# OECD Economic Surveys
# POLAND

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**OVERVIEW**

OECD

# Summary

- *Main findings*
- *Key recommendations*

## Main findings

Poland's overall economic performance has been impressive over the last decade, allowing living standards to converge steadily towards the EU average. Yet, the economy slowed abruptly in 2012-13. This *Survey* focuses on making the labour market work better and strengthening product-market competition as ways to foster firms' competitiveness, overcome strong demographic headwinds and boost both short- and longer-term economic prospects. While substantial progress has been made in these areas since the nineties, important weaknesses are still restraining the country's economic potential.

**Boosting employment**

Despite long working hours, labour utilisation is only average due to structurally low employment. Insufficient product market competition and obstacles to internal mobility induce significant misallocation of labour resources. Employment protection is not particularly stringent, but the labour market is heavily segmented. This is likely to weigh on economic performance by limiting investment in human capital and making some specific groups bear a large share of adjustment costs. The public employment services suffer from a lack of resources and function inefficiently. Local labour offices have limited incentives to adopt best practices; the government plans to start benchmarking them. There is ample scope to tighten jobseeker obligations and reform social and tax policies to make work pay. The female employment rate is especially low, in part due to poorly designed family and pension policies.

**Strengthening product market competition**

Although notable progress has been made, restrictive product market regulations still hinder activity substantially. These take the form of heavy barriers to entrepreneurship and the extensive involvement of the state, even in potentially competitive sectors. Business registration procedures are cumbersome, and the bankruptcy process is lengthy and costly. Public procurement plays a key role in Poland, but public ownership may lead to non-neutrality of the bidding process, and the criteria for awarding contracts rely excessively on the lowest price. Competition is weak in network industries, apart from telecoms. The presidents of most regulatory agencies have open-ended contracts and can be dismissed by the relevant Ministry in charge of their supervision.

**Macroeconomic policies**

Labour cost pressures have been moderate, and consumer price inflation has fallen sharply. Given the accommodative monetary stance and a moderate impact of fiscal tightening on activity, growth is projected to pick up and surpass its potential rate by mid-2014. Inflation could move back towards the official target, and the output gap is expected to close around the start of 2016. Even though loan quality has deteriorated to some extent, prudential policies have been effective, and foreign-currency denominated loans have been curbed. Both household and corporate debt are relatively low, and the banking system is well capitalised. However, the financial system still has a considerable amount of foreign funding. The macro-prudential policy framework is being modified by the introduction of a Systemic Risk Board.

The public deficit widened unexpectedly in 2013 due to a cyclical shortfall in tax receipts and higher social expenditure and public consumption. Since EU accession, fiscal objectives spelled out in convergence programmes have often been missed, pointing to a need to strengthen the fiscal framework. Most of the 2014-15 fiscal efforts involve the change in the second-pillar pension system. Given real GDP growth dynamics, sticking to the target of 3% of GDP for the 2015 deficit so as to ensure the government debt-to-GDP ratio is firmly on a downward path would still require additional fiscal tightening.

## Key recommendations

**Boosting employment**

- Reduce labour market dualism by: making all contracts subject to the same tax and social contribution regime as Labour-Code contracts; extending the maximum length of trial-period contracts; streamlining legal dismissal procedures; and setting a maximum cumulative duration for temporary contracts with the same firm.
- Expand the resources of public employment services to hire more skilled staff, and ensure that overall resources are better allocated to front-line placement tasks. Promote the adoption of best practices by labour offices through performance management and benchmarking.
- Tighten work availability and job-search requirements for job consistency seekers. Reduce passive social assistance by making more transfers conditional in part on being employed or seeking work
- Boost female employment by: developing childcare and long-term care facilities, and pre-school education; and increasing women's retirement age at a more rapid pace than scheduled. Monitor closely the impact of the long maternity leave on the employment of mothers.

**Strengthening product market competition**

- Lower further the costs of entry and exit, such as cumbersome business registration. Reduce the length and cost of bankruptcy procedures.
- Pursue privatisation, and substantially reduce government ownership in competitive segments of the economy while ensuring sound governance of remaining state-owned enterprises.
- Modify public procurement practices to select the contractors offering the best value for money rather than the lowest price. Focus procurement decisions on a mix of prices and technical bid details, including environmental impact assessments. This will require enhancing staff skills to deal with complex selection criteria.
- Introduce fixed-term non-renewable mandates for the presidents of the Competition Authority and sectoral regulators during which they cannot be dismissed without fault. Create an independent regulator for water and sanitation services.

**Macroeconomic policies**

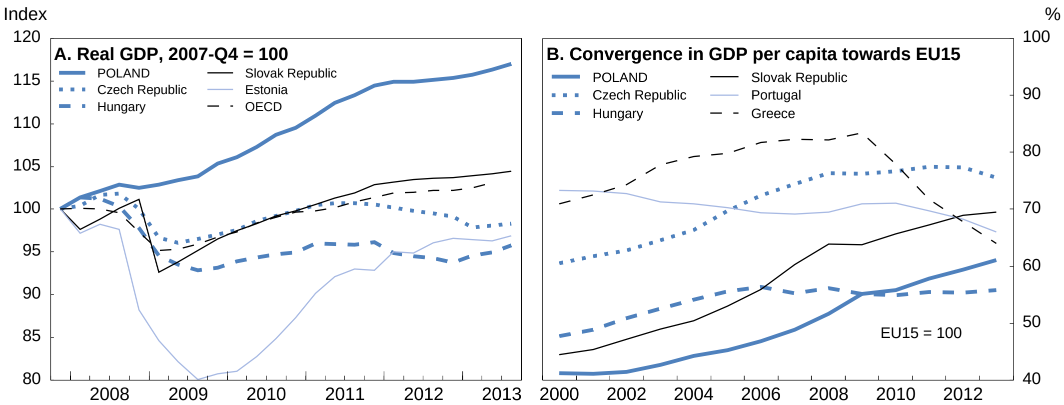
- If activity and inflation accelerate as projected by the OECD, gradually increase the official monetary policy rate.
- Ensure that the Systemic Risk Board (SRB) has the independence and power to make recommendations coupled with a "comply or explain" mechanism. Ensure a clear allocation of roles between the SRB and the current regulators; in particular, retain the ability of the financial supervision authority (KNF) to issue prudential recommendations.
- Achieve greater fiscal consolidation in 2015 than currently planned to be able to meet the below-3%-of-GDP general government deficit target.
- Create an independent institution to monitor underlying budget assumptions and fiscal performance relative to targets. Strengthen the fiscal framework by implementing detailed multi-year budgeting, basing budgets on unbiased assumptions and harmonising the domestic and Maastricht debt definitions.

# Assessment and Recommendations

- *The economy is projected to rebound towards potential rates*
- *Monetary and financial policy*
- *Fiscal policy*
- *Achieving sustainable and inclusive growth*

Following important reforms which have deeply transformed the structure of the economy, Poland's economic performance has been impressive since the beginning of the 2000s, allowing it to catch up steadily with the EU15 in GDP-per-capita terms (Figure 1). By 2013, the country had achieved levels of income and quality of life likely never experienced before (Piatkowski, 2013). Yet, in 2012-13 the economy slowed abruptly, and important challenges remain ahead. Boosting job prospects (see Chapter 1 of the *Survey*) is critical, because employment rates are low and because the country is facing strong demographic shrinkage (Figure 2) and persistent emigration risks. In the context of rapid population ageing, improving the health-care system remains a priority, as analysed in the last *Survey* (OECD (2012); Boulhol et al. (2012)). Enhancing the business environment and strengthening product market competition (see Chapter 2 of the *Survey*) are keys to maintaining a high level of competitiveness and raising medium-term economic prospects. Structural reforms in these areas are prerequisites for climbing the technological ladder, developing knowledge-based capital and becoming a more innovation-based economy. Macroeconomic imbalances are limited and policy settings appropriate for now, but fiscal consolidation should be pursued to achieve the Medium-Term Objective (MTO) of a structural deficit of 1% of GDP.

Figure 1. **Poland has outperformed other OECD countries in GDP growth outcomes**

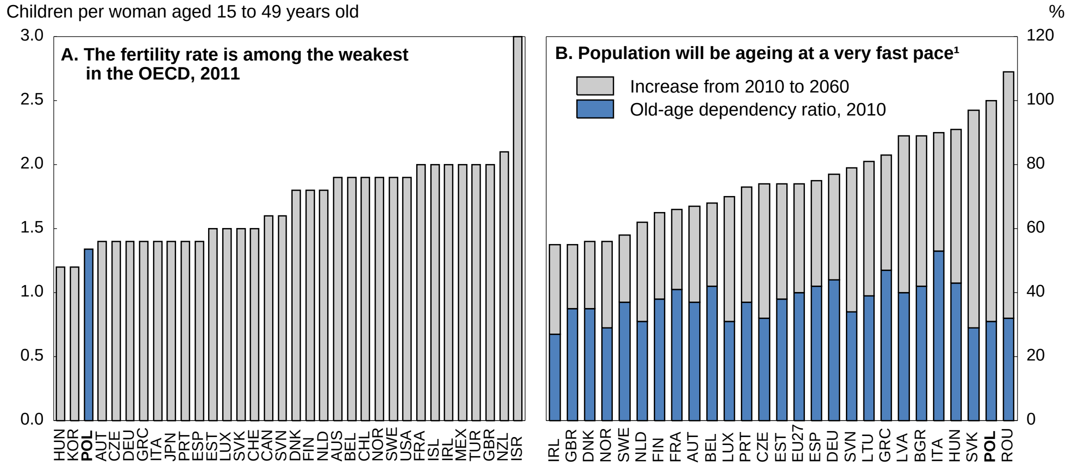



*Source*: OECD Economic Outlook 94 database and updates.

## The economy is projected to rebound towards potential rates

Economic activity slowed sharply in 2012-13, with year-on-year real GDP growth plummeting from 4.8% in mid-2011 to 0.8% in early-2013 (Table 1; Figure 3, Panel A). Public investment collapsed after the 2012 construction boom generated by large road infrastructure investments, mostly financed by EU funds, and the European football championship (Figure 3, Panel B). While the absorption of EU funds remains an important driving force behind the idiosyncratic part of the Polish economic cycle, the fall in public investment also resulted from fiscal pressure on local governments. Such a big swing contributed to the strong growth in 2010-11 and the sharp deceleration in 2012-13. Moreover, weak external demand due to euro-area difficulties heavily penalised both exports and private investment, while rising unemployment and fiscal consolidation damped household consumption. As recommended in the 2010 *Survey*, macro policies should adequately take into account the full impacts of EU transfers and the potential imbalances they may induce. In particular, co-financing needs to be accommodated by reducing other budget lines, and a more efficient fiscal framework (see below) would help in designing and implementing the appropriate fiscal response.

Figure 2. **Demographic prospects are unfavourable**




1. Effective economic old-age dependency ratio, measured as inactive population aged 65 and over as a ratio to the 20-64 employed population.

*Source*: OECD, Population Statistics and OECD Health indicators; European Commission (2012), *The 2012 Ageing Report.*

Euro-area prospects have improved of late, and the Polish economy has rebounded. Given the currently accommodative monetary stance and an only moderate impact of fiscal tightening on activity, quarterly growth is projected to gain momentum and surpass its potential (annualised) rate of about 3% by the middle of 2014. Construction activity should be supported by a resurgence in EU funds but remains fragile, as sectoral bankruptcies have risen substantially. While labour market weakness still weighs on private consumption, joblessness should decline sustainably albeit slowly.

Risks to Polish growth are now broadly balanced. The most severe risks to the euro area have diminished, improving external-demand prospects, even though important risks remain. In addition, as happened in the recent past, investment and private consumption could respond strongly to swifter confidence improvements, although the extremely low household saving rate might limit the upside. Polish banks have a considerable amount of foreign funding (see below) and might be vulnerable to a delayed resolution of European banking problems. However, their strong capital positions provide some cushion against unfavourable developments. While the narrowing of the current account deficit has diminished contagion risks, Poland may be affected by emerging-market volatility through the foreign-investment channel.

A favourable competitiveness position and weak domestic demand have fuelled a sharp improvement in the external goods and services balance, which has been in surplus since the middle of 2012 (Figure 4). Businesses still benefit from a competitive exchange rate following the sharp depreciation of the zloty in 2009, and labour-cost pressures have been moderate (Figure 5), with real wages having risen less than labour productivity by a cumulated 20% since 2002 (Figure 8, Panel B, below). Hence, after some sluggishness in 2010-12, export volume increases have clearly outpaced export market growth. On the other hand, imports have been lethargic amid depressed domestic demand. As a result, the current account deficit has been substantially reduced, from 6.5% of GDP in 2008 to less than 1% in recent quarters, the lowest level since 1995. This has contributed to limiting spillovers on Poland from the emerging-market turmoil triggered by US monetary tapering.

