

OECD ECONOMIC SURVEYS

1998

SPECIAL FEATURES
Privatisation
Pension reform
Labour market

POLAND

© OECD, 1998.
© Software: 1987-1996, Acrobat is a trademark of ADOBE.
All rights reserved. OECD grants you the right to use one copy of this Program for your personal use only. Unauthorised reproduction, lending, hiring, transmission or distribution of any data or software is prohibited. You must treat the Program and associated materials and any elements thereof like any other copyrighted material.

All requests should be made to:

Head of Publications Service,
OECD Publications Service,
2, rue André-Pascal, 75775 Paris
Cedex 16, France.

OECD ECONOMIC SURVEYS

1997-1998

POLAND

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

The original Member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became Members subsequently through accession at the dates indicated hereafter: Japan (28th April 1964), Finland (28th January 1969), Australia (7th June 1971), New Zealand (29th May 1973), Mexico (18th May 1994), the Czech Republic (21st December 1995), Hungary (7th May 1996), Poland (22nd November 1996) and Korea (12th December 1996). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention).

Publié également en français.

© OECD 1998
Permission to reproduce a portion of this work for non-commercial purposes or classroom use should be obtained through the Centre français d'exploitation du droit de copie (CFC), 20, rue des Grands-Augustins, 75006 Paris, France, Tel. (33-1) 44 07 47 70, Fax (33-1) 46 34 67 19, for every country except the United States. In the United States permission should be obtained through the Copyright Clearance Center, Customer Service, (508)750-8400, 222 Rosewood Drive, Danvers, MA 01923 USA, or CCC Online: http://www.copyright.com/. All other applications for permission to reproduce or translate all or part of this book should be made to OECD Publications, 2, rue André-Pascal, 75775 Paris Cedex 16, France.

Table of contents

Assessment and recommendations 1

I. Macroeconomic developments and prospects 13

A sustained and more broadly-based expansion 13
Receding unemployment 17
Continuing disinflation 18
Emergence of a sizeable external gap 20
Prospects 23

II. Macroeconomic policies 27

Financial policy framework 27
Monetary policy 28
Fiscal management 36
Assessment 44

III. Privatisation and management in public enterprises 46

State divestiture 46
Corporate performance, management and restructuring in public sector enterprises 55
Assessment 61

IV. Pension reform 63

The current system 64
Reforming the system 72
Assessment 78

V. Implementing the OECD Jobs Strategy 81
Labour market and employment performance 82
Policy requirements 86
Assessment and scope for further action 109

Notes 118

Bibliography 127

Annexes

I. How large is foreign direct investment? 133
II. Devolution 135
III. Selected large privatisations 137
IV. Chronology of main economic events and policy measures 143

Statistical annex and structural indicators 149

Boxes

1. Ursus and Ursus S.A. 58
2. The old-age pension formula 69
3. The life insurance boom 76
4. Hidden unemployment in agriculture 86
5. The OECD Jobs Strategy: Synopsis of recommendations for Poland 111

Tables

Text

1. Growth of value-added by sector 15
2. Contributions to growth 16
3. Summary of outcomes and OECD projections 24
4. Commercial bank credit to enterprises and households 31
5. Indicators of banks' health and performance 32
6. Key fiscal indicators 37

7. General government revenues, expenditures and balance 38
8. State budget: the income side 39
9. State debt and debt service 42
10. Number of public and private economic entities 47
11. Sectoral employment shares 48
12. The many tracks of ownership transfer 49
13. Selected debtors to the State 59
14. Standard age of entitlement to public old-age pensions 67
15. Employment by main sectors 87
16. Selected social benefits 96
17. Labour market programmes 100

Annexes

A1. Foreign direct investment flows and stocks 134
A2. Selected large enterprises subjected to privatisation 138
A3. Privatisation modalities and outcomes 139

Statistical annex and structural indicators

A. Selected background statistics 150
B. Long-run evolution of consumer and producer prices 151
C. Monetary survey 152
D. Balance of payments 153
E. Direction of trade 154
F. Foreign trade by commodity group 155
G. Equities market 156
H. Size and breakdown of public social spending 157
I. Finances of the Main Social Insurance Funds 158

Figures

Text

1. GDP levels: International comparison 14
2. Unemployment 17
3. Inflation: International comparison 18
4. Disinflation 19

5. Real exchange rates 21
6. Gross official foreign exchange reserves 23
7. Money and credit 29
8. Interest rates 34
9. Nominal exchange rates 35
10. Stock prices 53
11. Public pension expenditure 64
12. Factors underlying pension expenditures 65
13. Elderly dependency ratios 66
14. Expected old-age pension gross replacement rates 70
15. Disability pensions 71
16. Accumulation of pension rights and replacement rate: illustrative simulation 75
17. Key features of the labour market 83
18. Regional unemployment rates 84
19. Working-age population in and around the labour force 85
20. Real wages and productivity 89
21. Earnings dispersion 90
22. Average and marginal tax wedges 93
23. Overall index of benefit generosity 95
24. Educational attainment of the working-age population 103
25. Education and labour market performance 104

BASIC STATISTICS OF THE REPUBLIC OF POLAND

(1997 unless noted)

THE LAND

Area (sq. km)	312 680
Arable land (in per cent of total area)	60

THE PEOPLE

Population (million, mid-year)	38.7	Employment, 1996 (million)	15.8
Projected population growth rate, per annum (1996-2000)	0.2	Employment by sector, 1996 (percentage of total):	
Rural population (percentage of total)	38	Agriculture	28
Life expectancy at birth (1996):		Industry (including construction)	29
Male	68.1	Services	43
Female	76.6		
Infant mortality (per thousand)	10.2		

Registered unemployment (percentage of the labour force, March 1998)	10.6
Labour force survey unemployment (percentage of the labour force, February 1998)	11.1
Number of pensioners (million)	9.3

PARLIAMENT

Bicameral Parliamentary system	
Sejm membership (lower house)	460
Senate membership (upper house)	100
Number of political parties in Sejm (elections of September 1997)	5
Share of seats in Sejm held by governing coalition (per cent)	56.7

PRODUCTION

GDP (billion zlotys, current prices)	445
GDP per capita (US$, market exchange rate)	3 512
Gross fixed capital formation (percentage of GDP)	21

PUBLIC FINANCE

General government budget balance (percentage of GDP)	–3.4
General government revenues (percentage of GDP)	44.7
General government expenditures (percentage of GDP)	48.1
Public debt (end-year, percentage of GDP)	48.0

FOREIGN TRADE AND FINANCE

Exports of goods and services (1996, percentage of GDP)	25
Imports of goods and services (1996, percentage of GDP)	28
Gross international reserves (US$ billion, March 1998)	23.1
Gross external debt (US$ billion, end-1997)	38.5

CURRENCY

Monetary unit: zloty (redenominated in January 1995)	Currency units per US$ (fixing)	
	Average 1997	3.28
	Mid-May 1998	3.40

This Survey is based on the Secretariat's study prepared for the annual review of Poland by the Economic and Development Review Committee on 18 May 1998.

•

After revisions in the light of discussions during the review, final approval of the Survey for publication was given by the Committee on 4 June 1998.

•

The previous Survey of Poland was issued in November 1996.

Assessment and recommendations

Poland's impressive growth record can be sustained provided restructuring efforts are stepped up

Over the past four years, the Polish economy has been expanding at an impressive annual rate of almost 6 per cent, comparing favourably with all other central European countries. This record largely reflects the dynamism of private firms in manufacturing and services, contrasting starkly with the mediocre performance in agriculture and the dismal results in a number of public enterprises in mining and heavy industry. The pace of real GDP growth is projected to remain above 5½ per cent per annum over the near term, not least on the strength of the investment boom observed since 1994. Sustaining it in the longer run, however, clearly requires further and more rapid restructuring of the problem sectors and enterprises. Poland's own experience in the 1970s illustrates, over and beyond the obvious differences in policy regime, that high growth may not be indefinitely self-sustaining.

Unemployment has declined considerably but may not fall much further

Rapid output growth has been underpinned by large productivity gains, reflecting the scope for dishoarding of labour and the installation of new capital equipment. Employment has therefore risen more modestly, at an annual rate of 1 to 2 per cent. Even so, the unemployment rate has declined considerably from its 1994 peak, approaching the single digit range by late 1997. The severe tightening of the unemployment benefit regime accounts for a significant portion of the fall in joblessness. Unfortu-

nately, this trend is unlikely to continue: even if the pace of gross job creation picks up somewhat, it will probably be largely offset by the arrival of large youth cohorts and the foreseeable labour outflows from agriculture and heavy industry. Thus, unemployment is projected to decline only slightly this year and next.

Inflation is nearing the single digit zone but needs to be brought down further

Inflation has continued to slow down in 1996-97, although it remains high. In contrast with the overshooting observed in earlier years, consumer price inflation in 1997 barely exceeded the 13 per cent end-year target. Disinflation is projected to continue, albeit more gradually, provided that the stance of financial policy is indeed tightened as significantly as envisaged in the authorities' recent medium-term programme. Even so, it is likely to overshoot the targets set for 1998, reflecting front-loaded administrative price hikes and overly rapid wage growth.

The current account deficit and capital inflows call for a tighter fiscal policy than the one envisaged by the authorities

With domestic demand outpacing output, the trade and current account deficits widened sharply in 1996-97, though this trend became less pronounced in the second half of last year. The emergence of a sizeable current account deficit, coupled with the floods that swept through the country in July 1997, triggered concerns that the balance-of-payments crises that had affected the Czech Republic in spring and that were starting to erupt in Asia could spill over to Poland as well. However, while the stock and bond markets did suffer somewhat, confidence did not collapse. In the event, Poland's fundamentals were deemed strong enough for capital inflows to pick up after a few months. Indeed, the authorities in early 1998 were facing the pressure for real appreciation of the zloty associated with large-scale capital inflows, either through a nominal appreciation or through higher inflation. However, even if the stance of fiscal policy is tightened along the lines of

the authorities' more restrictive policy scenario, as assumed by the Secretariat, the current account deficit might merely stabilise around 1999, at what could be an unsustainably high level.

Monetary policy has become increasingly restrictive

Continued disinflation would not have been possible without a substantial tightening of monetary policy. Reserve requirements and interest rates were progressively raised, both to very high levels. In a more unusual move, the central bank in September 1997 started to collect household deposits directly. The pace of credit growth did cool down a bit, but is still very rapid. Consumer credit in particular has expanded faster than the ability of some of the banks to monitor the associated risks: while the share of total bad loans in bank portfolios has continued to decline, non-performance has become more frequent on consumer credits. High domestic interest rates led some firms to borrow abroad instead, on a limited but no longer marginal scale. At the same time, the demand for the interest-bearing component of money did increase, which helps to explain why inflation fell in line with objectives despite continued overshooting of the money supply target. The monthly pace of exchange rate crawl was left unchanged throughout 1996-97, at 1.0 per cent, resulting in some real depreciation last year. In late February 1998, to support disinflation and discourage speculative capital inflows, the newly installed Monetary Policy Council decided to slow it down to 0.8 per cent, at the same time as the width of the exchange rate band was broadened from ±7 per cent to ±10 per cent. By early May, the nominal exchange rate had appreciated considerably, standing at less than 2 per cent below the upper edge of the new band.

Fiscal policy has been overly loose and should be tightened

In contrast, and as noted in the previous Survey, the stance of fiscal policy has remained relatively loose in 1996-97, with the general government deficit rising to well above 3 per cent of GDP, even as nominal GDP increased more rapidly than projected. The authorities have stated their resolve to eliminate the fiscal deficit altogether by 2003. This seems feasible, despite the sizeable negative initial impact on the budget of some of the social programme reforms. In fact, a somewhat faster reduction is desirable to raise domestic saving and stem the widening of the external gap. In pursuing this, the burden of taxation – which despite a fall of 2 percentage points of GDP over the last two years remains very high – should not be increased. The containment of expenditures, notably through more efficient procurement practices, is thus a priority even as the composition of spending is rebalanced towards growth-enhancing human and physical investment. Faster tightening would also allow real interest rates to come down from their current, very high levels. The magnitude of the adjustment efforts made since 1995 in Hungary to avoid an open crisis as well as the full-blown crises witnessed over the past year in some other emerging economies underline the importance of such action and should make the needed measures easier to accept. In this context, the renovation of the financial policy framework – involving constitutional restrictions on deficit financing and public debt – deserves to be commended.

The era of large privatisations has dawned but the pace of state divestiture ought to be accelerated

Even before the new government announced its intention to speed up large privatisations, several major Polish firms had been sold successfully. In 1997, privatisation receipts thus increased to 1.7 per cent of GDP (reducing public debt but not the deficit). The assets in state hands are still considerable and a significant portion of future privatisation receipts is to be set aside to finance pension reform which

in effect front-loads a fiscal burden that would otherwise have been borne by future generations. For that reason, but also to improve corporate incentives and performance, the pace of state divestiture needs to be stepped up, notably in the financial and network sectors (telecommunications, energy, transportation). Foreign capital and expertise can and should play an important role here. The new government is also contemplating some new ownership transfer schemes, but these initiatives should not become a pretext for further delays.

Effective governance of public enterprises remains lacking

As a direct or indirect owner, the State has not exercised its ownership functions in an efficient way, as attested by the lack of wage moderation in firms that are in dire financial straits, which in many cases defaulted on tax and social contribution dues even as they allowed wages to rise as fast as in healthy enterprises without reducing employment. This lack of financial discipline has been particularly conspicuous in coal mining for instance, but is observed in many other cases as well. Transfer of ownership to private, outside parties, be it through liquidation of the existing concern, appears necessary if corporate performance is to be monitored and sanctioned more effectively. Where sectoral restructuring programmes are introduced, debt relief should be more strictly conditional on recovery measures, as was the case under the 1993 law on the restructuring of banks and enterprises. In some sectors of heavy industry, extended tariff protection has been sought as a means to provide enterprises with the time needed to restructure successfully, but the risk is clearly that extra delays will weaken incentives to restructure up-front. Another temptation has been the creation, under the aegis of the State, of large holdings, on the grounds that survival requires a certain minimum size. Such schemes tend to facilitate cross-subsidisation, thus retarding painful but nec-

essary adjustment. They are not easy to impose on the stakeholders of the enterprises concerned, and may end up delaying privatisation and the infusion of sorely needed fresh money.

Wholesale pension reform has finally been set in motion

The first OECD Survey of Poland, published in 1992, highlighted the unsustainability of existing, pay-as-you-go pension arrangements. Some measures have been taken to curtail their generosity, but the indispensable overhaul of the whole system was delayed, notwithstanding the widespread recognition of its urgency. Serious action began only in late 1996, with the elaboration of a comprehensive blueprint taking into account the proposals floated thus far in Poland as well as the experience built up abroad in this field. Three of the key bills setting up the new system were passed in 1997, and three more are currently being examined by Parliament. Continued, active legislative support is required if implementation is to start on schedule, in January 1999.

The new old-age pension system rests on three pillars

The new system is to comprise three pillars, namely a reformed pay-as-you-go social insurance fund, pension funds and additional insurance. The pensionable age would remain 60 for women and 65 for men. Unlike in the present system, the first pillar involves a direct and transparent link between contributions and future pensions, structured so as to provide a strong incentive to retire later rather than earlier. The second pillar capitalises individual contributions and would be phased in over time, being compulsory up-front only for the younger generations: pension funds would be established, as well as a supervisory body. Besides, a minimum pension would be guaranteed to all provided age and years-of-service requirements are met. The third and wholly voluntary pillar consists of company pension plans and commercial savings vehicles. It already

exists but would be developed further, in part through tax incentives.

It would solve a number of problems...

In the longer run, the new arrangements are expected to favourably influence public and private saving rates, as well as labour and asset markets. Specifically, the rationalisation of the first pillar – especially the increase in the minimum retirement age – will reduce pension outlays. Workers will face stronger incentives to have their incomes declared, which will improve heretofore mediocre compliance. The prominence of the second and third pillar will also stimulate household saving. By channelling resources through pension funds, capital market development will receive a boost. And by making explicit a hidden intergenerational debt and the need to acknowledge it earlier on, the new system will facilitate privatisation. If implementation is successful, there will further be room to cut the overall rate of social contributions, and hence increase labour demand.

... but some challenges and risks lie ahead

Several legislative steps still need to be taken, however, before the multi-pillar system can start functioning, including some that involve curtailing existing sectoral privileges. Parliament still needs to decide on the pensionable age. In this respect, it would be highly desirable to revert to the original proposal of a single minimum retirement age of 62 for both genders. Much technological upgrading and institution-building work also remains to be accomplished. There is a risk that computerisation could become a bottleneck. The existing social insurance bureaucracy needs to adapt rapidly in order to perform its new duties appropriately. Pension funds will emerge, as well as a brand-new supervisory body. Accreditation procedures should ensure maximum transparency. It will also be important to try to avoid the pitfalls encountered in the countries that preceded Poland in the move to funded pensions, notably as regards

the funds' portfolio composition and their management and marketing costs. Another challenge pertains to the financing of the shift to a multi-pillar system. The speed of change needs to be calibrated so that the ensuing fiscal impact can be broadly offset by savings in the first pillar and privatisation receipts. This requires that the pace of state divestiture be stepped up. Although the issuance of bonds redeemable in state-held enterprise shares would allow some short-run privatisation delays to be coped with, this mechanism should not become an excuse for indefinite postponement. Furthermore, the ongoing reform does not directly concern the bulk of farmers' pensions, even though they clearly need to be rationalised as well. Last and not least, pension reform, however far-reaching *per se*, needs to be complemented by other social security reforms. As discussed in the previous Survey, health care reform has a long way to go. Its fate, however, is tied up with that of administrative reform, which involves the creation of a new decentralised layer of government (*powiats*) and the consolidation of existing regions into larger ones, accompanied by further devolution of responsibilities.

Labour market policies stricto sensu have been adjusted...

The OECD's *Jobs Strategy* was elaborated before Poland joined the Organisation but many of its recommendations are relevant for Poland as well. In the early years of transition, the labour market has seen massive early retirement, as well as considerable inflows, and soaring open joblessness. The budgetary burden and incentive distortions associated with overly generous unemployment benefits called for a more restrictive regime, which was phased in progressively. In parallel, a number of other social benefits started to be means-tested so as to better target the needy. More attention also started to be given to active labour market policies (ALMPs) as the institutional capacity of the public employment service was strengthening.

... but some shortcomings remain

Yet, further improvements are required. The tax wedge is high, driving or maintaining some activity underground, and needs to be reduced. Wage-bargaining should be more decentralised and linked more directly to company performance. The possibility of administrative extensions of wage agreements reached locally to the whole sector should be closed. The minimum wage is not particularly high by international standards, although it is distinctly higher than in Hungary and the Czech Republic. The qualifications of the labour force are rather uneven and to avoid impairing the employment opportunities of the least qualified, the minimum wage should no longer grow faster than consumer prices. Some flexibility could also be gained by extending the period over which average weekly working hours are to be computed. The current regional differentiation of unemployment benefit durations should be reconsidered in the context of the envisaged reversal to a more insurance-based system. While the apparent effectiveness of ALMP schemes has improved, their net impact (*i.e.* controlling for substitution effects) has to be better monitored. Within ALMPs, the relative importance of training should grow, and the design of its contents should involve more co-ordination between providers and users, which would encourage employers to finance a larger share of human capital investment. The job-brokerage function of the public employment service has been strengthened but has to improve further. Other chronic labour market problems include the need to reduce safety and health hazards at the workplace – one of the areas where regulations are in practice widely circumvented.

Some favourable changes have occurred with respect to other determinants of labour market performance

Labour market performance also hinges on the quality of the education system, the entrepreneurial climate, and the proper functioning of product markets, including as regards the incentives governing innovation and its diffusion. Some distinctly positive developments should be noted in this respect. Enrolment in higher education has soared since the late 1980s. Curricula, including in vocational schools, have started to be re-oriented towards the requirements of the emerging market economy. Small and medium-sized enterprises have bloomed, accounting to a large extent for the high aggregate growth rate. Competition is intense in many sectors, and a specialised agency tries to enforce it where it is lacking, pushing for deregulation and market contestability.

Yet, there remains considerable room for further progress

Even so, progress is still called for in those areas. The adaptation of the education system has a long way to go, and will require public as well as private initiatives and funding. Access to quality education for rural residents deserves special attention. The efforts to modernise vocational schools need to be continued. The business climate is still clouded by a plethora of often changing and sometimes ambiguous regulations, not least in the foreign trade area, prompting the new government to launch a ''de-bureaucratisation'' drive. By weeding out contradictory or superfluous rules and licensing obligations, it should help reduce uncertainty and the scope for corruption, which hinder growth. It should be carried out, however, in such a way as not to add one more layer of complexity. Monopoly power continues to be exercised, *inter alia* in some network sectors, at the expense of consumers and jobs, suggesting that the competition authorities need strengthening. The phasing out of rent controls should foster worker mobility and reduce mismatches between supply and demand on the labour market. All these changes would contribute to an

environment propitious to the development of innovative venture businesses.

Summing up

Poland's overall economic performance in 1996-97 has been commendable, even better in some ways than generally expected by outside observers or hoped for by the authorities. The enviable results achieved as regards growth, disinflation, and unemployment reward the continued adherence to prudent, if gradualist, macroeconomic and structural reform policies. Bolder fiscal action, however, is required to put the public finances on a sustainable footing, to contain and subsequently reverse the widening of the current account deficit and to support monetary policy in furthering disinflation. In this context, close prudential supervision of the financial sector is also important, as is improved corporate governance at large. On the structural front, the new coalition government's programme involves deeper and faster efforts in some areas, consistent, on most scores, with the general direction of the market-oriented reforms carried out since late 1989. The favourable outlook in Europe should facilitate the pursuit of these reforms. As well, Poland's ambition to be among the first transition countries to join the European Union will be a powerful incentive to push ahead with the more difficult changes still in store. These changes, however, are indispensable in their own right if the momentum of the catch-up process is to be maintained.

I. Macroeconomic developments and prospects

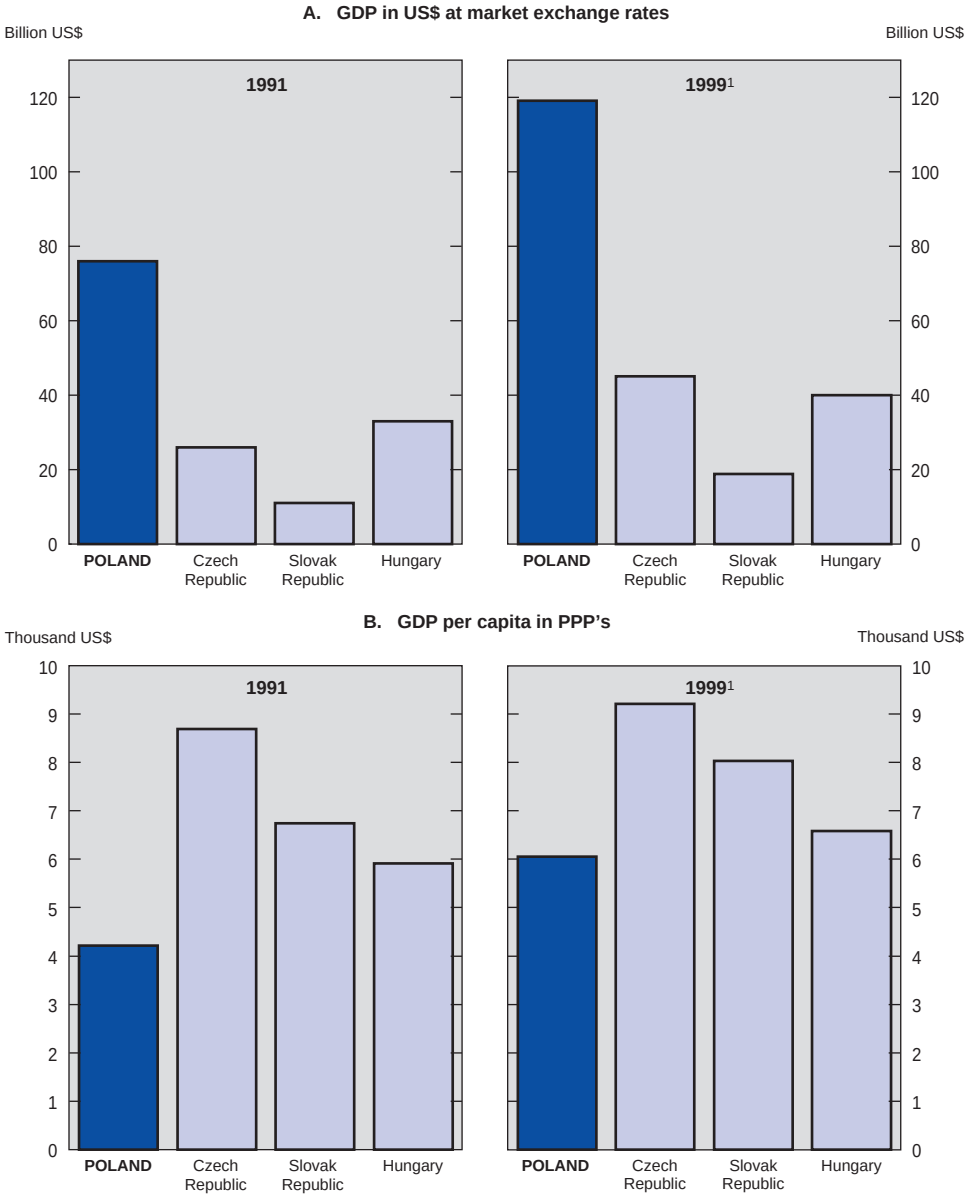
Poland has continued to enjoy a remarkably vigorous expansion into 1998. The benefits of sustained growth have materialised in the form of rising real wages and consumption and falling unemployment. At the same time, the momentum of gradual disinflation has been maintained. However, as domestic demand accelerated and export growth slowed down, the current account has rapidly shifted from a large surplus to a sizeable deficit. The outlook for 1998-99 remains bright, provided that policies (analysed in subsequent chapters) remain squarely geared toward the containment of the current account deficit and the pursuit of bold structural reforms.

A sustained and more broadly-based expansion

Real GDP has now been growing at an average annual rate of almost 6 per cent for over four years, comparing favourably with performance in neighbouring countries and in the European continent at large. Not only has the pace been impressive, but so has the duration of the expansion, which by early 1998 was entering its seventh consecutive year. The last time Poland experienced growth on this scale goes back to the 1970s.[1] On current projections, the size of the Polish economy will have increased by around 50 per cent between the 1991 trough and the end of the decade.[2] However, given its comparatively low per capita income level at the onset of transition, this process will not be sufficient for Poland to fully catch up with the other ''Visegrad countries'' (Figure 1). Even so, much of the gap is projected to be made up by 1999.

Growth in 1996-97 has been fairly broad-based, both sectorally and geographically, but far from uniform. Value-added rose in all main branches of the economy (Table 1). Industrial output has soared at an average annual rate approaching 10 per cent, pulled by manufacturing, which was expanding at

Figure 1. **GDP LEVELS: INTERNATIONAL COMPARISON**
In constant 1991 US$



1. Projection.
Source: OECD.

Table 1. **Growth of value-added by sector**

In per cent, in real terms

	Share in GDP 1995	1993	1994	1995	1996	1997[1]
Agriculture, hunting, forestry	6.5	7.0	–15.1	10.4	2.4	0.7
Fishing	0.1	–53.9	10.6	–8.3	7.0	
Industry	29.2	8.6	10.3	10.4	7.1	9.7
of which:						
Mining and quarrying	4.0	–9.8	–1.9	1.5	4.7	
Manufacturing	21.8	11.9	11.2	13.8	8.1	
Electricity, gas and water supply	3.4	1.5	16.2	2.1	3.5	
Construction	5.6	1.1	2.7	6.1	3.5	17.8
Trade and repair of consumer goods	13.0	5.8	–1.5	6.1	8.0	
Hotels and restaurants	0.5	2.3	7.3	2.3	16.2	
Transport, storage and communication	6.0	–5.3	0.5	1.9	5.7	4.8
Financial intermediation	1.1	29.1	102.1	21.4	11.3	
Real estate and business activities	6.1	1.5	6.9	3.7	2.4	
Public administration and defence	4.4	5.2	7.8	4.2	4.4	
Education	3.3	0.1	10.3	1.4	1.3	
Health care and social work	3.4	0.5	4.1	1.5	1.5	
Other	20.8[2]	–18.2	3.4	1.7	1.2	

1. Preliminary.
2. Of which 5.9 percentage points reflect other sectors and 14.9 percentage points the difference between GDP at purchaser and at basic prices.

Source: Central Statistical Office.

12 per cent per annum. Activity in the construction sector grew below the economy-wide average in 1996 but much faster in 1997. In contrast, output in mining was essentially flat. So was total agricultural production, following the rebound recorded in 1995.[3] The service sector as a whole expanded slightly less rapidly than the rest of the economy, reflecting very uneven performance across types of services.

At a more disaggregated level, the structure of output continued to change: the production of some items soared (*e.g.* cars and television sets), while that of others declined further (*e.g.* radio sets, tape-recorders and sewing machines). From a regional standpoint, industrial output grew at double digit annual rates in well over half of the 49 *voivodships* (regions), and in 1997, the volume of industrial output was more than double its 1991 level in 13 regions.[4]

The overall dynamism of the Polish economy was not substantially affected by the floods, that swept through the southern parts of the country in the summer

of 1997, even though the damage in a number of localities was extensive. Indeed, the floods were of an unprecedented magnitude, affecting 0.5 million hectares of arable land across 29 voivodships and some 700 localities (*gminas*). The grain harvest in particular is estimated to have been reduced by 2 to 3 per cent owing to this natural disaster.

Viewed from the demand side, growth has been increasingly pulled by domestic absorption (Table 2). Export growth slowed down significantly from 1996 as imports soared (see below). As a result, over 28 per cent of total domestic demand was met by imports in 1997, against 25 per cent in 1995.[5] The investment boom that started around 1994 continued at an ever accelerating pace through 1997, boosted *inter alia* by foreign investment inflows. It was facilitated by an increase in profitability in private firms and by the take-off in bank lending (see Chapter II). Housing construction also picked up, emerging from a protracted depression. Nonetheless, gross fixed capital formation remains comparatively low in Poland, at an estimated 21 per cent of GDP in 1997.[6] Consumption accelerated sharply in 1996 and continued to rise very fast in 1997. It was fuelled by the pick-up in real wage growth, which averaged 6 per cent per annum in the economy as a whole when using consumer prices as a deflator, and close to 10 per cent in industry when deflated by producer prices. The dynamism of

Table 2. **Contributions to growth**

In per cent, based on prices of previous year

	1993	1994	1995	1996	1997[1]
Gross domestic product	3.8	5.2	7.0	6.1	6.9
Consumption	4.0	3.3	2.8	6.1	5.1
Private consumption	3.3	2.8	2.3	5.5	4.5
Public consumption	0.8	0.6	0.6	0.6	0.6
Gross capital formation	1.9	1.4	4.1	3.7	4.3
Gross fixed investment	0.5	1.5	2.7	3.5	4.1
Stockbuilding	1.4	–0.1	1.4	0.2	0.2
Domestic demand	5.9	4.7	6.9	9.8	9.4
Exports of goods and non-factor services[2]	0.8	3.0	5.6	3.2	3.7
Imports of goods and non-factor services[2]	–2.9	–2.5	–5.5	–6.9	–6.2

1. Preliminary estimates.
2. Estimated unrecorded trade flows are incorporated on a net basis in exports.

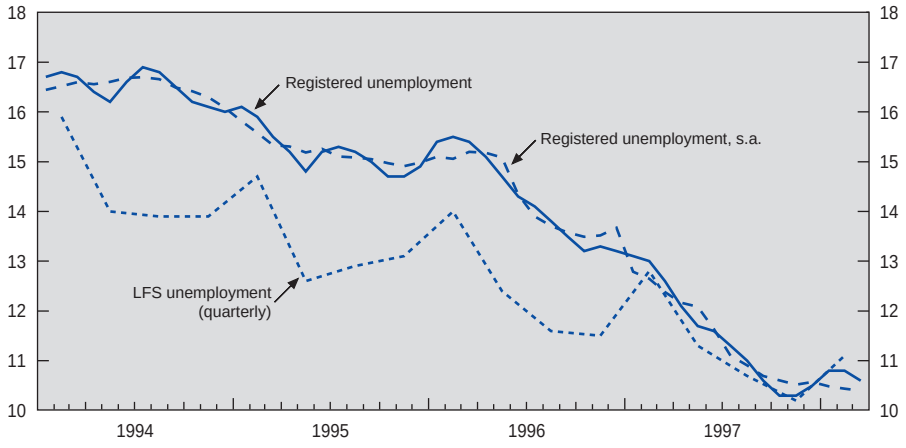
Source: Central Statistical Office; OECD Secretariat.

consumption, notably of durable goods, also reflected the rapid development of consumer loans (see Chapter II). Car sales in particular soared by 41 per cent in 1996 and 27 per cent in 1997.

