GUS	Central Statistical Office
IMF	International Monetary Fund
KFPK	National Credit Guarantee Fund
KPWIG	Securities and Exchange Commission
KRUS	Farmers' Insurance Fund
KUKE	Corporation for Credit Insurance
MTEF	Medium-Term Economic Framework
NBP	National Bank of Poland
NIK	National Audit Office
PAYG	Pay-As-You-Go pension system
PES	Public Employment Service
PGNiG	Polish Oil and Gas Company
PHARE	Poland, Hungary Assistance for Restructuring of the Economy
PHS	Polish steel holding company
PIT	Personal Income Tax
PLZ	Zloty, Polish currency unit
PSE	National Power Operator
PUNU	National Office for Insurance Supervision (now merged with UNFE)
PZU	Polish largest insurance company
RIO	Regional Clearing Chamber
SMEs	Small and Medium Sized Enterprises
SNA	System of National Accounts
SOK	Compensation Payment System
TPSA	Polish telecom historical operator
UNFE	Pension Funds Supervisory Office (now merged with PUNU)
UNUZ	Health Insurance Supervisory Office
UOKIK	Office for Competition and Consumer Protection
URE	Polish Energy Regulatory Authority
URT	Office for Telecommunication Regulation
URTiP	Office for Telecommunication and Postal Services Regulation (replaces URT)
VAT	Value Added Tax
ZUS	National Insurance Fund which acts as the umbrella extra-budgetary fund organisation

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BASIC STATISTICS OF THE REPUBLIC OF POLAND
(2003 unless noted)

THE LAND

Area (sq. km)	312 690
Arable land (in per cent of total area)	59

THE PEOPLE

Population (million, end-year)		38.2
Rural population (percentage of total)		38
Life expectancy at birth (2001):	Male	70.2
	Female	78.4
Infant mortality (per thousand)		7.7

Employment (million)	13.7
Employment by sector (percentage of total):	
Agriculture	18
Industry (including construction)	29
Services	52

Registered unemployment (percentage of labour force)	18.0
Labour force survey unemployment (percentage of the labour force)	19.7
Number of pensioners (million)	9.2

PARLIAMENT

Bicameral Parliamentary system	
Sejm membership (lower house)	460
Senate membership (upper house)	100
Number of political parties in Sejm	15
Share of seats in Sejm held by governing party (per cent)	34

PRODUCTION

GDP (Zl billion, current prices)	815
GDP per capita (US$, market exchange rate)	5 487
Gross fixed capital formation (percentage of GDP)	18

PUBLIC FINANCE

General government budget balance (percentage of GDP)	–4.2
General government revenues (percentage of GDP)	42.0
General government expenditures (percentage of GDP)	46.2
State treasury debt (end-year, percentage of GDP)	46.5

FOREIGN TRADE AND FINANCE

Exports of goods and services (percentage of GDP)	34
Imports of goods and services (percentage of GDP)	36
Gross official reserves (US$ billion, end-2003)	34.0
Total external debt (US$ billion, end-2003)	103.8

CURRENCY

Monetary unit: zloty
(redenominated in January 1995)

Currency units per US$		
Average:	2002	4.0816
	2003	3.8884
	April 2004	3.9623

Note: An international comparison of certain basic statistics is given in an annex table.

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•

The economic situation and policies of Poland were reviewed by the Committee on 1 April 2004. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 11 May 2004.

•

The Secretariat's draft report was prepared for the Committee by Andrew Burns, Przemyslaw Kowalski, Stéphanie Jamet, Boris Cournède and Line Vogt under the supervision of Willi Leibfritz.

•

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