Table 1. **Macroeconomic indicators and projections**

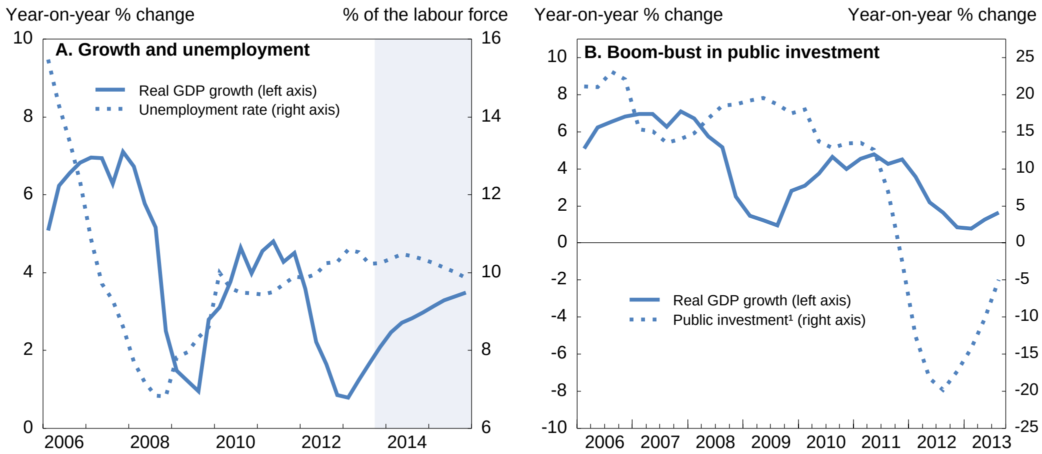
| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|
| | Current prices PLN billion | Percentage changes, volume (2005 prices) | | | | |
| **GDP** | 1 414.7 | 4.5 | 2.0 | 1.4 | 2.7 | 3.3 |
| Private consumption | 868.5 | 2.6 | 1.2 | 0.7 | 2.2 | 3.1 |
| Government consumption | 266..9 | -1.3 | 0.1 | 2.3 | 1.0 | 1.0 |
| Gross fixed capital formation | 278.2 | 8.2 | -1.9 | -1.7 | 4.4 | 5.7 |
| *Of which: Housing* | 37.5 | 4.4 | 9.4 | -4.9 | 5.6 | 5.2 |
| Final domestic demand | 1 413.5 | 3.0 | 0.4 | 0.5 | 2.4 | 3.2 |
| Stockbuilding[1] | 19.5 | 0.5 | -0.5 | -0.7 | 0.2 | 0.2 |
| Total domestic demand | 1 433.0 | 3.4 | -0.2 | -0.2 | 2.6 | 3.4 |
| Exports of goods and services | 596.7 | 8.4 | 3.3 | 4.7 | 5.0 | 6.3 |
| Imports of goods and services | 615.0 | 5.8 | -1.7 | 1.1 | 4.2 | 6.4 |
| Net exports[1] | -18.3 | 1.0 | 2.3 | 1.7 | 0.4 | 0.0 |
| **Other indicators** (% change, unless otherwise specified): | | | | | | |
| Potential GDP | - | 3.1 | 3.1 | 2.9 | 2.9 | 3.0 |
| Output gap[2] | - | 1.8 | 0.8 | -0.7 | -0.8 | -0.5 |
| Employment[3] | - | 0.6 | 0.2 | -0.4 | 0.2 | 0.5 |
| Unemployment rate[4] | - | 9.6 | 10.1 | 10.4 | 10.4 | 10.1 |
| GDP deflator | - | 3.1 | 2.5 | 0.8 | 1.4 | 2.1 |
| Consumer price index | - | 4.2 | 3.6 | 1.1 | 1.9 | 2.2 |
| Household saving ratio, net[5] | - | -0.2 | 2.6 | 1.0 | -1.5 | -3.3 |
| Trade balance[6] | - | -1.2 | 0.3 | 1.7 | 1.4 | 1.2 |
| Current account balance[6] | - | -5.0 | -3.7 | -2.6 | -2.7 | -2.7 |
| General government financial balance, ESA-1995[6] | - | -5.0 | -3.9 | -4.8 | 4.6 | -3.1 |
| General government financial balance, ESA-2010[6,7] | | - | - | -4.8 | -4.1 | -3.8 |
| Underlying government financial balance[2] | - | -6.6 | -4.7 | -5.0 | -4.1 | -3.9 |
| Underlying government primary balance[2] | - | -4.4 | -2.4 | -2.7 | -1.8 | -1.8 |
| General government gross debt, OECD definition[6] | - | 63.1 | 62.4 | 66.0 | 58.7 | 58.9 |
| General government debt, Maastricht definition[6] | - | 56.2 | 55.6 | 59.2 | 52.0 | 52.1 |
| General government net debt, OECD definition[6] | - | 32.5 | 33.5 | 37.6 | 31.5 | 33.0 |
| Three-month money market rate, average | - | 4.6 | 4.9 | 3.0 | 2.9 | 3.8 |
| Ten-year government bond yield, average | - | 6.0 | 5.0 | 4.0 | 4.3 | 4.6 |

1. Contributions to changes in real GDP, actual amount in the first column.
2. As a percentage of potential GDP.
3. Based on LFS data.
4. As a percentage of the labour force aged 15 or more.
5. As a percentage of household disposable income.
6. As a percentage of GDP.
7. According to ESA-2010 rules to be adopted in September 2014, asset transfers will no longer reduce the deficit.

*Source*: OECD Economic Outlook 94 Database plus updates.

Long-term government bond rates have nevertheless increased in Poland more than in other central and eastern European countries (CEECs), following foreign investors' heavy sales in June and August 2013 (Figure 6, Panel A). Poland had attracted massive portfolio inflows in 2008-12, accounting for cumulative liabilities of about 15% of GDP, more than twice that in other CEECs (Citibank, 2013). This led to an upsurge in the share of non-resident holdings of domestic sovereign debt to 37% in April 2013 (Panel B), posing a risk as capital flows could quickly reverse course. In the early-2014 episode of renewed emerging-market turmoil, Poland's long-term yield rose to a limited extent, and the zloty weakened only slightly. The IMF's USD 34 billion flexible credit line (for which Poland's eligibility was confirmed in 2014), the broadly adequate level of international reserves (IMF, 2013a) and the swap agreement with the Swiss National Bank diminish contagion risks.

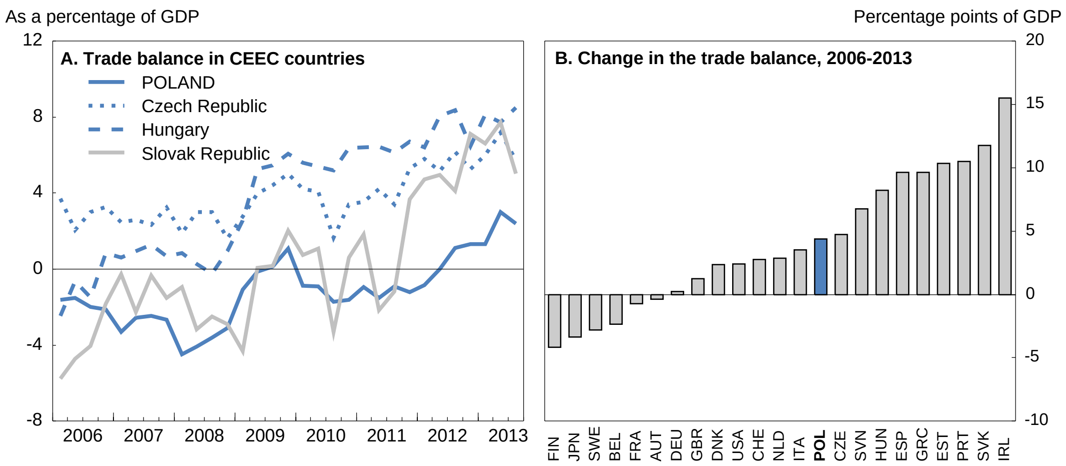
Figure 3. **Economic activity is projected to rebound**




1. Deflated by the total gross fixed capital formation deflator.

*Source*: OECD Economic Outlook 94 database plus updates.

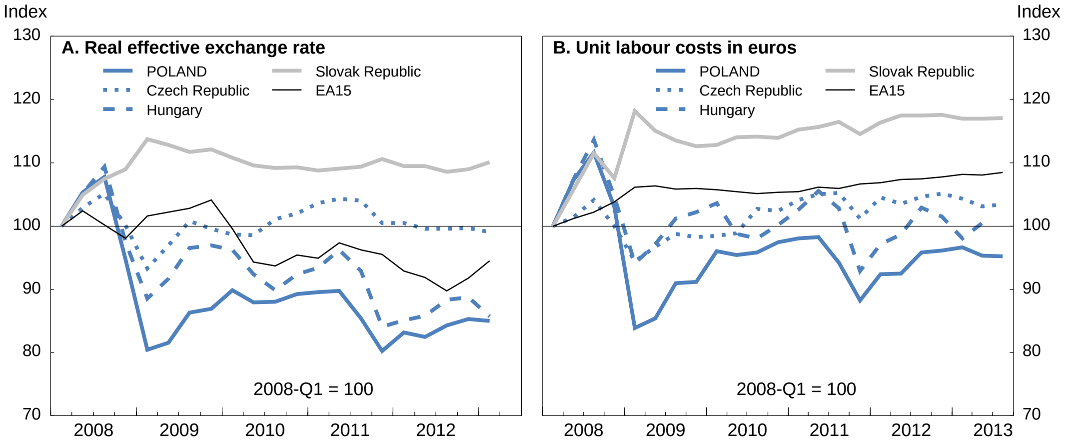
Figure 4. **Sharp improvement in the balance of goods and services**[1]




1. Value, National Accounts basis.

*Source*: OECD Economic Outlook 94 database.

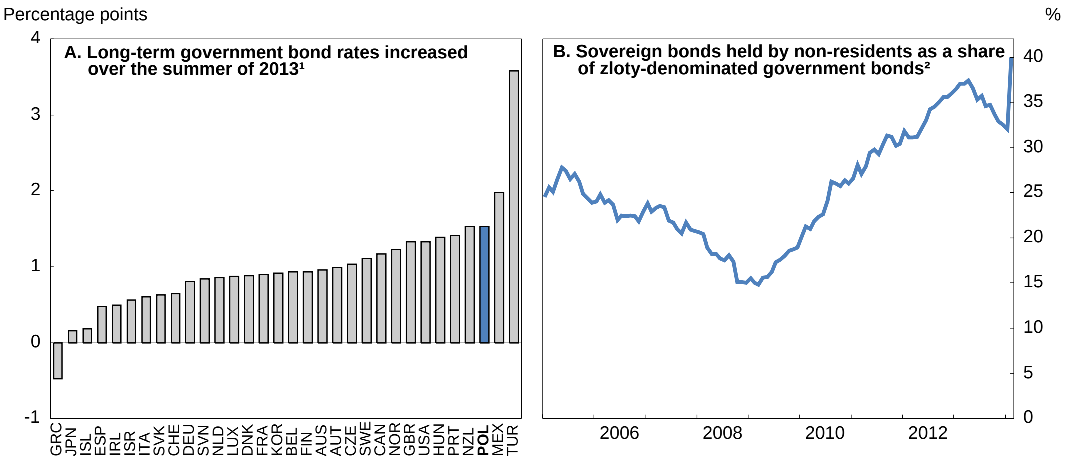
Figure 5. **Poland benefits from competitive exchange rates and moderate labour costs**




*Source*: OECD Economic Outlook 94 database plus updates.

**How to read this figure:** Real effective exchange rates (REERs) – displayed in Panel A – measure the value of a country's currency relative to a weighted average of other currencies, with weights reflecting the importance of trading partners, and adjust for cross-country inflation differentials. A decreasing REER implies competitiveness gains as the relative value of the currency depreciates in real terms, and vice-versa. Unit labour costs – displayed in Panel B – are labour costs per unit of (real) output, converted to euros. The figure shows, for example, that Poland's unit labour costs decreased by more than 25% in the period following the onset of the crisis (from 2008 Q3 to 2009 Q1), more than elsewhere.

Figure 6. **Bond yields and non-resident holdings**



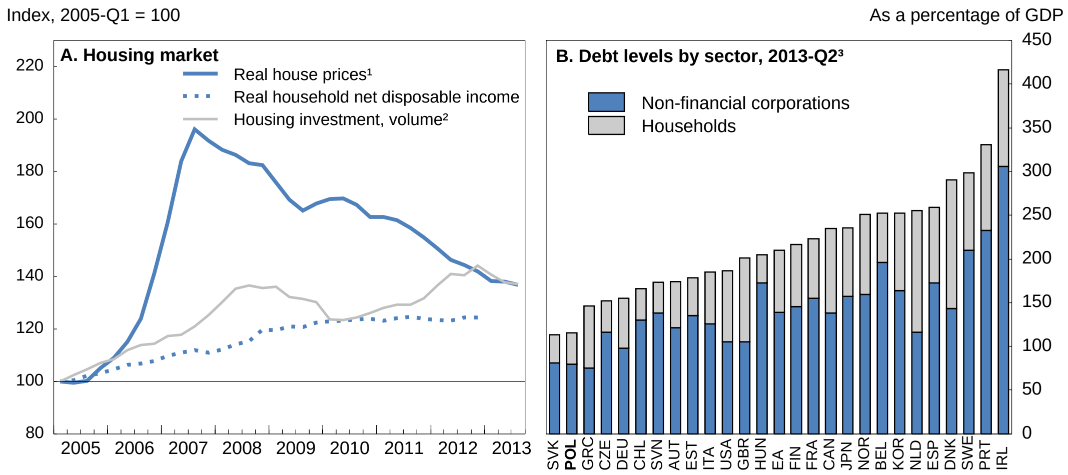

1. Difference in percentage points between 1 May and 5 September. The specific dates correspond to the trough and peak of the average long-term government bond yield across OECD countries excluding Greece. Greek yields have been excluded from the computation of the averages due to their extreme volatility: they fell from 13.08% on 27 March 2013 to 8.12% on 20 May 2013 before bouncing back to 11.71% on 24 June 2013.
2. The February 2014 sharp increase is due to pension system changes detailed in Box 1.

*Source*: OECD Economic Outlook 94 database and Ministry of Finance.

Monitoring of the housing market and therefore conducting macroeconomic policies remain complicated, since satisfactory overall house price indices do not exist (OECD, 2008a). The best indicator, the average price of apartments in the 16 main cities, has stabilised since the middle of 2013 after a decline of about 30% in real terms since its 2007Q1 peak. Thanks in part to tighter prudential regulations applying to mortgages

(OECD, 2012), the bursting of the housing bubble led to a correction of about two-thirds of the rise recorded in the 2005-07 boom (Figure 7, Panel A). However, the impact of tumbling house prices has been contained owing to modest wealth effects, interest rate cuts and restrictions on borrowing by low-income households. As a result, although the share of non-performing mortgages has increased steadily, it remains limited (see below).

Figure 7. **Housing market and private debt**



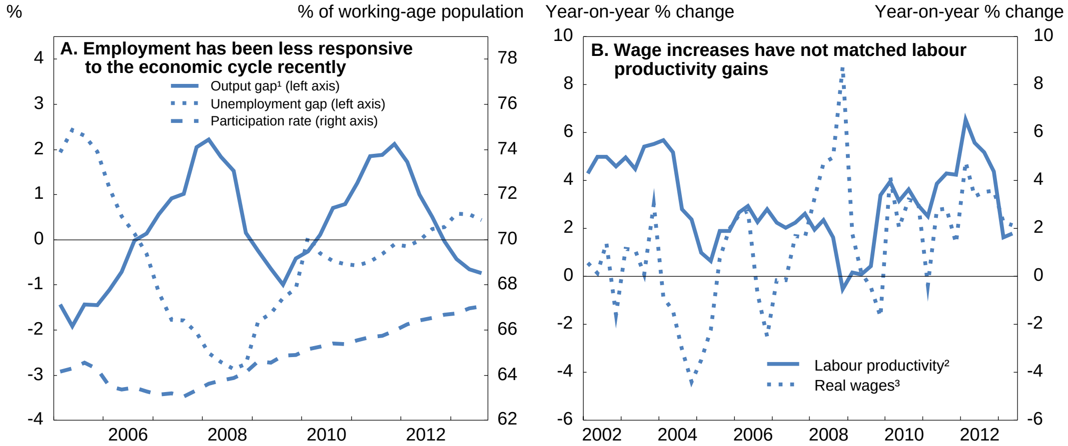

1. Simple average of house prices for the existing stock of dwellings in 16 of Poland's bigger cities, deflated by the CPI. Data prior to 2006Q3 are taken from the NBP's information note on home prices in Poland in 2013Q1.
2. Four-quarter moving average.
3. 2013-Q1 for Korea; 2012 for Germany, Ireland and the Netherlands. Debt by sector is computed by subtracting shares and other equity, as well as financial derivatives, from total liabilities.

*Source*: GUS; NBP; OECD Economic Outlook 94 (plus updates) and Quarterly National Accounts databases.

Credit expansion has been sluggish due to both lacklustre loan demand and tightened lending terms. Despite the low household saving rate, there is no problem with leverage, as both household and corporate debt are reasonable (Figure 7, Panel B). In March 2013 the government launched a loan-guarantee programme to facilitate micro firms' and SMEs' credit access. The maximum working-capital loan amount (PLN 3.5 million, or about EUR 0.8 million) and length (27 months) are low enough to ensure exemption from EU state-aid regulations. Since November 2013, investment loans of up to 99 months duration have also been included. The rules restricting consumer lending (Recommendation T) were also relaxed in 2013.