Receding unemployment

The rate of registered unemployment, which had peaked in 1994 at almost 17 per cent of the labour force, declined sharply, to 10.5 per cent at the end of 1997 (Figure 2). The labour force survey (LFS) measure of joblessness showed a somewhat smaller decline, however. In fact, the spread between the two indicators, which averaged close to 2 percentage points in 1995, had virtually vanished by 1997. This is consistent with the tightening of eligibility requirements described in Chapter V, even though it does not mean that the two groups – *i.e.* the registered unemployed and the unemployed as identified in the LFS – now fully overlap.[7]

Figure 2. **UNEMPLOYMENT**
In per cent of the labour force



Source: Central Statistical Office, OECD.

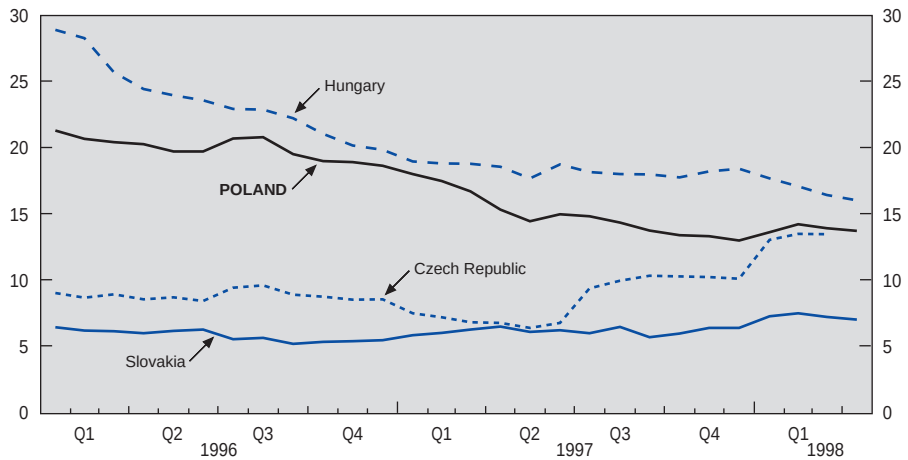
The more modest decline in unemployment indicated by the labour force survey is partly related to the slow increase in employment. Output growth has largely stemmed from investment and productivity gains, with the volume of labour input contributing only marginally. Employment has risen at an average annual rate of only 1.3 per cent in 1996-97, although a slight acceleration was perceptible in the course of the last two years.

Continuing disinflation

Disinflation has been virtually uninterrupted since the early 1990s. This record of gradual but steady slowdown contrasts with developments in the Czech Republic and Slovakia, where inflation has long been lower but ceased to decline in 1997 (Figure 3). Poland's inflation performance also compared favourably with Hungary's in 1996-97.[8]

Disinflation over this period has moreover been more successful than widely expected. While inflation objectives were systematically exceeded by a signifi-

Figure 3. **INFLATION: INTERNATIONAL COMPARISON**
Percentage change in CPI over 12 months



Source: OECD.

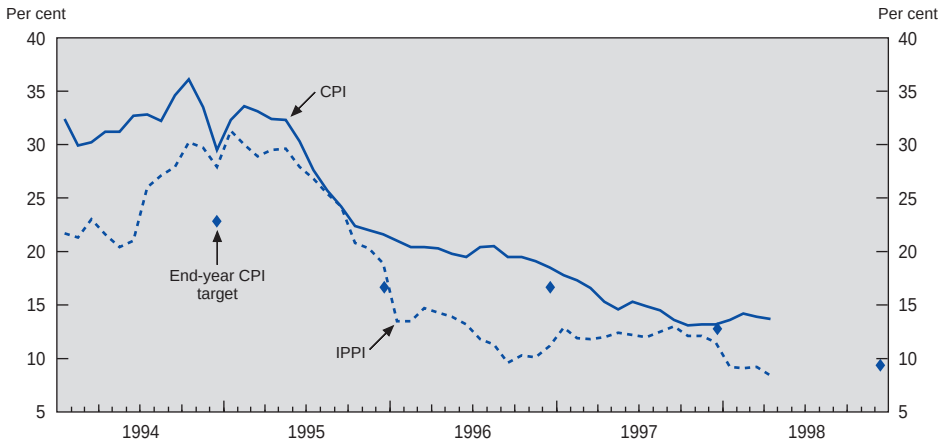
cant margin until 1995, the end-year increase in the consumer price index turned out to be only 1.5 percentage point above target in 1996, and only 0.2 percentage point above the fairly ambitious 13 per cent target for 1997 (Figure 4). In contrast to earlier years, food prices rose much less than other prices in 1997, thanks in part to the more intense competition on the domestic market associated with the easing of some import barriers.

The pace of disinflation slackened somewhat, however, in late 1997-early 1998. To some extent, this reflected hikes in regulated prices and indirect taxes. Excise duties on gasoline, tobacco products and alcohol were raised considerably (for many items by much more than 1997 inflation), and value-added tax rates on fuels, electricity, telephone services and medicines were increased.[9]

In addition to the one-time price level adjustment entailed by those measures, several factors have stoked inflationary pressures. On the cost side, nominal wages have been rising much faster than foreseen *ex ante* by the Tripartite Commission (comprising representatives of the employers, the employees and the State). While the Commission had set a nominal wage norm[10] of 21.8 per cent

Figure 4. **DISINFLATION**

Consumer and industrial producer price indices
12-month per cent increase



Source: Central Statistical Office.

for 1996 (average annual CPI inflation being projected at 19.8 per cent), wages in enterprises rose by 26.9 per cent. For 1997, the norm was 17.0 per cent (for an average annual CPI inflation projection of 15.0 per cent) and the outcome 21.4 per cent. Nominal wages in the budgetary sphere also increased rapidly over the period, by 27.8 per cent in 1996 and 23.2 per cent in 1997.

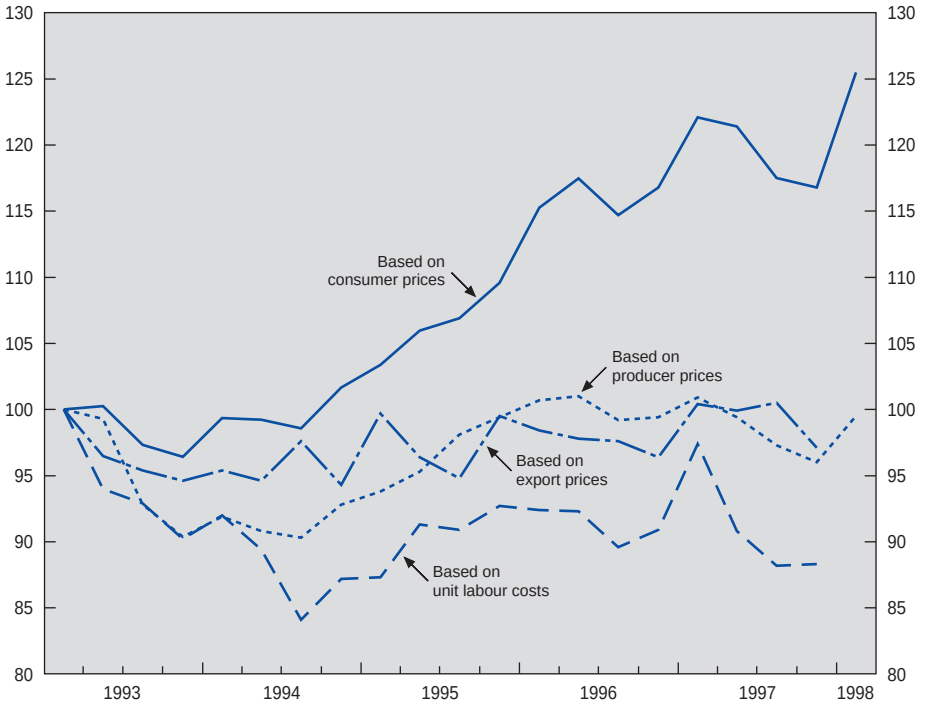
Also disquieting has been the pick-up in industrial producer price inflation in 1997, partly due to the maintenance of a rather rapid rate of exchange rate depreciation (see Chapter II), which in due course is bound to be largely passed through at the consumer price level. The pressures thus building up in the tradeables sector were reinforced by the fact that service price inflation has barely declined since late 1996 from an annual rate of close to 20 per cent. The rapid expansion of monetary aggregates, while in part a response to rising real money demand, has to some extent tended to accommodate those pressures (see Chapter II).

Emergence of a sizeable external gap

The marked deceleration of exports and the maintained momentum of import growth caused the trade deficit to widen from 1.5 per cent of GDP in 1995 to 6.1 per cent in 1996 and 7.4 per cent in 1997.[11] The deterioration of the terms of trade in 1996 and 1997 worked in the same direction. Even if estimated unrecorded exports and imports are factored in,[12] the resulting shift in the current account position was swifter and more pronounced than had generally been anticipated, from a surplus of 0.7 per cent of GDP in 1995 to a deficit of 2.4 per cent in 1996 and over 4 per cent in 1997.[13]

The slowdown in exports witnessed in 1996 was partly the lagged effect of the marked appreciation of the real exchange rate in the course of 1995 (Figure 5). It also resulted from the slowdown in demand in the European Union (which absorbs almost two thirds of Poland's exports), especially in Germany (whose share in Poland's exports dropped from 38 per cent in 1995 to 33 per cent in 1997).[14] The subsequent reversal in exchange rate and external demand trends contributed to the pick-up in export growth recorded in the second half of 1997. It should be noted in this context that the oft-voiced concerns about Poland's alleged lack of competitiveness are not borne out by export growth rates, which since 1994 have been rather rapid. Nor have they been justified, at least until

Figure 5. **REAL EXCHANGE RATES**[1]
Q1 1993 = 100



1. Real effective exchange rate *vis-à-vis* the US dollar, German mark, British pound, French franc, Austrian schilling, Swiss franc, Dutch guilder, Italian lira, Swedish crown and the Belgian franc: weighted by shares in foreign trade.
Source: National Bank of Poland.

1996, by the level of Polish wages: cross-country econometric investigations suggest that, despite their rapid increase during the first half of the 1990s, dollar wages in manufacturing in 1996 remained significantly below the level consistent with relative productivity (Krajnyak and Zettelmeyer, 1997).[15]

Looking ahead, continued export growth could be fostered by some of the measures envisaged by the authorities, notably the development of export credit insurance, which remains embryonic, the ongoing openings of new border posts

(19 in 1997 alone) and the modernisation of Poland's sorely wanting road system. Those measures recently taken or under consideration to streamline customs clearance procedures should also help.[16]

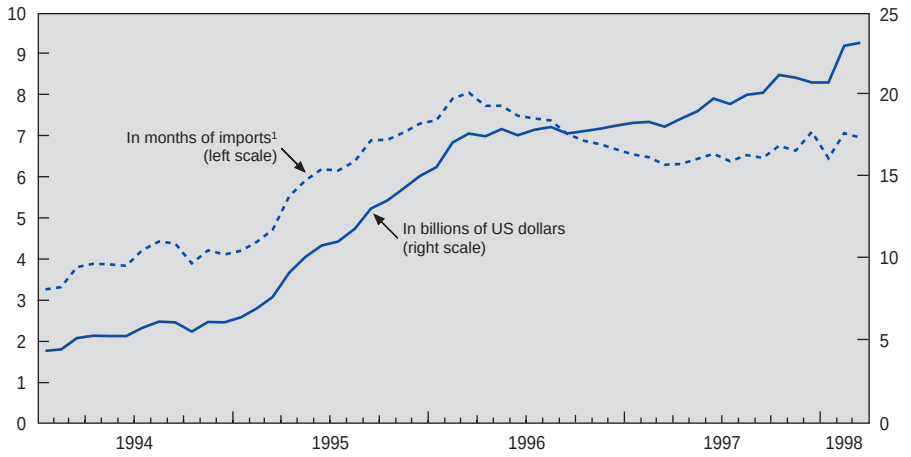
Imports were stimulated by buoyant domestic demand, the strengthening of the real exchange rate in 1995, and the phasing out of the import surcharge and lowering of import tariffs in a number of sectors.[17] The dynamism of imports was notably related to rising foreign direct investment inflows, since the latter often translate up-front into imports of capital equipment and only gradually contribute to export capacity expansion. It was also driven by consumption, as illustrated by the sharp rise in imports of cars and car parts.

An additional factor driving the current account into a growing deficit has been the expansion of unrecorded imports–which have been estimated to run at about $2 billion in 1996[18] – and the decline in unrecorded exports, which peaked in 1996 at some $5.6 billion (goods plus services). These trends are related to the appreciation of the CPI-based real exchange rate *vis-à-vis* the deutschemark through early 1997 and to the proliferation of supermarkets in the eastern border regions of Germany, at the expense of outlets in Poland.[19] Unrecorded exports were also hampered for a while by the mid-1997 floods. They were further slowed down in early 1998 by the restrictions introduced on the entry of traders crossing the eastern border.

The rather abrupt turnaround in the current account triggered fears about Poland's vulnerability to some adverse exogenous shock, all the more so after the balance of payments crisis in the Czech Republic in the spring of 1997. The devastating floods subsequently endured by Poland during the summer heightened those concerns, and contributed to increase volatility on the foreign exchange market (see Chapter II). The succession of crises erupting in Asia over the summer and autumn of 1997 also intensified speculations that contagion could spread to Poland. In the event, the Warsaw stock and bond markets suffered somewhat, but no wholesale confidence crisis materialised. In fact, Poland probably benefited from the rebalancing of emerging market portfolios triggered by the ''flight to quality''.

Inasmuch as market sentiment hinges on fundamentals, this was a recognition of the fact that Poland's current account deficit has thus far remained below what is conventionally perceived as a critical threshold (5 to 7 per cent of GDP).[20] There were several other reasons for this: foreign direct investment

Figure 6. **GROSS OFFICIAL FOREIGN EXCHANGE RESERVES**



1. Moving average of monthly imports over the last 12 months.
Source: National Bank of Poland.

rather than portfolio inflows financed the bulk of the current account deficit in 1997, supporting the view of the deficit as part and parcel of a ‘‘virtuous’’ investment-driven growth process, as it was for example in Ireland during the 1970s;[21] while increasing, the exposure of domestic banks and enterprises to foreign exchange rate risk has been much more limited than in some of the countries that suffered an external crisis last year; the real effective exchange rate kept depreciating in the course of 1997, again in contrast to what happened in many of those countries; foreign exchange reserves remained at fairly comfortable levels, around half a year of imports (Figure 6); and finally, the external debt and debt service ratios were set to rise over time, but from a relatively low base, namely 30 per cent of GDP at the end of 1996 and 9 per cent of exports in that year respectively.[22]

Prospects

The outlook through the end of 1999 is a favourable one, provided the pace of fiscal adjustment and privatisation is stepped up. The new government and the

freshly installed Monetary Policy Council have started to take measures to tighten monetary policy (see Chapter II), and the medium-term programme recently put forward by the Ministry of Finance spells out a fiscal adjustment path that would help slow down domestic demand. The Secretariat's projections (Table 3) assume that the policy stance described in the tighter of the two scenarios featuring in this document will be adhered to.

Table 3. **Summary of outcomes and OECD projections**

Year-average, real percentage change, unless noted

	1995	1996	1997[1]	1998[2]	1999[2]
GDP	7.0	6.1	6.9	5.8	5.6
Level, in $ billions at market exchange rate	119	135	136	149	159
Household consumption	3.6	8.7	7.0	4.6	3.7
Government consumption	2.9	3.4	3.3	1.8	1.5
Gross fixed investment	16.9	20.6	21.9	15.1	12.5
Total domestic demand	7.1	9.8	9.2	6.4	5.5
Exports of goods and services	23.6	12.5	15.0	11.8	11.6
Imports of goods and services	24.3	28.0	22.7	13.4	11.0
Unemployment (LFS, per cent of the labour force)	13.3	12.3	11.2	10.1	9.3
Employment (LFS, per cent increase)	0.9	1.2	1.4	1.5	1.6
Consumer price inflation (end-year, in per cent)	21.6	18.5	13.2	10.5	9.2
General government (cash basis, in per cent of GDP)[3]					
Revenues[4]	46.5	45.9	44.7	43.9	42.1[8]
Expenditures	49.2	49.3	48.1	46.8	44.2[8]
Balance[4]	–2.7	–3.4	–3.4	–2.9	–1.9[8]
Debt[5]	57.9	51.1	48.0	47.4	..
Broad money (nominal increase, end-year)[6]	35.0	29.2	28.9	20.0	15.0
Nominal interest rate on 3 month T-bills (end-year)	24.2	18.8	23.5	..	..
Current account balance, taking into account estimated unrecorded trade[7]					
In $ billion	0.9	–3.3	–5.9	–8.8	–9.6
In per cent of GDP	0.7	–2.4	–4.4	–6.0	–6.1
Gross NBP foreign exchange reserves (end-year, $ billion)	15.0	18.0	20.7	..	..
Gross external debt (end-year, in per cent of GDP)	36.9	30.1	28.4	..	..

1. Preliminary.
2. OECD projections.
3. Overdue taxes and arrears on government expenditures are excluded.
4. Privatisation receipts are excluded from revenue and treated as deficit finance.
5. State debt. The general government debt ratio is not known precisely but is several percentage points higher.
6. Including foreign exchange deposits.
7. Accruals-based balance of payments.
8. The impact of pension and other social reforms is not factored into the 1999 projection.

Source: Central Statistical Office; Ministry of Finance; National Bank of Poland and OECD.

The rapid pace of output growth barely slackened in early 1998. Combined with the build-up in productive capacity associated with a prolonged investment boom, this suggests that the 5.6 per cent growth projection underlying the 1998 budget is not particularly optimistic. Domestic demand should remain vigorous in 1998, even though very high real interest rates are projected to cool it down somewhat. External demand is likely to be strong enough to allow Polish exports to continue to grow at a double digit rate, given the fairly propitious outlook in Western Europe and the ongoing recovery in the countries neighbouring Poland eastwards, and despite lower demand and heightened competitive pressures from East Asia, particularly in such sectors as shipbuilding, steel and copper. Export growth should also benefit from the take-off of the exports associated with a number of the inward foreign direct investment projects. Import growth will probably continue to slow down while remaining strong, sustained inter alia by new large foreign direct investment projects. Furthermore, the terms of trade are favourably influenced by the recent sharp drop in oil prices.[23] While foreign debt service will rise over time, its impact should not be so large as to prevent a stabilisation of the current account deficit at slightly above 6 per cent of GDP at the turn of the century – an uncomfortably high level, however.

Although the pace of the expansion is projected to remain above 5.5 per cent in 1998-99, unemployment is unlikely to drop as swiftly as it did in 1996-97. Indeed, employment in restructuring industries and in agriculture is projected to shrink, and more youth are to enter the labour force than older workers to leave it. Accelerated job creation in the growing sectors of the economy should nonetheless allow unemployment to fall below 10 per cent.

Further disinflation is projected, despite the pause observed around the turn of this year, helped by the sizeable nominal exchange rate appreciation recorded during the first quarter of 1998. The pace of consumer price growth is projected to fall into the single digit range by the end of 1999. However, the front-loading of the 1998 hikes in regulated prices as well as continuing rapid wage growth imply that the annual average is likely to exceed the authorities' 11.0 per cent target in 1998.

Two risks surround this generally enviable outlook. The first one is that domestic demand would continue to expand too rapidly, despite the measures taken so far to cool it down somewhat (see Chapter II). With a stronger real exchange rate than foreseen in the budget, fiscal policy needs to be tightened at

the very least as much as envisaged in the authorities' more restrictive policy scenario, and preferably more so. The second risk pertains to capital flows, which picked up forcefully in early 1998. As the remaining controls are lifted, including the present restrictions on short-selling zlotys, the authorities feel that the currency may become more vulnerable to ephemeral swings in market sentiment.[24] The risk of a sudden reversal of capital flows will be minimized if fiscal adjustment and structural reforms are pursued vigorously.

II. Macroeconomic policies

To fend off the looming threat of overheating discussed in Chapter I, the stance of monetary policy was progressively tightened during the period under consideration. On the fiscal side the policy stance remained relatively loose over that period, but the new government in place since last fall has started to take some measures that tend to reduce the imbalance in the macroeconomic policy mix.

Financial policy framework

The new Constitution, which came into force in October 1997, the two banking laws which took effect at the start of 1998, and legislation on privatisation proceeds have somewhat modified the institutional setting of fiscal and monetary policy.

A key change with respect to fiscal management has been the introduction of a public debt ceiling set by the Constitution at 60 per cent of GDP (the exact methodology for compiling the debt, however, has yet to be spelled out in a legislative act).[25] The new Constitution bans direct central bank lending as a source of deficit finance, starting in October 1998. Also noteworthy is the fact that the President of the Republic was deprived of the power to veto the budget. Furthermore, a 1997 law stipulates that privatisation receipts can no longer be treated as budget revenue.

The 1997 law on the National Bank of Poland (NBP) created a new policy-making body: the Monetary Policy Council (MPC). It is chaired by the NBP President, who is nominated by Parliament for a six-year term and can only be dismissed in very exceptional circumstances. The MPC comprises nine other members, of whom one third are nominated by the lower house of Parliament,

one third by the upper house and one third by the President of the Republic, all for six year terms.[26] The MPC was to start operating in the first days of January 1998, but delays in agreeing on some of the candidate members deferred the inauguration by a month and a half. As a result, and attesting to the importance of this new body, several important policy measures foreshadowed in some late 1997 public statements by NBP management were put on hold. Furthermore, Parliament can no longer amend the annual *Monetary Policy Guidelines*, which henceforth are presented to deputies only for information. The MPC, however, has to report yearly to Parliament on the implementation of the *Guidelines*. Although the MPC enjoys broad powers, fundamental changes in policy regime, such as a change in the exchange rate system, are to be decided by the Council of Ministers.

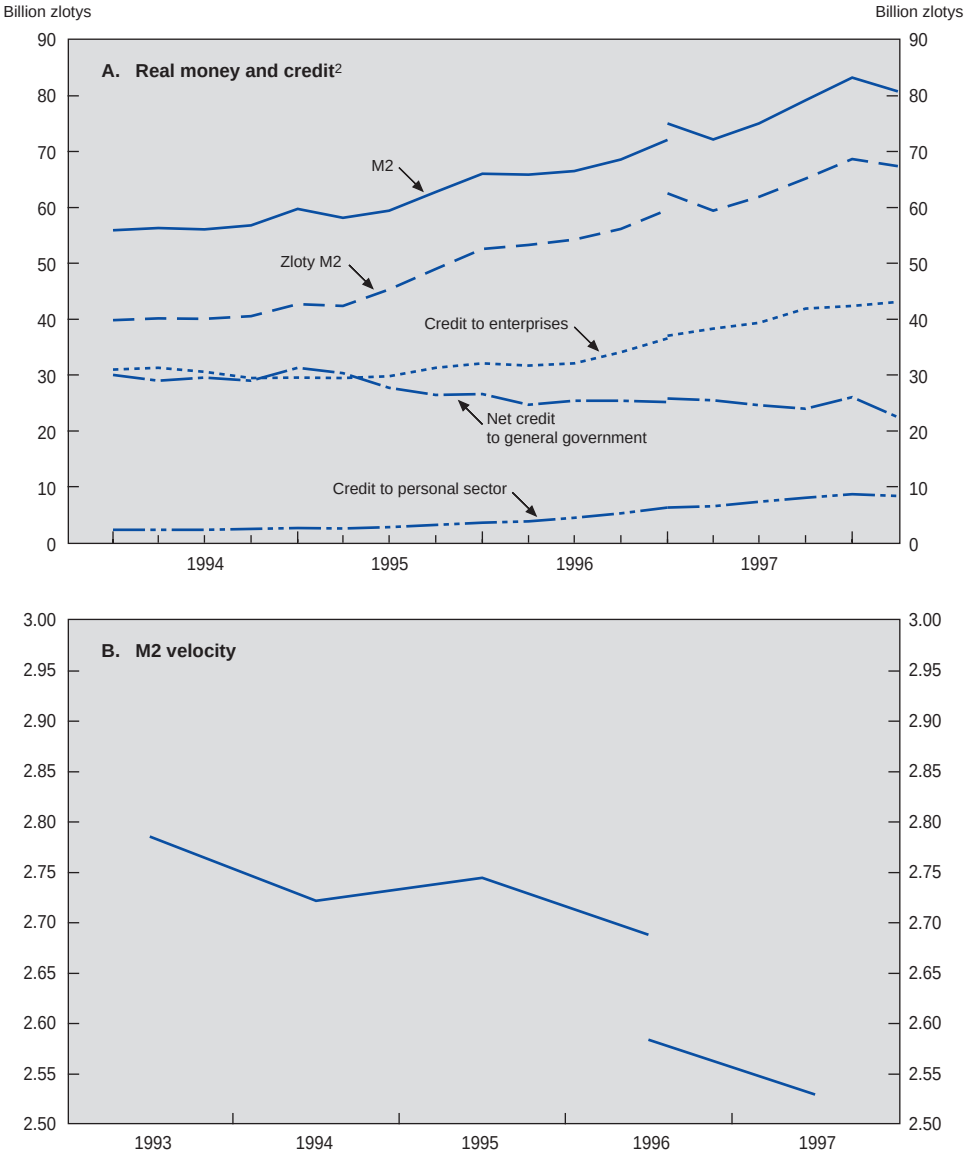
Banking supervision arrangements were also adjusted, and some rules tightened. Although the operational work continues to be carried out by the NBP's General Inspectorate, a new Banking Supervision Commission was set up, chaired by the NBP President and including representatives of the President of the Republic, the Finance Ministry, the Securities and Exchange Commission, and the Banking Guarantee Fund. Restrictions have been placed on commercial bank lending to staff and shareholders. Banking secrecy provisions have been amended: banks are now obliged to reveal the state of a client's account if asked by a prosecutor presenting specific charges against the client. In an effort to fight money laundering, banks are now also required to keep a register of persons making large cash payments. Lastly, anyone wishing to set up a bank now has to prove that the capital is of legal origin, and candidate bank presidents have to be approved by the NBP head.

Monetary policy

The pursuit of gradual disinflation

Over the past few years, the authorities have consistently pursued a strategy of gradual disinflation, not least on the grounds that an attempt to choke off inflation abruptly might endanger the sustained expansion of output enjoyed by Poland since 1992. While M2 (including foreign exchange deposits) has remained the intermediate objective of monetary policy, the operational target has

Figure 7. **MONEY AND CREDIT**[1]



1. The break at the end of 1996 reflects a change in coverage in the monetary statistics. March 1998 data are preliminary.
2. Deflated by CPI.

Source: National Bank of Poland and Central Statistical Office.

shifted back and forth between short-term interest rates (in 1994-95 and 1998) and base money (in 1996-97).[27] Meanwhile, the pre-determined rate of crawl of the central parity of the ±7 per cent exchange rate band has also served as a nominal anchor, meaning that to some extent the authorities have tried to pursue two targets with one instrument.

As in 1994 and 1995, the objective set for M2 was exceeded by a wide margin in 1996 and again in 1997, with real M2 rising on average at a double-digit annual rate (Figure 7). The inflation target, however, was not considerably overshot in 1996 and was essentially met in 1997. The overshooting of the M2 target partly reflects the fact that real GDP increased more than projected. It also stems from a faster-than-projected fall in velocity, which by international standards still has ample room to decline.[28] Indeed, the NBP's late 1997 projections for 1998 foresaw a further decline in velocity, the aim being to contain the expansion of the money supply to 21 per cent while real GDP was projected to rise by 5.6 per cent.[29] However, to the extent that recent increases in demand for M2 reflect rising real interest rates, the scope for velocity to decline this year may be somewhat narrower than hoped for.

Sources of monetary expansion

The vigorous expansion of monetary aggregates was largely driven by the acceleration of credit to enterprises and households (Table 4), which far exceeded the authorities' projections. This credit boom was driven in part by competition among incumbent banks for market shares ahead of the entry of foreign institutions from 1999. Credit to government, in contrast, played a smaller role, its contribution amounting to one sixth of money growth both in 1996 and in 1997.

During the first half of the 1990s, banks were generally loath to extend new loans to firms. As the health of potential borrowers and banks themselves improved, corporate credits started to pick up, with their share in bank portfolios rising at the expense of that of Treasury bills and bonds. The maturity of credits lengthened, with the share of medium and long-term lending rising from 38 per cent at the end of 1995 to 48 per cent at the end of 1997. Even as domestic credit to enterprises soared, firms stepped up their borrowings abroad (Durjasz and Kokoszczynski, forthcoming), in part motivated by high domestic interest rates. Although this type of debt has not yet reached alarming proportions, totalling

Table 4. **Commercial bank credit to enterprises and households**

In Zl million, end-period

	1991	1992	1993	1994	1995	1996	1996[1]	1997[1]
State-owned enterprises	**10 379**	**11 770**	**14 252**	**16 751**	**20 327**	**25 007**	**24 025**	**28 612**
Short-term[2]	6 203	5 989	6 534	6 971	8 852	9 980	9 720	10 301
Housing	759	24	13	9	6	0	0	24
Other long-term	3 418	5 050	6 408	8 364	10 142	14 283	13 616	17 759
Interest unpaid	0	707	1 297	1 406	1 328	743	690	528
Private firms	**8 249**	**11 907**	**16 679**	**21 464**	**30 262**	**43 323**	**44 200**	**59 343**
Short-term[2]	4 565	4 905	6 317	7 988	11 951	18 796	18 606	25 481
One to five years	1 440	1 878	2 787	3 941	6 316	10 238	10 177	14 696
Housing	1 976	3 304	4 010	4 734	5 547	5 443	5 764	5 770
Other long-term	268	1 024	1 450	1 951	2 867	5 367	6 078	9 542
Other (including interest unpaid)	0	796	2 115	2 850	3 580	3 479	3 575	3 855
Households	**714**	**1 187**	**2 239**	**3 324**	**5 602**	**11 647**	**11 753**	**18 368**
Short-term[2]	335	633	1 058	1 442	2 217	3 613	3 496	4 532
One to five years	255	339	770	1 311	2 646	6 564	6 612	10 461
Housing	115	197	346	470	562	931	1 020	1 815
Other long-term	9	10	17	37	88	413	380	1 333
Interest unpaid	0	9	47	64	89	127	245	228

1. New format.
2. Up to one year.

Source: National Bank of Poland.

$3.5 billion at the end of 1997 – *i.e.* 14 per cent of domestic bank borrowing – it ought to be closely monitored.[30]

Loans to household have increased almost twice as fast as those to enterprises, albeit from a very low base. At the end of 1997, they accounted for 17 per cent of total credit to the non-financial sector, up from 10 per cent at the end of 1995. So far, those loans have mostly financed the purchase of durables – automobiles in particular – although housing loans have recently begun to show some signs of revival, thanks in part to facilitating legislation on mortgages. The experience in other countries should however serve as a reminder that the ability to assess credit risk may not develop as swiftly as the loan portfolio. While, overall, banks' prudential ratios have kept improving (Table 5), defaults on consumer loans are no longer isolated occurrences: in late 1997, 7 per cent of instalment loans were classified as non-performing, up from 2 per cent at the end of 1996. Banks would therefore be well advised to provision those loans more substantially and to grant new ones more selectively.[31] Indeed, if the pace of

Table 5. **Indicators of banks' health and performance**

Excluding co-operative banks and banks undergoing liquidation or bankruptcy

		1993	1994	1995	1996	1997
Number of banks		87	82	81	81	83
Solvency						
Below required 8 per cent level		18	18	13	8	8
of which: Negative solvency ratio		13	15	11	7	6
Profitability						
Number of loss-making banks		24	20	11	11	7
Gross profit/income (in per cent)						
All banks		6.0	6.0	16.9	19.4	15.3
Banks with majority state equity		5.9	5.2	15.2	18.9	13.0
of which: Directly owned by the Treasury		6.6	5.7	16.0	20.2	13.7
Private banks		6.7	9.6	21.0	20.5	17.3
of which: With majority Polish equity		0.5	5.8	21.0	21.3	19.8
With majority foreign equity		32.3	17.9	20.9	19.7	13.6
Non-performing loans (in per cent of total loan portfolio)						
Substandard [1]		7.1	5.7	5.4	4.1	4.0
Doubtful [2]		6.0	5.3	3.5	1.7	1.1
Lost [3]		17.9	17.7	12.0	7.4	5.3
Total		31.0	28.7	20.9	13.2	10.4
Provisioning (in per cent of loan portfolio in the category) [4]	Required	←		Actual		→
Substandard [1]	20.0	16.3	25.8	26.1	27.0	25.9
Doubtful [2]	50.0	25.0	55.4	59.3	53.4	52.5
Lost [3]	100.0	87.1	100.1	100.2	99.7	99.7
Total		82.6	103.1	104.1	103.1	103.3
Total amount of provisions (Zl billion)		4.6	6.9	7.4	6.7	6.1

1. *a)* Principal or interest payments are delayed by one to three months; *b)* the debtor's financial situation may jeopardise timely payments.
2. *a)* Principal or interest payments are delayed by three to six months; *b)* the debtor's financial situation has deteriorated substantially.
3. *a)* Principal or interest payments are delayed by more than six months; *b)* the debtor has been declared insolvent or put into liquidation (excluding liquidation in the context of privatisation); *c)* the debtor's bank has petitioned for foreclosure or commenced recovering assets under other procedures; *d)* the debtor contests the claim in court; *e)* the debtor's whereabouts are unknown; *f)* the debtor's situation has deteriorated irretrevably.
4. Provisioning is not compulsory for collateralised loans.

Source: National Bank of Poland, General Inspectorate for Banking Supervision.

household income growth were to slow down from its current high rates, repayment could become problematic for many debtors.

Capital inflows, which were a major source of monetary expansion in 1995, continued to boost money supply substantially, albeit to a lesser extent. In 1996,

the share in money creation of the increase in net foreign assets more than halved, to 40 per cent. In 1997, however, this share bounced back to 59 per cent. Despite the widening of the trade deficit, foreign exchange reserves continued to increase over the period, by around $3 billion per annum, driven mainly by inward foreign direct investment, which on a cash balance of payments basis amounted to $2.8 billion in 1996 and $3.1 billion in 1997 (see Annex I). The magnitude of the capital inflows exceeded the authorities' expectations, leading to a significant upward revision of the NBP's projection for money supply in 1998.

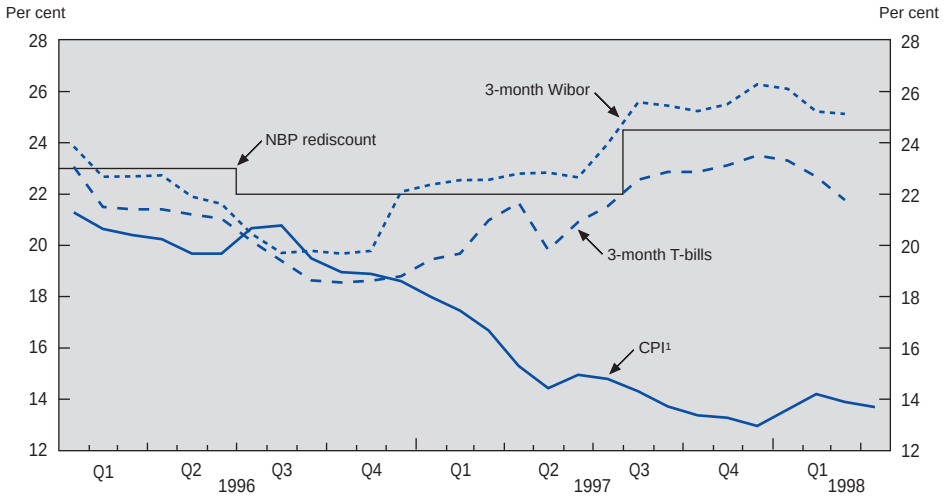
Evolution of the monetary policy mix

The relative importance of the exchange rate and of interest rates in bringing down inflation has changed over time. In 1996, exchange rate policy played more of a role, since the rate of crawl of the central parity was still far below domestic inflation even as real interest rates were rather low. In 1997, the pattern was reversed, as the unchanged rate of crawl barely exceeded even backward-looking measures of inflation and nominal interest rates rose sharply (Figure 8).

The monthly rate of crawl of the central parity remained at 1.0 per cent from January 1996 to February 1998 despite recurrent pronouncements by NBP officials to the effect that it would probably be cut soon (Figure 9).[32] To a large extent, the implied progressive de-emphasis of the exchange rate as a disinflationary instrument stemmed from the desire to counteract the widening of the trade deficit. Pressures on the foreign exchange market, and NBP intervention, have mostly been one-sided, the central bank trying to contain the appreciation of the currency. Although the market has deepened somewhat, it remains shallow. Considering also that non-residents' holdings of Treasury paper and other securities amount to no more than a fraction of official foreign exchange reserves and that the NBP can essentially prohibit short-selling the zloty, the authorities feel confident that they are not vulnerable to speculators' whims. However, a new foreign exchange law providing for more extensive capital account convertibility is under preparation, which will reduce the NBP's leverage.

In this context, and as capital inflows accelerated, the Monetary Policy Council decided at its inaugural meeting in late February 1998 to widen the exchange rate band to ±10 per cent and to slow the monthly rate of crawl to 0.8 per cent. It also announced that more short-run volatility of the exchange rate

Figure 8. **INTEREST RATES**



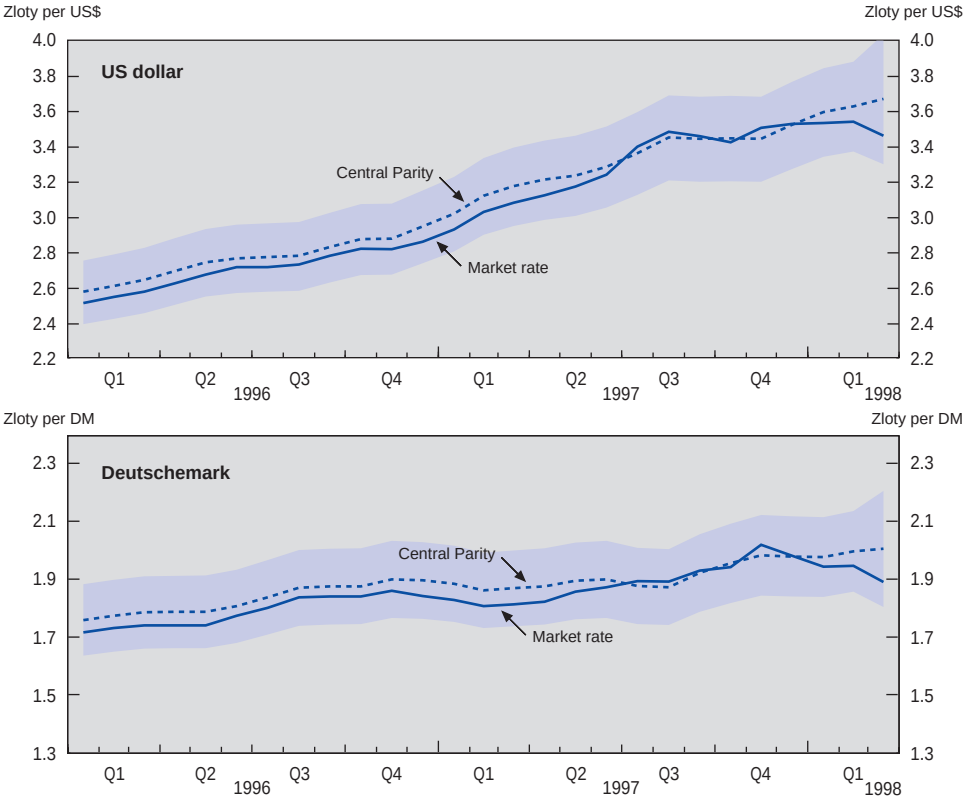
1. Percentage increase in the CPI over the last 12 months.
Source: OECD.

within the band would be allowed. By early May, the market rate had appreciated to 2 per cent below the new upper limit.

As noted, nominal and real interest rates have risen a lot since late 1996, rendering zloty deposits more attractive, and contributing to the aforementioned decline in velocity. In order to steer interest rates upwards, against the backdrop of the banking sector's over-liquidity, the NBP used a variety of tools. Open market operations were one of them, notably in the form of reverse repurchase operations and auctions of NBP money market bills.[33] The rediscount and Lombard rates were also raised respectively by 2.5 and 2 percentage points in the summer of 1997. The NBP continued to struggle with a dilemma that it had faced already in 1995: on domestic grounds, higher interest were called for to slow credit expansion; high interest rates, however, attracted capital inflows, which had to be sterilised at great cost.[34]

The NBP also actively used hikes in required reserve ratios in order to contain the expansion of banks' liquidity. They were raised three times over the period under consideration (in February 1996 and in February and May 1997). In

Figure 9. **NOMINAL EXCHANGE RATES**
Central parities, market rates and crawling bands[1]



1. Monthly averages.
Source: National Bank of Poland.

the process, the gap between the ratio applicable to foreign exchange deposits and those imposed on zloty deposits was narrowed somewhat. Required reserve ratios currently stand at very high levels: 20 per cent for zloty demand deposits, 11 per cent for zloty term deposits and 5 per cent for foreign exchange deposits.[35] This is a considerable burden on banks, as no interest is paid on these amounts.[36]

In the summer of 1997, concerns arose that the tightening of monetary policy was not sufficient to slow down domestic demand, especially in the wake

of the budgetary measures announced to cope with the floods. The NBP indicated that it was considering additional steps to cool down credit expansion, including the imposition of credit rationing and direct collection of household deposits. In mid-September, the NBP started to offer households 6 and 9-month deposits carrying attractive interest rates with a view to inducing banks to post higher rates and to encouraging saving.[37] By the end of the year, the NBP had drained Zl 3.6 billion through this channel, *i.e.* 4.5 per cent of the total stock of household deposits in December 1997 and twice as much as what the NBP had envisaged when it introduced the scheme.[38] Part of this amount was collected at the expense of commercial banks (including the savings bank), which did not raise their interest rates as much as the authorities had hoped they would, but a significant portion probably represented conversion of cash into deposits, as suggested by the fall in the ratio of cash to broad money in the last four months of 1997. In any event, total household zloty deposits did increase sharply in the course of 1997, by 24 per cent in real terms (in part reflecting continuing de-dollarisation).

In the fall of 1997, the NBP was contemplating further restrictive measures, notably the introduction of a stamp duty on consumer loans and required reserves on loans contracted abroad. In January 1998, it introduced a 20 per cent reserve requirement on zloty-denominated accounts of non-resident banks in resident banks and a 5 per cent reserve requirement on their foreign exchange deposits in resident banks with a maturity of less than two years.

Fiscal management

The stance of fiscal policy

Two key objectives have guided fiscal policy over the period under consideration. One was the need to reduce the overall tax pressure, which was extremely burdensome compared to other countries with similar per capita incomes. The other was to contain the deficit, which at around 3 per cent of GDP was also high given the low level of monetisation of the Polish economy (Table 6). While some success was scored on the first point, results were disappointing on the second one.

On the revenue side, the overall tax pressure has indeed dropped since the mid-1990s. Spending as a ratio to GDP, however, did not fall in 1996, leading to

Table 6. **Key fiscal indicators**

In per cent of GDP

	1992	1993	1994	1995	1996	1997[1]	1998[2]
General government, cash basis							
Revenue (excluding privatisation receipts)	44.7	47.1	47.5	46.5	45.9	44.7	43.9
Expenditure	50.0	49.9	50.5	49.2	49.3	48.1	47.1
of which: Interest	3.1	3.8	4.4	5.0	4.0	3.7	4.2
Balance	–5.3	–2.8	–3.0	–2.7	–3.4	–3.4	–3.2
Primary balance	–2.2	1.0	1.4	2.2	0.6	0.3	1.0
Privatisation receipts (state budget)	0.4	0.5	0.8	0.9	1.0	1.5	1.3
Fiscal balance, national accounts basis[3]							
Public sector	–7.1	–4.5	–3.7	–3.0	–4.4	–3.6	–3.5
State budget	–8.1	–5.0	–4.2	–3.8	–4.6	–3.3	–3.4
Local budgets	0.0	0.0	0.0	0.1	–0.1	–0.2	–0.1
Extra-budgetary funds	0.8	0.3	0.4	0.5	0.3	–0.1	0.0
Other	0.3	0.2	0.1	0.2	0.1	0.0	0.0

1. Preliminary.
2. Ministry of Finance forecast based on 1998 Budget Law.
3. Through 1995, Central Statistical Office national accounts data; thereafter, preliminary Ministry of Finance estimates. The difference between the cash and national accounts-based deficit measures reflects a number of adjustments, including on account of the following: changes in budgetary units' payables, issuance of restructuring bonds and bonds for bank BGZ (and capitalised interest thereon) and changes in the zloty value of dollar-denominated State bonds.

Source: Central Statistical Office; Ministry of Finance.

a larger deficit (Table 7). It did decline in 1997, notwithstanding the floods and interest rate developments, but so did revenue. As a result, the deficit remained well above 3 per cent of GDP. Given that GDP growth was rapid, even exceeding fairly rosy budget projections both in 1996 and in 1997, the stance of fiscal policy erred on the loose side.[39]

The draft 1998 budget prepared by the former government was amended during the fall of 1997 by the new one, and made slightly more restrictive. The enacted 1998 budget targets a cash deficit 0.2 percentage points of GDP below the 1997 outcome, and still above 3 per cent of GDP. Most of the adjustment is to come from the expenditure side.

Revenue

In accordance with the objective to ease the overall tax pressure on economic agents, a number of tax rates are gradually being cut.[40] At the same time, efforts are deployed to restrict the scope of exemptions and to eliminate loop-

Table 7. **General government revenues, expenditures and balance**

In per cent of GDP, including privatisation receipts as revenue

	1995 Outcome	1996		1997		1998 Law
		Law	Outcome	Law	Outcome	
Total revenue [1]	47.4	48.1	47.0	45.7	46.5	45.5
State budget						
Including transfers	29.0	29.1	27.5	26.8	27.0	26.6
Excluding transfers	29.0	29.1	27.4	26.8	26.9	26.5
Local budgets	4.4	4.9	5.2	5.0	5.5	4.9
Extra-budgetary funds [2]	10.9	11.5	11.2	11.3	11.1	11.4
State extra-budgetary units	1.4	1.0	1.4	1.0	1.3	1.0
Local extra-budgetary units	1.7	1.5	1.7	1.6	1.7	1.6
Total expenditure	49.2	50.9	49.3	48.7	48.1	47.1
State budget						
Including transfers	31.6	31.8	30.0	29.7	28.3	28.1
Excluding transfers	21.5	21.8	20.1	20.3	18.8	19.4
Local budgets	5.3	6.2	6.8	6.2	7.3	6.6
Extra-budgetary funds [2]	19.0	19.6	18.9	19.1	18.7	18.1
State extra-budgetary units	1.2	1.1	1.3	1.0	1.1	1.0
Local extra-budgetary units	2.3	2.2	2.2	2.0	2.2	2.0
Total balance [1]	–1.8	–2.9	–2.3	–3.0	–1.6	–1.6
State budget						
Including transfers	–2.6	–2.8	–2.5	–2.8	–1.3	–1.5
Excluding transfers	7.5	7.3	7.4	6.5	8.1	7.1
Local budgets	–0.9	–1.3	–1.7	–1.3	–1.9	–1.7
Extra-budgetary funds [2]	–8.0	–8.1	–7.6	–7.8	–7.6	–6.7
State extra-budgetary units	0.2	–0.1	0.1	0.0	0.2	0.0
Local extra-budgetary units	–0.6	–0.7	–0.5	–0.5	–0.5	–0.4
Memorandum item: Nominal GDP (in Zl billion)	288.7	344.6	362.8	429.7	445.1	511.1

1. Excluding intra-governmental transfers.
2. Mainly the social insurance fund (FUS), the farmers' fund (KRUS) and the Labour Fund.

Source: Ministry of Finance, Central Statistical Office.

holes. The corporate income tax rate is being reduced by 2 percentage points each year, from 40 per cent in 1996 to 32 per cent in 2000. In parallel, allowances for investment outlays are being reduced. Personal income tax rates were cut from 21, 33 and 45 per cent in 1996 to 20, 32 and 44 per cent in 1997 and to 19, 30 and 40 per cent in 1998, while the deductibility of some items (notably purchases of Treasury paper, housing investment and donations) was curtailed. Tax and duty rates on imports were also significantly lowered in recent years. In

contrast, VAT rates were increased for a number of low-rated items. In the summer of 1997, the introduction of a flood tax (or of flood bonds) was much discussed but the idea was subsequently abandoned, and a special NBP credit line was set up instead.

Among the striking revenue developments was the buoyancy of VAT receipts, which rose from 7.2 per cent of GDP in 1995 to 8.3 per cent in 1997 (Table 8). This largely reflected the fact that growth has been increasingly driven by domestic demand. In contrast, personal income tax receipts declined by almost one percentage point of GDP in 1996, mainly owing to widespread abuse of a loophole entitling households to deduct ''donations'' broadly defined from taxable income. This option was used by 6.3 million taxpayers, whose declared generosity exceeded Zl 9 billion (3.5 per cent of household income), trimming tax receipts by an estimated Zl 1.9 billion. This loophole was essentially closed in 1997. Also noteworthy has been the loss of over one per cent of GDP in receipts from the phasing out of the import surcharge and the decline in the contribution

Table 8. **State budget: the income side**

In per cent of GDP

	1995 Outcome	1996		1997		1998 Law
		Law	Outcome	Law	Outcome	
Total revenue, excluding privatisation receipts	28.1	28.3	26.4	25.8	25.5	25.2
Tax revenue	23.9	24.5	23.1	22.9	22.2	22.8
VAT	7.2	7.5	7.7	8.0	8.3	8.6
Excise duties	4.2	5.2	4.3	4.7	4.0	4.7
Personal income tax	8.1	8.1	7.2	7.1	6.7	6.5
Corporate income tax	3.1	2.9	3.0	3.0	3.0	2.8
Import surcharge	1.1	0.7	0.8	–	–	–
Other taxes	0.2	0.1	0.1	0.1	0.1	0.1
Non-tax revenue	4.2	3.8	3.3	2.9	3.3	2.5
Dividends	0.3	0.4	0.3	0.2	0.3	0.2
NBP profit contribution	1.0	0.5	0.1	0.1	0.3	0.1
Customs duties	2.0	1.9	1.8	1.7	1.6	1.4
Other	0.9	0.9	1.1	0.9	1.1	0.8
Privatisation receipts	0.9	0.7	1.0	1.0	1.5	1.3

Source: Ministry of Finance, Central Statistical Office.

of import duties associated with the lowering of trade barriers (notwithstanding the import boom).

In assessing tax collection performance, the accumulation of arrears should also be taken into account.[41] At the end of 1997, the total stock of arrears on taxes and social contributions amounted to Zl 11.6 billion, or close to 6 per cent of general government revenue in that year. Over time, the share of arrears on social contributions has increased, to 50 per cent of total arrears at the end of 1997. A few large state enterprises stand out with disproportionately large outstanding dues (see Table 13 in Chapter III). On a number of occasions, arrears have been written off. In the 1996 State budget, Zl 250 million were set aside to cancel social contribution arrears incurred by state enterprises (down, however, from Zl 788 million in 1995). In the 1997 budget, the allocation for this type of write-off was reduced to Zl 100 million and in the 1998 budget, there was none.

Expenditure

A number of factors have boosted expenditure growth. Budgetary sector wages increased even more rapidly in 1996-97 than wages in enterprises. Pensions also rose swiftly, especially in 1997. In addition, the July 1997 floods caused considerable damage[42] and entailed extra fiscal outlays (including tax concessions), a significant portion of which is to be incurred after the 1997 fiscal year. In contrast, expenditures on unemployment compensation dropped by 0.9 points of GDP between 1995 and 1997, thanks to a sharp decline in the number of registered unemployed and a tightening of benefit eligibility rules (Chapter V).

Against this background, a number of features of the 1998 budget stand out. Old-age wage-earner pensions and budgetary wages are to rise less rapidly, respectively by 2.1 and 1.8 per cent in real terms, although pensions for the uniformed services are slated to rise by 12 per cent in real terms.[43] A number of subsidies to enterprises and households are cut, notably those pertaining to heating, hot water and railway fares. Some investment outlays, in contrast, receive a boost, for instance those on roads.

While a major portion of budgetary outlays is difficult to compress in the short or even medium run, room for savings exists, as attested by some documented cases of misallocation. One striking example pertains to central investment projects, which absorb around 2 per cent of state budget expenditure (NIK,

1997*a*). A close examination of 37 of the 185 such projects underway in 1996 showed that about one fifth of the budget outlays were wasted. Control over the appropriation of the state's financial assistance was lacking, some projects were dragging on indefinitely, and resources were being spent for unauthorised purposes.[44] A more efficient use of public funds would be ensured by imposing stricter *ex ante* documentation requirements, funding the projects through the banking system, and conditioning budgetary disbursements to banks on the prior fulfillment by suppliers of their contractual obligations.

Another chronic problem on the expenditure side of the budget has been the build-up of debts to suppliers, mostly in the health care and education sectors. Towards the end of 1997, the government owed some Zl 5 billion on that account, of which close to Zl 3 billion was overdue. An active secondary market for the corresponding claims has been operating for several years, encouraging the abuse of what was in effect a soft budget constraint.[45] Some enterprises have extensively used the possibility to offset their tax bills with the claims held on budgetary entities, to the tune of Zl 666 million in 1996 and Zl 763 million in 1997. From January 1998, the scope for tax offsets was restricted to the primary holders of claims connected with the delivery of goods or services in conformity with public procurement rules (selection by tender).

Some other measures have been taken or are under preparation to improve the efficiency of the State as a purchaser. For instance, public procurement rules were amended in late 1997: henceforth, the winning bid has to be selected within 45 days instead of 90, interest is to be paid on bidders' deposits, and insurance guarantees are accepted in lieu of deposits. A law on state aid is furthermore under preparation, which should improve the monitoring and allocation of public assistance.

Deficit and debt

As noted, the general government deficit deteriorated in 1996-97. The same holds for the primary balance (*i.e.* the balance after exclusion of interest charges), which shrank from 1.9 per cent of GDP in 1995 to 0.3 per cent of GDP in 1997. A considerable portion of the deficit was financed by privatisation receipts, which far surpassed budgeted amounts, reaching 1.1 per cent of GDP in 1996 and 1.7 per cent in 1997. The rest was financed domestically (foreign finance being negative in both years), and largely through the issuance of Treasury bills and

bonds.[46] Bonds were particularly popular with households in 1996, thanks to the generous tax treatment they then enjoyed.[47]

The ratio of state debt to GDP fell swiftly through 1996, helped in particular by external debt relief, real exchange rate appreciation, and buoyant GDP growth (Table 9). Owing to a persistent deficit, rising real interest rates, and a weakening real exchange rate, and despite rapid GDP growth, it improved much less in 1997, although it did fall below the 50 per cent mark. If the indebtedness of other levels of government were to be added in, however, as well as accrued interest, the public debt would still significantly exceed 50 per cent of GDP.[48] The share of the domestic component of the state debt has been rising uninterruptedly, to 45 per cent at the end of 1997. This increase has essentially been absorbed by the

Table 9. **State debt and debt service**[1]

In Zl million

	1993	1994	1995	1996	1997	1998 Budget law
Debt (end-year)						
Domestic	**40 067**	**55 846**	**66 104**	**79 552**	**95 805**	**115 030**
Treasury securities	35 446	52 186	61 443	74 042	87 966	106 102
of which: Traded bills and bonds	21 131	31 946	41 246	52 377	60 147	78 585
Other	4 621	3 660	4 661	5 510	7 838	8 929
Foreign	**98 070**	**96 361**	**101 107**	**105 994**	**117 653**	**135 947**
Credits	97 814	76 684	81 231	82 550	93 578	107 322
Paris Club	61 187	65 362	68 866	76 094	85 300	94 866
Other	36 627	11 323	12 365	6 456	8 278	12 456
Bonds	0	19 468	19 719	23 437	24 074	28 625
Bradys	0	19 468	19 102	22 255	21 297	23 608
Eurobonds	0	0	617	1 181	2 778	5 017
Other	256	208	157	7	0	0
Total						
In zlotys	138 137	152 207	167 210	185 546	213 457	250 977
In per cent of GDP	88.7	72.3	57.9	51.1	48.0	49.1
Debt service						
Total	**5 961**	**9 233**	**14 360**	**14 402**	**16 271**	**21 235**
Domestic	4 750	7 401	11 097	11 032	12 588	16 145
Foreign	1 211	1 832	3 263	3 370	3 683	5 090
In per cent of budget expenditures	11.8	13.4	15.8	13.2	12.9	15.1
In per cent of GDP	3.8	4.4	5.0	4.0	3.7	4.2

1. Excludes some components of public debt.
Source: Ministry of Finance, Central Statistical Office.

issuance of traded bills and bonds, the share of which in the total state debt rose to 28 per cent. The liquidity of T-bills improved with their availability in electronic form.

The state debt as shown above also excludes a number of contingent liabilities, such as guarantees that one day might be activated. The stock of state guarantees on bank loans amounted to Zl 19.7 billion at the end of 1996, or 5.4 per cent of GDP. In 1997, only one fourth of the volume of guarantees authorised by the budget law was granted, totalling Zl 1.2 billion. Further excluded from conventional debt indicators (as in the other OECD countries) is the ''hidden'' pension debt, discussed in Chapter IV, which is estimated to exceed 200 per cent of GDP (rather more than in most other OECD countries).

Fiscal reforms

A number of fiscal reforms are underway which aim at reducing the tax burden, improving the allocation of budgetary resources and bringing the rules closer to European Union (EU) standards. Several reform efforts stand out: the streamlining of extra-budgetary funds, the decentralisation of state finances, and the harmonisation of indirect taxation with EU regulations.[49]

Gravitating around the hard core of the fiscal system are a host of extra, or para-budgetary funds and agencies.[50] The new government considers that their *modus operandi* should be reviewed and their number reduced.

The new government has stepped up the debate on devolution which had been lingering in Parliament during the previous legislature. The plans currently under discussion involve significant decentralisation of public finances and the creation of a new level of local government (see Annex II). However, the physionomy of the fiscal arrangements associated with the new political and administrative structure will only be clarified in a second stage, once a number of other reforms (*e.g.* regarding health care) are more advanced.

Another strand of ongoing reform pertains to indirect taxation, the relative importance of which is to continue to increase. Major adjustments in excise taxes are still required if the Polish system is to come closer to EU standards (Committee for European Integration, 1997*b)*: as of early 1998, key differences included the rates applied for certain products (*e.g.* fuels and cigarettes) and the treatment of imports. VAT rules require fewer changes, although a few are still needed

regarding the range of exemptions (particularly as regards agricultural products) and refunds to non-residents.[51]

Assessment

So far, the overall stance of financial policies has not been sufficiently restrictive to prevent the current account deficit from widening rapidly. Monetary policy has been gradually tightened, using almost all the levers at the disposal of the central bank. In contrast, the fiscal balance has deteriorated from a level that, as underscored in the previous Survey, was already excessive.

Besides increasing nominal interest rates, the NBP has raised reserve requirements and directly collected household deposits. More recently, faced with the resurgence of capital inflows, it has cut the rate of crawl of the central parity, widened the width of the band and let the market rate appreciate above its former upper limit. Over the last few months, a deceleration in money and credit aggregates has been perceptible, suggesting that those measures have started to bite.

On the fiscal front, some tightening is enshrined in the 1998 budget. The deficit recorded at the State level for the first quarter seemed in line with the annual target, and the authorities' record in recent years suggests that budget execution will if anything err on the cautious side. If a revenue bonus were to materialise as a result of higher-than-projected growth, it should not be spent but used to bring down the deficit more decisively.

As preparations for next year's budget get underway, the need for faster fiscal adjustment can hardly be overstated. The Ministry of Finance prepared two medium-term policy scenarios, which were discussed by the Council of Ministers in March and April. The more restrictive of the two envisaged a very gradual reduction in the general government deficit, which would still stand at 2 per cent of GDP in 2001 and be balanced only around 2003. Even taking into account the adverse impact of the implementation of the administrative, pension and other social programme reforms to start in 1999,[52] the implied pace of fiscal adjustment would represent a bare minimum, leaving little margin if for example growth were to slacken. In this context, it should also be recalled that the properly measured public debt ratio is already not that far from its constitutional ceiling.

Increased reliance on fiscal policy should take the form of additional expenditure restraint, since tax pressure broadly defined remains too high. As noted, there remains room to rationalise spending in some areas. A tighter fiscal stance would facilitate a reduction in interest rates, which in turn would ease the debt service burden, and help to cope with the current capital inflow dilemma.

III. Privatisation and management in public enterprises

Ownership transfer has continued in 1996-97 along an increasingly diverse set of tracks. Some very large enterprises have started to be privatised, and the new government in late 1997 announced its intention to step up the pace of state divestiture. Even so, the residual State sector remains large for the time being. Its overall performance has been comparatively mediocre, reflecting problems inherited from times past but also inadequate corporate governance and the lack of effectiveness of sectoral restructuring programmes.

State divestiture

Poland's remarkable overall growth performance so far has been largely driven by a thriving private sector. The number of new private firms soared in the first half of the 1990s and has continued to increase rapidly since, even though the pace slowed down somewhat in 1997 as some consolidation started to occur (Table 10). At the same time, privatisation was initiated in many state enterprises, the number of which declined significantly. The expansion of the private sector is also reflected in the composition of employment (Table 11). At the end of 1997, more than two thirds of the total labour force were working in the private sector.

Privatisation paths

Privatisation has followed many different tracks (Table 12). In addition, a number of new schemes have been proposed since 1996, and one of them withdrawn after the parliamentary elections in the fall of 1997. A key pillar of the legal framework is the August 1996 Law on commercialisation and privatisation.[53]

Table 10. **Number of public and private economic entities**

End-period

	1989	1990	1991	1992	1993	1994	1995	1996	1997
Public sector									
State-owned enterprises [1]	7 337	8 453	8 228	7 245	5 924	4 955	4 357	3 847	3 369
Municipal enterprises	0	32	741	542	647	564	481	444	265
State Treasury commercial companies [2, 3]		248	376	1 075	1 374	1 746	2 023	2 230	2 056
of which: With 100 per cent state shareholding		..	..	530	638	876	1 032	941	644
Commercial companies owned by state entities [3]	1 224	1 135	909	3 908	4 250	4 432	4 697	5 129	5 226
of which: With 100 per cent state shareholding		..	..	594	635	672	842	967	1 074
Commercial companies owned by local authorities		0	0	0	19	1 125	1 219	1 339	1 594
Private sector									
Domestic commercial companies	15 252	33 239	47 690	58 218	66 391	69 284	74 299	98 758	106 743
Joint ventures	429	1 645	4 796	10 131	15 167	19 737	24 086	28 622	32 942
Small and medium-sized foreign companies [4]	841	862	787	686	647	587	548	535	518
Individual entrepreneurs (thousands)	813	1 135	1 420	1 630	1 609	1 713	1 693	1 950	2 090
Co-operatives and co-operative banks	16 691	18 575	18 949	19 372	19 746	19 816	19 822	19 868	19 775

1. Governed by the 1981 law on state enterprises (as subsequently amended).
2. Governed by the Commercial Code.
3. From 1992, a different methodology is used.
4. Main form of foreign investment prior to transition. Some of those were subsequently transformed into joint ventures and some closed down.