The 2012-13 slowdown left its mark on the labour market. The unemployment rate rose to a high of 10.6% in 2013Q1, up from a record low of 6.8% in 2008Q4 when the economy was overheating. Despite strong growth in 2010-11, the unemployment rate did not recede, in part due to stronger participation (Figure 8, Panel A). Its current level (10.2%) is close to the OECD estimate of the NAIRU (10%), which remains among the OECD's highest. This suggests that high unemployment is largely structural, although current low inflation could mean the NAIRU is overestimated, implying some slack in the labour market. Wage increases have indeed been consistently smaller than productivity gains (Panel B). Following the December 2011 expiry of earlier measures (OECD, 2012), in November 2013 the government began providing direct financial assistance (*de minimis* aid) to employers experiencing a decrease in turnover

Figure 8. **Recent growth has had a weak labour content**




1. As a percentage of potential GDP.
2. Labour productivity is measured as real GDP per worker.
3 Dependent employment.

*Source*: OECD, Economic Outlook 94 database.

**How to read this figure:** The output gap measures the difference between the level of real GDP and its potential. Hence, a positive output gap indicates that real GDP exceeds its potential, which is likely to trigger inflationary pressure, and conversely a negative gap should put downward pressure on inflation. The unemployment gap measures the difference between the unemployment rate and its estimated equilibrium level (NAIRU). The unemployment gap is an important component of the output gap, and a positive unemployment rate gap tends to be associated with a negative output gap (and vice-versa). But this is not always the case, as the output gap is also influenced by other components such as deviations from trends in total factor productivity and labour force participation. The chart shows that in the 2007-08 boom employment was very responsive to the economic cycle, and the unemployment rate fell below its equilibrium level as real GDP increasingly exceeded its potential level. However, in 2011 the employment response to the acceleration in activity was relatively muted, in part due to the increase in labour supply as reflected by the higher participation rate.

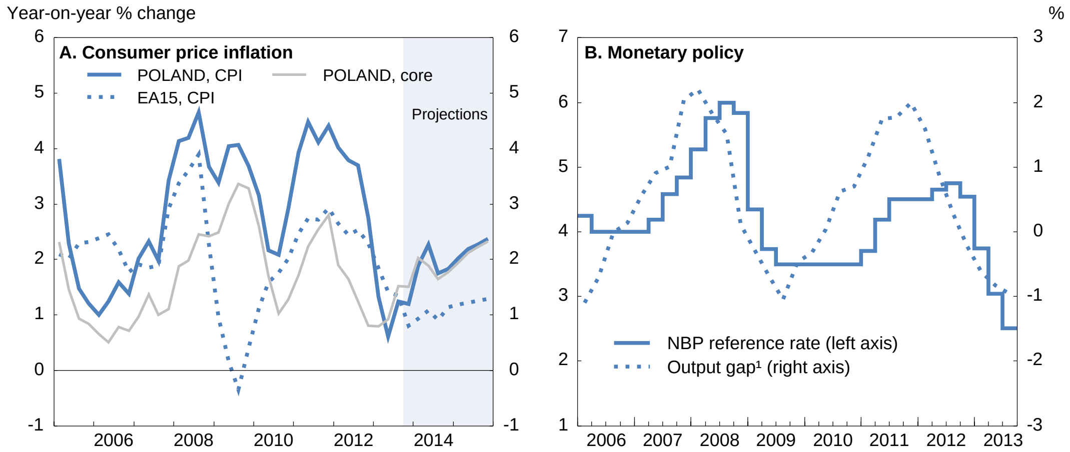
## Monetary and financial policy

### *Short-term interest rates may need to be raised as inflation moves closer to the target*

Consumer price inflation fell considerably below the NBP target in 2013 (Figure 9, Panel A), driven by the rise in unemployment, subdued wage pressure and the slowdown in food and energy prices, attributable in part to lower administered prices (NBP, 2013a). Core inflation has also drifted below 1%. The Monetary Policy Council (MPC) reacted progressively to the deterioration in the outlook by easing policy rates from 4.75% in May 2012 to 2.50% in July 2013 (Panel B). This should mark the end of this cycle. Indeed, the pick-up in activity projected by the OECD is expected to move inflation back towards the 2.5% official target. In November 2013, the MPC extended its forward guidance of no rate change until at least the end of June 2014.

Summing up, economic imbalances are limited and broadly shrinking, and inflation, while historically low, should move back towards target. While the macroeconomic policy mix has been appropriate so far, given that the growth impact of announced fiscal consolidation is likely to be only slightly negative (see below), monetary policy will need to be less accommodative following the expiry of the current period of forward guidance. The exact timing and scope of interest rate normalisation should, however, depend on incoming data and the resulting risks for the inflation target in the medium term. The OECD projections assume stable nominal exchange rates, and therefore the extent of monetary tightening should be adjusted to account for exchange-rate developments. For example, if rising short-term interest rates in a context of persistently easy global monetary conditions were to spur excessive capital inflows, strengthening the zloty and increasing the vulnerability of the financial system, the extent of monetary policy tightening consistent with the inflation target would be lower *ceteris paribus*. Also, as argued below, more fiscal efforts than currently planned will be needed to meet public-deficit objectives in 2014-15. If these are implemented, monetary tightening can similarly be more gradual.

Figure 9. **Inflation and monetary policy**




1. As a percentage of potential GDP.

*Source*: OECD Economic Outlook 94; NBP.

As discussed in past *Surveys*, the insufficient continuity of monetary policy making should be addressed to increase its effectiveness. Continuity is weakened by the lack of overlapping terms for MPC members, as the whole Council (other than the Governor) turns over at virtually the same time (every six years). This results in a periodic severe loss of human capital, experience and institutional memory. The government is working on a draft bill that could address these concerns.

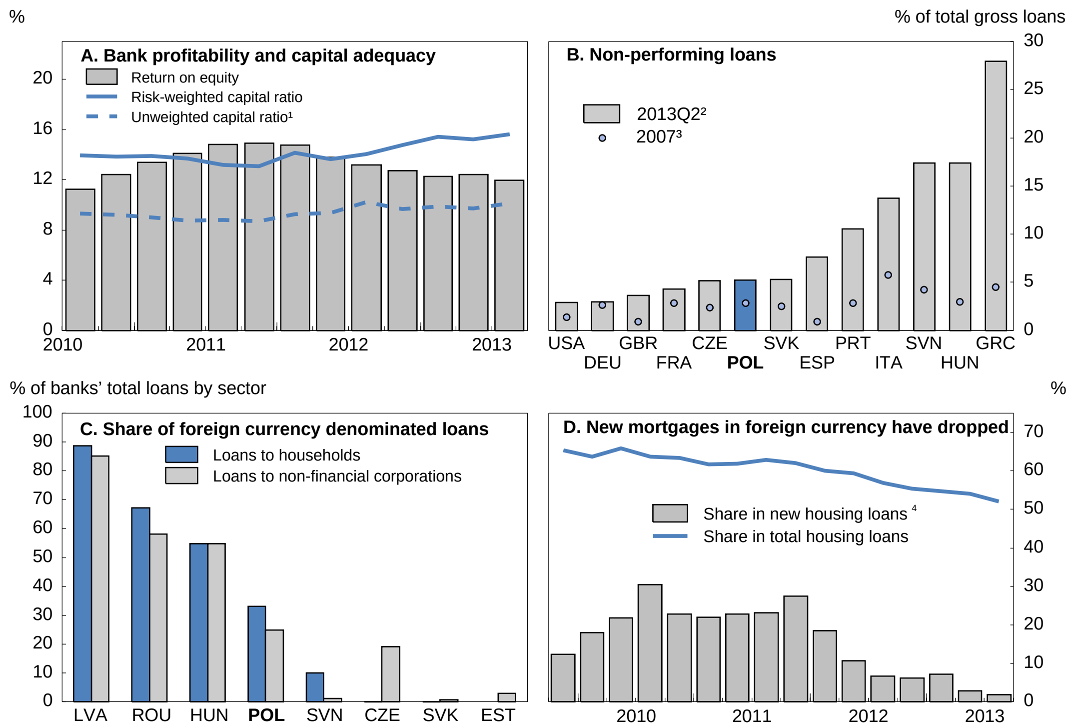
Successive governments have had the objective of adopting the euro, although euro-area economic difficulties have cooled enthusiasm. The 2010 *Survey* focused on conditions to be met for its safe adoption. Concerning the timing, the key is not to pre-commit before the economy is ready, as this could destabilise expectations. Improved product and labour market flexibility would bolster the economy's resilience to asymmetric shocks. For a catching-up country experience has illustrated the threat from domestic booms that can no longer, under a common currency, be controlled by monetary policy. A well designed fiscal policy and strong prudential supervision are needed to avoid the development of such imbalances.

### *The financial system remains sound, despite deteriorated loan quality*

The growth slowdown and euro-area turmoil did not significantly affect the resilience of the financial sector. Poland's largely foreign-owned banking system has remained profitable, well capitalised and liquid (Figure 10, Panel A). The average ratio of capital to risk-weighted assets increased to 15.8% at end-November 2013, with core Tier 1 capital adequacy at 14.3%, well above the level required under Basel III. The unweighted capital ratio has also increased and is among the highest in EU countries.

Loan quality deteriorated during the 2012 slowdown, reflecting rising bankruptcies and an increase in mortgage defaults. However, the share of non-performing loans has stabilised at around 5%, a moderate level although much higher than US or German levels (Figure 10, Panel B). In 2012, in a welcome move to address banking-sector credit risk stemming from its high outstanding foreign-currency-denominated (FX) loan portfolio (Panel C), the financial supervision authority (KNF) increased the risk weight of FX loans from 75 to 100%, well above the 35% applied to domestic-currency loans. As a result, the share of new FX housing loans dropped from 27% at end-2011 to less than 2% (Panel D). KNF has restricted banks to providing FX mortgages only to households with a steady income in the same currency from July 2014

Figure 10. **Banking sector developments**



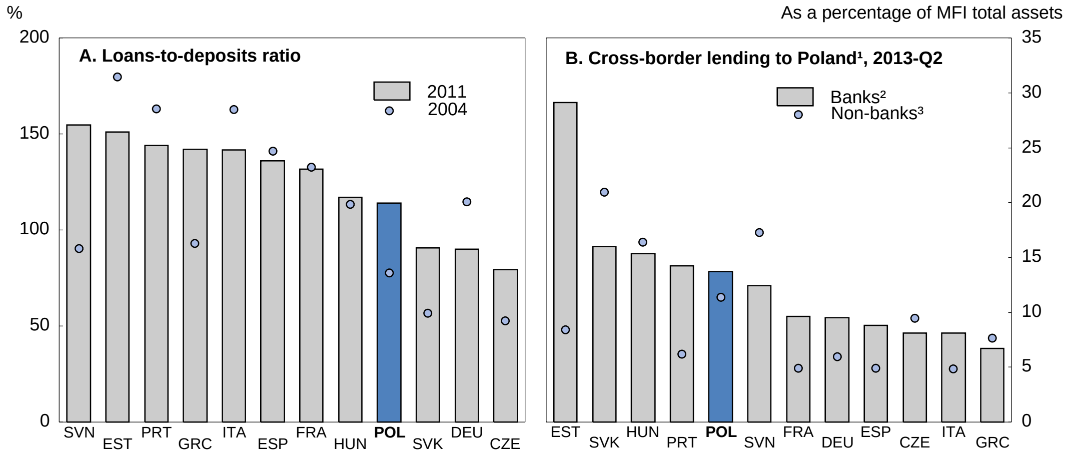

1. Median bank capital ratio (core capital over unweighted assets).
2. Or latest available observation.
3. Or first following available observation.
4. Currency structure of new housing loans to households.

*Source*: Narodowy Bank Polski; KNF; ECB and IMF, Financial Soundness Indicators (FSI).

Although financial stability is not threatened, some mortgages still appear to carry excessive risk. In 2013 Q2, 47% of the newly issued mortgages had a loan-to-value (LTV) ratio in excess of 80% (AMRON-SARFiN, 2013). In line with 2012 *Survey* recommendations, in June 2013 the KNF decided to gradually reduce maximum LTV ratios from 95% in 2014 to 80% in 2017. But, in February 2013, the KNF also removed its already high debt-service-to-income (DTI) ceilings (50 to 65%, depending on income), indicating that prudent DTI policies should be set by the banks themselves, while the KNF has the right to challenge banks' choices as part of the regular supervisory process. Survey data published by the NBP indicate that around 20% of loans originated in 2011 and 2012 had DTIs above 50% (NBP, 2013c). If household indebtedness becomes excessive, the KNF should not hesitate to introduce tight DTI ratios, well below 50%.

The banking system is deeply integrated with international (especially euro area) banks and has a considerable amount of foreign funding (Figure 11). The loan-to-deposit ratio is much greater than before the boom (Panel A), although it has drifted down since 2009 (NBP, 2013b) as competition for deposits has increased among domestic banks. The ratio of Polish liabilities to foreign banks as a percentage of total assets of the domestic banking sector remains relatively high in international comparison (Panel B). External shocks, such as strong deleveraging of euro area banks, could reduce credit supply and generate liquidity problems as foreign liabilities may become difficult to roll over. The decline in FX mortgages will gradually curb dependence on foreign funds, and developing the domestic covered bond market would further strengthen banks' funding structure. Also, the strong capital positions of Polish banks provide some cushion against unfavourable developments.

Figure 11. **External funding dependence remains substantial**




1. Cross-border liabilities are divided by total assets of monetary and financial institutions, excluding central banks' assets.
2 Banks' liabilities towards foreign BIS-reporting banks on a locational basis.
3. Non-banks' liabilities towards foreign BIS-reporting banks on a locational basis. Non-banks include other financial companies, government and the non-financial private sector.

*Source*: World Bank, Financial Development and Structure dataset (November 2013) and IMF (Panel A); BIS and ECB (Panel B).

### *Strengthening macro-prudential and supervisory arrangements*

Poland is reforming its macro-prudential policy framework to introduce a Systemic Risk Board (SRB). A draft law stipulates that the NBP would hold the Chair position with a casting vote. Voting membership would include the Minister of Finance (Vice-Chair), the Chair of the KNF and the President of the Bank Guarantee Fund. The draft empowers the SRB to issue recommendations (publicly, if it so wishes) on a "comply or explain" basis as well as warnings and opinions. The presence of the Minister of Finance would improve information exchange and political commitment. But it may also undermine the SRB's role to lean against the financial cycle because of political considerations and give rise to potential conflicts of interest, given the Treasury's control of three commercial banks (including the largest), representing about a fifth of total banking sector assets (excluding the public investment bank, BGK). The full privatisation of state-owned commercial banks would mitigate potential conflicts of interest.