Source: Central Statistical Office.

Table 11. **Sectoral employment shares**

In per cent

	Share in total employment		Share of private employment in the sector	
	1993	1996	1993	1996
Agriculture	26.6	28.1	94.9	97.8
Fishing	0.1	0.1	20.0	39.1
Industry	24.6	24.3	40.7	55.2
of which:				
Mining and quarrying	2.7	2.2	1.9	3.3
Manufacturing	20.2	20.4	49.2	64.9
Electricity, gas, water supply	1.7	1.7	2.5	4.5
Construction	6.0	5.6	69.6	84.5
Trade and repair	13.4	12.3	92.7	94.9
Hotels and catering	1.2	1.2	83.1	84.0
Transport, storage and communication	5.6	5.4	27.6	28.8
Financial intermediation	1.5	1.8	33.9	38.6
Real estate and business activities	3.9	3.8	57.9	65.4
Public administration and defense	2.3	2.6	0.1	0.2
Education	5.9	5.9	2.5	3.4
Health and social work	6.7	6.5	5.5	4.5
Other municipal services	2.3	2.4	56.6	60.7
Total	**100.0**	**100.0**	**58.9**	**65.1**

Source: Central Statistical Office.

The privatisation of large enterprises is typically preceded by their commercialisation, and therefore called ''indirect''. So far, this type of ownership transfer has mainly concerned manufacturing companies, but it has also started to encompass infrastructure firms, notably with the sale of a controlling stake in a power plant to a foreign investor in 1997.[54] When a strategic investor is sought (as opposed to flotation in a public offering), the selection takes into account not only the price offered, but also development plans for the company and social and environmental commitments. The proportion of stock offered to investors varies, but in accordance with the 1996 Law up to 15 per cent can be reserved for free distribution to qualifying employees,[55] which in some cases represents a large sum per capita. Moreover, at least 10 per cent has to be set aside for social security reform (see below),[56] and another 5 per cent for restitution purposes (see below). The State can retain control over the privatised enterprise by keeping

Table 12. **The many tracks of ownership transfer**

	1990	1991	1992	1993	1994	1995	1996	1997
Number of enterprises (end-period stock)								
Commercialisation[1]								
Started	58	308	480	636	845	1 075	1 229	1 269
Completed through:								
Capital privatisation[2]	6	27	51	96	132	159	183	227
of which:								
Public offerings[3]	5	11	12	15	22	27	28	37
Trade sales	1	16	39	81	110	132	152	165
Written tenders (sealed bids)	0	0	0	0	0	0	3	25
NIF-programme (mass privatisation)[4]	0	0	0	0	0	321	512	512
Debt-equity swaps (under the law on financial restructuring)[5]	0	0	0	0	60	90	115	130
Direct privatisation								
Started	31	449	719	917	1 042	1 149	1 319	1 489
of which: Through leasing	24	339	557	672	736	788	869	968
Completed	0	182	475	707	945	1 054	1 244	1 423
Liquidations (under the law on state-owned enterprises)								
Started	18	540	857	1 082	1 245	1 358	1 405	1 420
Completed	0	19	86	186	303	396	564	675
Bankruptcies (under the Bankruptcy Law)	..	..	314	634	814	1 045	1 559	..
Liquidation of agricultural enterprises	0	0	720	1 338	1 645	1 654	1 654	1 654
Income from privatisation (flows into the state budget, in Zl million)								
Total	..	171	484	780	1 595	2 642	3 749	6 538
Leasing and sale of liquidated assets	..	46	172	287	323	406	973	359
Capital privatisation	..	125	309	439	847	1 714	1 945	3 254
Privatisation of banks	0	0	4	54	425	521	831	2 925

1. Also referred to as corporatisation.
2. Also referred to as indirect privatisation. The State typically retains ownership of a portion of the shares.
3. Often combined with direct sales to strategic investors, but nonetheless recorded as public offerings.
4. Some of the enterprises have been floated or declared bankrupt in 1996-97, and therefore appear in other lines of the table as well.
5. Sometimes combined with capital privatisation.

Source: Ministry of Privatisation, Ministry of Finance, Central Statistical Office.

enough of the stock or by assigning a special status to the stocks it continues to hold (preferential voting rights). The 1996 Law does not stipulate any deadlines for the completion of privatisation. The pace of commercialisation and privatisation thus depends on governmental policy priorities and market conditions.

Smaller firms rather tend to undergo direct privatisation, which in two thirds of the cases involves leasing to the employees. The 1996 Law, however, specifies

that if the company's size exceeds a certain threshold,[57] its privatisation through this route requires the approval by the Council of Ministers, which is not automatically granted. While some control over the disposal of state assets by a government agency is necessary, this provision is overly time-consuming and distracts the attention of the higher levels of state authority from genuinely strategic issues. The new government is reportedly reconsidering it.

The implementation of the mass privatisation programme (MPP) saw an unexpectedly high participation rate, with 96.1 per cent of the population retrieving their share certificates in the year to November 1996.[58] Their transformation into electronic book entries was initiated in June 1996, and as of mid-January 1998, 69 per cent of the total stock had been thus transformed. Trading of the certificates on the Warsaw Stock Exchange (WSE) commenced in July 1996. In May 1997, the certificates started to be converted into national investment fund (NIF) shares, which began to be quoted on the WSE shortly thereafter. By early 1998, 42 per cent of the certificates held in electronic form had been converted into NIF shares (certificates can be converted until the end of 1998).

Holdings of certificates and NIF shares have become more concentrated over time, even if they remain widely dispersed. Likewise, a process of consolidation has started in the NIF portfolios. Initially, each of the 15 NIFs had been allocated shares in all of the 512 companies included in the programme: for each company one NIF was assigned a 33 per cent stake and all the others a total of 27 per cent (of the remainder of the shares, 15 per cent were reserved for employees and 25 per cent retained by the State). The NIFs have started to consolidate their minority stakes, but until the end of 1998 are legally prevented from increasing their stake in those companies in which they were assigned a leading role. This restriction, reflecting the legislator's wish to ensure a sufficient degree of portfolio diversification, has caused bitter complaints on the part of some NIF managers. The State's shares are to be used in due course for pension system reform.

The NIFs have so far focused their attention on the larger or more promising companies in their portfolios. They have thus acted as active shareholders in only about one tenth of the firms, helping them raise fresh money from banks or on the WSE, assisting them in restructuring their existing debts via rescheduling, sale of liabilities and debt-equity swaps, or engaging bankruptcy procedures. By the end of 1997, 10 MPP companies had been floated on the WSE and 9 on the newly

created over-the-counter market, 8 admitted for public trading but not yet quoted, 84 sold to strategic investors and 19 declared bankrupt.[59] In the process, some differentiation is emerging across NIFs. Some tend to become highly diversified and to withdraw from corporate governance activities. Others adopt more of a venture capital fund profile, or strive to become more specialised in certain sectors, and thereby play much more of an active shareholder role.

Another privatisation path has involved the conversion of debt into equity, which has been conducted in the framework of the 1993 Law on financial restructuring.[60] Straight debt-equity swaps have been rare so far, having encompassed only 6 firms by the end of 1997. Debt conversions carried out as part of bank conciliation proceedings have been more common, covering 143 enterprises.

Two additional routes explicitly couple restructuring and privatisation. One is the programme ''Privatisation through Restructuring'', which invites management groups to submit restructuring proposals for specific companies. It offers managers a claim on the firm tied to the latter's performance. This ambitious and sophisticated scheme has thus far not been applied on a large scale, with only a handful of such management contracts signed up to 1996 and only 10 under preparation at the end of 1997. The other route is the ''Stabilisation-Restructuring-Privatisation'' programme launched in 1994 and sponsored by the European Bank for Reconstruction and Development (in the form of equity stakes up to $40 million and loans on the same scale). It is meant to strengthen corporate governance in ailing but ultimately viable medium-sized state enterprises through the setting up of special investment companies providing fresh capital and managerial skills. Three such entities have been created and 33 enterprises selected for inclusion in this scheme.

In agriculture, 1 654 former state-owned farms were taken over by a special agency established in 1991 to oversee their restructuring. The bulk of the 3.7 million hectares of associated land transferred to this agency is currently leased out. Despite a slight acceleration in 1997, only one sixth of the land had been sold by the end of last year.

One more privatisation path was to come into being in late 1997, as foreseen in the law on industrial funds that was passed by the previous legislature. This law bore a resemblance to the NIF scheme. It was to cover around one hundred enterprises, notably in heavy industries, with a book value of over Zl 30 billion.

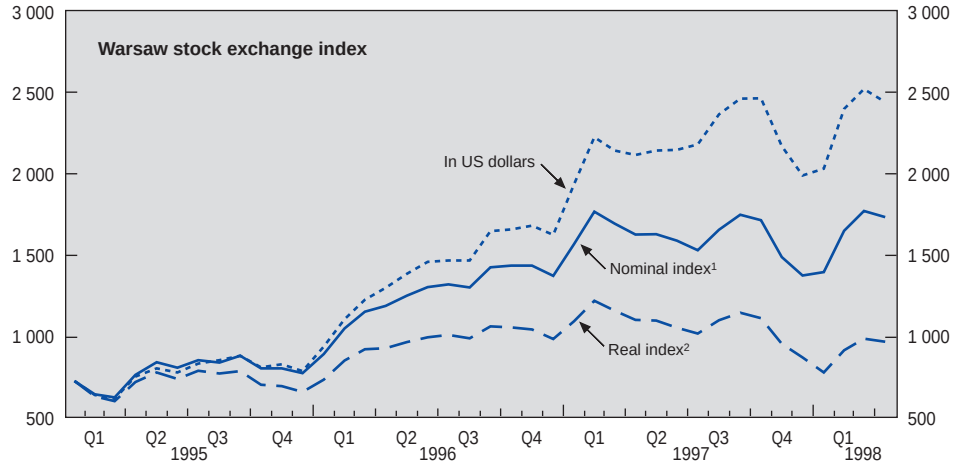
Half of the fund shares would have been distributed to citizens who did not receive free or half-price shares in privatised enterprises (one per person for adults up to 50 and three for older people, who remain in a pay-as-you-go pension regime), with an option to contribute those shares to their social insurance account. The proceeds of the sale of the other half of industrial fund shares would have been used to finance the deficit of the pay-as-you go pension scheme entailed by pension reform. The new government, however, decided not to go ahead with this scheme.

Privatisation speed

Privatisation is an inherently complex process, involving a large-scale redistribution of property and other rights among stakeholders (the state, the local governments, the managers, the employees and the trade unions, the creditors and potential outside investors). It is also intertwined with restructuring, deregulation and demonopolisation, each of which is a challenge on its own. In 1996-97, privatisation was further complicated by the reform of the central government's economic administration, which saw the creation of a Ministry of the Treasury taking over the privatisation responsibilities of the former Ministry of Privatisation and those of the Ministry of Finance (as regards bank privatisation) and certain other ministries and ex-ministries (ministries of communications, transport, industry and foreign economic relations). This new Ministry of the Treasury is also in charge of the supervision of a few hundred large state enterprises. Under its umbrella, an Agency for Privatisation was established, with some delay, to carry out privatisation operations on the request of founding bodies. Over 3 000 smaller companies are supervised by the regional governments, who are in charge of their direct privatisation or liquidation. Adding to the uncertainty generated by the re-organisation of the central bureaucracies involved were the anticipation of a new legal framework and the subsequent lag between the adoption of the 1996 Law and its implementation.

In this context, privatisation along some of the various tracks proceeded more slowly than planned by the government itself in its annual *Privatisation Guidelines*.[61] The number of indirect privatisation operations in particular was more limited than foreseen (24 against 90 in 1996, 44 against 120 in 1997).[62] Privatisation by the regional governments has also been slow in some cases,[63] although on the whole the number of direct privatisations came closer to what

Figure 10. **STOCK PRICES**



1. 16 April 1991 = 100.
2. Deflated by CPI.

Source: OECD.

was envisaged in the *Guidelines*. On the other hand, privatisation receipts increased considerably, exceeding budgeted amounts by close to 50 per cent both in 1996 and in 1997.[64] The 1997 result was achieved despite the fact that the Polish stock market was much less bullish than in 1996 (Figure 10) and largely reflected two very large operations, which alone generated 46 per cent of last year's privatisation receipts (Bank Handlowy and Polska Miedz).

Further privatisation

The new government made the acceleration of privatisation one of its priorities, on the grounds that it leads to better corporate performance and eases the pressure of budgetary constraints. The fairly ambitious schedule for capital privatisation operations spelled out in the draft *Privatisation Guidelines for 1998* prepared by its predecessor was by and large endorsed by the new government, and some operations were even brought forward or their scope expanded (see Annex III). A distinct emphasis is placed on the sale of large enterprises, some

of which have been slated for privatisation for some time, notably the national airline, the dominant insurer and the national telecommunications operator.

The privatisation programme is linked to the reform of the pension system described in Chapter IV, since the transition from the current pay-as-you-go arrangement to a multi-pillar one is to be largely financed by using the assets that are still in state hands. A law came into effect in December 1997 allowing the use of the proceeds from privatisation for this purpose and providing for the issuance of state bonds convertible into public sector enterprise shares in case the proceeds in a given year are insufficient to finance the fiscal gap associated with pension reform. At the same time, the latter will increase demand for the shares of the privatised companies.

In addition, the new Minister of the Treasury has tabled a so-called enfranchisement programme. As of May 1998, the concept being discussed within the Ministry was as follows.[65] Special investment corporations would be set up, based on shares of Treasury-owned companies slated for privatisation within three years. The corporations' shares would be floated on the WSE and the proceeds from their sale would be transferred to a National Enfranchisement Fund. This fund would issue vouchers, to be distributed to citizens deemed not to have benefited from privatisation yet. The fate of this concept, however, remains in doubt.

In another recent development, a new programme of regional investment funds is starting to be implemented. The shareholders in those funds are the voivods, contributing in kind with state-owned enterprise property, and financial institutions, which are expected to bring fresh capital. Four such funds are to be established soon.

Two other schemes are still pending, involving compensation through privatisation. One, dubbed re-privatisation, or restitution, pertains to the compensation for those whose property was confiscated under communist rule in violation of the laws in force at the time, and for those whose property was located in the territories annexed by the Soviet Union after the Second World War, or for their heirs. Poland is now one of the very few central European countries where no restitution law has yet been passed, leading a number of former owners to seek redress in court. A draft law, akin to the one submitted to Parliament in 1993 but not passed due to the Sejm's dissolution, is expected to be ready soon. It envisages restitution in kind wherever feasible, and otherwise in the form of

substitute property (*e.g.* municipal apartments or parcels of state-owned forests) or tradeable certificates exchangeable for state-held company shares. The state liabilities in this regard are hard to quantify, but tentative official estimates made in late 1997 were as high as Zl 83 billion.[66]

The other scheme pertains to the payment of certain wage and pension arrears. The Constitutional Tribunal having ruled against the incomplete indexation in 1991-92 of public sector employee wages and the suppression of certain pension bonuses, the Ministry of the Treasury is to distribute compensation certificates to those who were affected. On current plans, those certificates would be exchangeable for company shares set aside for this purpose by the State in capital privatisation. About 2.5 million public sector employees and 1.2 million pensioners are concerned, and the State's liability on this account is considerable, amounting to around Zl 13.5 billion at the end of 1997.

Corporate performance, management and restructuring in public sector enterprises

Size and performance of the public sector

Poland still counts a myriad of public enterprises (Table 10) representing a large share of employment (Table 11). In industry, 45 per cent of the labour force was employed in public enterprises at the end of 1996. As of the start of 1998, the share of private entities in sectors such as mail, mining, fuels, power generation, defence industry, heavy chemicals, telecommunications, air and rail transportation, sugar, spirits, and insurance was still very limited or altogether non-existent. The State still owned a press distributor, road transport companies, distilleries and other firms which clearly fall outside the perimeter of any definition of the activities that should remain under government control. No comprehensive valuation of the assets remaining in state hands has been carried out, but the Ministry of the Treasury has published the following partial estimates: assets as of end-1996 included Zl 86.4 billion of shares in companies wholly owned by the Treasury, Zl 9.7 billion of shares in firms it partly owns, Zl 32.9 billion belonging to government organs (other than the Ministry of Defence), Zl 14.3 billion entrusted to agencies (notably the State Treasury's Agricultural Assets Agency), Zl 1.0 billion in leased assets, and Zl 616.1 billion in land.[67]

On the whole, performance has been distinctly inferior in public sector enterprises, dragging down economy-wide measures of success. While public sector firms received an overwhelming share of subsidies, gross and net profitability ratios have improved in the private sector since 1995 and deteriorated in the public sector, with mining posting the worst degradation.[68] In 1996, investment in the private sector increased twice as rapidly as in the public sector and in 1997, investment in the private sector soared by over 50 per cent in real terms even as it was stagnating in the public sector. To some extent, the performance gap *vis-à-vis* the private sector may be attributed to the fact that in a number of branches privatisation has tended to start with the more profitable enterprises, although some empirical studies conclude that such a selection bias is not present (Frydman *et al.*, 1997).[69] It may also stem from inherited liabilities, burdening some traditional heavy industries but not the newly created private firms. At the same time, relative wages are intriguingly high in many of the least profitable public enterprises, and spending priorities are not always geared to restructuring imperatives.[70] The issue thus arises of the effectiveness of corporate governance in public sector enterprises.

Governance arrangements

Public sector enterprises are of two sorts. The first one is state-owned enterprises (SOEs). They are ruled by a 1981 Law, which has been amended on numerous occasions but still fails to ensure effective governance. In the case of big enterprises deemed of strategic importance for the national economy, the owner's responsibilities now lie with the Ministry of the Treasury. For smaller firms, they are vested with regional governments, who thus oversee some 3 200 enterprises, of which almost half are engaged in some type of winding-up process. The number of SOEs is too large for the national or sub-national governments to be in a position to properly monitor all of them. Moreover, SOE managers are legally subordinated to the firm's workers' council. SOE governance is therefore overly influenced by insiders, making it difficult to achieve the necessary degree of wage restraint (Grosfeld and Nivet, 1997) and *a fortiori* to push through painful restructuring decisions. As regards wages, penalties are applicable to managers of poorly performing firms granting wage increases above the ceiling set by the Trilateral Commission but in practice such sanctions do not seem very dissuasive. One important reason is that in a number of cases the

remuneration of managers is set as a function of the average wage in the firm rather than of its performance.

The second type of public enterprises is commercialised companies owned by the State. Commercialisation, also referred to as corporatisation, is the transformation of an SOE into a joint-stock or limited company. This procedure precludes direct privatisation and therefore concerns the larger SOEs. The Ministry of the Treasury has more restricted powers over those companies, which are regulated by the Commercial Code. It appoints supervisory board, and in rare cases management board, members but it has little direct influence over everyday management decisions. Its role is essentially confined to approving companies' by-laws and statutes, approving annual financial statements, and endorsing profit distribution schemes. Supervisory board members, including since the 1996 Law those chosen by the company's workers, are required to have passed a special qualifying exam. Those who are appointed by the Ministry of the Treasury can in principle be dismissed without justification by the Minister. Wage setting patterns and problems are analogous to those encountered in SOEs.

While this general characterisation of absentee State ownership holds for many public enterprises, it is not valid in the case of some of the very large ones, where government representatives and politicians tend to become actively involved. Notorious examples would include the Ursus tractor factory in Warsaw or the Gdansk shipyard.

Ursus has thus far failed to successfully restructure, despite massive financial support from the budget, notably in the form of two cancellations of tax and social contribution arrears. Notwithstanding large-scale debt relief, totalling around Zl 750 million, the enterprise remains highly indebted. The first write-off took place in 1994, under a 1934 Law on judicial settlement procedures. The second one was carried out at the end of 1997, under the Law on financial restructuring, and was accompanied by the commercialisation of Ursus and some management changes. As of early 1998, restructuring plans reportedly involved the sell-off of some of the plants' receivables, the issuance of convertible bonds, the concentration of production on a smaller site and the leasing of the vacated premises. No agreement had been reached, however, on the modalities of privatisation: the firm favoured the transfer of the bulk of the shares to an employee-run company, while the government advocated the sale to an outside and possibly foreign strategic investor, who might be in a better position to inject

Box 1. **Ursus and Ursus S.A.**

In 1993, an employee-run company, Ursus S.A., was set up within Ursus, taking over free of charge the assets used to produce spare parts, which are in higher demand than new tractors, as well as the social assets (such as holiday homes and health care facilities). Ursus S.A. is de facto managed by the trade union; it employs some 600 workers and has started to generate a profit and to pay out dividends, unlike the parent company. Such arrangements are not uncommon in large Polish state enterprises.

new capital. Pressures have also recently been mounting for increased tariff protection on tractor parts and used tractors and government-subsidised credits for the purchase of Ursus equipment.[71]

The Gdansk shipyard is another instance of a large entity, employing several thousands of workers, where the lack of decisive restructuring measures early on and the intrusion of political considerations have needlessly put off the firm's resurrection.[72] The shipyard was declared bankrupt in August 1996 and its management assigned to a trustee. A few ships are still being produced, but the fate of the shipyard remained uncertain as of early 1998, although several potential buyers had come forward.

A feature common to a number of the larger distressed firms, particularly in heavy industry, is the build-up of arrears on taxes and social contributions even as those firms benefit from tax relief and subsidies of various sorts (Table 13).[73] At the end of 1997, a mere 19 firms thus accounted for over one third of the economy-wide arrears on social contributions. The scale of this problem was disquieting enough for the government to decide in early 1998 to set up a comprehensive monitoring system that would track the direct and indirect forms of financial assistance provided by the State to individual enterprises. A list of the largest debtors was to be prepared and published quarterly.

Sectoral and regional programmes

Although the State is not micro-managing the bulk of the public enterprises, it has put forward a host of sectoral programmes, including in particular for coal mining and steel, which have a bearing on their corporate governance.

Table 13. **Selected debtors to the State**[1]

Arrears and aid, in Zl million, as of end-1997

Enterprise	Producing	Arrears on[2]			State aid received from[3]	
		Taxes	Social contributions	Environmental fines	Tax offices	Ministry of Finance
Polskie Gornictwo Naftowe i Gazownictwo	Oil and gas	230.7	0.0	0.0	103.6	67.6
Zaklady Przemyslu Ciagnikowego Ursus	Tractors	34.6	160.6	0.2	198.5	181.7
Zaklady Koksownicze Przyjazn	Coke	38.8	22.8	0.0	0.0	3.1
Huta Bobrek (in bankruptcy)	Steel	9.0	15.9	29.1	0.0	2.7
Huta Stalowa Wola SA	Steel	6.5	25.9	0.0	74.4	110.9
Huta Batory SA	Steel	21.1	2.0	0.0	0.0	3.0
Zaklady Tworzyw Sztucznych Pronit	Plastics	14.5	13.0	0.0	0.0	4.6
Przedsiebiorstwo Tworzyw Sztucznych Erg, Pustkow	Plastics	13.2	0.0	0.0	15.4	0.7
PZL WSK Swidnik	Aircrafts	16.2	8.1	0.0	14.5	9.9
WSK PZL Mielec	Aircrafts	5.4	17.2	0.0	36.7	34.5
Radomska Wytwornia Telefonow SA	Phones	20.3	0.0	0.0	0.0	2.0
Elekrocieplownia Radom	Power plant	6.6	5.1	0.0	0.3	0.0
Bytomska Spolka Weglowa[4]	Coal	92.5	370.0	0.1	172.5	74.8
Rybnicka Spolka Weglowa	Coal	79.6	320.2	2.2	17.9	105.6
Gliwicka Spolka Weglowa	Coal	16.2	305.2	8.0	55.4	106.3
Katowicki Holding Weglowy	Coal	26.7	280.3	1.1	91.8	166.9
Nadwislanska Spolka Weglowa	Coal	0.0	155.4	149.1	2.7	415.2
Rudzka Spolka Weglowa	Coal	13.9	217.1	3.4	40.8	95.7
Jastrzebska Spolka Weglowa	Coal	0.0	78.4	0.0	67.0	355.2

1. Firms in the list discussed in February 1998 by the Economic Committee of the Council of Ministers.
2. Arrears on dividends are not shown.
3. Received over the period 1991-97.
4. In addition, this firm received Zl 140 million in other forms of assistance under the law on the financial restructuring of coal mining.

Source: *Rzeczpospolita*, 6 February 1998; KERM.

The situation in the hard coal industry, which as described in the previous Survey was already dismal in 1995, has deteriorated since. Production remained broadly unchanged in 1996-97 (instead of falling in line with the governmental programme), and losses increased. In 1997, the volume exported rose by 6 per cent even as the average margin on exports stood at a staggering –14 per cent. With domestic prices exceeding international levels, imports (mostly from the Czech Republic and Siberia) rose significantly, from 1.2 million tonnes in 1995 to 3.2 million in 1997.[74] Inventories increased, from 2.8 to 5.4 million tonnes in the two years ending in December 1997 (summing those held by producers and by trading companies). At the same time, wages in coal mining kept rising at about the same pace as in the overall economy.

The restructuring programme approved in 1996 by the government and by Parliament (after no fewer than 17 versions had been discussed) outlined a gradual and heavily subsidised adjustment path but has so far remained largely theoretical. Although employment in coal mines did fall by over 5 per cent last year, heavily loss-making pits continued to operate. Coal interests had a draft bill presented in the Sejm in mid-1997 deferring until 2000 the industry's repayment of its (huge) arrears on social contributions and environmental fees and fines, granting it substantial subsidies and introducing a hefty surcharge on the price of coal earmarked for a new extra-budgetary fund which was to finance some restructuring operations, and for the Upper Silesian Fund, to promote job creation. This law was passed in August but in December the new Parliament postponed the introduction of the surcharge by one year. The new government's intentions in this area were unveiled in mid-April 1998. A new and bolder restructuring plan was proposed, involving a 30 per cent reduction in employment by 2000, mainly through generous early retirement provisions and grants for miners willing to quit to set up their own business (those incentives would apply to miners working underground but not to administrative employees nor to workers in companies attached to mines). The plan also foresees large-scale debt relief. Under the plan, 24 pits would be closed and total output would fall to 114 million tonnes in 2000, *i.e.* by 17 per cent compared to 1997. Moreover, wages in the mining sector would be frozen in real terms until 2002. The government was furthermore considering the privatisation of some of the most profitable mines.

The steel sector shows more signs of progress. State-of-the-art technologies are now in place in a number of steel mills: 60 per cent of capacity now relies on continuous casting, against 8 per cent in the early 1990s. At the same time, employment shrank from 147 000 to 90 000. The number of loss-making firms has declined, even though the finances of many continue to be strained, as attested by significant arrears on taxes and social contributions. The authorities' steel sector recovery programme involves financial assistance but also, importantly, protection against import competition.[75] While the original schedule agreed with the European Commission had import duties drop from 9 per cent in 1996 to 6 per cent in 1997, 3 per cent in 1998, and zero in 1999, Poland invoked the restructuring clause of Article 28 of the Europe Agreement to postpone the lowering of trade barriers, and the 1996 rate was maintained in 1997.[76] In early 1998, the import duty was lowered to 6 per cent. A restructuring programme is currently under preparation, which is to be discussed with the European Commission during the spring.

Another type of programme launched by the State to foster restructuring and private sector development against adverse local odds has been the creation of special economic zones (SEZ) granting investors generous tax holidays and other advantages. Those incentives vary from one zone to the next but typically include total corporate income tax relief for 10 years, followed by a 50 per cent relief for another 10 years, thus extending beyond what could be described as initial assistance. The first SEZ was set up in Mielec in 1995, and 16 others in as many different regions have been created since. The proliferation of SEZs tends to undermine the central government's tax revenue base and in the fall of 1997, the government somewhat restricted the scope of the tax exemptions offered. The munificence of the concessions granted in some of the zones seems to exceed what European Union competition rules would allow.

Assessment

The dynamism and performance of private enterprises over the past few years contrast starkly with the more mixed, and sometimes outright dismal, record of public firms, especially in heavy industry. The best way to prevent an aggravation of this dualism is to accelerate privatisation, as the new government intends to do. Transferring ownership in a reasonably fair and efficient fashion is

by no means a trivial task, as illustrated by the shortcomings of the rush privatisations carried out in some other transition countries. Divestiture can and should indeed help to reduce Poland's large open and hidden public debt burden, meaning that the modalities of privatisation should be designed so as to maximise the receipts thereof, which may take some time. However, this concern should not become a pretext for multi-year delays, all the more so as the Polish experience so far suggests that delays tend to be accompanied by a deterioration in the situation of the firms waiting for privatisation. There is also a risk that some of the novel but as yet incompletely spelled out schemes put forward by the new government would result in the postponement of some privatisation operations. Fresh, private capital, be it of domestic or foreign origin, urgently needs to be injected in many of those firms, and will contribute to their restructuring more effectively than limited budgetary funds or other forms of government protection, such as trade barriers.

However, even if the pace of privatisation is stepped up, the problem remains of how to manage the numerous enterprises that for the time being are still controlled by the State. Thus far, governance arrangements in those firms have often been woefully lacking. In many cases, the State has not had the means or the will to exercise its ownership rights effectively, notably with respect to the setting of workers' and managers' remuneration, but also as regards the payment of taxes and social contributions. As discussed in Chapter V, wage determination in public enterprises needs to be made a function of performance, and managers ought to be made more tangibly accountable of the decisions they take or endorse. Since last fall, the Ministry of the Treasury has focused less on those incentive problems than on merging public firms or setting up holdings, with the declared aim to increase the value of the property to be privatised by realising latent economies of scale and scope. This strategy has met strong resistance on the part of some of the more profitable firms involved, which do not want to end up subsidising weaker ones. It may indeed retard privatisation and restructuring rather than create value where private investors would otherwise have failed to do. Meanwhile, the Ministry of Economy has worked on new plans for the restructuring of several heavy industries, including steel and coal. It will be essential to ensure that this time the infusion of public money be strictly and credibly conditional on genuine and decisive adjustment efforts.

IV. Pension reform

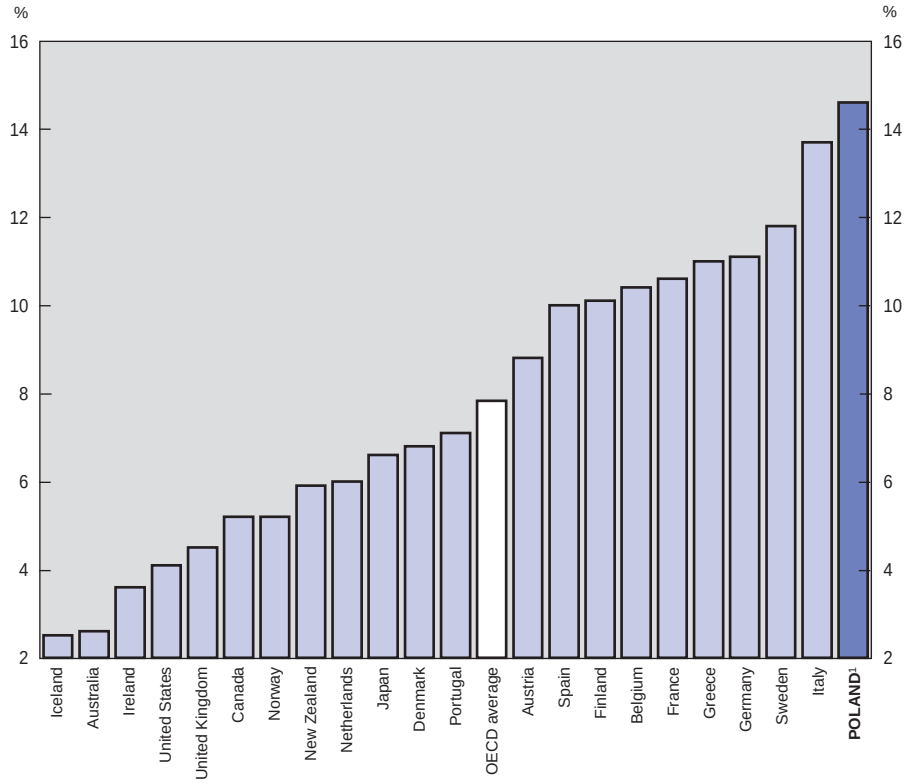
Pension outlays soared during the early 1990s. As a result, Poland now ranks among the countries with the heaviest current pension burden (Figure 11). Altogether, old-age, disability and survivor pensions represent close to 16 per cent of GDP, or one third of total general government expenditure.

This disquieting trend reflects the generous indexation of pensions and the large-scale recourse to early retirement and disability pensions to contain a surge in open unemployment in the early 1990s (Figure 12). In the absence of reforms, the share of pensions in GDP is projected to rise even more, since on current rules the ratio of contributors to beneficiaries is bound to deteriorate further over the next few decades. As in many other OECD countries, and even though its level is somewhat lower, the elderly dependency ratio is projected to rise steeply when the baby boom generation starts to retire, from 17 per cent in 1997 to 23 per cent in 2020 and 35 per cent in 2050 (Figure 13).

Pension reform has been high on the government's list of priorities in recent years, and public opinion polls show a general awareness that it is urgently needed. Some changes were introduced, most notably as regards indexation. Fundamental reform was long debated but started in earnest only with the creation, in October 1996, of a new agency, the Office of the Government Plenipotentiary for Social Security Reform.[77] The latter prepared a comprehensive blueprint for the overhaul of the pension system, taking into account the various proposals that had already been tabled. The diagnosis underlying the blueprint and the broad features of the proposed reforms met general approval. A set of bills was prepared, three of which were passed in 1997, with support from across the political spectrum. Several more bills are currently under consideration.

This chapter starts with an overview of the main features and problems of the pension system, comparing Poland with other OECD countries. Next, the

Figure 11. **PUBLIC PENSION EXPENDITURE**
1995, per cent of GDP



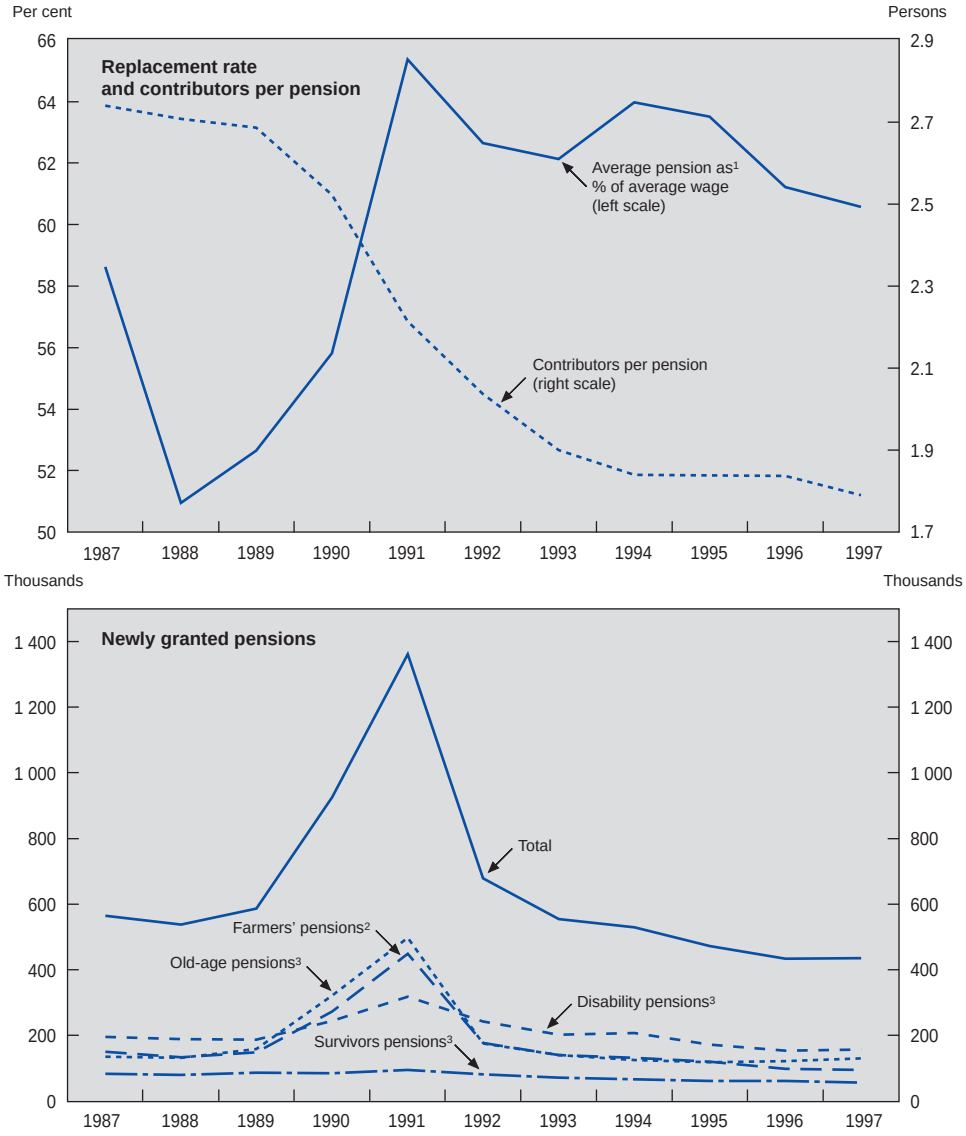
1. The ratio for Poland excludes pensions paid directly from the budget.
Source: Roseveare *et al.* (1996); Polish Ministry of Finance; Ministero del Tesoro, Ragioneria generale dello Stato, February 1997; Greek Social Security budget.

characteristics of the new system are presented. A number of momentous challenges still lie ahead, which are discussed in the last section.

The current system

The Polish public pension system is an unfunded, pay-as-you-go scheme with quasi-universal coverage for employees, self-employed and farmers. As in

Figure 12. **FACTORS UNDERLYING PENSION EXPENDITURES**

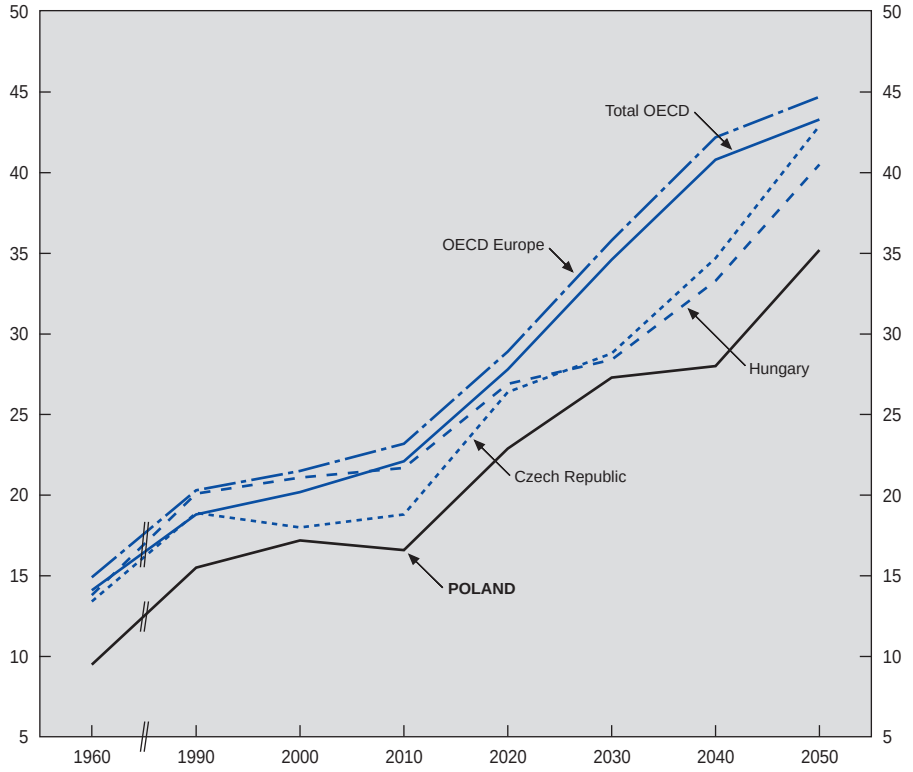


1. Retirement, disability and survivor pensions combined (uniformed service and farmer pensions excluded). Pensions and wages in net terms through 1991 and in gross terms since.
2. Paid by KRUS.
3. ZUS pensions.

Source: Central Statistical Office and Social Insurance Board.

Figure 13. **ELDERLY DEPENDENCY RATIOS**[1]

Per cent



1. Population aged 65 and over as a per cent of working age population (all persons 15-64 years of age).
Source: United Nations, *World Population Prospects 1955-2050* (1996 revision).

many OECD countries, it is segmented, combining basic state pensions with mandatory occupational ones. These are defined-benefit schemes, *i.e.* benefits are not directly related to previous contributions but determined according to some fixed rules which may differ across sectoral affiliations and professions. For example, teachers and railway employees are subject to special rules, farmers have their own system, and the military are paid pensions directly from the budget.

The standard age of entitlement to public pensions is not strikingly low in Poland, at 60 for women and 65 for men (Table 14), but there are many exceptions, notably for sectors such as mining, railways, aviation, navigation, education, journalism and the arts.[78] Moreover, until recently, the system offered individuals access to pensions up to five years earlier provided that they had contributed for a sufficient number of years (25 for women and 30 for men). As a result, the average retirement age in 1997 stood at only 59 years for men and 55 for women, much below the OECD average of 62 for men and 61 for women.

Table 14. **Standard age of entitlement to public old-age pensions**

1995

	Males	Females
Australia	65	60
Austria	65	60
Belgium	60	60
Canada	65	65
Czech Republic	60	53-57
Denmark	67	67
Finland	65	65
France	60	60
Germany	65	65
Greece	62	57
Hungary	60	56
Iceland	67	67
Ireland	66	66
Italy	62	57
Japan	60	58
Korea	60	60
Luxembourg	65	65
Mexico	65	65
Netherlands	65	65
New Zealand	62	62
Norway	67	67
Poland	**65**	**60**
Portugal	65	62.5
Spain	65	65
Sweden	65	65
Switzerland	65	62
Turkey	46-60	41-55
United Kingdom	65	60
United States	65	65

Source: US Department of Health and Human Services, *Social Security Programs throughout the World*, various issues.

As from 1998, however, early retirement provisions have been significantly restricted (with the termination of this option for workers dismissed by public enterprises and longer seniority requirements).

Pensioners are allowed to work. The pension is reduced if they earn more than 60 per cent of the average wage, and benefits are suspended if earnings exceed 120 per cent of the average wage.[79] It is estimated that at least 30 per cent of old-age and disability pensioners remain legally employed (Wiktorow, 1996). In addition, some 3 per cent of the population aged over 60 is estimated to work in the shadow economy (Kalaska *et al.*, 1996).

Non-farmer old-age pensions are managed by the Social Insurance Board (ZUS) and paid through the Social Insurance Fund (FUS). Employers contribute 45 per cent of wage and related earnings (gross of the personal income tax), while employees do not contribute.[80] The scheme is heavily supported by the state budget, to the tune of Zl 7.2 billion (1.6 per cent of GDP) in 1997. Farmers' pensions are paid through the Farmers Social Insurance Fund (KRUS), overwhelmingly financed by the state budget and only marginally from farmers' contributions. In 1997, government transfers to KRUS totalled Zl 9.5 billion, accounting for 94 per cent of KRUS outlays. In principle, farmers contribute a flat and modest 30 per cent of the minimum pension, but in practice compliance is very low. Schemes for the military, police and prison personnel are financed from the state budget. They offer eligibility to an old-age pension after only 15 years of service, with a benefit starting at 40 per cent of the last remuneration received, which increases with additional years of service and is indexed on wages in those professions.

The level of the average old-age pension peaked at over 76 per cent of the average wage in 1991, far above the levels typically observed in other OECD countries. To reduce this rate somewhat, an adjustment factor was introduced in the pension formula in 1993 (see Box 2). The calculation base was also gradually lengthened. Furthermore, the indexation base was shifted from wages to prices in September 1996. As a result, the replacement ratio declined, reaching 70 per cent in 1997. By international standards, it is still at a very high level (Figure 14).[81] Pensions are currently re-valued quarterly if the pensioners' cost-of-living index is up by at least 5 per cent by comparison with the quarter when it was last revised. In 1997, average real pensions rose by almost 5 per cent.[82] A more

Box 2. **The old-age pension formula**

The formula for the basic pension (both for regular and early retirement) is:

$P = 0.24\lambda W + (0.013T + 0.007N)B$

where:

P = monthly pension
λ = set at 0.91 in 1993 and gradually increased since, to 0.97 from March 1998
W = average, gross, economy-wide, monthly wage in relevant quarter
T = total years of contributions
N = other eligible years
B = individual assessment base

The old-age pension is split into three parts:

- A flat component, equal to 24 per cent of the reference wage, adjusted by a moderating coefficient (λ).
- An earnings-related component, equal to 1.3 per cent of the applicant's assessment base for each year of contributions paid.
- A supplement of 0.7 per cent of the applicant's assessment base for each year of non-contribution during the 40 year career. Other eligible years (*e.g.* for bringing up children) may not exceed one third of contribution years.

The individual assessment base equals average monthly earnings over a period as indexed for inflation. In 1993, the employee chose the best three consecutive years from the last 12 years; each year since, one year is added to the averaging period, until in 2000 it reaches 10 years from the last 20. The pay in a chosen year is compared to the average wage in the government sector for that year. The resulting ratio, capped at 250 per cent, is multiplied by the indexed figure for economy-wide earnings to derive the notional salary entering the averaging process.

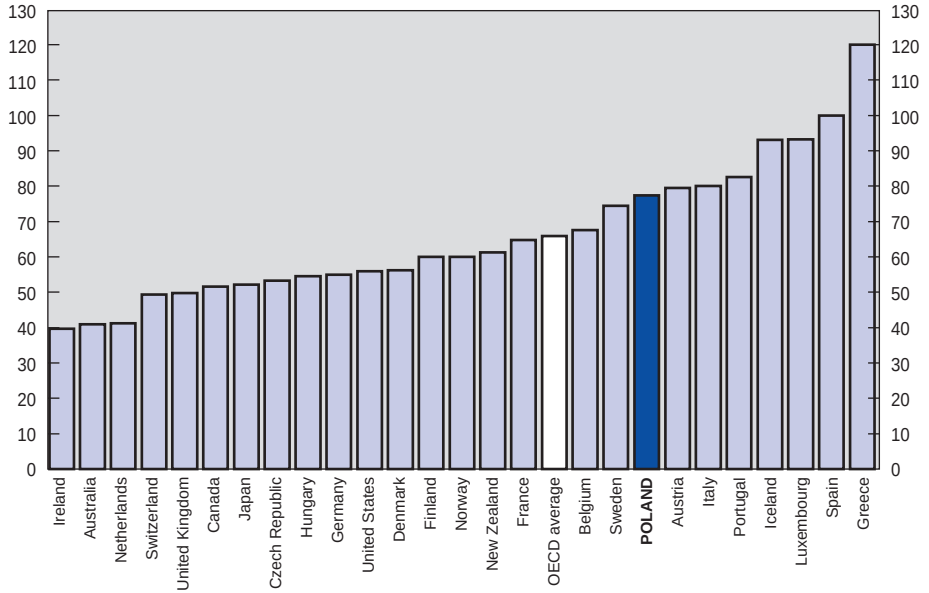
The minimum pension stood at Zl 375 in late 1997, which represented 31.7 per cent of the average wage in the fourth quarter. A supplement of 10 per cent of the average wage is payable from age 75 onwards.

modest increase of about 2 per cent is budgeted for 1998. Pensions range from 32 to around 160 per cent of the average wage.

The pension system also covers disability and survivor benefits. The share of disability pensioners in the total number of pensioners doubled during the first half of the 1990s, not for health reasons but because disability certification was widely used to limit the increase in registered unemployment when the rules

Figure 14. **EXPECTED OLD-AGE PENSION GROSS REPLACEMENT RATES**[1]

1995, per cent

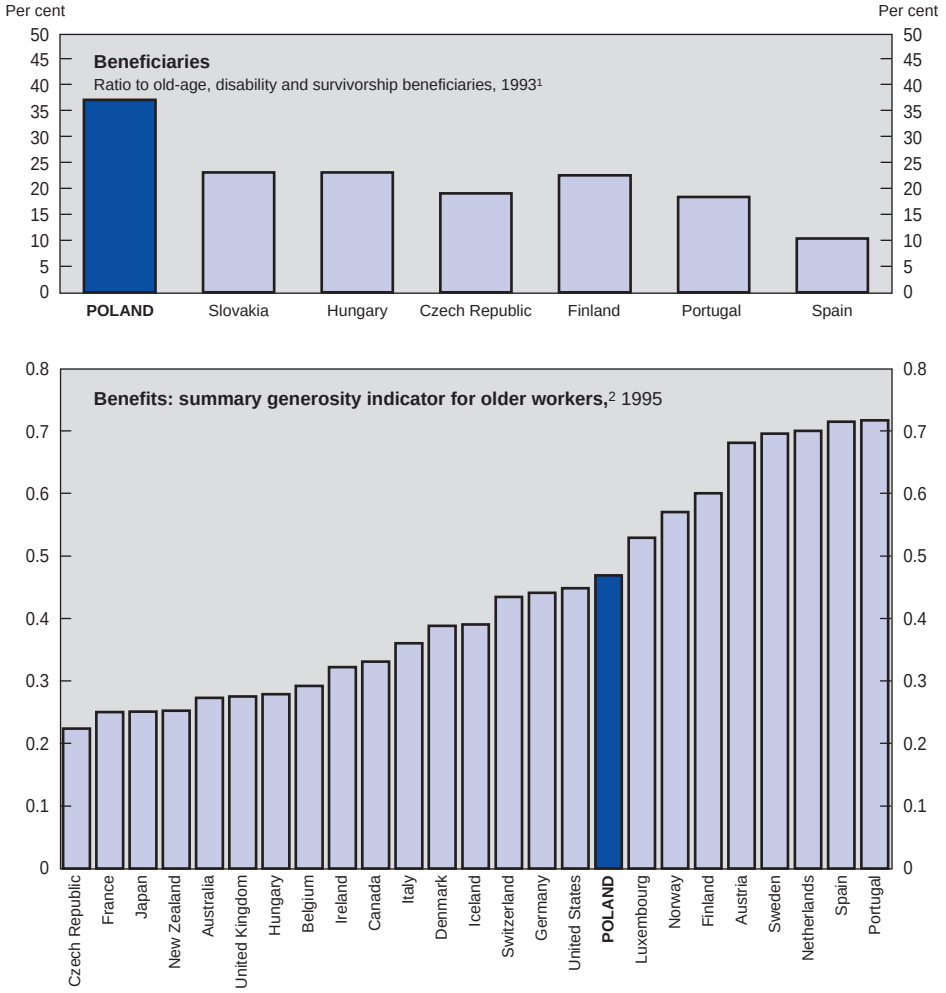


1. Pre-tax replacement rate that a 55-year old worker can expect if he were to continue to work until standard retirement age. The replacement rates are averages of four cases: two earnings levels (*i.e.* average and two-thirds of average) and two household compositions (*i.e.* single and a worker with a dependent spouse). For all cases it is assumed that the employee starts work at the age of 20 and that he has uninterrupted work until the standard age of entitlement to public pensions. The earnings profile over the working life is assumed to be flat and earnings revalued in line with changes in average earnings. The reported rates cover basic pensions, means-tested supplements and mandatory occupational pensions only.

Source: Secretariat calculations.

precluded granting a regular or early old-age pension. This share is now among the highest world-wide (Figure 15, top panel). Disability benefits are paid on a pay-as-you-go basis. A minimum contribution payment period of one year of work for persons under age 20 to 5 years of work for persons over 30 is required and disability must have arisen during the qualifying employment period or within the next 18 months. Two degrees of disability are distinguished, depending on whether the person is deemed totally or partially incapacitated. Overall,

Figure 15. **DISABILITY PENSIONS**



1. Data for Finland, Portugal and Spain are for 1995.
2. The generosity indicators are averages of six cases: two earnings levels and three household compositions. For each case, replacement rates are calculated for each year in the 55-64 year age range, and the annual average derived. This implies that schemes which become available only at a relatively late stage in this period take a low value as the annual replacement rate is zero until benefits can be accessed. The main assumptions behind the calculations are the same as for the calculation of the old-age pension replacement ratio: the employee works uninterruptedly from age 20 to age 55, and the real earnings profile over the working life is assumed to be flat. In the case of disability benefits, the replacement rates refer to 100 per cent disability.

Source: Andrews and Mansoora (1996), Secretariat calculations.

disability benefits are distinctly more generous than in the Czech Republic, Hungary and a number of other OECD countries (Figure 15, bottom panel).[83] The medical criteria conditioning the right to receive a disability pension have recently been tightened, however.

Survivor benefits are payable to a spouse aged over 50 for women or 65 for men, or disabled, or caring for children. The pension amounts to 70 per cent of the disability pension the deceased would have been entitled to upon death, plus another 5 per cent for each additional survivor (with a maximum of 85 per cent). A minimum survivor's pension is provided for, equal to the old-age minimum pension.

Reforming the system

The Plenipotentiary Office prepared a comprehensive pension reform plan which was presented by the government to Parliament in June 1997 in a report entitled *Security through Diversity*. This section outlines the key features of the new system proposed in this blueprint. Some of them, however, may be amended in the course of parliamentary debate.

The main objective of pension reform is to ensure the financial sustainability of the system in the long run given the foreseeable demographic pressures and the likelihood that growth will not indefinitely remain as buoyant as it has been in recent years. To achieve this, the current pay-as-you-go system is to be replaced by a multi-pillar and partly funded one providing more diversified sources of retirement income. The first pillar involves a mandatory pay-as-you-go scheme with a direct and transparent link between contributions and benefits. The second and entirely new, funded, pillar consists of pension funds. The third pillar encompasses all voluntary additional forms of saving for retirement; it has already started to develop as the awareness grew that current arrangements cannot guarantee sufficient old-age income, but would be encouraged further. The shift to the new system is to take place gradually, over several decades. It would not concern those born before 1948.

The first pillar

The first pillar would encompass the first tier of old-age pensions. It would be based on the principle of a notional defined contribution plan (pioneered in Sweden). Individual accounts are to be opened by ZUS for working-age citizens below 50. Employer and employee contributions would be credited to those accounts, with interest paid equal to the growth of the economy-wide wage bill or somewhat less.[84] Capital accumulation would be notional since the contributions would in effect be paid out to current pensioners rather than invested, and since this capital is not bequeathable. The size of the pension would be determined when the individual retires as his notional capital divided by the average, population-wide life expectancy at his age.[85] The pension would then be indexed so that it does not decrease in real terms, but at a rate no higher than the growth of the wage bill. A demographic reserve would be created to absorb the effect of short-run fluctuations in the size of cohorts of contributors and beneficiaries. These arrangements would pertain to all of those who are currently covered by ZUS. They would not concern the farmers, who would remain under the umbrella of KRUS, but include the military, police, and other uniformed services.[86]

Originally, the minimum retirement age was set at 62 years for both men and women, offering a strong financial incentive to continue working beyond that age. Indeed, under this system, and in stark contrast to the existing rules, the replacement ratio was to rise very steeply between ages 62 and 70.[87] However, the government decided in early 1998 not to change the pensionable age, and to keep it at 60 for women and 65 for men. Should this be approved by Parliament, it would result in much lower pensions for women and perpetuate adverse labour market selection effects.

The second pillar

The most prominent change in Poland's pension reform is the creation of private pension funds. One fifth of the current 45 per cent ZUS contribution would be channelled to those funds, still via ZUS, but with the latter acting as a transfer agent. All of the 9 percentage points would be counted as the employee's contribution. As for the first pillar, contributions would be levied on earnings up to at most 250 per cent of the average salary, which would encourage the hiring of more qualified personnel and stimulate the third pillar. Also like in the first

pillar, contributions would not be subjected to income taxation (nor would the pension funds' investment earnings) but benefits would.

The employee would notify his choice of pension fund to ZUS (or, by default, be randomly assigned one) and would be allowed to switch funds without penalty after a minimum enrolment spell of two years. Pension fund managers would make investment decisions but the assets would be held by an independent depository, which would be either the National Securities Depository or a bank with assets of at least ECU 100 million. Portfolio composition (quality of the assets, diversification) would be strictly regulated.[88] A minimum relative rate of return would be guaranteed, to be financed by a special reserve.[89] A new body, the Pension Fund Supervision Office (UNFE), would closely monitor the activities of fund managers. The latter would be paid from the fund's assets, with the monthly management fee limited to 0.05 per cent of total asset value. The only other fee would be a percentage commission on contributions, which would be lower for long-standing participants. Pension funds would regularly have to send detailed information on the funds' composition and performance to their participants and to the UNFE.

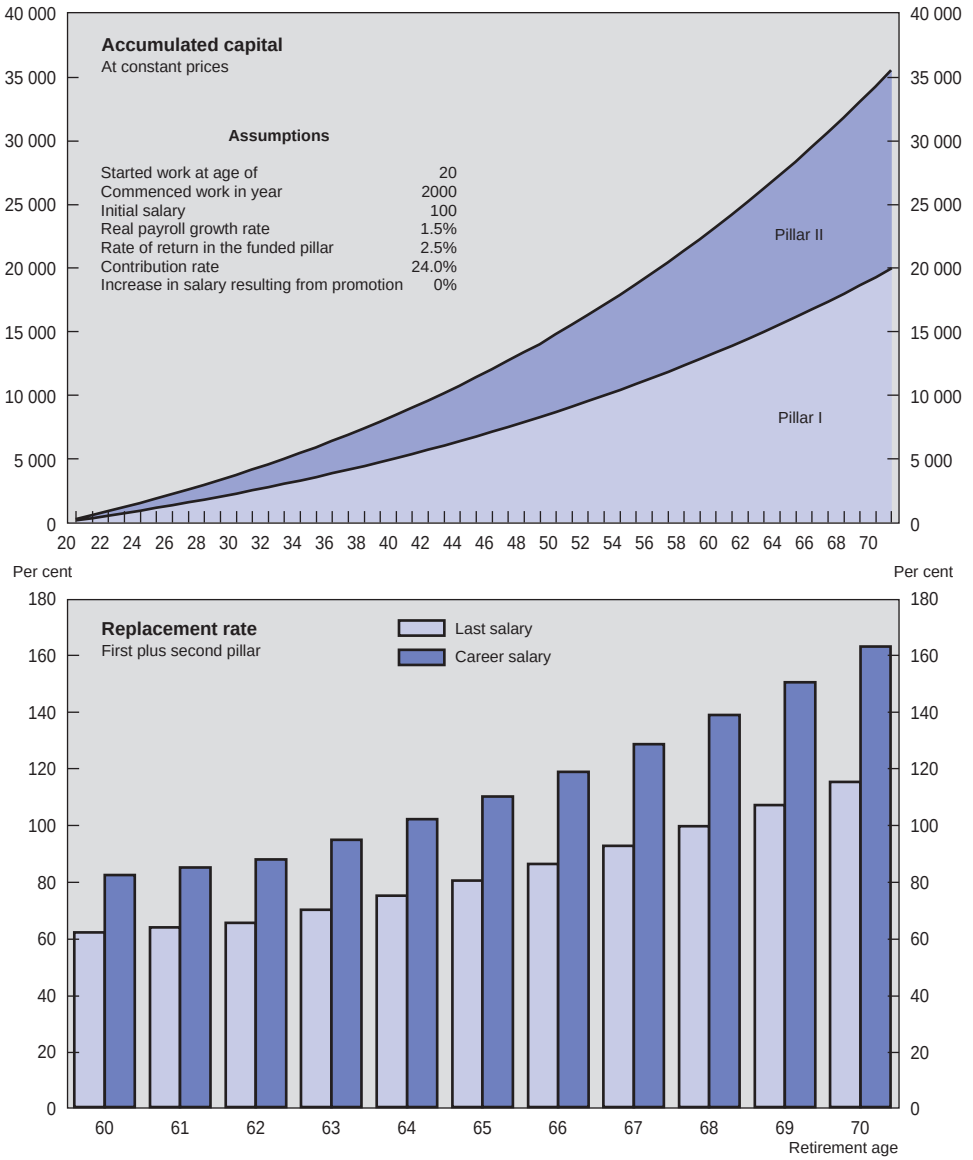
Upon retirement, the employee would have to use the accumulated capital to purchase a life annuity from a specialised, licensed insurance company with a sufficiently large paid-in share capital. Such companies would not start to operate, however, before the first participants in pension funds had approached the minimum retirement age (*i.e.* around 2010). They would be subjected to investment limits even stricter than those presently applying to insurance firms. The Insurance Guarantee Fund would cover the full payment of benefits were such an insurer to go bankrupt.

Like that of the first pillar, the design of the second pillar encourages later retirement. Indeed, illustrative simulations show that a few years make a very large difference to the overall – first plus second pillar – replacement rate (Figure 16).

For perhaps one tenth of the population, the pension rights accrued in the first and second pillars would not be sufficient to provide a decent retirement income. The shortfall would be covered from the state budget, which would guarantee a minimum pension to all, subject to age (65) and years of service (25) conditions. This minimum would equal Zl 415 in 1999 (*i.e.* a bit below 30 per

Figure 16. **ACCUMULATION OF PENSION RIGHTS AND REPLACEMENT RATE ILLUSTRATIVE SIMULATION**

First and second pillar



Source: Security Through Diversity.

cent of the projected average wage), and would subsequently be indexed like the regular old-age pensions. Some redistributional function would thus be retained.

The third pillar

The third pillar would include all additional, voluntary forms of retirement savings. As attested by the boom of life insurance in recent years, it is already expanding dynamically (Box 3). Another common form of saving consists of employee pension programmes organised on an enterprise or sectoral basis,[90] which can provide individuals with coverage on more favourable conditions than what they would have been able to obtain on their own. The rules applicable to employee pension funds are similar to but less stringent than those governing the second pillar, open pension funds: they have to be registered by the UNFE but their investment policy is freer and there is no required minimum return.

The tax regime for the third pillar is the opposite of the one applying to the first two pillars, taxation being front-loaded. This apparently contrasts with the

Box 3. **The life insurance boom**

The emergence of the third pillar is already visible in Poland as life insurance has been developing rapidly. Households invested some Zl 4 billion in life insurance in 1997, 47 per cent more than in 1996. Currently, about 2 million citizens have a life insurance. Net profits of life insurance companies increased by 80 per cent in 1997, reaching Zl 213 million.

The state-owned company PZU, which enjoyed a monopoly in the insurance market until 1990, is still in a strong position, accounting for 69 per cent of the market in 1997. The second largest player is Commercial Union (16 per cent), followed by Amplico Life (9 per cent) and Nationale Nederlanden (5 per cent). However, these market shares do not reflect recent entries into the insurance market. In 1997, new partnerships with foreign insurance firms were established, including between Germany's Allianz and Bank Gospodarki Zywnosciowej, America's Cigna and STU, and France's CNP Assurances and Polisa.* Moreover, banks are starting to produce and distribute retirement income products.