The reform should ensure a clear separation of roles between the SRB and other financial regulators. In particular, the KNF, which has been praised for its independence and prudential policies (OECD, 2012), should retain its capacity to react effectively to banking-sector distress by issuing non-legally binding regulations ("recommendations"). In any case, KNF's ability to issue such recommendations should be extended to insurance and securities markets. Ideally, they should be made legally binding (IMF, 2013b), though this may be inconsistent with Poland's constitution. The Bank Guarantee Fund's independence from the banking sector should also be strengthened, as its council currently includes two representatives of the Polish Bankers Association, which creates potential conflicts of interest.

**Monetary and financial policy recommendations**

**Key recommendations:**

- If activity and inflation accelerate as projected by the OECD, gradually increase the official monetary policy rate.
- Ensure that the Systemic Risk Board (SRB) has the independence and power to make recommendations coupled with a "comply or explain" mechanism. Ensure a clear allocation of roles between the SRB and the current regulators; in particular, retain the ability of the financial supervision authority (KNF) to issue prudential recommendations.

**Other recommendations:**

- Closely monitor debt-service-to-income ratios, and introduce binding caps on them if household-sector leverage becomes excessive. Reduce banks' external vulnerabilities by developing the domestic covered-bond market.
- Introduce staggered non-renewable terms for MPC members' appointments to strengthen policy continuity.

## Fiscal policy

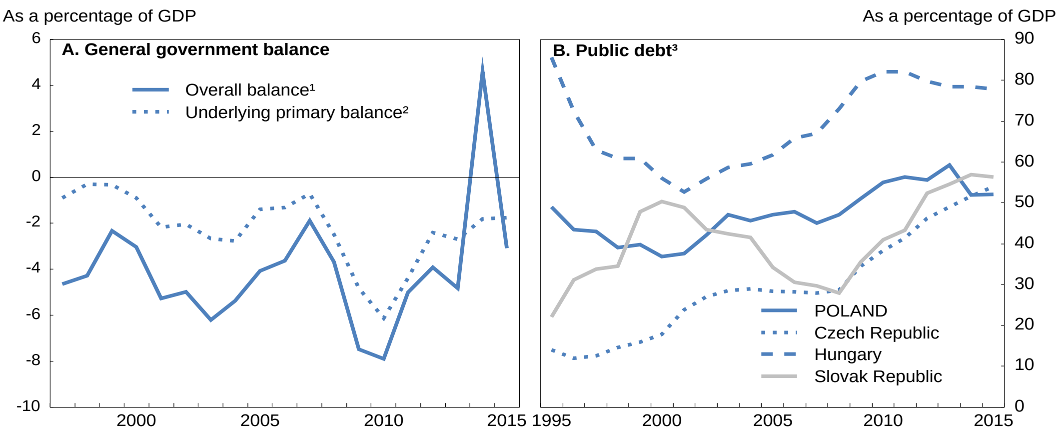
After halving to 3.9% of GDP between 2010 and 2012, the general government deficit widened in 2013 to an estimated 4.8% of GDP, against the planned 3.5% in the April 2013 convergence programme (Figure 12). In 2013, despite freezes on public wages and personal income tax (PIT) thresholds, fiscal slippage resulted from lower-than-expected tax receipts due to the sharp economic slowdown and higher social expenditure and public consumption. The current fiscal rules incorporate two government debt thresholds (50% and 55% of GDP, according to the national debt definition) that trigger corrective actions to prevent it from reaching the constitutional limit of 60% of GDP. To allow the automatic stabilisers to operate the government suspended the 50% debt threshold for 2013-14, which otherwise would have required an additional tightening of around 1.2 percentage points of GDP in 2013. An additional spending rule based on a moving average of GDP growth was introduced in December 2013 (see below).

Convergence programmes and their associated budget laws have spelled out profiles for restoring fiscal balance that have often subsequently not been achieved. This is in part due to growth forecasts that turned out to be optimistic (Table 2), but that does not fully explain the recent tendency to miss the target. Postponing official fiscal targets and the slower return to the 1% of GDP Medium-Term Objective (MTO) for the structural deficit may have tarnished the credibility of multi-year budget planning and more broadly of the conduct of fiscal policy. To regain this credibility the government should base future budgets on unbiased assumptions, as was done for 2014.

Most of the fiscal effort in 2014-15 is focused on a change in the second-pillar pension system (Box 1 and Figure 12), which will have limited short-term effects on economic activity. It will reduce the 2015 government deficit by a cumulative 1.4% of GDP under the current accounting rules (ESA-95), but by only 0.8% of GDP under the new rules (ESA-2010) that will enter into force in September 2014. Modest additional measures (worth about 0.3% of GDP), including increases in excise duties as well as the continuing freeze of public employee wages and the personal income tax (PIT) thresholds, should reduce the headline (ESA-2010) deficit from 4.8% of GDP in 2013 to 3.8% of GDP in 2015 and bring Maastricht debt to 52% of GDP in 2015. The underlying primary deficit (excluding interest payments and one-offs) would fall from 2.7% of potential GDP in 2013 to 1.8% in 2015.

Figure 12. **After improvements in 2011 and 2012, the fiscal position deteriorated in 2013**




1. According to ESA-95. According to ESA-2010 rules to be adopted in September 2014, asset transfers will no longer reduce the deficit, and the general government financial balance would be -4.1 and -3.8% of GDP in 2014 and 2015, respectively.
2. As a percentage of potential GDP.
3. Maastricht definition.

*Source*: OECD Economic Outlook 94 database.

Table 2. **Budget balance and growth rate forecasts included in convergence programmes**

| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Convergence programme | A. Real GDP growth (%) | | | | | | | | | | |
| December 2004 | 5.0 | 4.8 | 5.6 | | | | | | | | |
| January 2006 | | 4.3 | 4.6 | 5.0 | | | | | | | |
| November 2006 | | | 5.1 | 5.1 | 5.6 | | | | | | |
| March 2008 | | | | 5.5 | 5.0 | 5.0 | | | | | |
| December 2008 | | | | | 3.7 | 4.0 | 4.5 | | | | |
| February 2010 | | | | | | 3.0 | 4.5 | 4.2 | | | |
| April 2011 | | | | | | | 4.0 | 4.0 | 3.7 | 3.9 | |
| April 2012 | | | | | | | | 2.5 | 2.9 | 3.2 | 3.8 |
| April 2013 | | | | | | | | | 1.5 | 2.5 | 3.8 |
| GDP growth outcome[1] | 3.6 | 6.2 | 6.8 | 5.0 | 1.6 | 3.9 | 4.5 | 2.1 | 1.4 | | |
| Convergence programme | B. General government budget balance (% of GDP) | | | | | | | | | | |
| December 2004 | -3.9 | -3.2 | -2.2 | | | | | | | | |
| January 2006 | | -4.6 | -4.1 | -3.7 | | | | | | | |
| November 2006 | | | -3.4 | -3.1 | -2.9 | | | | | | |
| March 2008 | | | | -2.5 | -2.0 | -1.5 | | | | | |
| December 2008 | | | | | -2.5 | -2.3 | -1.9 | | | | |
| February 2010 | | | | | | -6.9 | -5.9 | -2.9 | | | |
| April 2011 | | | | | | | -5.6 | -2.9 | -2.5 | -2.0 | |
| April 2012 | | | | | | | | -2.9 | -2.2 | -1.6 | -0.9 |
| April 2013 | | | | | | | | | -3.5 | -3.3 | -2.7 |
| Budget balance outcome[1] | -4.1 | -3.6 | -1.9 | -3.7 | -7.5 | -7.9 | -5.0 | -3.9 | -4.8 | | |

1. OECD projections for 2013.

*Source*: OECD based on successive convergence programmes and OECD Economic Outlook 94 database.

Box 1. **The 2014 pension changes**

The 2014 pension changes reverse part of the 1999 reform, which gave rise to transitional costs as pension contributions were diverted to the mandatory second pillar, increasing public debt cumulatively by an estimated 17.5 percentage points of GDP as of 2012 (Ministry of Labour, 2013; IMF, 2011). The changes will reduce both measured public debt and the deficit (Table 3) but will raise implicit public pension liabilities. On 3 February 2014 51.5% of the net assets of open pension funds (OFEs) were transferred to the public social security institution (ZUS). OFEs' Treasury securities holdings – the major part of the assets transferred – were cancelled. The changes in the pension system lowered gross general government debt by around 9.3% of GDP. Under ESA-95 rules the fiscal balance will become a large surplus in 2014 before being reversed again. However, this transitory swing will not occur under ESA-2010 rules to be adopted in September 2014, which will better capture the underlying deficit dynamics. In 2015 the headline and structural deficits would be reduced by 1.4% of GDP according to ESA-95 rules and 0.8% according to ESA-2010 rules.

Table 3. **The effect of the 2014 pension changes on general government budget balances**

As a per cent of GDP

| | 2014 | | 2015 | |
|---|---|---|---|---|
| | **ESA-95** | **ESA-2010** | **ESA-95** | **ESA-2010** |
| Cancellation of OFEs' Treasury bond holdings | 8.5 | 0 | 0 | 0 |
| Asset transfers from the OFEs for employees 10 years prior to retirement | 0.3 | 0 | 0.7 | 0 |
| Savings on debt service payments | 0.3 | 0.3 | 0.3 | 0.3 |
| Additional social security contributions | 0.2 | 0.2 | 0.4 | 0.4 |
| Total excluding asset transfers | 0.5 | 0.5 | 0.8 | 0.8 |
| **Total** | **9.3** | **0.5** | **1.4** | **0.8** |

*Source*: European Commission (2013a), "Analysis of the budgetary situation of Poland", *European Commission Staff Working Document*, No. 605, November.

While the default option is to contribute to the public pension system, workers can opt-in to allocate 2.92% of their gross wages (15% of their pension contributions) to the privately managed funds. The government assumes that 50% of contributors will choose to opt-in. These additional social security contributions would reduce the general government deficit by 0.2 percentage point of GDP in 2014 and 0.4 percentage point in 2015. Moreover, the assets of those individuals choosing to stay in OFEs will start being transferred to the public pension system 10 years prior to the retirement age, generating receipts of 0.3 and 0.7% of GDP in 2014 and 2015, respectively.

The combination of the 1999 reform and its partial reversal might well damage social trust in the pension system and harm the credibility of future structural reforms more broadly. The 2014 changes also reduce the total amount to be invested in financial assets and thus may cut already low future replacement rates by restricting investment portfolio choice. The increased role of the public pay-as-you-go system in a context of rapid population ageing may further lower future replacement rates. Another result of the recent reforms will be somewhat less liquidity on the domestic Treasury bond market, which serves as a benchmark in the region. Moreover, the cancellation of OFEs' Treasury bond holdings increased the share of non-resident investors in zloty-denominated public debt (from around 32% in January 2014 to 41% in February 2014) and curtail the participation of local investors with a long-term investment horizon. The upsides of the 2014 changes would be to reduce debt service payments and the high OFE operating costs, although it might have been possible to reduce these costs through better regulation of the funds (Égert, 2012a).

### *More medium-term consolidation*

Poland recently agreed with the European Commission to reduce the headline deficit to under 3% of GDP in 2015 to correct its excessive deficit (European Commission, 2013a). This target appears appropriate, given a 2015 projected growth rate above potential. Indeed, such efforts will be needed to reach the MTO and put debt on a sustainable declining trend. They would also help to rebuild fiscal buffers, as public debt will remain close to the fiscal rules' ceilings (even when taking into account the impact of the pension changes) and as medium-term health-care and pension spending pressures will increase. An additional fiscal tightening worth about 0.8% of GDP in 2015 will be required compared to the October 2013 programme presented to the European Commission.

Fiscal consolidation should be implemented in a way that minimises potential adverse side effects on short- and long-term growth but also on equity (Cournède et al., 2013). A number of consolidation options are possible, as argued in the previous *Survey* (OECD, 2012). Savings could be achieved by: *i*) enhancing cost efficiency in the public administration; *ii*) reforming the farmers' social-security scheme; *iii*) eliminating certain occupations' pension privileges, scaling back survivors' pensions and increasing women's retirement age faster (see below); and *iv*) revising the formula used to calculate disability pensions to limit their attractiveness (see below). The tax system should also be reformed to remove distortions, improve tax administration and compliance and raise additional revenues as needed (OECD, 2012; World Bank, 2013); the government plans to present a new simplified tax code in 2015 and to develop improved tax information systems. Additional revenues could be derived by: *i*) cutting tax expenditures, in particular eliminating reduced VAT rates (European Commission, 2013b) and abolishing child tax credits for high-income households; *ii*) linking social-security contributions of the self-employed to actual earnings; *iii*) increasing environmental taxation (Poland is one of the few European countries without explicit vehicle taxes based on fuel efficiency (OECD, 2012)); *iv*) increasing property taxes by establishing market-value-based property taxes and taxing capital gains on rented properties; and v) further privatisations in competitive segments of the economy. The potential conflicts between fiscal consolidation measures and equity objectives should be minimised by, for instance, targeted transfers, which could alleviate any regressive effects of tax expenditure cuts and environmental taxes

### *Further strengthening the fiscal framework*

There are positive features of the current process of the budget preparation: the MPC provides an official opinion on underlying macro-economic assumptions, and the social partners are likewise consulted. Yet, creating an independent institution, composed of high-profile national or international fiscal-policy experts, in line with the EU directive of 8 November 2011, would help to further improve the credibility of multi-year budgeting. It could monitor fiscal plans, including underlying growth assumptions, debt outcomes and deficit and spending targets. It could also be mandated to provide an independent analysis of current and planned fiscal policies on long-term debt sustainability. The OECD has recently developed principles for such institutions (OECD, 2013a).

The debt thresholds in the national fiscal rules should also be strengthened. The debt measure used for the thresholds is a national one, which has left it open to manipulation (OECD, 2012). Harmonising it with its Maastricht counterpart would make the ceilings more transparent and ultimately increase financial-market confidence.

In a welcome step Poland has recently introduced a new spending rule, covering 90% of general government expenditures. Spending growth will be capped by nominal targets based on a moving average of GDP growth, which will enhance transparency and credibility. It is also based on two corrective debt thresholds at 50 and 55% of GDP. The new spending rule could help to smooth the effects of EU transfers and the related public investment cycle. Following the pension system changes (see Box 1), the public debt thresholds are expected to be lowered by 7 percentage points. The fiscal rules (the current rules plus the new spending rule) would then take into account four debt thresholds: the two thresholds of the spending rule at 43 and 48% of GDP, a preventive debt threshold at 55% of GDP and the 60% of GDP constitutional limit, while the 50% of GDP debt threshold of the current rule would be abolished. Progress has also been made in extending budget discipline to local governments. Local government deficit rules were introduced in 2011, and, in line with the 2012 *Survey*'s recommendation, individual debt service limits will henceforth prevent excessive debt levels. However, safety buffers should still be included in the central government's budget to account for local governments' slippages or revenue shortfalls.

**Fiscal policy recommendations**

**Key recommendations:**

- Achieve greater fiscal consolidation in 2015 than currently planned to be able to meet the below-3%-of-GDP general government deficit target.
- Create an independent institution to monitor underlying budget assumptions and fiscal performance relative to targets. Strengthen the fiscal framework by implementing detailed multi-year budgeting, basing budgets on unbiased assumptions and harmonising the domestic and Maastricht debt definitions.