* In Hungary, foreign-held equity in the insurance sector stood at 65 per cent at the end of 1996. By that token, foreign presence is still limited in Poland.

rules prevailing in a number of OECD countries, where investments in life insurance for instance is (partly) tax deductible. In many cases, however, those countries have only one pillar besides the mandatory state pension. Another reason for up-front taxation is the fiscal impact of the diversion of contributions to the pension funds, which leaves little room for back-loading of tax receipts over and above that which is provided for in the first two pillars. Some fiscal incentive would nonetheless be offered up-front, in the form of an exemption from ZUS contributions of up to 7 per cent of the employee's income invested in an employee pension plan.

Supervision of third pillar institutions is entrusted to a variety of bodies, including the General Inspectorate for Banking Supervision, the Securities and Exchange Commission, the State Insurance Supervision Office, and the UNFE, depending on the form of savings.

From here to there

The shift to the multi-pillar system would start in January 1999 but its completion would require several decades. The baseline scenario envisaged by the Plenipotentiary Office is as follows. The first pillar arrangements would not be altered for those aged over 50 in 1999, nor for those benefiting from special pension schemes having worked long enough to be entitled to retirement (or to approach this threshold). The new first pillar rules would apply to all the other workers, meaning that some would lose their special early retirement rights. The switch to the second pillar would be optional for those already working in 1999,[91] and involves the transfer to the individual's pension fund account of one fifth of the rights accrued under the old system (based on the old pension formula). All of those under 30 in 1999 would be covered, and it is assumed a considerable proportion of those aged between 30 and 50 in 1999 would opt to join. Those entering the labour force from 1999 would automatically be enrolled in the second pillar.

The costs of the reform are hard to evaluate with any precision but would clearly be substantial. Some are to be incurred once-and-for-all, such as the outlays needed for the computerisation of ZUS accounts (which approach 0.2 per cent of 1998 GDP).[92] Others are of a recurrent nature. The loss in contributions associated with the cap of 250 per cent of the average salary would amount to some 0.4 per cent of GDP. Most importantly, the shift to the second pillar would

cost around 0.7 per cent of GDP in the early years and rise to twice as much over the next 15 years under the baseline scenario. This shift in effect makes explicit the heretofore implicit pension debt (*i.e.* the debt bequeathed by present generations to their descendants). This hidden debt is estimated by the Plenipotentiary Office to exceed 200 per cent of current annual GDP, which by international standards, and even taking into account the considerable uncertainty surrounding such estimates, is very large.[93]

Part of those costs would be offset by the rationalisation of the first pillar, in particular by the aforementioned increase in the minimum retirement age and by prohibiting early retirement for disabled persons and work for all early retirees. However, those gains would materialise only gradually. Over the next few years, therefore, another source of financing is called for. As mentioned in Chapter III, a substantial portion of privatisation receipts would be used for this purpose. In order to avoid pension reform being impeded by possible privatisation delays, the State would be empowered to issue convertible bonds redeemable with the shares held by the State in enterprises undergoing privatisation. The creation of the second pillar would boost demand for equity and thus facilitate the acceleration of privatisation.

Assessment

Three of the core pension reform laws were passed last year. The first one concerns the organisation and operation of private pension funds, the second one regulates employee pension programmes and the last one stipulates how privatisation receipts will help finance the reform. Three or four more laws are needed for the new system to start on time in January 1999, including legislation setting out the parameters of the first pillar and determining the minimum retirement age. The drafts of these laws have been sent to Parliament, following consultations with the social partners.

It is hoped that pension reform will improve long-run economic growth prospects by boosting the development of the still rather shallow domestic capital market and increasing Poland's relatively low national saving rate. Pension fund assets in the OECD area average over one third of GDP, suggesting that there is indeed considerable room in Poland for capital market broadening. The incentive changes that the reform would bring about should lead to an increase in the

private saving rate, if cross-country experience is a guide (OECD, 1997*g*). The size of the increase in the private saving rate depends on the parameters of the new system, not all of which are determined as yet. Simulations conducted for a selection of advanced OECD countries suggest that reducing the size of the pay-as-you-go component of the pension system does indeed raise the national saving rate as well as future potential output provided, however, that it is not financed by an increase in the conventionally measured public debt (OECD, 1997*g*). The ultimate impact on the national saving rate also depends on the extent to which individuals are forced or encouraged to participate in the second and third pillars (Bailliu and Reisen, 1997).

Besides the legislative hurdles that still need to be overcome, the logistics of the new system involve a number of challenges. Very immediately, it seems that the necessary computerisation of individual pension records may become a bottleneck that could delay the implementation of the reform. More fundamentally, the overhaul of some of the existing institutions and the creation of a whole set of new ones is fraught with risks, as the experience of Latin America since the early 1980s confirms.[94] The *modus operandi* of the existing, 40 000 person-strong ZUS apparatus has to change rapidly and substantively, in particular with the establishment of a new set of specialised funds dealing, besides pensions, with other types of benefits, and a new split between employer and employee contributions.[95] The law on pension funds tried to take into account the lessons learned in Chile and elsewhere by including provisions aimed at containing administrative and marketing costs. For example, the minimum rate of return requirement and restrictions on investments are less constraining than in other countries, where they have led to rather similar portfolios across funds and hence to competition for customers through the offer of frills that cause excessive switching between funds. Nonetheless, some risks cannot be readily legislated away. In particular, it is crucial that the supervisory authority employ highly qualified staff and be entrusted with a considerable measure of independence. It will have to monitor the nascent pension funds very closely and its readiness to sanction any wrongdoings should at all times remain beyond doubt.

Pushing ahead with pension reform is indispensable well before the dramatic effects of ageing become evident a decade down the road, all the more as the full impact of the changes legislated today can only be felt over time. Delays would worsen the problem and shorten the time available for adjustment. Since

the shift to a multi-pillar set-up brings forward budgetary outlays that would otherwise have materialised much later, some form of non-inflationary financing has to be secured. Accelerated privatisation can and should indeed plug part of the gap, but the value of the assets set aside for this purpose is far from sufficient to cover the implicit debt. Hence, streamlining the existing pay-as-you-go arrangements will play an essential role. Certainly, the unification of regulations within the first pillar offers scope for huge savings and would enhance equity, generate economies of scale, and facilitate the fight against abuse. It will also allow the eventual lowering of overall social contribution rates, thereby improving conditions on the labour market.

V. Implementing the OECD Jobs Strategy

Prior to 1990, unemployment was not officially recorded. Participation in the labour force was high, but labour was grossly misallocated in many ways, as shortages in some sectors or enterprises coexisted with massive hoarding in others (Gora, 1992). As transition to a market economy started in earnest, jobs were eliminated on a vast scale in closing or restructuring firms. Unlike in other transition economies, however, the size of the labour force did not decline. The rate of registered unemployment soared from 2 per cent in early 1990 to almost 17 per cent by mid-1994. It has since been declining steadily, helped by rapid economic growth, down to 10.2 per cent in april 1998.[96]

Unfortunately, this speed of decline in unemployment is not likely to continue. Given the current pace of job creation, the extent of further corporate restructuring that lies ahead, the size of hidden unemployment, especially in rural areas, and prevailing demographic conditions, the rate of unemployment is bound to remain above the OECD average in the foreseeable future.

Against this background, the authorities have launched a number of labour market initiatives. As noted in an early OECD labour market review (OECD, 1993), policies aimed at a reduction in labour supply at first played a prominent role. Since the mid-1990s, however, and as the relevant policy-making institutions accumulated experience, more attention has been paid to the relative costs and benefits of alternative schemes and greater emphasis has been placed on the promotion of labour market flexibility.

The challenge represented by high and persistent unemployment in OECD countries was highlighted in the OECD *Jobs Study*, which set out a broad programme of action.[97] This chapter is one of a series in published *Economic Surveys* dealing with the problem on a country-specific basis.[98] It starts with an overview of Polish labour market and employment performance since the early 1990s. Key aspects of the policies affecting the labour market are then reviewed.

The chapter concludes with an assessment and a discussion of the scope for further action.

Labour market and employment performance[99]

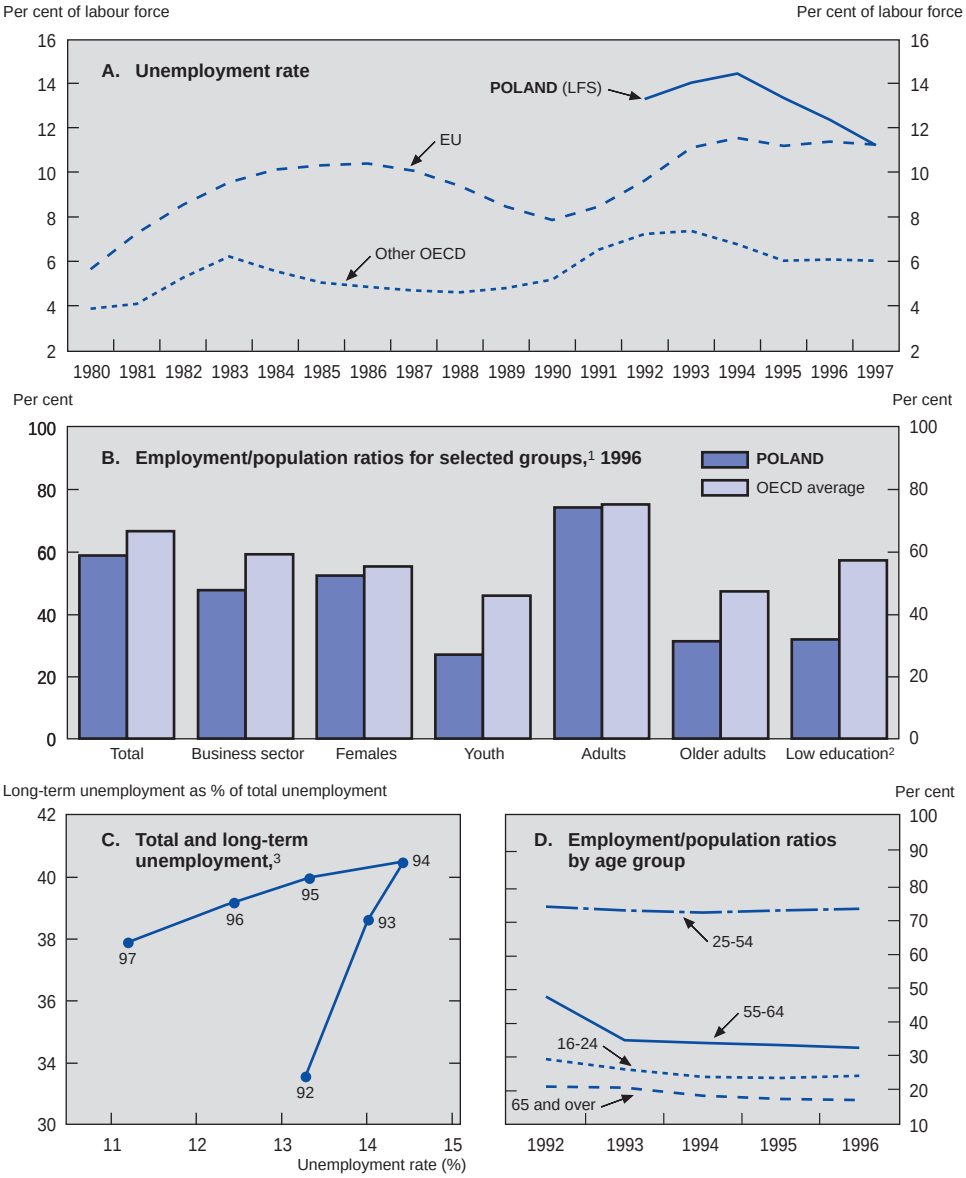
As noted, labour market indicators deteriorated ominously during the first five years of transition (Figure 17). Despite their spectacular overall improvement since, the structure of unemployment continues to display a number of worrisome features. As in many other OECD countries, the incidence of unemployment is higher among the youth, women and the unskilled, the share of long-term and recurrently unemployed is high, and regional variations are quite pronounced.

The rate of youth unemployment (15 to 24 year-olds) rose sharply early in the transition, exceeding the levels observed in most other OECD countries. It has declined since 1994 but less so than for other age groups. In 1997, every fourth youth was unemployed, an incidence 2.2 times above the labour force as a whole – which is not uncommon among OECD countries.

Long-term unemployment (defined as an uninterrupted spell of at least twelve months) peaked at over 40 per cent of total unemployment in 1994, *i.e.* a bit below the levels observed in the other Visegrad countries and in the range typical of some West-European countries, but far above that prevailing in some other OECD countries (United States, Japan). The share of long-term unemployment has dropped since, to around 38 per cent, reflecting higher rates of labour-market turnover and the intensification of flows into and out of unemployment.[100] Very long-term unemployment (two years or more) rose during the first half of the 1990s, approaching 20 per cent of total unemployment in 1995. Its relative importance subsequently declined, however, and is well below the EU average. Recurrent unemployment has become more common: in 1996, two-thirds of the flow of unemployment registrations consisted of persons who had already been registered as such earlier on (Kalaska and Witkowski, 1997).

As emphasised in the previous Survey, labour market conditions vary considerably throughout Poland, partly reflecting structural differences and an uneven speed of transformation. The rate of registered unemployment dropped in all regions between 1994 and 1997, while regional rankings remained relatively stable (Figure 18).[101] Nonetheless, geographical dispersion increased. At the end

Figure 17. **KEY FEATURES OF THE LABOUR MARKET**

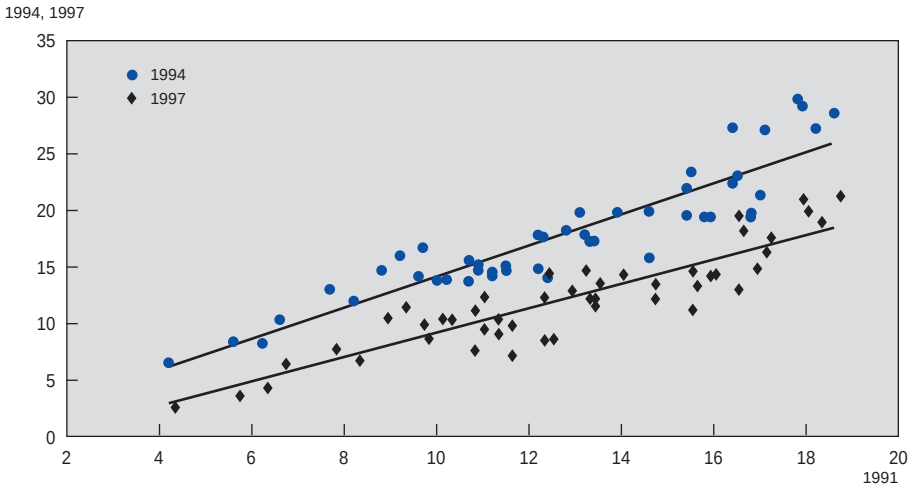


1. Defined as the percentage of each working-age population group.
2. Completed less than upper secondary education.
3. Long-term unemployment is defined as individuals looking for work for one year or more.

Source: *Labour Market Survey,* Central Statistical Office and OECD.

Figure 18. **REGIONAL UNEMPLOYMENT RATES**

Per cent, end-year, per voivodship



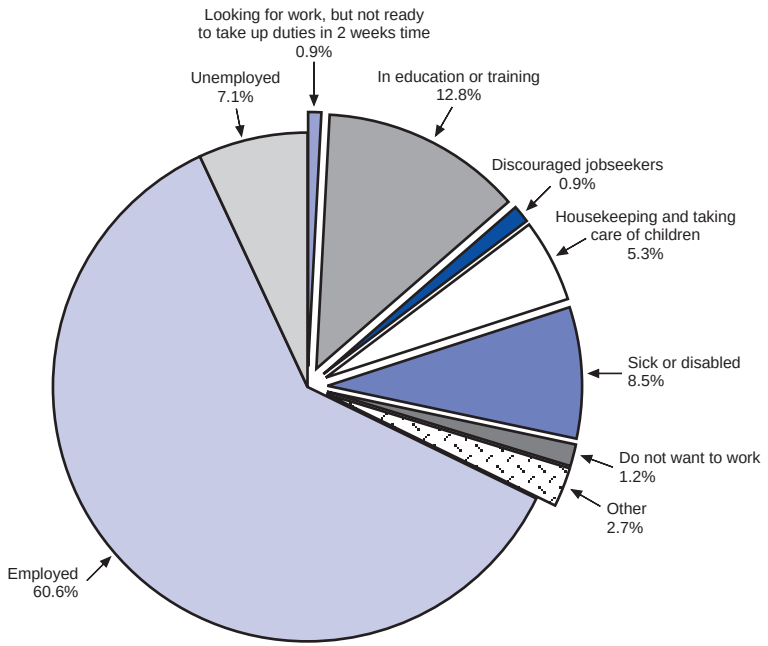
Source: Central Statistical Office.

of 1997, the unemployment rate ranged from 2.8 per cent in the capital to 21.2 per cent in the Suwalki region. The latter is one in a number of rural areas characterised by limited job opportunities outside a struggling agricultural sector, with high hidden unemployment. The high rate of registered unemployment in such regions reflects both a heavy incidence of joblessness and the long duration of unemployment spells.

The market economy in Poland is still young and it is not yet possible to split total unemployment into structural and cyclical components. A measure of ‘‘steady-state’’ unemployment has been proposed, based on observed separation and hiring rates, adjusted for demographic factors (Gora, 1998).[102] In 1996-97, this indicator suggested that the permanent component of unemployment was on the order of 10 per cent of the labour force, thus supporting the view that only limited further declines in unemployment should be expected. The analytical value of such a measure, however, is questionable, as the variables that determine it have not clearly settled down around some equilibrium.

The massive contraction in employment in the first stage of transition resulted in large-scale flows out of the labour force. The problem was compounded by a vigorous demography, with the population of working age on an upward trend of 0.5 per cent per annum. Non-employment rates, which in the late 1980s were very low in Poland and in other central and eastern European countries, rose very rapidly during the first half of the 1990s, reaching or even exceeding the levels observed in many western European countries. The overall participation rate in Poland stands at 67.7 per cent (Figure 19). Youth participation is relatively low. About 1 per cent of the working-age population is unemployed but no longer actively seeking jobs. Part-time work, at around one-tenth

Figure 19. **WORKING AGE POPULATION IN AND AROUND THE LABOUR FORCE**[1]
November 1997



1. Individuals aged 15-59 (women), 15-64 (men).
Source: Central Statistical Office, *Labour Force Survey.*

Box 4. **Hidden unemployment in agriculture**

A 1994 survey conducted by the Central Statistical Office confirmed the widespread perception that a significant number of individuals counted as working on farms are in effect largely unemployed. Depending on the exact criteria used, the redundant workforce in agriculture broadly defined was estimated at 0.45 to 0.69 million people, *i.e.* 12 to 18 per cent of total employment in that sector. The 1996 Agricultural Census included a number of specific questions designed to better quantify this phenomenon. It appeared that between 0.50 and 0.73 million persons were essentially redundant on private farms of over one hectare and that another 0.16 to 0.22 million were in a similar situation on smaller plots. Nonetheless, these individuals are typically treated as employed in the LFS (even when registered as unemployed with the local labour office). Overall, hidden unemployment in private farming was thus estimated to represent 4 to 5 per cent of the economy-wide labour force.

of total employment, is less common than in most OECD countries, and primarily concerns retirees. Work through temporary agencies is not widespread either. Hidden unemployment is extensive and mostly concentrated in farms (Box 4).

The structure of employment by sector is characterised by the very large and rather stable share of agriculture, which narrowly defined accounts for over 27 per cent of the total, against 8 per cent in Hungary, 7 per cent in the Czech Republic and an OECD average of 8 per cent (Table 15).[103] Employment in the service sector has increased uninterruptedly since the onset of transition, and now represents close to half of total employment, against 65 per cent on average in OECD countries. Employment in industry shrank by over one quarter during the early 1990s but has picked up since, although employment in mining continues to decline. Employment in the underground economy was estimated at around 13 per cent of the labour force in the mid-1990s.[104]

Policy requirements

The OECD *Jobs Study* identified a number of policy areas relevant for labour market performance. This section offers a synopsis along those lines. It starts with the most directly relevant dimensions, namely wage formation and

Table 15. **Employment by main sectors**

In thousands, end of the year

	1993	1994	1995	1996
Total	**15 117.5**	**15 281.9**	**15 324.5**	**15 841.9**
Agriculture	**3 938.3**	**4 054.4**	**4 045.9**	**4 371.5**
Agriculture, hunting and forestry	3 922.8	4 039.5	4 032.3	4 358.7
Fishing	15.5	14.9	13.6	12.8
Industry	**4 522.1**	**4 570.0**	**4 556.2**	**4 626.0**
Mining and quarrying	398.8	376.8	357.1	339.1
Manufacturing	2 985.5	3 071.4	3 102.5	3 158.8
Electricity, gas and water supply	257.1	268.8	269.2	259.4
Construction	880.7	853.0	827.4	868.7
Services	**6 657.1**	**6 657.5**	**6 722.4**	**6 844.4**
Trade and repair	1 982.2	1 892.2	1 903.1	1 900.3
Hotels and restaurants	170.1	175.8	185.9	188.0
Transport, storage and communication	823.3	844.2	838.1	832.3
Financial intermediation	221.6	252.1	268.2	285.8
Real estate and business activities	570.6	529.6	554.3	594.4
Public administration and defence[1]	692.9	733.6	737.9	757.0
Education	871.3	893.6	896.4	911.8
Health and social work	989.2	995.7	1 003,4	1 009.6
Other services	335.9	340.7	335.1	365.2

1. Including armed forces.

Source: Central Statistical Office.

labour costs, working-time flexibility and employment protection legislation, taxes and transfers, and active labour market policies. It then moves to a number of other framework conditions which are also important, particularly over the longer term, and include education, product market competition, the entrepreneurial climate, and technology and innovation.

Enhancing the ability to adjust and adapt

Wage formation and labour costs

The institutional framework for wage-setting has evolved considerably since the beginning of the 1990s.[105] The current system of collective bargaining in medium and large public enterprises (defined as employing at least 50 persons) and in the budgetary sphere was codified in 1994. A Tripartite Commission (TC) was set up including representatives of the State, the trade unions and the employers. Each year, the TC has to agree by the end of August on a quarterly

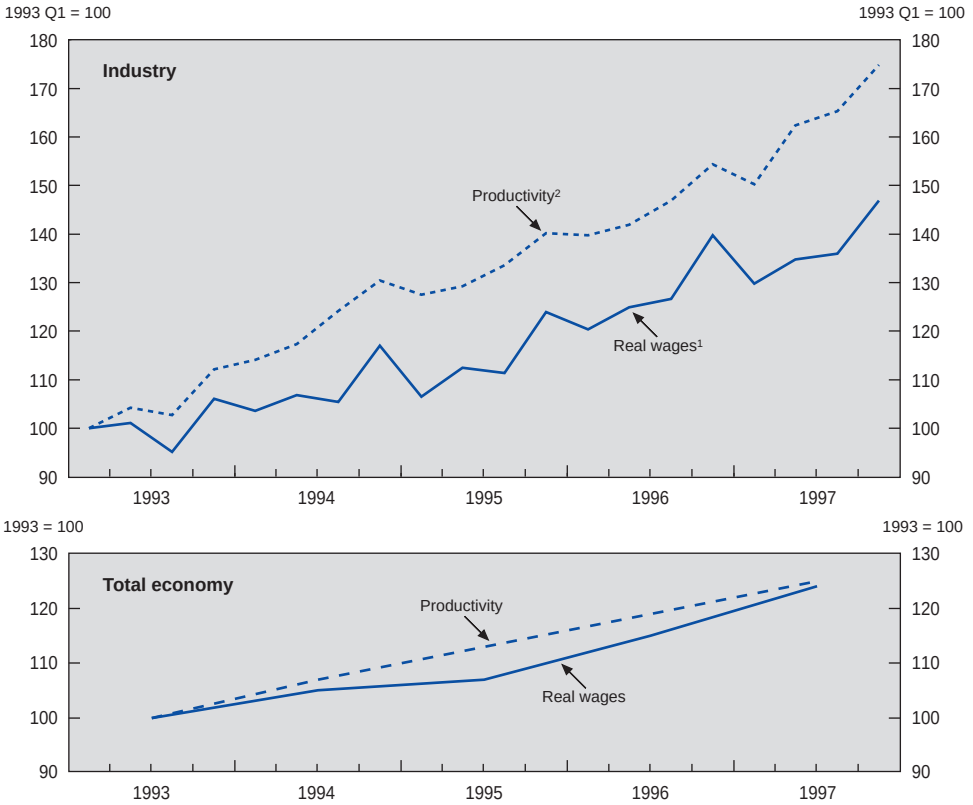
schedule of maximum wage increases for the forthcoming calendar year, taking into account the government's projections for GDP growth, inflation and budgetary wages. If the TC fails to reach an agreement, as was the case in the summer of 1997, the government decides unilaterally. In this context, the government plays a dual role since it is both the largest employer and the arbiter. The norm is not hard and fast: on occasion, it has been revised upwards in the course of the year. If the norm is exceeded in an enterprise displaying poor financial results, its managers can in principle see their bonuses cut or can even be dismissed.

Against this general background, wage bargaining in enterprises takes place mainly at the local or firm level.[106] However, the binding effect of collective agreements reached at the supra-plant level (for 500 000 members or at least 10 per cent of the workers in the sector) may be extended to employees of non-signatory employers by simple administrative procedure. Although this clause has never been formally used, there is a possibility that such a rule would implicitely serve as a co-ordination device in wage-setting. Apart from wages, collective agreements typically cover such aspects as working conditions, social benefits, trade union representation, and dispute resolution procedures.[107]

Despite their rapid increase, real wages have been outpaced by productivity since 1993 (Figure 20),[108] although two periods should be distinguished: in 1994-95, wages lagged productivity, but in 1996-97 they tended to catch up, rising so rapidly as to become a major source of concern. Yet, while average wage growth was perhaps not unduly strong, wages in some sectors and firms rose much more than warranted by productivity developments, reflecting inadequate corporate governance mechanisms (Chapter III). This problem was particularly acute in the coal mining and utilities sectors. At the enterprise level, the wage norm set by the TC appears to have functioned more as a floor than as a ceiling. The sanctions applicable to managers granting excessive wage increases also appear to have lacked dissuasive power. As a result, average wage growth has systematically exceeded the TC's norm.

Wages in the budgetary sphere are more directly under the control of the government and have evolved in accordance with the TC's guidelines. Between 1990 to 1994, they rose less than wages in the enterprise sector, dropping to 83 per cent of the average wage in the latter.[109] They have caught up somewhat since, to 87 per cent of the average in enterprises by 1997.

Figure 20. **REAL WAGES AND PRODUCTIVITY**



1. Gross wage in industry, deflated by the industrial producer price index.
2. Industrial output per employee in industry.

Source: Central Statistical Office.

The minimum wage is negotiated and set periodically by the government, the trade unions and the employers (quarterly until 1996, every semester since).[110] It applies to all employees in the private and public sectors and is not regionally differentiated. Over the last few years the minimum wage has increased at about the same pace as the average wage and only slightly less than the median wage. In 1997, the gross minimum wage stood at 40 per cent of the average wage, which ranks Poland somewhere in the middle of the range observed in OECD

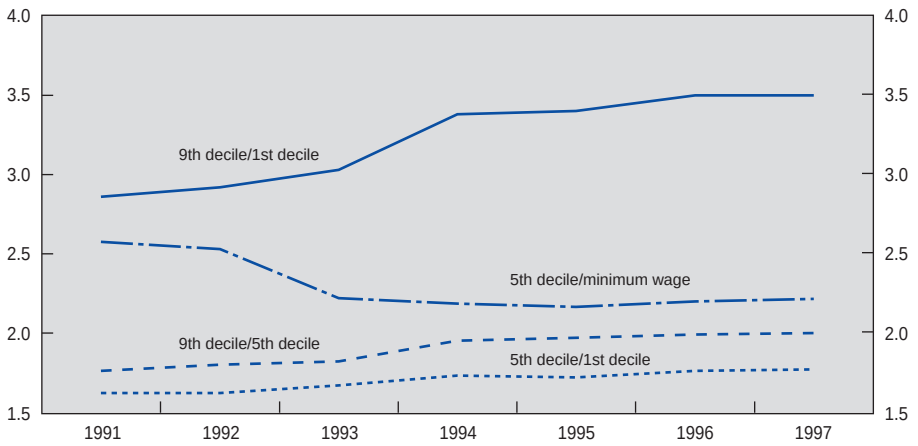
countries but distinctly above Hungary and the Czech Republic.[111] Barely 4 per cent of the employed receive exactly the minimum wage, but a larger fraction earn only slightly more.[112] The share of the low-paid (less than two-thirds of the median wage) approaches 19 per cent (September 1997). It is higher among youth (twice as high as for the 25 to 49-year-olds) and women (1.5 times higher than for men) (Rutkowski, 1997).

The dispersion of earnings now appears to be close to the OECD average. The wage structure in Poland is more compressed than in North America or Hungary, but less than in the Nordic European countries, Germany or the Czech Republic. Measured wage inequality rose markedly during the early transition years but has only marginally increased since 1994 (Figure 21).[113] The relatively smaller wage dispersion in the bottom half of earnings is largely related to minimum wage developments.

Working-time flexibility and employment protection legislation

Polish legislation spells out the following rules for working-time arrangements for full-time employees.[114] Hours should generally be kept within eight per

Figure 21. **EARNINGS DISPERSION**
Ratios, gross earnings



Source: Central Statistical Office, OECD.

day and 42 per week on average, calculated over three months.[115] However, many service sectors are allowed to extend working time up to 12 hours per day, provided that the average does not exceed the legal limit. Shorter working schedules can be negotiated in collective agreements. Work on Sundays and public holidays is allowed provided the employee is paid the overtime premium or granted compensatory leave. Overtime is restricted to 150 hours per year and 4 per day. Unless the employee requests compensatory leave, overtime premia are compulsory (at 50 per cent for the first two hours per day and 100 per cent for subsequent hours). Employees may request one or two days off in order to take care of some personal or family matter. Furthermore, there are 12 public holidays. Statutory requirements for annual leave are relatively generous, at 18 days after one year of employment, 20 after 6 years and 26 after 10 years. Maternity leave is 16 weeks for the first child and 18 weeks for subsequent ones.

In practice, in a given month, three out of four employed persons work over 40 hours per week, and one out of six over 50 hours, with some trend increase since the early 1990s. Over the year, the total number of hours worked, averaging 1 772 in 1996, is not out of line with present standards in other OECD countries but much lower than what was observed in most a few decades ago (*i.e.* when their income per capita equalled that of Poland today). Multiple jobbing is subject to few regulatory limitations and fairly common, concerning over 1.2 million persons in 1996. Although there are few legal restrictions to multiple shifts, single shifts are the rule in most sectors (except where continuous technological processes are involved).[116]

Legal procedures governing individual lay-offs vary depending on the motive and on the nature and length of employment. The normal advance notification period for a possible lay-off ranges from three months for indefinite duration contracts to two weeks for fixed-term contracts but can be shorter if the lay-off is due to economic reasons. In the case of redundancies for personal misbehaviour, the notice can be very short. In all cases, employees are entitled to two or three days of paid time off to look for other employment during the notification period. Managers often enjoy longer dismissal notices and more generous severance pay.

Dismissals are authorised in the event of serious violations of employee responsibilities or for economic reasons (bankruptcy or liquidation of the enterprise or reduction of the labour force). The Labour Code provides broad protec-

tion against unfair dismissals, which entail a right to reinstatement or compensation, at the choice of the employee, as per the decision of the labour court. Typically, the court will expect to see evidence of a prior warning, and gives the employee the opportunity to defend his case. If the trade union considers the dismissal unjustified, it can submit a reservation within a week. The opinion of the trade union is not binding on the employer but failure to take it into account increases the likelihood that the dismissal be declared unfair.

Collective lay-offs are defined as dismissals of at least 10 per cent of a workforce of less than 1 000 persons or at least 100 persons of a larger workforce. The trade union and the local labour office must be given written notice at least 45 days before individual termination notices are given. The reasons for the planned dismissals and the number of employees concerned should be stated. No later than 30 days after notification has been rendered, the employer and the union should enter into a written agreement.[117]

Dismissed employees are entitled to redundancy payments: a severance payment from the employer (one monthly pay for less than 10 years of service, two for 10 to 20 years, three for 20 or more years) and an equalisation bonus from the Labour Fund payable for six months when the salary in the new job is less than that in the old one, with a maximum equal to the average budgetary wage.

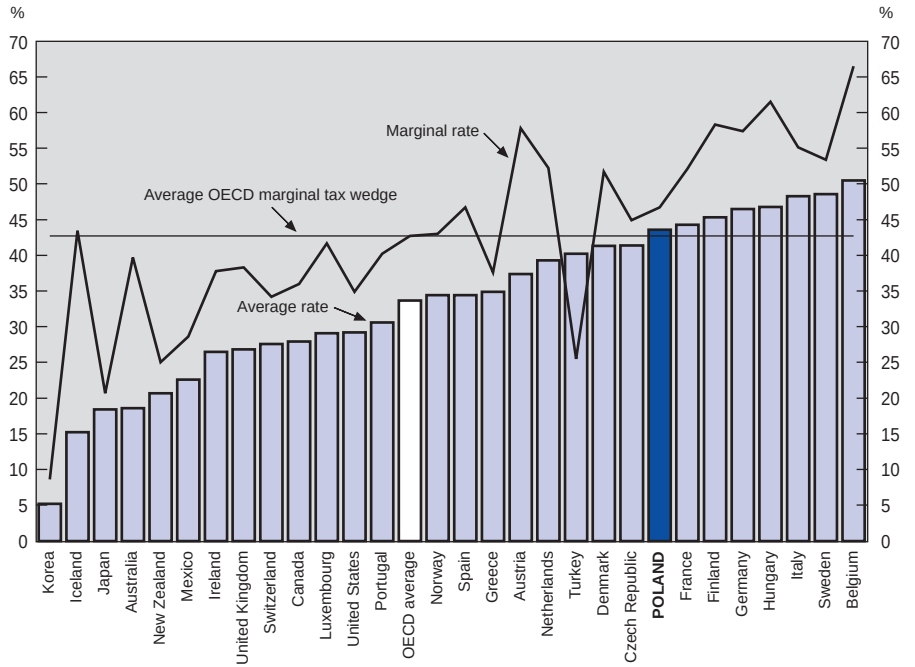
Poland's legislation on fixed-term contracts offers wage-earners an intermediate level of protection compared with other OECD countries. A fixed-term contract can only be renewed twice before being automatically transformed into an indefinite period contract. If the fixed term exceeds 6 months, the contract can be ended earlier on notice. The development of short-term contract employment has been spurred by some of the government employment support programmes and by the dynamic growth of small and medium-sized enterprises.

Taxes and transfers

High taxes on labour tend to either reduce labour demand in the formal sector or reduce labour supply, not least by strengthening incentives to work underground. The OECD *Jobs Study* recommended that, when fiscal conditions permit, taxes on labour should be lowered in order to promote employment. Average and marginal tax wedges in Poland are among the highest in the OECD area (Figure 22), mainly due to the high share of social security contributions, a

Figure 22. **AVERAGE AND MARGINAL TAX WEDGES**[1]

Single person receiving 67% of an average production worker's income



1. Data refer to 1996. The average wedge is the sum of employees' and employers' social security contributions and personal income tax as a percentage of gross labour costs *i.e.* gross wages plus employers' social security contributions. The marginal tax wedge is the percentage of any marginal increase in gross labour costs represented by increased employees' and employers' social security and income tax contributions, following a rise in net wages.

Source: OECD, *The Tax/Benefit Position of Employees.*

feature shared with Hungary and the Czech Republic. Social contributions are paid only by employers, and in general amount to 45 per cent for the social security fund (ZUS), plus 3 per cent for the Labour Fund, plus 0.18 per cent for the Employee Benefits Guarantee Fund (which compensates unpaid workers in closing companies).[118] The basis on which social contributions are levied was broadened in mid-1997 to encompass most types of bonuses and payments in kind alongside the wage *stricto sensu*. Even though contribution rates are lower

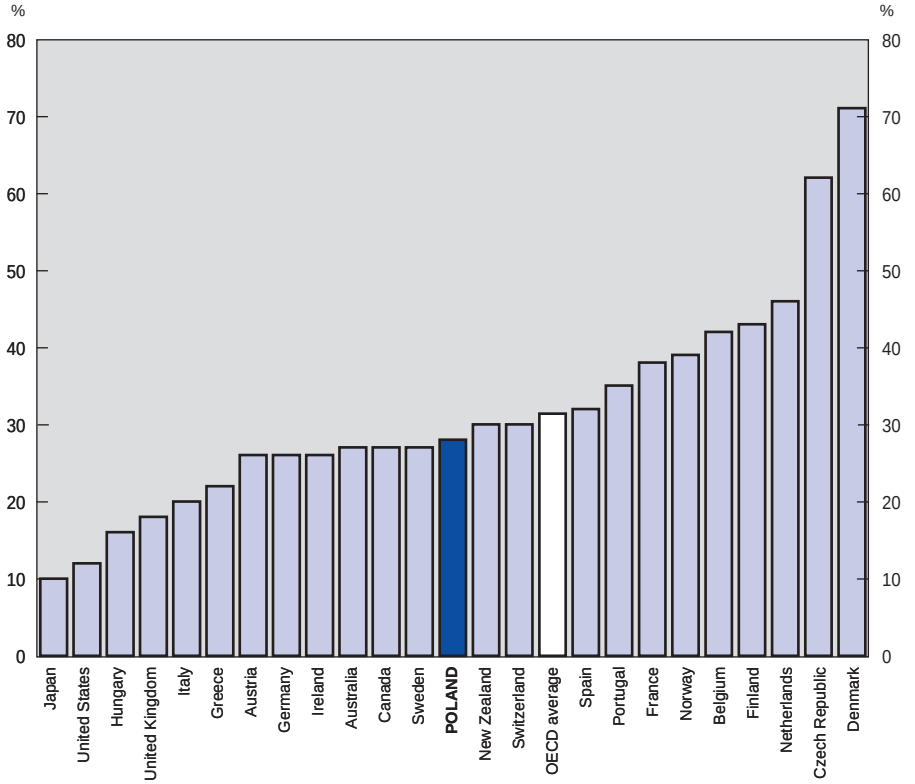
in some cases (agriculture, individual entrepreneurs, some categories of low-wage earners), their avoidance has constituted one of the main motivations for business to be carried out underground.

The personal income tax (PIT) schedule in Poland comprises three brackets. In 1997, income up to Zl 20 868 was taxed at 20 per cent; income between that amount and Zl 41 736 at 32 per cent; and incomes above the latter threshold at 44 per cent. The PIT rates were lowered to 19, 30 and 40 per cent respectively in 1998. The brackets are indexed on past average wage growth.[119] The PIT is withheld by the employer from the monthly pay. Overall, the burden of the PIT is also relatively heavy, despite the exceptions and exemptions (discussed in Chapter II).

Unemployment benefits cushion the fall in income endured by job losers, but when overly generous they can discourage active job search and put upward pressure on wages. The OECD has constructed a summary measure of gross benefit generosity, which takes into account replacement rates and benefit duration for different types of households. The level of this indicator has both across time and countries been associated with higher joblessness (Scarpetta, 1996).[120] Poland on this scale ranks below the OECD average (Figure 23), partly owing to comparatively low unemployment benefits (Boeri and Edwards, 1997). Early retirement, disability or sick pay schemes, when serving as substitutes for unemployment benefits, can have the same effects.

The conditions for receiving unemployment benefits have been restricted considerably since the early 1990s (Puhani, 1996), contributing to the spectacular decrease in the share of benefit recipients among registered jobseekers, from close to 80 per cent in late 1991 to 30 per cent in late 1997, a level well below that observed in most OECD countries.[121] The duration of benefits was capped, eligibility criteria were tightened, more frequent visits to the local labour office were required, the size of the allowance was cut and it was de-linked from past earnings. Further changes were introduced in March 1996, including the replacement of benefits for school-leavers by a stipend conditional on the enrolment in a training programme. Benefits are now paid for 6 to 18 months (6 months in regions where the unemployment rate stands below the national average, 12 months where it exceeds the national average and 18 months where it is more than twice as high and provided the unemployed has an eligibility period of at least 20 years) (Table 16). Benefits are fully indexed on the CPI on a quarterly

Figure 23. **OVERALL INDEX OF BENEFIT GENEROSITY**
1995



Source: OECD Database on Unemployment Benefit Entitlement and Replacement Rates; Boeri and Edwards (1997), Table 5*b*.

basis. They can be collected 7 days after registration in a local labour office (90 days in the event of a voluntary quit). Those who worked less than 5 years receive 80 per cent of the basic benefit and those with a tenure exceeding 20 years are entitled to 120 per cent, the basic benefit equalling 30 per cent of the average wage in 1997. The refusal of a suitable job, training, subsidised job or public work offer entails benefit ineligibility. Under certain circumstances, more lenient provisions apply.[122] A reform of the unemployment benefit system, how-

Table 16. **Selected social benefits**

As of December 1997

Benefit	Level	Duration	Main eligibility criteria	Expenditure in 1997
Unemployment benefit	Flat Zl 340 per month Indexed to CPI quarterly	6 to 18 months	Minimum of 365 days of work during the last 18 months; income below half of the minimum wage; no more than one job offer refusal	Zl 6 381 million
Stipend for school-leavers	The amount of the stipend per day of work equals one-fortieth of the regular unemployment benefit	Up to 12 months	Enrolment in ALP scheme	Zl 7.4 million
Family allowance	Flat rate equal to 7 per cent of the minimum wage, Zl 29 per month for the first two children[1] Indexed annually on CPI	Until child reaches 16 years (or 20 years if at school)	Income per family member below 50 per cent of average wage	Zl 2.5 billion[2]
Maternity allowance	Depends on previous wage	16-26 weeks	Working mothers	Zl 555 million[2]
Child-care allowance	Flat rate Zl 219 per month (Zl 348 per month for single mothers)	For 24-month child care leave	Income per family member below 25 per cent of average wage	Zl 487 million[2]
Sickness allowance	80 per cent of employee's wage	Up to 6 months, extension of 3 months	Unable to work due to illness	Zl 5 011 million[2]
Housing allowance	Average amount Zl 83 per month	Open-ended	Housing expenditures exceed a certain share of income; size of apartment below threshold; income per family member below minimum pension	Zl 647 million
Social assistance	Discretion of social worker, capped at Zl 287; indexed annually on CPI	Discretion of social worker	Income per family member below minimum pension, impossibility to work due to taking care of a disabled child	Zl 264 million
Pensions: Old age	Depends on past earnings and number of insured years; indexation to CPI, minimum of Zl 375 per month	Open-ended	Minimum contribution period 25 years for men and 20 years for women; age: 65 for men, 60 for women (but numerous exceptions)	Zl 27 365 million[2]
Disability	Depends on past earnings and number of insured years; indexation to CPI, minimum of Zl 288 (partial disability) or Zl 375 (total disability) per month	6 months, extension of 3 months with doctor's validation	Damage to health	Zl 16 539 million[2]

Table 16. **Selected social benefits** *(cont.)*

As of December 1997

Benefit	Level	Duration	Main eligibility criteria	Expenditure in 1997
Survivor's	Depends on pension that the deceased would have received if applicable; indexation to CPI, minimum of Zl 375 per month	Children: until age 16 (age 25 for school-goers); widows: open-ended	For children and spouses Entitlement age for widows: 50, for widowers: 65	Zl 8 538 million[2]
Memorandum items:				
Ratio of minimum over average wage (gross), 1997, 40 per cent				
Ratio of minimum over average pension (gross), 1997, 55 per cent				

1. Zl 36 for third child, Zl 45 for the fourth.
2. Excludes uniformed services and farmers.

Source: Central Statistical Office, Ministry of Labour and Social Affairs, Social Insurance Board.

ever, has been under consideration for some time, which would re-establish a link between the size of the allowance and the beneficiary's past earnings.

Beside unemployment insurance payments, Poland operates several transfer programmes. The social assistance programme targets people enduring extreme poverty. Permanent and temporary benefits are means-tested and capped at 28 per cent of the average wage. The long-term unemployed who are no longer entitled to unemployment compensation have become the largest contingent of beneficiaries of temporary cash transfers. Those payments can be supplemented by family allowances and housing benefits. Adding in the latter, overall social assistance replacement rates range from 30 to 36 per cent, depending on family circumstances. The net replacement rate associated with unemployment insurance may be smaller because unemployment allowances, in contrast to other social benefits, are taxable.

As in a number of transition countries, old-age and disability pension schemes have played an important role in coping with labour market slack. Employment ratios are relatively low for older employees as large numbers of workers have been granted early retirement, although, as noted in Chapter IV, pensioners are allowed to work, and quite a number do. Sickness benefits are being rather widely claimed, with an average of 17 days per person in 1996, which represents half of the 35 days of absence authorised with an 80 per cent remuneration.[123]

Active labour market policies

The OECD *Jobs Study* enumerated a number of active labour market policy (ALMP) measures which were found to facilitate the re-entry of the unemployed into employment. Those include job search assistance, training programmes, and financial support to potential entrepreneurs. All were found to be most effective when tailored to meet the needs of specific populations or regions. General programmes in these areas as well as broad programmes of public sector job creation and employment subsidies to private sector employment were seen as less effective.[124] At around 14 per cent, the share of ALMP expenditure in total spending on labour market support is low in Poland compared with other OECD countries. Likewise, the number of persons enrolled at any given point in time in training, subsidised employment or public works is limited, amounting to 8 per cent of the registered unemployed at the end of 1997.

ALMPs are carried out under the umbrella of the National Labour Office (NLO). They include public works, subsidised employment, training, scholarships, loans, job-search counselling and job-brokerage services (Table 17).[125]

In Poland, contrary to many OECD countries, the largest proportion of ALMP resources is directed towards subsidised employment, which in recent years has covered between 100 000 and 200 000 participants per annum. Participants are paid a wage subsidised by the labour office by an amount equal to the unemployment benefit. A premium is paid to the employer if the contract is prolonged beyond 6 months. While local labour office officials are encouraged to choose firms and unemployed workers whose characteristics make a long-lasting match more likely, in practice, the final decision to hire particular workers rests with the employer and only a minority of those who enter the scheme are retained in the same firm, suggesting that employment subsidies have large substitution effects. From the enrollees' viewpoint, this programme has been widely used to access income support by persons with no work experience or with a long unemployment history since they subsequently became eligible for unemployment benefits.[126]

Public works, which were initiated later, grew rapidly to become the second most important programme, covering around 100 000 persons each year. This scheme provides jobs with an average duration of 6 months, mostly in municipalities and regions with important investment projects and in dynamic industrial centres, but not necessarily in high unemployment areas. Typical public works jobs are in construction or cleaning. Public works are probably the least cost-effective ALMP: in per capita terms, they are twice as expensive as unemployment benefits while offering little evidence of enhanced human capital.

An unemployed establishing his own workplace can apply for a start-up loan from the Labour Fund of up to 20 times the average wage, carrying a concessional interest rate and part of which can be subsequently transformed into a grant. Between 5 000 and 6 000 persons per annum have benefited from this type of support. The fact that only a tiny fraction of the enrollees re-register as unemployed a few years down the road suggests that this type of support may be relatively effective. Analogous loans are also provided to employers creating new positions to be filled by unemployed.

Training programmes usually last from three to six months. Participants obtain an allowance equal to 20 per cent of the unemployment benefit, whether or

Table 17. **Labour market programmes**

	Public expenditures as a per cent of GDP						Participant inflows as a per cent of the labour force					
	1992	1993	1994	1995	1996	1997	1992	1993	1994	1995	1996	1997
1. Public employment services and administration	**0.02**	**0.02**	**0.01**	**0.01**	**0.02**	**0.02**						
2. Labour market training	**0.02**	**0.03**	**0.03**	**0.02**	**0.02**	**0.02**	**0.4**	**0.4**	**0.5**	**0.5**	**0.5**	**0.8**
Training for unemployed adults and those at risk	0.02	0.03	0.03	0.02	0.02	0.02	0.4	0.4	0.5	0.5	0.5	0.8
Training for employed adults	–	–	–	–	–	–	–	–	–	–	–	–
3. Youth measures	**0.15**	**0.09**	**0.07**	**0.08**	**0.10**	**0.10**	**2.3**	**1.9**	**1.5**	**1.8**	**1.9**	**2.5**
Measures for unemployed and disadvantaged youth	–	–	0.01	0.02	0.03	0.04	–	–	–	0.1	0.2	0.8
Support of apprenticeship and related forms of general youth training	0.15	0.08	0.06	0.06	0.06	0.06	2.3	1.8	1.5	1.7	1.7	1.8
4. Subsidised employment	**0.08**	**0.20**	**0.24**	**0.21**	**0.16**	**0.19**	**0.8**	**1.2**	**1.8**	**2.0**	**1.5**	**2.0**
Subsidies to regular employment in the private sector	0.05	0.10	0.13	0.12	0.08	0.07	0.6	0.8	1.2	1.2	0.8	1.0
Support of unemployed persons starting enterprises	0.01	0.02	0.02	0.02	0.02	0.02	–	–	–	–	–	–
Direct job creation (mainly public works)	0.02	0.08	0.10	0.08	0.07	0.09	0.2	0.4	0.6	0.7	0.6	0.9
5. Measures for the disabled	**0.04**	**0.05**	**0.04**	**0.01**	**0.01**		**–**	**0.2**	**0.8**	**0.1**	**0.1**	
Vocational rehabilitation	–	0.01	0.01	–	–		–	0.2	0.3	–	–	
Work for the disabled	0.04	0.04	0.04	0.01	0.01		–	–	0.4	0.1	0.1	
6. Unemployment compensation	**1.71**	**1.72**	**1.77**	**1.88**	**1.77**	**1.19**						
7. Early retirement for labour market reasons	0.77	0.15	0.10	0.05	0.05							
Total	**2.80**	**2.25**	**2.27**	**2.27**	**2.14**							
Active measures (1 to 5)	0.32	0.38	0.39	0.34	0.32		3.5	3.7	4.7	4.4	4.1	
Passive measures (6 and 7)	2.49	1.87	1.87	1.93	1.82							

Note: – = nil or less than half of the last digit used.
Source: National Labour Office, Central Statistical Office.

not they also receive the unemployment benefit itself. Failure to complete the courses entails the obligation to refund the allowance and deprives the participant of the right to receive unemployment benefits. Since 1993, some 80 000 to 90 000 persons have been enrolled in those programmes each year, a rather modest proportion by international standards. Under certain conditions, the Labour Fund also subsidises training provided by employers.

Consistent with the mixed results often observed in other OECD countries, studies generally find that the effects of most ALMP measures on employment are either small or non-existent in Poland. Some programmes are effective in the sense that they do raise employability: this is generally the case of training, even if some courses are not of obvious use (Bednarski, 1996). However, training is often provided to persons who would have found a job anyhow (Gora *et al.*, 1996). Subsidised employment and public works do not appear to enhance employability (Kwiatkowski, 1996, and Puhani, 1998). Microeconometric analysis suggests that ALMPs are not particularly well targeted at the problem groups: women and persons with basic vocational education do not receive enough attention (Gora *et al.*, 1996; Puhani and Steiner, 1997). The insufficient effectiveness of ALMPs may also reflect failures in the delivery mechanism and in the enforcement of regulations. Furthermore, some ALMP measures may simply be too recent for their effects to be properly evaluated.[127]

As noted, the success of ALMPs partly depends on the effectiveness of the public employment service (PES). Since the early 1990s, and with the help of substantial international financial assistance, an extensive, 18 000 person strong, network of 49 regional and 360 local labour offices has been set up. It co-operates with employment councils,[128] at the local, regional and national level. Progress was recorded in 1995-96 with respect to the NLO's job-search counselling and job-brokerage functions: 2 000 new placement officers were trained, visits of placement officers to employers became more frequent, more job offers were advertised, and vacancies were filled more rapidly. The authorities consider that a comprehensive evaluation of the effectiveness of ALMPs will remain difficult as long as the NLO network is not fully computerised. The proliferation of private employment services, of which over 300 are now operating, signals that the PES is not in all cases the most effective intermediary.

Increasing the knowledge base, efficiency and innovative capacity

Skills and competences

Human skills and competences are important determinants of productivity and human capital. As documented in the OECD *Jobs Study*, individuals with a higher level of education and training tend to receive better pay, have a lower unemployment risk, and hence also experience more secure job tenure.

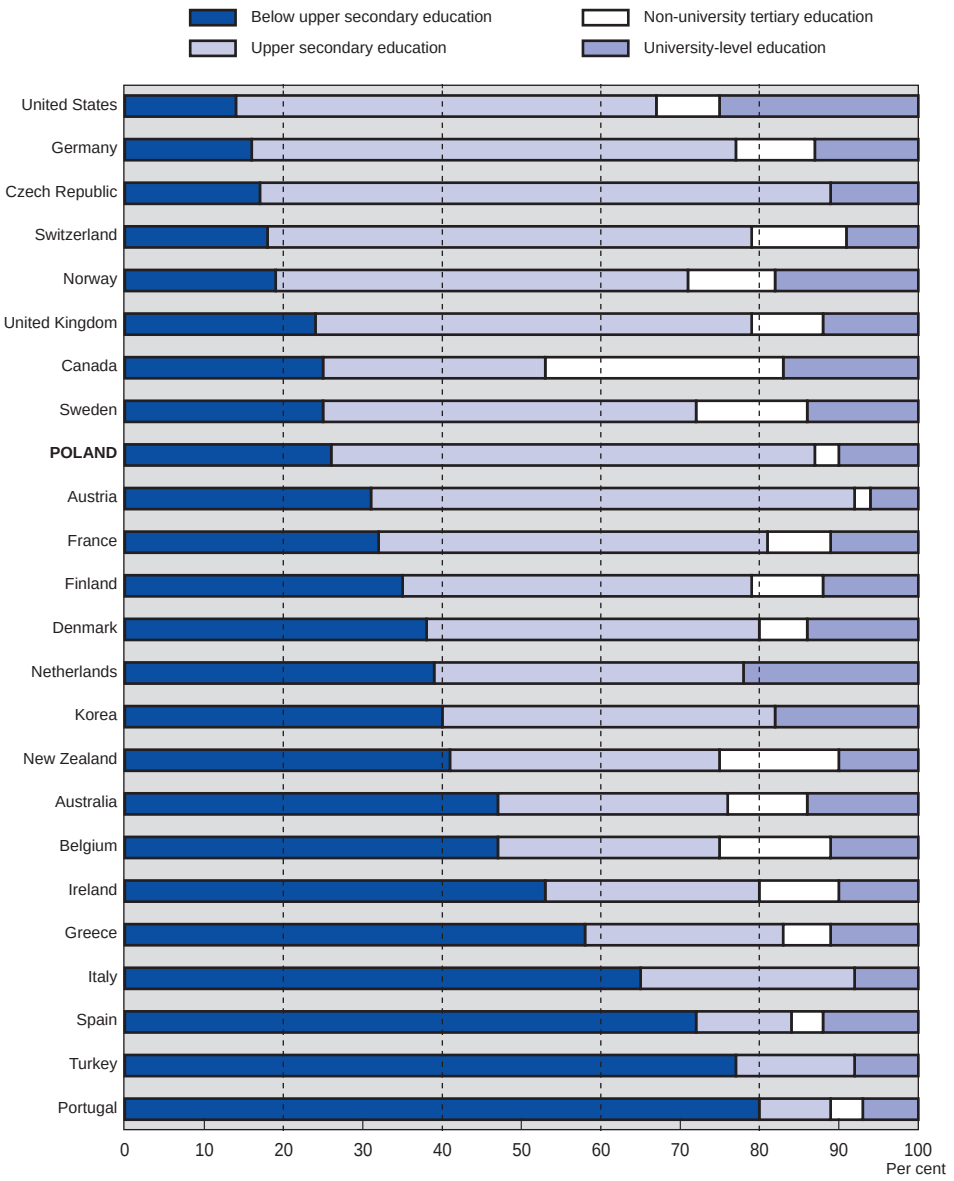
The proportion of the population with at least a secondary education is higher in Poland than in more than half of the other OECD countries (Figure 24). At the same time, and somewhat paradoxically, Poland scored poorly on international adult literacy tests (OECD, 1997*i*).

Against this background, the demand for tertiary education has soared since the late 1980s. The proportion of youth enrolled has more than doubled, approaching 30 per cent in 1996. This occurred even as education was becoming more costly, with private schools developing very rapidly and absorbing 14 per cent of tertiary students by 1996. Several factors underpin the growing demand for higher education. Demographic change plays a role,[129] although it is not sudden enough to fully account for the sharp hike in enrolment rates. Education dramatically lowers unemployment risk: the negative correlation between unemployment incidence and schooling is even starker in Poland than in other OECD countries (Figure 25, panel B).[130] Furthermore, individual returns to schooling have become more clearly positive since Poland has become a market-oriented economy, with the hierarchy of wages across occupations shifting towards that prevailing in other OECD countries (Rutkowski, 1996).[131] Lastly, higher enrolment rates may to some extent reflect bleak job prospects, leading young people to prolong their stay in school as an alternative to unemployment.

Traditional basic vocational schools offer very narrow qualifications, which is detrimental to their graduates' employability (OECD, 1996*c*). The recruitment of those schools has declined from half of the children in the 1980s to one-third presently. At the same time, the curricula in those schools are being broadened. Similar efforts at menu diversification are underway in the longer vocational streams (technicums). Some bridges are also being established between experimental vocational lycea and higher education. In this context, regional education officers have made commendable efforts to establish working contacts with

Figure 24. **EDUCATIONAL ATTAINMENT OF THE WORKING-AGE POPULATION**

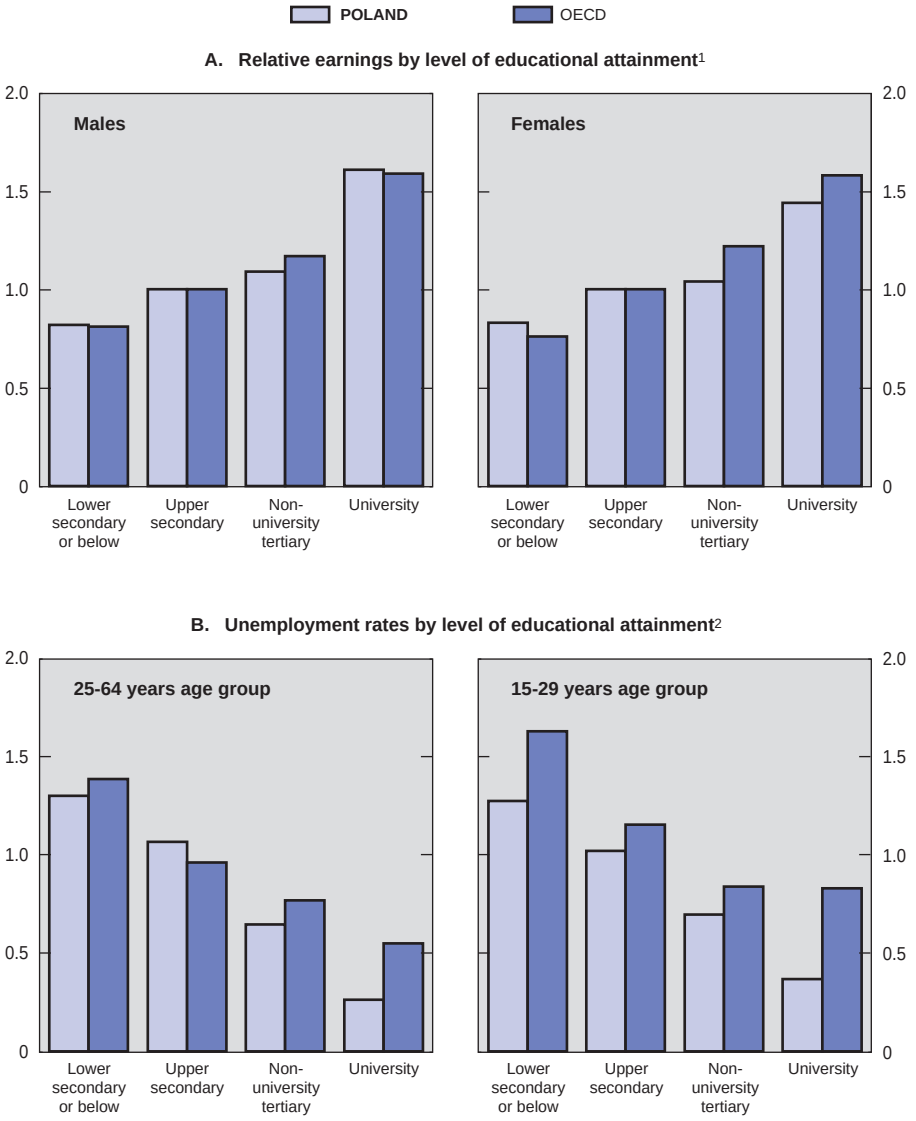
As per cent of total, 1995



1. Distribution of the population aged 25 to 64 by the highest completed level of education.

Source: OECD (1997*a*).

Figure 25. **EDUCATION AND LABOUR MARKET PERFORMANCE**
1995



1. Ratio of mean annual earnings by level of educational attainment to mean annual earnings at upper secondary level.
2. Ratio to overall unemployment rate for age group.

Source: OECD, *Education at a Glance,* 1997.

regional employment offices and other stakeholders of local and regional labour markets. Nonetheless, these linkages need to be further developed.

Unemployment rates of school-leavers have increased during the first half of the 1990s. One approach to easing the transition from school to work is to foster apprenticeship schemes. The existing ones concern mainly craft vocational training for primary school graduates. The employer is responsible for the training of those junior employees (15 to 18-year-olds) who receive a small salary (4 to 6 per cent of the average wage). Unlike in other central and eastern European countries, apprenticeship programmes are subsidised by the Labour Fund (Keune, 1997). Students of vocational schools may also acquire practical skills at workshops managed by schools or in enterprises on the basis of an agreement between schools and employers.

Product market competition

Lack of competition in the product markets can lead to higher prices to the detriment of consumers and generate sectoral rents, including as regards wages and job security, which entail lower employment. Opening the economy to international trade and capital flows is a powerful stimulus promoting competition. As highlighted in the previous Survey, Poland has made big strides in this respect since the late 1980s, even though restrictions remain in certain sectors. Privatisation, which was discussed in Chapter III, is also important in enhancing competition.

Slow deregulation in such sectors as energy, telecommunications, and railway transportation, has thus far limited the efficiency gains resulting from greater competition and private sector participation, even if the prospect of EU accession and the associated requirements tend to speed up the development of more competition-friendly regulatory frameworks. The energy law passed in 1997 constitutes an important milestone in that direction. It separates and clarifies the powers and duties of the entities involved in policy, regulation and management decisions, providing for the creation of an independent regulatory agency, which has started to operate. In the oil and gas industries as well as in the electricity sector greater competition would be served by faster privatisation (Annex III). The scheduled lowering of tariff protection will also be an important driving force.