**Other recommendations:**

- Reduce government spending as needed by: enhancing cost efficiency in the public administration, substantially reducing subsidies to the farmers' social security scheme from current levels and eliminating social security privileges available to some other occupations, scaling back survivors' pensions, increasing women's retirement age faster and avoiding that disability pensions become attractive relative to old-age pensions.
- Raise additional revenues as needed by: cutting tax expenditures, linking social security contributions of the self-employed to actual earnings, increasing environmental taxation, raising property taxes by establishing market-value-based property taxes and taxing capital gains on rented properties, and making further privatisations in competitive segments of the economy and improving tax compliance.

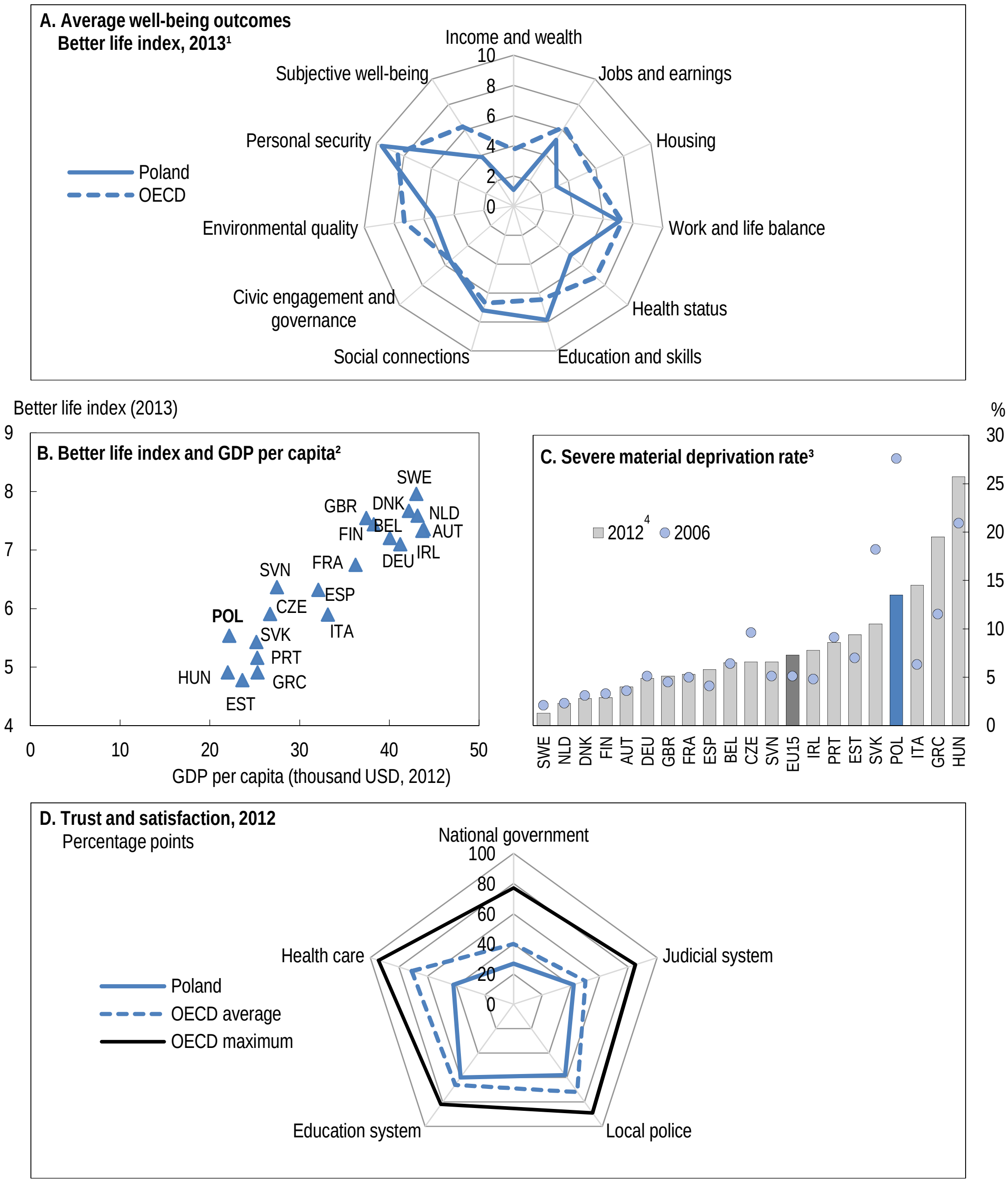
## Achieving sustainable and inclusive growth

Enhancing sustainable growth is crucial if Poland is to keep catching up to the best performers in well-being terms (Figure 13, Panels A and B). Well-being gaps are related to the still relatively high incidence of material deprivation – despite considerable progress (Panel C). This *Survey* focuses on making the labour market work better and strengthening product-market competition as ways to improve well-being. With slow implementation of reforms, there is always a risk that the full potential of the economy will not materialise, and in the case of Poland that risk is compounded by the general distrust in key public institutions (Panel D). The lack of affordable quality housing, low self-reported health and high emissions of some air pollutants are also among the most pressing concerns (OECD, 2013b) (Figure 14, Panel A).

### *Ensuring environmental quality*

The chapter on climate-change policies in the last *Survey* (OECD, 2012; Égert, 2012b) showed that progress has been made in reducing energy intensity and greenhouse gas emissions over the past decade (Figure 14, Panel B). Nevertheless, the potential for cutting emissions remains substantial and should be realised in a least-cost fashion. An economy-wide single carbon price is key to minimising abatement costs, but current explicit and implicit carbon prices vary widely across sectors.

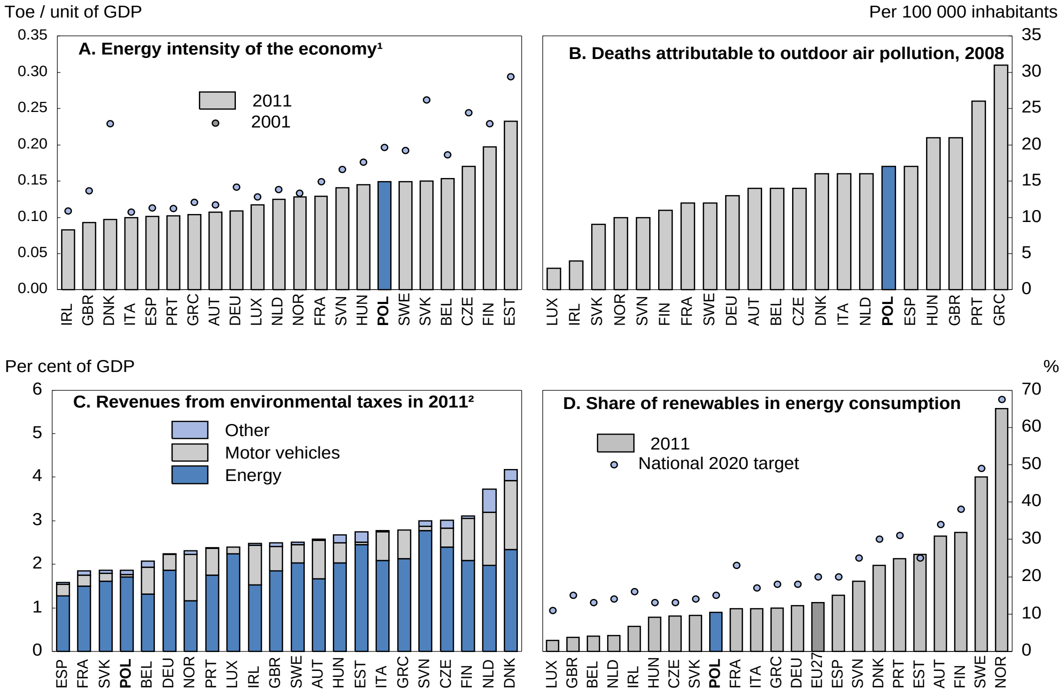
Figure 13. **Social indicators**




1. Each well-being dimension is measured by one to three indicators from the OECD Better Life indicator set. Normalised indicators are averaged with equal weights so they range between 10 (best OECD country) and 0 (worst OECD country).
2. For illustrative purposes, the Better Life Index is calculated here with equal weights on the 11 dimensions (see www.oecdbetterlifeindex.org for details). GDP per capita in US dollars at current prices and purchasing power parities; 2011 for Greece.
3. Severely materially deprived people are those unable to pay for at least four of nine items (e.g. rent, mortgage or utility bills; a washing machine or a car).
4. 2011 for Ireland and the United Kingdom.

*Source*: OECD (2013), OECD National Accounts Statistics (database), June and OECD Better Life Index; OECD Government at a Glance 2013; Eurostat (2013), Income and Living Conditions, Eurostat Database, June.

Figure 14. **Environmental indicators**




1. Total primary energy supply (estimated for 2012) in tonnes of oil equivalent (toe) per thousand USD. GDP in constant prices and purchasing power parities.
2. Data for Poland refer to 2010.

Source: OECD/EEA Database on Instruments used for Environmental Policy. WHO (2013), *Global Health Observatory Data Repository*, IEA (2013), *Energy Balances of OECD Countries 2013*, International Energy Agency.

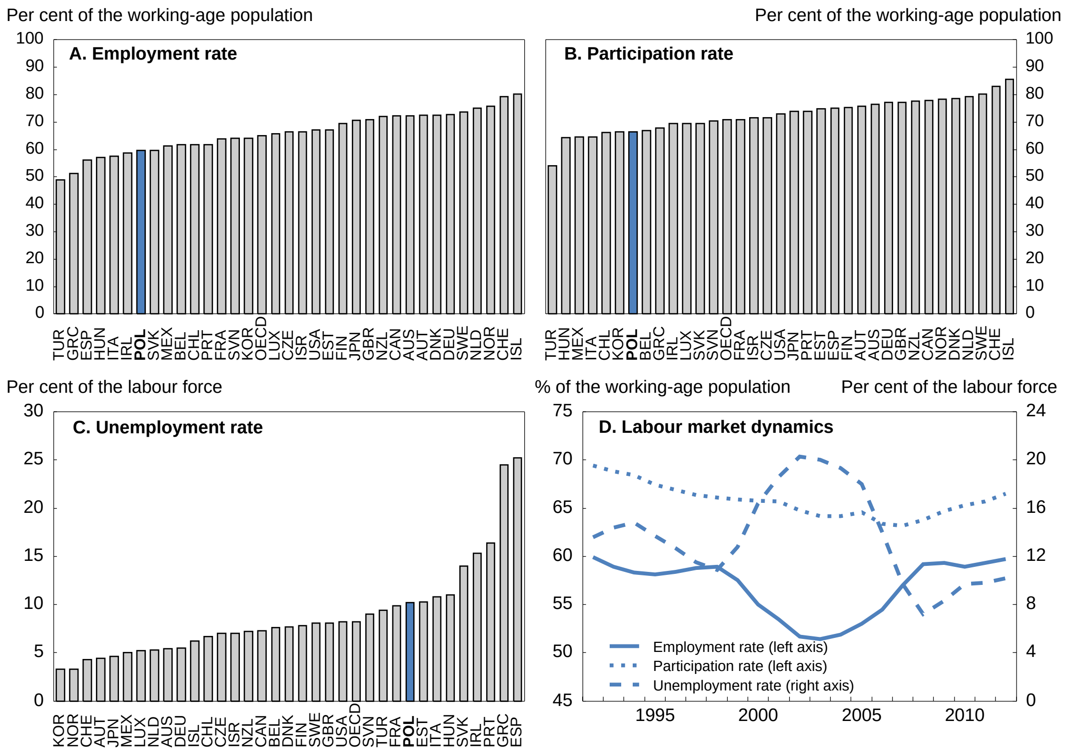
Air pollution levels are high on average, particularly in cities (WHO, 2011), partly due to the predominance of fossil-fuel-based energy production, outdated heating systems and transport-sector emissions. Pollution from private vehicles should be reduced by better reflecting their environmental performance in annual vehicle taxes and by developing the railway network (Panel C). Also, exploiting Poland's shale gas reserves – potentially Europe's biggest – needs to be handled carefully to avoid local pollution, especially from water contamination and methane leakages. Improving water quality and waste management are other important environmental challenges: fertiliser and pesticide use has risen, and Poland still uses mainly landfill-based solid waste management, while wastewater treatment should be further developed. Despite considerable progress, a third of the population was still not connected to a sewage network in 2011.

Renewable forms of electricity remain underdeveloped (Figure 14, Panel D). The National Renewable Energy Action Plan sets a 2020 target of 15% for such energies. Since 2005, mandatory quotas for power companies and a green-certificate market have pushed many state-owned coal-fired power plants to co-fire with biomass, but the development of other technologies has been limited. Better pricing of externalities could make other renewables more competitive. Yet, grid capacity and management also need to improve. Extending interconnection capacity with neighbouring countries would foster competition and facilitate supply-demand balancing in the context of increasing wind and solar-powered generation whose availability is typically intermittent (OECD, 2012a).

### *Making the labour market work better*

Despite significant improvements since the mid-2000s, employment remains one of Poland's major structural weaknesses, impeding firms' competitiveness and the nation's potential output. The employment rate, at 59.7% in 2012, is among the lowest in the OECD (Figure 15). Unemployment is at a high level and seems to be mostly structural. Participation has increased since 2007, breaking its declining trend thanks to relatively strong growth, tightened accessibility to early-retirement and disability pensions, cohort effects related to the 1980s baby boom and a decrease in the labour tax wedge.

Figure 15. **Labour market indicators, 2012**




*Source*: OECD, Labour Force Statistics 2013 database.

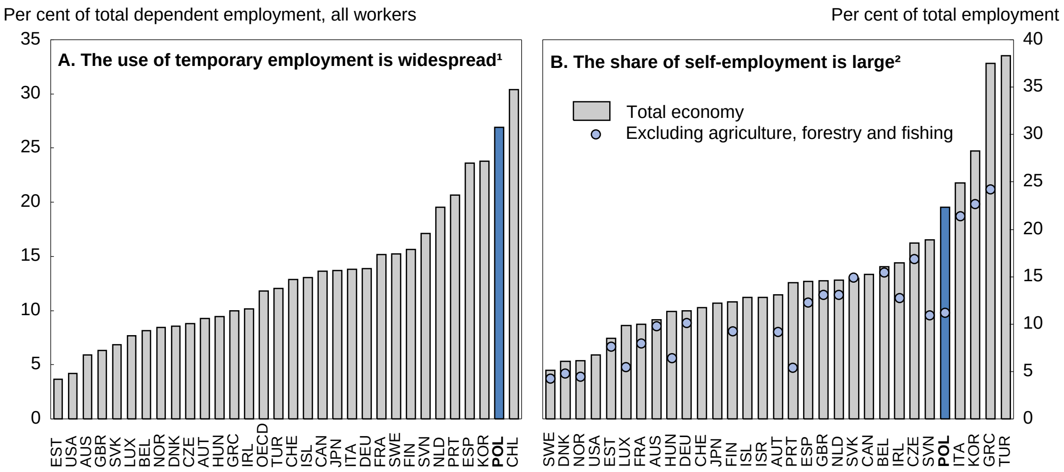
Poor labour market performance is by no means attributable only to labour market policies. Numerous inefficiencies induce significant misallocation and waste of labour resources. There is substantial scope to enhance competition, which could generate numerous job opportunities (see Chapter 2 of the *Survey*). Moreover, there are important impediments to internal labour mobility. The quality of transport infrastructure, discussed in the 2008 *Survey* (OECD, 2008a; Kierzenkowski, 2008), has improved recently thanks in part to EU funds, but remains insufficient, especially for rail. Urban housing is expensive because of a lack of private rental supply. As recommended in the 2013 *Going for Growth* (OECD, 2013c), the release of zoning plans by municipalities should be made mandatory and transaction taxes on housing purchases replaced by *ad valorem* property taxes. On the other hand, compulsory escrow accounts to protect buyers' advances were introduced in 2012, consistent with OECD's recommendations. Other barriers to labour mobility are also attributable to wage distortions and the design of unemployment and social assistance policies (see Chapter 1 of the *Survey*). In particular, the advantages resulting from the farmers' social insurance system induce people to hold onto small plots of land, even those no longer actively farming.

*Reducing labour market segmentation*

Employment protection is not particularly stringent. The notice period for dismissals is average, severance pay low and the definition of unfair dismissals among the OECD's least constraining. But legal procedures for disputed separations tend to be long and unpredictable, reinstatement obligations heavy and trial-period contracts, which can be used for both temporary and open-ended employment, rather short. According to a 2013 amendment to the Labour Code, working-time regulations have been made more flexible, as the reference period used to compute working-time limits was extended from four to twelve months, conditional on branch or firm-level agreement.

The labour market is nevertheless heavily segmented in a rather complex way. Shares of both temporary and self-employment are among the OECD's highest, although for the latter this is mainly due to the large share of agriculture (Figure 16). Although only two consecutive fixed-term contracts with the same firm are allowed, there is no cap on their duration. About 7% of total employment is governed not by the Labour Code but rather by civil-law provisions, which are less costly for employers, as such worker-contractors have only limited social protection and are not subject to minimum-wage regulations. Poland is also one of the OECD countries where informal employment poses the most serious challenges (OECD, 2008b). Simplifying and better enforcing tax regulations would reduce its incidence and scope, as would phasing out the various advantages granted to the self-employed (see Chapter 1 of the *Survey*). Such profound dualism may induce in-work poverty, limit investment in human-capital formation, lengthen the transition from school to stable work and make some specific groups, in particular the young and the low-skilled, bear a disproportionate part of the costs of adjustment to economic shocks (Lepage-Saucier et al., 2013).

Figure 16. **The labour market is heavily segmented, 2012**




1. 2011 for Korea; 2009 for Sweden and 2005 for the United States.
2. 2011 for Australia.

*Source*: OECD, Labour Force Statistics; OECD Economic Outlook 94 and OECD National Accounts databases.

### *Better activating the unemployed*

The unemployment benefit (UB) system has strict eligibility rules – only 20% of registered unemployed were eligible in 2012 – and the benefit is a low flat rate that falls by 20% after three months. Yet, strong incentives to register as unemployed stem from having access to free health-insurance coverage. This creates a situation where many registered unemployed are not searching for a job, having registered just to get the insurance. It also implies that some job-search support is bound to fail, thus discouraging both public employment service (PES) staff and employers posting job offers. Moreover, the general entitlement period of six months is doubled for older workers, reducing work incentives for that group, as well as in high-unemployment districts. It helps to maintain minimum living standards during job search, but it also discourages migration out of economically depressed areas.

There is a broad consensus that the PES functions poorly (Kaluzna, 2009). It suffers from a lack of human resources, both quantitatively and qualitatively, inefficient use of those in hand, insufficient relevant information at local levels and serious coordination problems. Merging local labour offices with UB and social assistance administration to create one-stop shops, and, more fundamentally, integrating their management, would help overcome those weaknesses. Job-seeker profiling should be expanded as the government intends, as well as the scope of private employment services. The umbrella function of the Ministry of Labour and Social Policy should also be strengthened, including by promoting the adoption of best practices through performance management and the introduction of a benchmarking system such as those developed in Australia or Switzerland (OECD, 2013d). The government plans to start benchmarking labour offices soon.

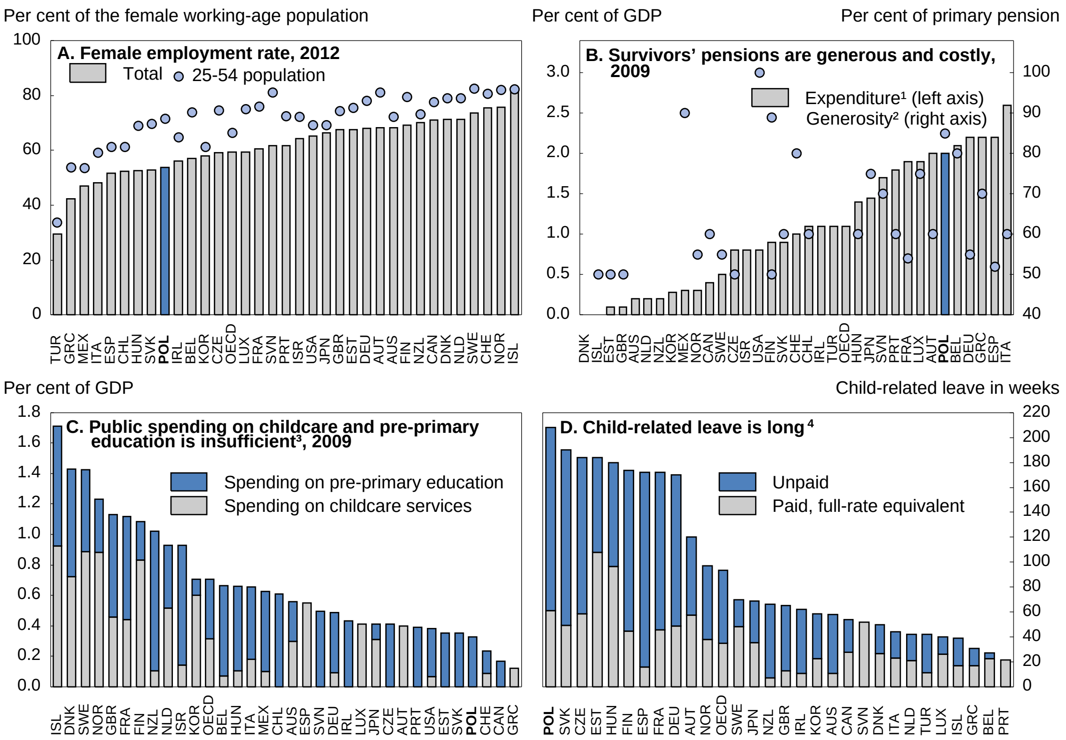
Jobseeker activation could also be improved. Work-availability and job-search requirements in the UB and social-assistance systems are minimal (Venn, 2012). Tighter obligations and better monitoring would sharpen incentives to return to work. Moreover, the provision that a suitable job offer need not be limited to a beneficiary's previous occupation is not effectively enforced. Although crude UB replacement rates are low, when combined with other transfers and relatively high tax wedges for those on low incomes, situations arise where effective replacement rates become very high. Gearing more assistance to being in work would *help* make work pay. This could be done by making more transfers (such as childcare subsidies) conditional on working or seeking work.

*Improving policies targeted at specific groups*

The female employment rate is especially low (Figure 17, Panel A). The 2012 pension reform –which is supposed to raise statutory retirement ages to 67, by 2020 for men (from 65 today) and by 2040 for women (from 60 today) – goes in the right direction, but its pace should be accelerated for women. The survivors' pension regime, about 90% of whose beneficiaries are women, is expensive and might undermine work incentives for some recipients (Panel B). Indeed, the ratio of the deceased partner's pension awarded to the survivor, at 85%, is among the highest in the OECD, and greater than the estimated ratio needed to sustain the surviving spouse's living standards. Moreover, the benefit falls if the survivor earns income, reducing work incentives. Such a system implies redistribution from women who engage in paid work to those who do not and from singles and dual-career couples to single-earner couples (James, 2009). Scaling back this programme and reducing the marginal implicit tax involved would increase employment and reduce the overall tax burden.

The insufficient development of childcare and pre-primary education in Poland is a major structural weakness (Figure 17, Panel C; OECD, 2013c). Yet, important recent progress has been made. In 2011, pre-school education became compulsory from the age of five, and primary education will start at age six in 2014. In June 2013, the government reduced parents' direct costs of accessing kindergarten. According to a July 2013 regulation, every four year-old will have the right to participate in pre-school education from September 2015 and every three year-old from 2017. However, paid maternity leave has been increased several times since 2006 (including in 2013) to an OECD record of 52 weeks (Panel D), in principle to promote fertility. For each child, maternity leave consists of a first six-month period paid at 100% of past salary and of a second six-month period paid at 60%; the second period can be shared between the mother and the father. On top of this, the parental leave of 156 weeks is also the longest among OECD countries. Such long leaves are costly for public finances and could result in mothers not returning to the workforce with no observed advantages for children (see e.g. Dahl et al., 2013). To enhance second-earners' employment the government should adopt an individualised tax system; develop childcare and long-term care facilities, and pre-school education; and encourage flexible working-time arrangements. The government intends to continue to develop a variety of child-care arrangements. Moreover, the impact of long child-related leave on the employment of mothers should be closely monitored.

Figure 17. **Female employment rate is low and work incentives are weak**




1. Public expenditure on survivors' pensions.
2. Survivors' benefits, as a percentage of individuals' primary pension entitlements.
3. Disaggregated spending data are not available for Spain.
4. Child-related leave periods by duration of unpaid leave and the duration of the full-rate equivalent of the leave period if paid at 100% of last earnings; child-related leave is the sum of maternity and parental leave. Poland's numbers take into account the 2013 extension of the maternity leave.

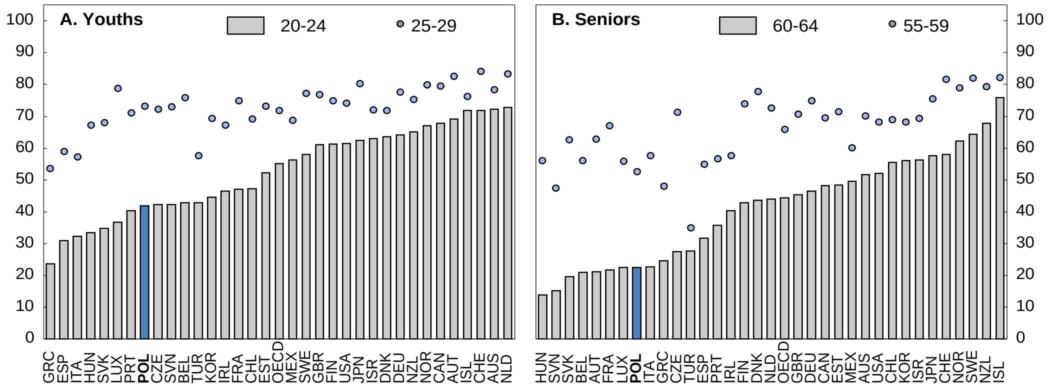
*Source*: OECD, Labour Force Statistics 2013 database; for Panel B: Whitehouse, E.R. (2013), "Adequacy and sustainability of pension systems: evidence from Europe", OECD Social, Employment and Migration Working Paper, OECD Publishing, forthcoming; James, E. (2009), "Rethinking Survivor Benefits", World Bank, *Social Protection and Labor Discussion Paper*, No. 928.

**How to read Panel D:** The figure is constructed by summing the paid and unpaid periods of maternity and of parental leave. In Poland as an example, maternity leave comprises 26 weeks paid at 100% of salary and 26 weeks paid at 60% for a total of 52 weeks. On a full-rate equivalent (FRE) basis, this means 26*100% + 26*60% = 41.6 weeks paid and 10.4 weeks unpaid. On top of this, parental leave is granted for a maximum of 156 weeks, two thirds of which are partially paid at the monthly benefit of PLN 400. This breaks down into 19.4 weeks of FRE paid leave and 136.6 weeks of unpaid leave: the 19.4 weeks of FRE paid leave are obtained by computing the replacement rate for the average-wage worker as the ratio of the monthly benefit (PLN 400) to the average wage (PLN 2 144), adjusted for the length of the paid period (two-thirds), i.e. 400/2144*2/3*156 = 19.4 weeks. Combining maternity and parental leave leads to 61.0 weeks paid at the FRE basis and 147.0 weeks unpaid.

Poland's poor labour-market performance is also concentrated at both ends of the age spectrum (Figure 18). For young people the shortfall in employment rates is concentrated in the 20-24 age group and is to a large extent attributable to their greater enrolment in education, which rose sharply up to 2005, and to the limited combination of work and study. The rise in educational attainment among youths is a major achievement, but the demand for skills has risen even faster (see Chapter 1 of the *Survey*). Less-educated youth in particular tend to go through an arduous transition through temporary contracts, which are widespread and seem to serve not as a springboard to stable employment (OECD, 2009a), but rather as a screening device (Baranowska et al., 2011). Precarious employment is therefore pervasive among youths.

Figure 18. **Employment rates are especially low at both ends of the age spectrum**

As a percentage of the population by age bracket, 2012




*Source*: OECD, Labour Force Statistics 2013 database.

Following earlier reforms, the improvement in educational performance over the past 20 years has been impressive. Yet, youth employment prospects could be improved by further enhancing work-based learning in Vocational Education and Training (VET) programmes, by boosting social partners' involvement, including in school boards, and by raising the quality of teaching. In line with past OECD recommendations (OECD, 2007), a clearer distinction between vocational and academic Higher Education Institutions (HEIs) is being introduced. Because employers have little incentive to hire apprentices (European Commission, 2013b), subsidies to cover employers' training costs of VET students should be expanded. The system of quality-based HEI financing could be bolstered, and promoting practical modules in tertiary curricula and strengthening the link with businesses should be continued.

The employment and participation rates of older workers have both risen strongly since the mid-2000s. Yet, the current levels remain well below OECD averages. Although recent measures are helpful, special old-age pension regimes (for farmers, miners, uniformed services, prosecutors and judges) should be phased out and remaining pre-retirement schemes eliminated. Important progress has been made since the mid-2000s to tighten access to disability pension schemes. However, the employment of the disabled is very limited and should be promoted by: reducing the employer quota of 6%, while raising the penalty for firms failing to reach it; and better training and activation of disabled workers (OECD, 2006). Moreover, following the 1999 old-age pension reform, which will reduce replacement rates by automatically decreasing initial pension values as life expectancy improves, the ratio of average disability to old-age pensions will increase significantly, boosting incentives to retire early under the disability regime when possible (IMF, 2013a). Therefore, the formula used to calculate disability pensions should be revised in line with that used for old-age or minimum pensions. Finally, prohibiting worker lay-offs less than four years before retirement also deters hiring of older workers and should be removed.

**Recommendations to boost employment**

**Key recommendations:**

- Reduce labour market dualism by: making all contracts for labour services subject to the same tax and social contribution regime as Labour-Code contracts; extending the maximum length of trial-period contracts; streamlining legal dismissal procedures; and setting a maximum cumulative duration for temporary contracts with the same firm.

- Expand the resources of public employment services to hire more skilled staff, and ensure that overall resources are better allocated to front-line placement tasks. Promote the adoption of best practices by labour offices through performance management and benchmarking.
- Tighten work availability and job-search requirements for jobseekers. Reduce passive social assistance by making more transfers conditional in part on being employed or seeking work.
- Boost female employment by: developing childcare and long-term care facilities and pre-school education; and increasing women's retirement age at a more rapid pace than scheduled. Monitor closely the impact of the long maternity leave on the employment of mothers.

**Other recommendations:**

- Reduce obstacles to internal mobility by: continuing to develop transport infrastructure, in particular by upgrading the quality of the rail network; reforming housing policies by requiring the release of zoning plans by municipalities, and replacing transaction taxes on property by annual *ad valorem* taxes.
- Disconnect health-insurance entitlement from unemployment registration. Eliminate regional and age-related differences in the maximum length of unemployment benefits.
- Accelerate the reduction of government subsidies to the farmers' social insurance system. Phase out all special occupational regimes, eliminate pre-retirement schemes, and avoid that disability pensions become attractive relative to old-age pensions. Remove the prohibition to lay off workers less than four years before retirement.

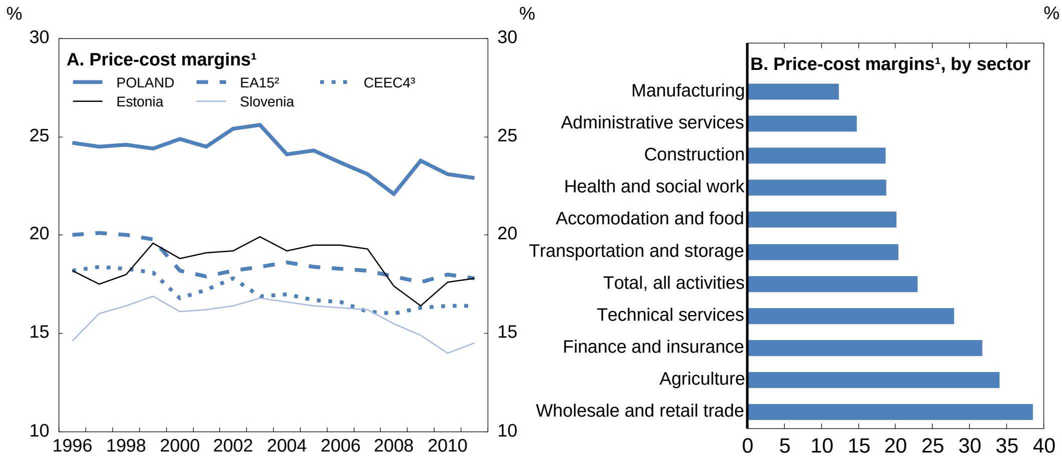
### *Strengthening product market competition*

Boosting product market competition is crucial for Poland to speed up convergence towards euro-area income levels, given the large remaining productivity gaps. The extent of economic rents seems higher than in most other OECD countries (Figure 19). Although tremendous progress has been made, restrictive product market regulations still hinder activity substantially. Poland has the OECD's largest potential to increase productivity by aligning regulations with best practices, especially in network industries (Bouis and Duval, 2011). While improvements have been significant in terms of the competition policy framework, changes have been less so for barriers to entrepreneurship and state control.

#### *Reducing competition-distorting public ownership*

Polish public ownership is one of the most extensive in the OECD (Figure 20): the state is involved in many potentially competitive sectors such as mining, banking, real estate and chemicals. The government launched ambitious privatisation plans in 2008-11 (during the world economic crisis) and 2012-13, and the process is still on-going. In several cases it has opted for partial privatisation and kept a controlling stake in many state-owned enterprises (SOEs), largely in the energy, financial and mining sectors, which are in most cases considered to be of strategic importance, thereby reducing the benefits of private ownership. In 2013 the government created an investment fund fed by future privatisation revenues and government assets to co-finance infrastructure and investments mainly in chemical, energy and extractive industries. While this might help improve access to long-term finance (which may not be available solely in the private market) and therefore stimulate economic growth, it could also mean further state involvement in some competitive segments of the economy.

Figure 19. **Economic rents are much higher than in most other OECD countries**




1. Adjusted for self-employment: self-employed are assumed to earn the average wage in the sector, except for agriculture. For Panel B, the reference period is 2008-11, and sectors which comprise less than 2% of Polish employment – mostly public activities (education, public administration and defence) – are not displayed.
2. Excludes Ireland for which data are missing.
3. Excluding Poland.

*Source*: Eurostat's National accounts database and OECD calculations.

**How to read this figure:** Price-cost margins represent the difference between sales and variable costs – intermediate inputs and labour – divided by sales. Higher margins indicate lower competitive pressures and higher economic rents.

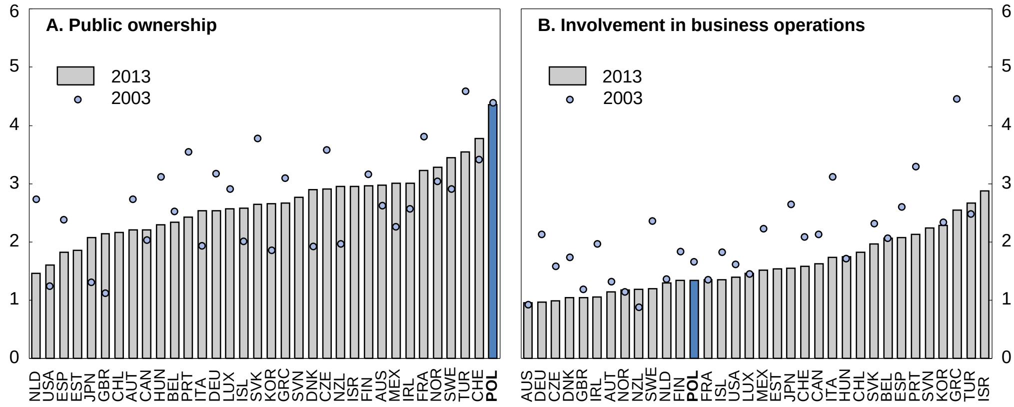
### *Strengthening competition enforcement*

Poland's Competition Authority appears to be efficient. Yet, there is scope to strengthen it. Its size and budget are limited: with 132 people working on competition enforcement, its staff is a smaller share of total employment than in many other countries. Its President has an open-ended contract and can be removed at any time by the Prime Minister. Indeed, the President was dismissed in February 2014. The Competition Authority also lacks the power to split up dominant firms or to force vertical separation. A welcome draft law would provide it with some power in this area and increase incentives for cartel disclosure and whistleblowing by setting up an US-inspired "leniency plus" programme. However, judicial system inefficiencies slow court procedures that would help to end cartels; more use of information and communication technologies would help (Palumbo et al, 2013). Furthermore, private enforcement of competition laws remains rare. Class actions were introduced into Polish law only in 2010, but consumer claims applying to antitrust infringements and anti-competitive practices are scarce, in part because of judicial weaknesses.

Substantial barriers to the entry and exit of firms weaken competition and entrepreneurship. The transposition of EU single-market legislation is unsatisfactory, according to the European Commission (2012). Red tape has been significantly reduced in recent years, and on-line procedures to register a limited liability company were used in more than 20% of all 2013 registrations. Although starting a business remains costly in terms of both time and money (Figure 21, Panel A; World Bank, 2013), reform of the procedure, approved by the government in early 2014, should reduce the registration time from more than 20 to 7 days (Ministry of Justice, 2014). The government reduced the paperwork related to the collection of taxes and social security contributions in June 2013 and recognises the need to further ease the administrative burden by implementing new streamlining measures.

Figure 20. **State involvement in the economy, 2003 and 2013**[1]

Index scale from 0 to 6, from least to most restrictive

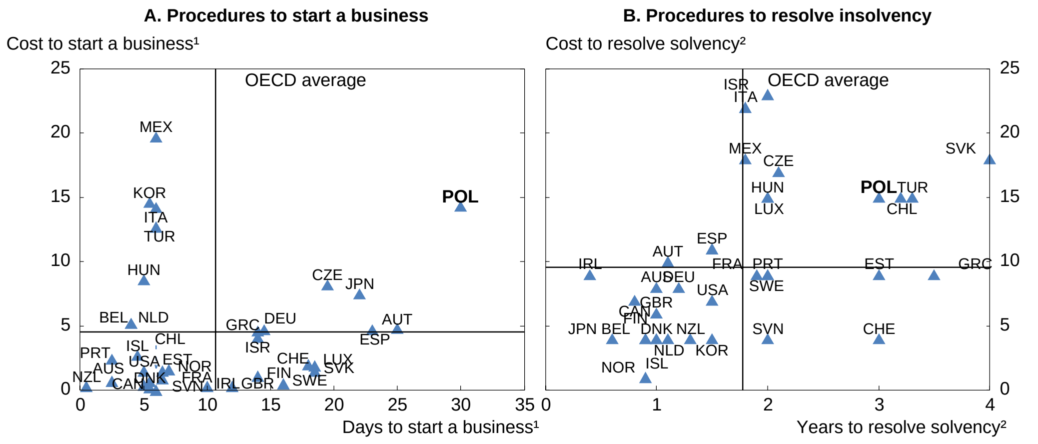



1. 2008 for the United States.

*Source:* OECD (2014), preliminary Product Market Regulation database.

**How to read this figure:** The OECD public ownership indicator – displayed in Panel A – measures the presence of public ownership in 30 sectors, the extent of state-ownership in network industries and the level of public control in enterprises where the state owns shares. The indicator is based on qualitative information, for example the presence or absence of SOEs in a given sector. It measures the scope of public ownership across sectors rather than the quantitative scale of public ownership in the economy. Measures of the scale of the privatisation process between 2003 and 2013 are presented in Chapter 2 of the *Survey*. The OECD indicator of involvement in business operations – displayed in Panel B – measures the use of regulated prices and command and control regulations. The reported indicators for Mexico, Poland and Turkey are based on preliminary estimates as some of the underlying data have not been validated with national authorities. Subsequent data validation may lead to revisions to the indicators for these countries.

Figure 21. **Procedures to start a business and resolve insolvency remain long and costly**




1. The cost to start a business is recorded as a percentage of the economy's annual GDP per capita. It includes all official fees and fees for legal or professional services if such services are required by law. Time to start a business captures the median duration that corporate lawyers indicate is necessary in practice to complete a procedure with minimum follow-up with government agencies and no extra payments.
2. The cost of insolvency proceedings is recorded as a percentage of the value of the debtor's liabilities. Time to resolve insolvency represents the time for creditors to recover their credit in calendar years. The period of time measured by *Doing Business* is from the company's default until the payment of some or all of the money owed.

*Source*: World Bank (2013), *Doing Business, 2014.*

Bankruptcy procedures are lengthy and costly (Figure 21, Panel B), restricting the ability to save viable firms and deterring entrepreneurship. Polish bankruptcy law is also limited to corporations, exposing small unincorporated businesses to huge uncertainty about potential personal liability. As proceedings remain open as long as valid creditor claims are outstanding, the process can be lengthy, and consequently few bankruptcies actually occur, curbing resource reallocation. The government is preparing a reform of bankruptcy procedures for 2014 and developing second-chance policies for entrepreneurs.

*Improving public procurement*

Public procurement amounts to about 20% of GDP, among the highest shares in the OECD. Ensuring fair competition and selecting the best suppliers are therefore critical. Public ownership, especially in local-government-dominated sectors, may lead to non-neutrality of the bidding process. A waste-management law implemented in June 2013 transferred responsibilities to local governments, requiring them to establish public procurement processes. However, in Poland, sub-central governments have often tried to shield local public enterprises from competition, for example in areas such as waste collection, water services and public transportation (OECD, 2009b). Moreover, awarding public contracts relies heavily on the criterion of lowest price, rather than on effective implementation of complex projects or environmental impacts. This led to serious problems, which the government intends to address. Proposed legislation includes both improved assessment of the likelihood of successful contract completion as a criterion for contractor selection and dissuasive sanctions in case of abnormally low prices. Adopting more complex criteria will require an increase in administrative capacity.

*Raising competition in network industries*

Competition is weak in network industries except telecoms. Strengthening it in the potentially competitive upstream and downstream segments should be combined with non-discriminatory third-party access to the natural monopoly segment. Other than in telecommunications, the independence of sectoral regulators needs to be enhanced by awarding their presidents fixed-term and non-renewable contracts during which he or she cannot be dismissed without fault, and preventing revolving-door opportunities.

Production, transmission and distribution of electricity and gas are largely dominated by SOEs. For example, despite legal unbundling, the incumbent gas operator (PGNiG) controlled 95% of the market in 2012. Yet, the energy market is gradually being liberalised. At the end of 2012, a gas exchange was created, and 97 entities were entitled to trade. The government laudably plans to oblige PGNiG to sell 55% of its gas production on the exchange in 2015. Yet, vertical ownership separation would further improve third-party access. Also, better pricing of externalities could encourage renewable electricity development. Finally, improving grid capacity and management, especially by expanding international interconnections, would keep costs down and safeguard reliability (OECD, 2012).

The water industry is very fragmented and dominated by municipally owned utilities, which are mostly not corporatised. They suffer from overstaffing, a lack of automation and low wages (OECD, 2011). There is no national regulator: water companies and tariffs are supervised by mayors or municipal councils. An independent water and sanitation services regulator could improve efficiency by imposing productivity targets using international benchmarking and yardstick regulation. This could push the nation's 1 600 water companies to merge to reap the benefits of scale economies and help finance badly needed investment.

The railway sector also suffers from inefficiency resulting from insufficient competition (OECD, 2008a; World Economic Forum, 2013). More than 90% of passenger transport is controlled by central or local governments. The historical operator was split into different entities for freight (PKP Cargo), long-distance passenger transportation (PKP Intercity) and infrastructure management (PKP PLK S.A.) within a holding company (PKP Group), while local governments are responsible for regional passenger transport. The holding company plays a key role and also dominates infrastructure management. There has been significant progress in freight, as PKP Cargo's market share fell from 80% in 2006 to about 60% in 2012.

Yet, third-party access by non-government providers remains an issue. The main public manager of the rail network (PKP PLK S.A.) should be totally independent of the PKP Group.

*Strengthening competition in professional services*

The government recently launched an impressive programme to deregulate professional services. This is an area where OECD indicators suggest that entry requirements were substantially stricter than in best performing countries; by contrast, conduct regulations tended to be lax. About 70% of the currently 350 regulated professions have been selected for full or partial deregulation in three waves, the first of which included 51 professions, notably legal professions, occurred in early 2013. It is important that the two other waves be fully implemented.

**Recommendations to strengthen product-market competition**

**Key recommendations:**

- Lower further the costs of entry and exit, such as cumbersome business registration. Reduce the length and cost of bankruptcy procedures.
- Pursue privatisation, and substantially reduce government ownership in competitive segments of the economy while ensuring sound governance of remaining state-owned enterprises.
- Modify public procurement practices to select the contractors offering the best value for money rather than the lowest price. Focus procurement decisions on a mix of prices and technical bid details, including environmental impact assessments. This will require enhancing staff skills to deal with complex selection criteria.
- Introduce fixed-term non-renewable mandates for the presidents of the Competition Authority and sectoral regulators, during which they cannot be dismissed without fault. Create an independent regulator for water and sanitation services.

**Other recommendations:**

- Give the Competition Authority more powers to split up firms to reduce dominant market positions and to impose vertical separation as a remedy for reduced third-party access.
- Increase competition in rail transportation. Insure total independence of the main public infrastructure manager from the operators.

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*Annex*

# Progress in structural reform

This Annex reviews action taken on recommendations from previous *Surveys*. Recommendations that are new in this *Survey* are listed in their relevant chapters.

This Annex presents under each theme:

- Past recommendations
    - ❖ *Actions taken and current assessment*

## Product market competition and Competitiveness (see also Chapter 2 of the *Survey*)

- Continue efforts to further ease the administrative burden on businesses.

  ❖ *Information requirements when starting a business were simplified, an e-registration process was introduced and tax registration procedures shortened, but the administrative burden remains high. In 2014, the government plans to streamline further the procedures to start a firm and to reform those dealing with insolvency.*

- Continue the privatisation of state-owned companies in the financial, mining and chemical sectors.

  ❖ *The 2012-13 privatisation plan was implemented. The Polish Investment Programme will use future privatisation receipts to ease access to long-term finance for infrastructure projects, but it could also allow further state involvement in chemical and heavy industries.*

- Ease competition-restraining regulations by reducing public ownership in the potentially competitive segments of network industries.

  ❖ Action *taken is limited to the selling of shares in three electricity companies in 2012-13.*

- Pursue gas and electricity market liberalisation by fully complying with EU regulations and possibly by implementing ownership unbundling in those sectors.

  ❖ *The energy* market *is gradually being liberalised. A gas exchange was set up in 2012 together with an obligation to sell on it at least 30% of production in 2013, 40% in 2014 and 55% in 2015 of the gas entering the gas network. Yet, the impact is partly blurred as most of the producers and distributers have strong vertical ties through state ownership, and the incumbent still controlled 95% of the gas sector in 2012.*

- Deepen financial development through a consolidation of co-operative banks and an improved legal framework for collateral.

  ❖ *The* government *is working on a new cooperative banking act.*

- Scale down regulations in professional services regarding both educational requirements and licensing.

  ❖ *Significant progress is being made: 51 occupations were deregulated in 2013. There are plans to deregulate 195 other professions in two on-going legislative procedures.*

## Monetary, prudential and exchange-rate policies

- Introduce staggered terms for Monetary Policy Committee members' appointments to ensure continuity of monetary policy.

❖ *A welcome draft reform proposes that one third of the Monetary Policy Council members would be replaced every two years to ensure continuity.*

- Reduce currency mismatches in banks' balance sheets by appropriately calibrating liquidity requirements to strengthen their funding structure and diminish the reliance on foreign funding.

❖ *FX lending has been drastically curtailed (see Assessment and Recommendations). Loan-to-deposit ratios have diminished. Yet, the banking sector has a considerable amount of external financing.*

## Fiscal policy and the budgetary framework

- Let the automatic stabilisers function within the debt ceiling constraints, if the economy slows more than projected.

❖ *The government let the automatic stabilisers play during the recent slowdown.*

- Cut tax expenditures. Broaden tax bases by making revenues from farming activities liable to income tax, introducing cash registers for all professional services to improve VAT collection, significantly tightening eligibility for the lump-sum income tax, and linking social security contributions of the self-employed to actual earnings.

❖ *Little progress has been made to cut tax expenditures. The PIT deductibility of expenses related to authorship contracts was limited, the eligibility to the internet tax relief was tightened, and high income households with one child were excluded from family tax relief, but relief for the third child and each subsequent child was increased. The sales threshold granting exemptions from keeping records was divided by two in 2013, raising the use of cash registers.*

- Redesign and increase the least distortive taxes, by establishing market-value-based property taxes, taxing capital gains on rented properties, eliminating the tax discrepancy between diesel used as a motor fuel and that used as heating oil, and implementing an economically meaningful carbon tax.

❖ *No action.*

- Further tighten eligibility criteria in the generous disability pension system. Reform the farmers' social security scheme, eliminate pension privileges for certain occupations, and equalise retirement ages for men and women at 67.

❖ *In 2012, the government decided to increase the retirement age to 67 for both genders. The reform phases in the increase until 2020 for men and 2040 for women. It also reduces pension privileges for uniformed services.*

- Enhance the efficiency of public administration.

❖ *A performance-based budgeting system was introduced in 2012-13, and its application will strengthen allocative and operational efficiency. The government launched an initiative to reform the civil service and increase e-procedures by 2020.*

- Strengthen the fiscal framework by: introducing a deficit rule, putting in place detailed multi-year budgeting and spending ceilings, creating an independent fiscal council, and harmonising the domestic and Maastricht definitions of government debt.

❖ *The 50% public debt threshold in the existing fiscal rules was suspended in August 2013. Additional debt thresholds of 50 and 55% of GDP were introduced in a new spending rule in December 2013. Following the pension system changes (see Box 1), these thresholds are expected to be reduced to 43% and 48%, respectively, while the preventive debt threshold of 50% of GDP in the existing fiscal rules is to be abolished. The new spending rule covers a larger share of the general government sector and aims to stabilise the general government deficit at the MTO level of 1% of GDP. An amendment has imposed the publication of detailed multi-year budgets and spending ceilings.*

- Use some sort of period-average exchange rates, rather than end-of-year values, for the evaluation of foreign-currency public debt.

    ❖ *The government now uses the most favourable exchange rate, between the end-of year value and the annual average, to compute public debt. The temptation to influence the end-of-year exchange rate persists if its level is weaker than the annual average.*

## Labour markets (see also Chapter 1 of the *Survey*)

- Refrain from increasing the minimum-to-average wage ratio. Consider differentiating the minimum wage across regions depending on local labour-market conditions.

    ❖ *The minimum-to-average wage ratio increased from 0.36 in 2011 to around 0.39 in 2013 but remains fairly low by OECD standards.*

- Consider introducing an earned-income tax credit to encourage labour market participation of marginal groups.

    ❖ *No action.*

- Facilitate labour-market access for foreign workers to meet specific project needs. Provide easier access to workers from a broader range of countries than those on the eastern border.

    ❖ *In 2014, the access to the labour market will be facilitated at the margin for short-term workers from Armenia.*

## Education

- Reduce the skills mismatch in the labour market by: improving the training system, developing a flexible lifelong learning system and promoting a clearly distinct tertiary VET system.

    ❖ *A new curriculum for vocational education, including at least 50% practical training and developed with employers, was introduced in 2013. A new programme based on grants aims at increasing internships in higher education institutions (HEIs). Furthermore, according to a 2013 draft law, HEIs would have to specialise in either academic or vocational (practice-oriented) education. The proposal would make three-month internships mandatory in vocational education and allow students to validate skills acquired outside the formal system. The Council of Ministers also adopted a strategic document "Perspective for lifelong learning" in September 2013.*

- Improve tertiary education by allowing public higher education institutions (HEIs) to introduce cost-related tuition fees for all students, developing student loans and reinforcing HEI quality assessment.

    ❖ *Following the 2011 reform, the assessment of HEIs was modified and quality-oriented subsidies have been implemented, amounting to about 2% of tertiary education spending. In October 2012, mandatory payments for the second and additional degrees were introduced at public HEIs.*

- Expand provision of free pre-school education at ages 3 to 5, focusing particularly on poor and rural areas.

    ❖ *Following the 2011 reform, the number of childcare institutions for children under 3 years old almost doubled from 2010 to 2012, but their total capacity remains extremely low. The enrolment rate in pre-school education for children at ages 3 to 5 increased from 47% in 2007 to 70% in 2012. Pre-school fees beyond the minimum five hours were capped at 1 PLN per hour in June 2013.*

## Health care

- Broaden access to care and reduce inequality by: targeting extra resources to shorten waiting lists; extending dental services covered by public insurance, introducing co-payments on medical services while imposing a means-tested cap on the level of out-of-pocket payments; and increasing transparency of dual physician employment in the public and private sectors.

  ❖ ***The coverage of dental services by public insurance was extended in November 2013, and further X-ray diagnostics were introduced in the basic benefit package.***

- Improve the allocation and use of current resources by: shifting resources from hospitals to primary and long-term care, potentially by integrated health-care delivery models; strengthening primary medicine's gate-keeping role; providing clearer incentives to hospitals to rationalise the their resource use; promoting the development of hospital management skills; and streamlining the responsibilities of the national health fund (NFZ) and central and local governments.

  ❖ ***In 2013, the NFZ strengthened the role of outpatient specialists for some minor surgical procedures. Pilot projects testing different forms of coordinated care are expected to start in 2014. The government plans to decentralise the NFZ in 2014-5. This would streamline responsibilities between independent regional centres in charge of assessing health needs and investment planning, and a national authority in charge of pricing, quality control and technology assessment.***

- Avoid labour shortages in the health-care sector by: training more staff; improving retention, particularly through better management policies and delaying retirement; enhancing re-integration in the workforce of the departed; enhancing the role of advanced practice nurses and physicians' assistants; linking pay to performance; and developing targeted immigration policies.

  ❖ ***A planned change would shorten doctors' specialisation training by 2 to 3 years.***

- Develop a comprehensive strategy to address growing long-term care needs, thereby facilitating female labour force participation.

  ❖ ***The Health Ministry is preparing a strategic document analysing demographic pressures, utilisation of medical resources and patient behaviours to facilitate health planning.***

## Housing

- Remove fiscal incentives supporting the residential sector.

  ❖ ***VAT refund on building materials will be abolished in 2014.***

- Make the release of municipal zoning plans mandatory.

  ❖ ***No action.***

- Publish official composite house price indexes for the country as a whole as well as different market segments.

  ❖ ***No action. The Central Statistical Office has developed a house price index. However, it is not yet publicly available.***

- Work towards further easing of controls on rent increases.

  ❖ ***The "occasional renting" scheme, which allows sub-letting part or all of the dwelling without restrictions on rent increases, was expanded to entrepreneurs.***

## Transport

- Elaborate and publish a precise and comprehensive top-down strategy for the transport sector, addressing long-term prospects and interrelations among projects, based on cost-benefit analysis.

  ❖ ***A top-down strategy for the whole transport sector until 2020 was published. However, the precise projects and their implementation schedule have not yet been presented.***

- For providing regional rail services, implement competitive tendering procedures, and consider creating independent system operators to plan traffic and rail connections.

  ❖ ***No action.***

- Split the Polish Airports State Enterprise (PPL) into different entities, consider their privatisation, and introduce a formula for the transparent calculation of caps on take-off and landing fees.

  ❖ ***PPL remains fully state-owned, but its corporatisation has started.***

## Climate-change policies

- Equalise implicit and explicit carbon prices across sectors outside the EU-ETS, and align them to its prices, first by progressively eliminating tax exemptions for coal and gas for household use. Provide lump-sum cash compensation for the poor, and ensure that the costs of all negative global and local externalities are fully internalised by taxes on petrol, diesel and other fossil fuels.

  ❖ ***No action. In July 2013, poor households became eligible for a lump-sum energy benefit.***

- Strengthen the price signal for investment by deepening the wholesale electricity market, improving cross-border interconnections and implementing a long-term plan for grid development.

  ❖ ***A new connection of the electricity network with Lithuania is planned for 2015, and several international connections are included among the EU Projects of Common Interest for the period 2014-20.***

- Retain the cost-efficiency advantage of uniform support to renewables via green certificates.

  ❖ ***The support scheme for renewable energy sources did not change.***

- Create a sustainable regulatory environment including: *i*) easing administrative burdens associated with connecting new generation capacity to the grid; *ii*) insulating the approval of the expert evaluation of the costs of future decommissioning and long-term waste disposal from political influence and strengthening the independence of the nuclear energy regulator by a fixed-term non-renewable nomination and during which he or she cannot be removed; *iii*) imposing and enforcing strict safety and environmental standards to minimise tail risks of nuclear energy; and *iv*) effective monitoring of environmental risks connected with the extraction of shale gas.

  ❖ ***Little progress has been made. Connections to the grid of micro-installations were exempted from fees in July 2013. Since 2012, applications for mining and shale gas extraction require provision of additional information about drilling technology and geological properties. An on-going project is monitoring the environmental effects of shale gas extraction to set mandatory requirements and recommend best practices.***

  ❖ ***Implementation in 2012-13 of amendments to the Atomic Law Act imposes strict safety and environmental standards in line with the 2012 Survey.***

# Chapter summaries

## Chapter 1. Making the labour market work better

*Poor labour-market outcomes remain one of Poland's major structural weaknesses, impeding firms' competitiveness and the nation's potential output. Boosting employment prospects is also critical as the country will soon be ageing at a fast pace. Despite long working hours, labour utilisation is only average due to structurally low employment rates, particularly at both ends of the age spectrum, with some marked regional differences. The female employment rate is especially low, in part due to poorly designed family and pension policies. Insufficient product-market competition and obstacles to internal mobility induce significant resource misallocation. Employment protection is not particularly stringent, but the labour market is nonetheless heavily segmented. This is likely to weigh on economic performance by limiting investment in human capital and making some specific groups bear a large share of adjustment costs. Public employment services suffer from a lack of resources and function inefficiently. Local labour offices have limited incentives to adopt best practices; the government plans to start benchmarking them. There is ample scope to tighten jobseeker obligations and reform social and tax policies to make work pay.*

## Chapter 2. Strengthening competition

*Poland's productivity has grown strongly over the past decade, and efforts to reduce the regulatory burden have been significant. Despite impressive progress, product market regulation remains more burdensome than in most OECD countries, partly due to the importance of red tape and the level of state involvement in the economy. Further reduction in red tape and pursuing privatisation in competitive markets would increase competitive pressures and ensure neutrality, notably in public procurement processes. Economic rents in many sectors seem high, as stringent entry regulations, regulatory barriers and inefficient bankruptcy procedures induce significant resource misallocation. A welcome deregulation of professional services is ongoing, and the government plans to further ease firm registrations and reform bankruptcy procedures. The independence of the sector regulators in network industries and the powers of the Competition Authority can still be enhanced as the reform efforts in these sectors remain patchy. The dominant positions of the incumbents and the failure of network sector regulators to introduce a level playing field in order to secure third-party access to the sectoral infrastructure and allow new entry in the competitive segments are another main issue. The advantages of being considered a farmer are also slowing the consolidation process in the agricultural sector.*

*This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.*

*The economic situation and policies of Poland were reviewed by the Committee on 6 February 2014. 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 21 February 2014.*

*The Secretariat's draft report was prepared for the Committee by Hervé Boulhol, Antoine Goujard and Balázs Égert under the supervision of Peter Jarrett. Research and editorial assistance was provided by Patrizio Sicari.*

*The previous Survey of Poland was issued in March 2012.*

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