In telecommunications, competition has been stifled by the licensing restrictions imposed on cellular phone operators, which were deemed illegal by the Office for Competition and Consumer Protection (*ex* Anti-Monopoly Office) (OCCP, 1997). The latter has proposed to open the long-distance segment of the market to other operators who could use alternative carrier capacities such as the railways' currently under-utilised nation-wide network of fibre-optic cables or the power lines of the electricity grid. The emergence of new long-distance networks would increase competition, lower prices on long-distance calls, and speed up the development of telecommunication infrastructure, which despite remarkable progress so far remains very insufficient.[132] The OCCP has also sought to promote competition by trying to prevent the dominant former monopolist – TPSA – from blocking the entry of a cable television operator. Full liberalisation of telecommunications is not envisaged before 2003.

A 1995 law provides for the re-organisation of the national railway company (PCP), separating the management of the infrastructure from the running of trains, and unbundling freight and passenger traffic. The elimination of subsidies in line with the relevant EU directive would necessitate substantial employment cuts, estimated between 70 000 to 100 000 (World Bank, 1997). Progress with implementation has been limited thus far.

Distortions in the housing market adversely affect geographical labour mobility, as reflected in an interregional migration rate far lower than in west European countries. The Polish housing market is characterised by an acute shortage of dwellings (UNDP, 1996). The recorded supply of new housing plummeted from 179.1 thousand units per year in 1986-89 to 62.1 thousand in 1996, although it picked up slightly last year to 65.6 thousand. The privatisation process has not been completed, with local governments still owning 1.7 million communal flats (*i.e.* 15 per cent of the total number of housing units). Rent controls still apply to 28 per cent of the housing stock,[133] inhibiting the supply of rental housing and pushing up the price of vacant dwellings. Finally, the creation of housing savings and loans institutions made possible by 1995 legislation has not been implemented yet and high mortgage rates continue to be a constraint. Housing and real estate reforms are continuing, however, and recent measures go in the right direction. For instance, laws were passed in 1997 to free rents in the public sector and fully remove rent controls in the private sector by 2004.

Moreover, housing allowances have been rationalised and eligibility criteria refined.

The entrepreneurial climate

The OECD *Jobs Study* stressed that entrepreneurship is one of the keys to a robust economy capable of coping with structural change. Entrepreneurship helps generate jobs and incomes and contributes to greater flexibility in the labour market.

Poland's recent growth performance largely rests on a strong entrepreneurial basis, with many dynamic small and medium-sized enterprises (SMEs) and creations of new firms. As in most other countries, SMEs make up the bulk of Poland's 2.2 million registered non-agricultural enterprises: over 99 per cent are SMEs (defined as enterprises employing less than 250 persons), and almost 90 per cent micro-enterprises (employing from 1 to 5 persons).[134] In 1995, SMEs generated almost a third of total GDP and employed 58 per cent of the non-agricultural work force. Productivity and profitability indicators suggested that SMEs were on the whole more efficient than larger firms. Time worked as a share of time paid was also higher in SMEs, reflecting shorter holidays and sick leave. The highest density of SMEs is recorded in hotels, restaurants, trade, construction, and repair businesses (Zienkowski, 1996).

A lack of finance is often quoted as a major impediment to enterprise growth, particularly for small and new enterprises. Enterprise access to bank credit has been limited during the first stages of transition, notably because of stringent collateral requirements. Financing of start-ups by venture capital has also remained embryonic. The aforementioned Labour Fund loans have contributed to the creation of new small enterprises and the development of existing SMEs, but only on a very limited scale. The resources allocated to start a business therefore usually come from private savings and property. Some recent measures should help, however: in 1994, the taxation of individual entrepreneurs was streamlined as they were offered the option of a lump sum tax on certain types of incomes and a low, flat rate for others, which significantly reduced the burden of red tape and tax evasion incentives (Grabowski and Smith, 1995); several credit guarantee funds for SMEs have been set up, notably the one managed by Bank Gospodarstwa Krajowego (Hübner, 1997); legislation was passed in 1996 providing for the creation of a central register of liens on movable

property, eliminating the risk of multiple pledging; and a computerised commercial register is being established, linking local court registers, which should help speed up registration procedures. Various programmes sponsored by foreign countries (including PHARE, Struder, CARE, Polish-American Enterprise Fund, and the Know-How Fund) also offer advisory and financial support to SMEs (OECD, 1996*d*).

Another impediment to enterprise development has been excessive legislative instability. Between end-1994 and mid-1996, no fewer than 128 amendments were made to 76 legal acts regulating business activity, often with short notice and in a few cases with retroactive power.[135] Particularly detrimental to smaller businesses has been the lack of clarity of many regulations, which leaves room for arbitrary interpretations by representatives of the executive branch, occasionally at odds with the legislator's original intentions. SMEs other than micro-enterprises are further burdened by such obligations as spelling out internal work and remuneration regulations.

Faced with the sharp regional contrasts described above, the authorities have differentiated enterprise support policies across localities. Special support is provided for the localities that the government classifies as threatened by high structural unemployment, of which there were 406 in early 1998 (spanning 18 regions). This support typically takes the form of tax concessions, mainly at the expense of the state budget (notably, accelerated depreciation, tax allowances for training and investment, guarantees, and income tax cuts). It also involves help complementing the aforementioned Labour Fund loans, in the form of lowering social security contributions and providing training and advice. As described in chapter III, special economic zones have also been set up in a number of regions, which are intended to foster job creation.

Technology and innovation

Technology both destroys and creates jobs, and workers with different characteristics are affected differently. The decline in wages or employment opportunities of unskilled workers as well as the wage premia or better employment prospects of skilled workers are partly attributable to technical progress. Therefore, training to upgrade the skills of those who benefited least from the introduction of new technologies is an important investment in human capital. At the same time, spending on research and development (R&D) and the level of

innovation, especially in high-technology sectors, are indicators of the future competitiveness of a country.

The overall innovation level in Poland measured by the number of patent applications by resident inventors and by gross domestic expenditure on R&D (GERD) declined dramatically between the late 1980s and the mid-1990s (OECD, 1996*b*), possibly in part as a reflection of earlier ''over-investment'' in this sphere but also contributing to ''brain drain'' (Hryniewicz *et al.*, 1997). The number of patent applications submitted by domestic inventors in Poland halved, as did that of patents granted. The number of non-resident applications, however, evolved more favourably. Following a nose-dive, GERD and employment in the R&D sector have picked up slightly since the mid-1990s. Relative to GDP, GERD amounted to ¾ of a percentage point in 1996, on a par with Hungary and at about 40 per cent of the OECD average.[136] At the same time, employment in the R&D sector is relatively higher: at 4.9 per thousand professionally active persons, Poland ranks alongside Spain and slightly above Hungary and the Czech Republic. R&D continues to be mainly funded by the state budget. Only a small fraction of R&D activities are carried out in the business enterprise sector, as would be predicted given Poland's modest per capita income level. Within overall GERD, a relatively large share is devoted to basic research.

At least as important as innovation per se is the diffusion of technological progress. Scattered anecdotal evidence suggests that in Poland as elsewhere trade and foreign direct investment play an important role in this regard.[137] The latter has a direct impact, especially in the case of green-field projects, but also an indirect impact, by forcing incumbent domestic firms to upgrade their products and to reward their skilled staff more generously.

Assessment and scope for further action

Although the OECD *Job Study* recommendations were conceived before the accession of the Czech Republic, Hungary and Poland, many of them are relevant for these new members as well, not least because the latter have traditionally maintained elaborate systems of social protection but also because in their efforts at closer integration with the EU they have to make choices on how fast and to what extent they should align labour market norms to those prevailing in the other European OECD countries. Likewise, the problems faced in the areas of

education, R&D, product market competition and entrepreneurship in many ways resemble those encountered in the other OECD countries with relatively low per capita incomes. The conclusions reached in this chapter are summarised in Box 5.

On several counts, labour market institutions and performance have greatly improved over the past few years. Even so, further progress is called for along various policy dimensions if the foreseeable pressures are to be successfully absorbed, particularly the inflows of youths and the outflows of low-skilled workers from agriculture and heavy industry (including mining).

Coping with this challenge firstly requires containing labour costs and ensuring that they be sufficiently flexible. The gap between the cost of labour to the employer and the return to the employee is far too wide in Poland, driving or maintaining a significant portion of activity underground. The reform of the pension system discussed in Chapter IV will help reduce the size of this distortion and ameliorate employer and employee incentives. The systematic itemisation of social contributions on pay slips would also heighten employees' awareness of the importance of non-wage labour costs.

If employment is to expand faster, wage-setting in public enterprises should be more directly related to firm-specific productivity gains than has been the case since 1995. As noted in the previous Survey, the nation-wide norm set for wage increases under the aegis of the Trilateral Commission tends to function perversely as a floor in firms where performance only warrants a much lower rise. If any centralised norm is to be established, it should therefore be much more restrictive. Preferably, wage adjustments would be negotiated at a more decentralised level, which would help achieve a more efficient relative wage structure. In this context, administrative extension of local wage agreements should be proscribed.

The minimum wage in Poland is relatively high compared with Hungary and the Czech Republic, and has been generously indexed over the past few years. Thus, it would be appropriate henceforth to adjust its level only so as to preserve its current purchasing power. Consideration might also be given to the creation of a lower, first-job minimum wage that would be consistent with the limited skills of many of the school-leavers. A lower minimum wage could furthermore be envisaged for high-unemployment areas.

Box 5. **The OECD Jobs Strategy: Synopsis of recommendations for Poland**

The OECD *Jobs Study* spelled out a strategy for improving the ability of OECD economies to cope with structural changes through enhancing the ability to adjust and to adapt, and increasing the capacity to innovate and be creative. With respect to labour and product market flexibility, the study identified the need for initiatives in the following areas: wage and labour cost flexibility, unemployment and related benefit systems, employment security provisions, active labour market policies, working time flexibility, labour force skills and competences, the entrepreneurial climate, technology and product market competition.

This chapter assesses labour market performance and policy requirements in Poland. Noting that in some respects the regulatory framework is less inhibiting in Poland than in many other OECD countries and that on a number of points significant progress has already been made, it concludes that the following policy orientations deserve further attention:

Increase wage and labour cost flexibility

- *Reduce the tax wedge* in order to boost labour demand and to encourage the registration of activities heretofore carried out underground.
- *Decentralise wage-setting*. Poland should move from a wage-setting mechanism that in effect leads to an economy-wide floor for wage increases to a system tying wage awards more closely to productivity at the microeconomic level. The possibility to administratively extend collective wage agreements reached for some firms in a sector to other firms should be eliminated.
- *Ensure that the minimum wage does not price out low-skilled labour*. The minimum wage should no longer grow faster than consumer prices, and consideration should be given to the introduction of a lower minimum wage in regions with higher unemployment, and for youths' first job.

Amend unemployment and related benefit systems

- *Reconsider unemployment benefit rules*. The link between their duration and the regional unemployment rate should be a transitory feature, as it may otherwise distort adjustment incentives. The envisaged re-introduction of a link between the allowance and the last earnings is welcome.
- *Tighten the rules applying to working pensioners.* The possibilities to cumulate early-retirement and employment, and the generosity of pensions when cumulated with wage earnings, need to be curtailed.
- *Tighten the regime of sickness benefits* in order to discourage abuse.

(continued on next page)

(continued)

Reform employment security provisions

- The re-allocation of labour called for by further economic restructuring would be facilitated *if separation were easier*. The main impediments to swifter re-allocation stem from inadequate corporate governance mechanisms (see Chapter III). In addition, the dismissal rules applicable to managers should be aligned on those applicable to employees, and the temporary equalisation bonus payable to workers ending up in lower-paid jobs should be reconsidered.
- *The regulations governing fixed-term contracts should be eased*, as this form of employment could absorb a portion of the labour force that would otherwise be unemployed.

Enhance active labour market policies

- *The effectiveness of ALMPs needs to be monitored on an on-going basis*. The efficiency of the various schemes is uneven, and hard to measure precisely owing to deadweight, substitution and displacement effects.
- Even so, there is clearly a *need to de-emphasise public works and subsidised employment and stress training*. It is equally important to continue to *improve the content of training programmes*, notably by involving enterprises more directly in their design and funding, and to *strengthen the targeting* of high-risk groups.
- The job-brokerage function of the PES needs to be strengthened further.

Increase working-time flexibility

- In order to increase the use of the capital stock and better adjust to fluctuations in demand, *the period over which the maximum average weekly number of hours is calculated should be lengthened*.

Improve education

- *Continue to widen access to tertiary education and increase the capacity to effectively educate more students accordingly*. This calls for increased funding, albeit not necessarily, and certainly not only, of a public nature.
- *Improve vertical and horizontal integration*. Vertical integration between secondary and tertiary education is lacking, and so is horizontal integration within and across university, technical and vocational school programmes.
- *Continue to reorient the curricula of vocational schools towards the needs of enterprises*, in particular by expanding foreign language and business courses.

(continued on next page)

(continued)

Nurture an entrepreneurial climate

- *Lowering the overall tax rate faced by registered enterprises* would reduce incentives for avoidance or under-reporting and improve compliance. Likewise, *streamlining tax and regulatory frameworks*, as envisaged in the context of the recently initiated ''de-bureaucratisation'' drive, would foster enterprise creation and development. For example, the threshold above which employers have to formulate enterprise-specific work and remuneration regulations could be raised.
- *Venture capital* is still embryonic and needs to be encouraged.

Facilitate the creation and diffusion of technological know-how

- The links between basic and applied research as well as between research and industry need to be enhanced.
- The diffusion of new technology to smaller firms and to traditional sectors should be facilitated.

Broaden and intensify product market competition

- *Encourage competition in the network sectors* (energy, telecommunications, railways).
- *Enhance the independence of the Office for Competition and Consumer Protection.*
- *Accelerate enterprise privatisation* with an emphasis on improving governance arrangements.
- Continue to reduce external trade barriers.
- Phase out rent controls.

The level and eligibility rules of unemployment and related benefits were overly generous in the early 1990s. As in the Czech Republic and Hungary, abuses were not uncommon. Poland has gradually tightened the criteria and reduced the size of unemployment allowances, with a dramatic impact on related outlays. This has certainly sharply reduced the number of pseudo-unemployed registered with the labour offices. It has also contributed to reducing the risk of an unemployment trap. At the same time, and as in other transition countries, it has encouraged a number of people to opt for disability or early retirement benefits instead. The risk of such a spill-over was curtailed in 1997 for disability benefits, when their attribution was made more strictly conditional on the physical inability to work. Early retirement provisions have also been tightened, from

1998. Even so, the conditions for cumulating pension and wage earnings should be made more restrictive.

A rather unusual feature of the current unemployment compensation system is the differentiation of its duration across regions. Admittedly, an eager job-seeker will in all likelihood find work in less than six months in the capital and may need up to 18 months to do so in a high-unemployment region. On the other hand, setting the benefit duration as a function of the existing regional unemployment rate may tend to perpetuate the *status quo*, and can create inequities (consider, for instance, two neighbouring cities facing similar economic conditions but situated one in a region with ''average'' unemployment and the other in a region with ''high'' unemployment). It should therefore be a temporary measure rather than a permanent fixture. Another recent feature of the unemployment compensation system is the absence of any link between contributions and benefits. Re-establishing such a link, as is envisaged by the authorities, would be appropriate, in order to reduce the potential work incentive distortions associated with the current system.

Polish workers enjoy a fair amount of legal employment protection, especially following the 1996 revisions to the Labour Code. *De facto* protection is even more extensive in sectors with strong union representation, including some of the problem sectors discussed in Chapter III, to the point of inhibiting structural adjustment and exacerbating labour market segmentation. This contributes to a lower turnover of the unemployment pool, trapping a larger number of people in long-run joblessness. Furthermore, the dismissal rules for managers should not be more generous than for employees. In addition, the equalisation bonus paid by the Labour Fund to dismissed workers taking up a less remunerative job may be superfluous given the relatively modest level of unemployment benefits. At the same time, the regulations governing fixed-term contracts could be eased.

ALMPs still represent a modest share of the Labour Fund's outlays. If this share is to be increased, however, this should be accompanied by some rebalancing among programmes. While their nominal effectiveness has improved significantly over recent years, it remains uneven and so do the related deadweight, substitution and displacement effects. Such side-effects are admittedly difficult to measure, but more continuous and intensive monitoring would allow a better evaluation of the merits and shortcomings of the alternative programmes. It

would also permit a more accurate targeting of those groups who stand to gain most from each of the programmes.

Overall, it would seem that a stronger emphasis on training is desirable. The content of the courses, however, should match more closely the requirements associated with existing vacancies. Classroom training may be enriched by more on-the-job training, and employers should be playing a more active role in course design. The local employment councils might be the appropriate forum for such interaction, which may also call for local labour offices to be granted somewhat more autonomy than at present. The diversity of local conditions certainly would seem to warrant giving those who are most directly facing them some latitude for discretionary action.

The effectiveness of the PES as a job broker has improved somewhat but there remains scope for further progress. There is clearly room for alternative, private job brokerage institutions to play a complementary role. To the extent that they are directly competing with the PES, they offer an impetus for the latter to become more efficient. Relieving the Labour Fund of some ancillary tasks, such as the servicing of the loans it has granted, could help improve its performance on its core responsibilities.

Increasing working time flexibility and expanding part-time work opportunities would raise the elasticity of employment to output, which as described in Chapter I has been low thus far. Allowing employers more leeway to spread labour inputs over the course of the year would lead to a higher return on installed capacity and make room for new hires.

Improving education and training increases effective labour supply by increasing human capital and helps match the supply and demand of skills. It clearly lowers individuals' unemployment risk. Starting from a rather unfavourable situation in the late 1980s, Poland has made commendable progress, notwithstanding budget constraints. Enrolment rates in higher education have soared and curricula both in vocational schools and in universities are being gradually refocused on the needs of the emerging market economy. One important challenge, in the midst of those momentous changes, is to ensure adequate co-ordination between the various educational levels and streams. As primary and secondary education are being decentralised, mechanisms should be developed to ensure a minimum quality across regions.

In early 1998, the government announced a major overhaul of the education system, *inter alia* making schooling or learning in some form compulsory until age 18 (Ministry of Education, 1998). This reform process should be conducted with the overarching imperative to prepare young people more effectively for work and life-long learning in adulthood. In this regard, vocational schools and apprenticeship programmes need to continue to be adapted to employment opportunities.

Private sector initiative has played a growing role in education and training. This is a welcome trend, in a context where public resources in this area are insufficient even to ensure decent physical facilities throughout the country. It is also to be encouraged because in a rapidly changing environment the private sector is often in a better position to identify the skills that are really in demand.

Making the most of the available human resources further requires a friendly entrepreneurial climate. SMEs have bloomed, testifying to the fact that in practice, the business environment has been fairly conducive to enterprise creation. However, as in many other OECD countries, some regulatory obstacles stifle initiative, or unduly relegate entrepreneurial dynamism to underground activities. Apart from the above-mentioned sizeable tax wedge, regulatory frameworks are sometimes overly cumbersome, and the legislative fine print is not always as unambiguous as would be desirable, which is particularly detrimental to SMEs. A de-bureaucratisation drive was launched in early 1998 with a view to achieving greater regulatory transparency and coherence, and to eliminating unjustified red tape. Cross-country experience suggests, however, that the authorities should be careful not to add to the net regulatory burden in their efforts to simplify the existing rules or to align them with EU standards.

For production to move upscale and for returns on the growing stock of human capital to be maximised, the R&D environment should be favourable. Poland's successes in some sectors (*e.g.* medical equipment) illustrate the job creation potential of home-grown high-tech firms. The role of foreign direct investment in the diffusion of state-of-the-art technologies is also important. As in many OECD countries, the links between basic and applied scientific research as well as between research and industry should be enhanced, with a particular need to facilitate diffusion to the traditional sectors and smaller firms.

Another prerequisite for an efficient allocation of labour resources and a good employment performance is the proper functioning of product markets.

While competition is vigorous in many sectors of the Polish economy, barriers to entry and other obstacles exist in several major sectors, notably in heavy industry and infrastructure, where markets are not contestable. Although gradual deregulation and privatisation are underway in some of the latter, movement has typically been rather slow. Earlier country reviews of the implementation of the *Jobs Study* recommendations have stressed the importance of making progress in this area, and the advice holds for Poland as well.

More specifically, privatisation can and should be accelerated, as Poland's new government has indicated (see Chapter III). Competition should become more of a way of life in the network sectors. Enhancing the status of the Office for Competition and Consumer Protection would help: its president should no longer be dischargeable at will and the fines it levies should be more substantial in order to be more dissuasive, allowing it to adopt a more activist posture. This may be needed to counteract the formation of large holdings that are envisaged in some sectors, under the umbrella of the State. There is indeed a distinct risk that such conglomerates would stifle competition and retard restructuring. Regarding the energy sector, faster progress with the secondary legislation associated with the 1997 energy law is called for. In telecommunications, competitive pressures stem both from technological advances (call back systems, internet phones) and from the commitment to conform to EU rules. Forcing the incumbent monopoly to anticipate it by confronting alternative operators earlier rather than later would be beneficial for all the parties involved.

Among product markets, housing stands out in Poland, as in other transition economies, as a source of labour market rigidities (although the lack of an internal migration tradition also plays a role). Geographical mismatches would be mitigated by a more efficient housing market, which will emerge as rent controls are phased out and the financing options available for potential purchasers become more attractive. A better transport infrastructure is also important to ease long-distance commuting.

Notes

1. Growth in the 1970s was unbalanced, however, and was followed by a major recession around the turn of the decade.
2. A bit less in constant zloty terms and a bit more in constant US dollar terms, reflecting trend real exchange rate appreciation.
3. For details on agriculture, see OECD (1997*d*).
4. Although gross regional product estimates exist (see Saganowska and Smilowska, 1996 or RECESS and Statistical Office in Katowice, 1997), they are tentative and only become available with long lags, so that industrial output (sold) is the closest proxy to measure the evolution of overall economic activity at the regional level.
5. Both ratios are biased downwards because the national accounts treat unrecorded trade on a net exports basis.
6. Even more important than the volume of investment, however, are its quality and return, which warrant a close watch.
7. In late 1997, 30 per cent of the LFS unemployed were not registered as unemployed with the local labour office. For a detailed explanation, see Annex III of the previous Survey dealing with hidden employment and unemployment.
8. However, inflation was higher in Poland in 1997 than in Russia, Ukraine and the Baltic states.
9. The coincidental decline in oil prices on the world market helped cushion the impact of the excise hike on the CPI.
10. Applicable to medium and large public sector enterprises and to the portion of the wage treated as a tax-deductible expense, *i.e.* exluding profit-sharing bonuses (see Chapter V).
11. Those figures are based on payments. Customs data show a deterioration from 5.2 per cent of GDP in 1995 to 12.2 per cent in 1997, reflecting much higher import numbers.
12. See Annex II of the previous Survey for details on unrecorded trade and its reflection in balance of payments statistics. The accruals-based balance of payments established by the National Bank of Poland (which becomes available with a much longer lag) takes into account unrecorded trade flows and shows a deficit of 1.4 per cent of GDP in 1995 and 5.4 per cent in 1996.
13. In conformity with international practice, accruals-based figures and estimates are used here. They are economically more relevant than cash-flow data.

14. On the sensitivity of Polish exports to fluctuations in foreign demand, see Marczewski (1997).

15. The first comprehensive labour cost survey carried out by the Polish Central Statistical Office (GUS, 1997*c*) showed that in 1996, economy-wide hourly labour costs averaged Zl 10.11 (excluding units employing five persons or less), *i.e.* one seventh of the level in Germany. The productivity gap probably remains considerably smaller (van Ark *et al.* (1996) estimated that value-added per employee in manufacturing in Poland was 23.5 per cent of that in Germany in 1993, and productivity has risen more rapidly in Poland than in Germany since).

16. The introduction of a new customs code in January 1998, however, sparked complaints that procedures were becoming more byzantine.

17. For details on trade policies, including the stepwise tariff cuts in the framework of the Association Agreement with the European Union, see the previous Survey. An elaborate description of the exchange and trade system can be found in IMF (1997), which also lists the measures taken by the European Union affecting Polish exports.

18. According to NBP (1996*a*). So far, no systematic surveys of unrecorded imports have been conducted, but starting this year these transactions are to be subjected to some statistical monitoring.

19. German shoppers may also have been discouraged by the length of the queues at customs or worried about their safety (FTRI, 1997*a*).

20. See Milesi-Ferretti and Razin (1996) for a cross-country assessment of current account sustainability and a discussion of early warning indicators. It should also be noted that the current account deficit ratio in Poland is far smaller than in some other central European countries (Slovakia and the Baltics in particular).

21. In contrast, import and investment-led growth in Poland during the 1970s resulted in a major balance of payments crisis (Hanson, 1982). Admittedly, the economic system then in place was inimical to an optimal use of imported technology. Even so, this precedent should serve as a reminder that a significant share of capital goods in total imports does not necessarily imply that the return on the associated investment will be sufficient to justify them *ex post.*

22. Statements by a leading Polish politician in the fall of 1997 to the effect that Poland's Paris and London club debts ought to be renegotiated were therefore all the more surprising.

23. The underlying exchange rate assumption is that the monthly rate of crawl of the central parity remains at 0.8 per cent through the end of 1998 and is lowered to 0.7 per cent from January 1999.

24. This concern explains why the new foreign exchange bill to be submitted to Parliament this spring maintains a number of restrictions on capital movements, particularly at the short end, and contains some safeguard clauses.

25. A draft law on public finances endorsed by the government in May 1998 spells out a set of preventive and remedial procedures: if the public debt ratio exceeds 50 but is lower than 55 per cent, the deficit to revenue ratio of the state budget becomes a maximum for local government deficit to revenue ratios; between 55 and 60 per cent, a reduction in local government deficits is to be effected and the government has to present an adjustment

programme to Parliament; if the debt ratio reaches or exceeds 60 per cent, no deficits at all are allowed, neither at the central nor at the local levels, in the next budget bill, no public guarantees can be budgeted and the government has to present an adjustment programme to Parliament.

26. Unlike in France for instance, the inaugural nominations were all for six years. As a result, the periodic renewal of the MPC membership will not be naturally staggered in the future, which could in some cases affect policy continuity.

27. In a sense, however, the choice of the operational target can be seen as a matter of emphasis rather than as a strategic orientation.

28. For further analysis of money demand, see NBP (1996*b*).

29. Those projections involved substantial revisions from the draft *Guidelines* prepared earlier in the fall. While superseding the draft *Guidelines*, those projections have a rather informal status since they have not been explicitly endorsed by the MPC.

30. This figure excludes trade credits. The latter, however, are roughly counter-balanced on the asset side by receivables. Note that banks themselves had borrowed some $1 to 1.5 billion abroad in late 1997.

31. Including by ensuring more rigorous customer screening by the non-bank intermediairies to whom this task is sometimes devolved.

32. See also the draft *Guidelines* for 1997, which envisaged an annual depreciation of 9 per cent (NBP, 1996*a*).

33. The technology of open market operations also improved, in particular through the increasing use of bills in electronic form.

34. Gomulka (1997) estimates that the cost of sterilisation amounted to 0.8 per cent of GDP in 1996. NBP transfers to the state budget in 1996 represented 0.4 per cent of budget revenue, against a budgeted 1.9 per cent.

35. As argued by Konopielko (1997), who notes that the same holds for Hungary, this is a considerable source of quasi-fiscal revenue. Note that the NBP continued to support banks undergoing financial restructuring programmes by exempting them from reserve requirements (in 1996, 80 co-operative banks and 8 commercial banks benefited from this assistance).

36. Banks are currently allowed to hold up to 10 per cent of the required reserves in the form of vault cash (against 50 per cent until December 1997).

37. Although unusual, and decried by banks as unfair competition, this measure was not unprecedented: the Bundesbank for instance applied it in 1971 and 1993.

38. This window was closed at the end of 1997 and the law on the central bank henceforth prohibits this type of measure. In early 1998, however, the Ministry of Finance was contemplating offering those savers T-bills as their deposits mature.

39. In the absence of a meaningful measure of potential output growth, it is not possible to decompose the observed deficit into a structural and a cyclical component.

40. See IMF (1997) for a detailed summary of the tax system as of 1996.

41. A daily but non-compounded penalty of 0.14 per cent of the principal is applied to such arrears.

42. Initial estimates of the damage amounted to some Zl 15 billion; subsequently, an official estimate of Zl 10 billion was released; in March 1998, the Central Statistical Office published an estimate of Zl 12 billion based on a more thorough analysis.

43. The new government modified this provision but its amendment was vetoed by the President.

44. Some spectacular examples include the construction of hospitals, some of which had become technologically obsolete by the time the building was nearing completion.

45. A budgetary entity could procure goods or services over and beyond budgetary allocations without too much immediate pain.

46. Note that in December 1996, the NBP was made to acquire T-bills for a par value of Zl 2.3 billion. During 1997, the Ministry of Finance sold another Zl 2.5 billion worth of T-bills to the NBP. However, at the end of the year, it bought back the outstanding T-bills.

47. Positive discrimination in favour of state debt can be distortionary (Norregaard, 1997). This problem was partly remedied in 1997, once the government felt that the public had become familiar enough with state bonds.

48. For instance, several cities have issued municipal bonds, which are not reflected in Table 9 (in 1996, Gdansk, Gdynia and Lodz respectively issued Zl 99 million, Zl 29 million and Zl 29 million of such paper). Some cities also reportedly borrow from banks to cover local deficits. Accrued interest may represent 1.5 to 3 per cent of GDP (Kolodko and Nuti, 1997).

49. The ''de-bureaucratisation'' drive launched in early 1998 is another recent initiative that has some clear fiscal aspects.

50. Detailed information on many of those funds, going back all the way to the 1950s, has been compiled by NIK (1996).

51. Draft legislation providing for VAT refunds to non-residents was sent to the Sejm in March 1998. The implied direct revenue loss will be offset to some extent by a larger revenue base. This measure offers an incentive to businesses operating in the grey zone to register and start paying taxes.

52. A difference between pension reform on the one hand, and health and education reform on the other, is that the recorded deficit resulting from the introduction of pension funds will be largely financed, in a non-inflationary way, by the latter.

53. Details on the alternative paths and on this new law were provided in the previous Survey.

54. Annex III contains information on a selection of large privatisation deals, including this one. On privatisation of infrastructure, see Carbajo and Fries (1997).

55. In food processing firms, an additional 15 per cent can be distributed to the farmers or fishermen supplying the enterprise.

56. The June 1997 law on the use of privatisation receipts to support pension reform restricted this requirement to firms sold through initial public offerings but there is now a proposal to abolish this restriction.

57. Namely, 500 workers, ECU 6 million in sales or ECU 2 million in capital.

58. Annex IV of the previous Survey describes the features of the mass privatisation programme.

59. Bankruptcy is in some cases the only way to ensure the survival of the enterprise, be it in a different shape.

60. See Chapter II of the previous Survey for details.

61. Privatisation has also been conducted rather gradually compared with some other transition countries (see Nivet, 1997).

62. The phrasing in the *Privatisation Guidelines* was vague, however, since it did not specify whether the number of capital privatisations mentioned referred to starts or completions.

63. Examples are provided in a report published by the Supreme Board of Inspection (NIK, 1997*b*).

64. This pertains to receipts accruing to the state budget (1½ per cent of GDP in 1997). If those accruing to local governments are included (¾ per cent of GDP in 1997), the outcomes are 16 per cent above target in 1996 and 38 per cent above target in 1997.

65. The physionomy of the original proposal was somewhat different (it was described in the press, see for instance *Gazeta Wyborcza*, 5 November 1997).

66. The previous government's programme *Privatisation 2000* included a much lower estimate of Zl 7-10 billion. The new and much higher estimate may be an overstatement, as it is based on valuations by the former owners themselves. In May 1998, however, the Ministry of the Treasury came up with a new estimate of Zl 190 billion for the total value of the property involved (although at the same time, it considered that not all of the 170 000 persons likely to request compensation would be able to prove their title and receive compensation).

67. The shares are priced at book value, which may differ considerably from market value. The methodology underlying the valuation of land is not known.

68. On the whole, posted profitability ratios are not high, even for private firms. In 1997, net profits averaged 2.0 per cent of sales for the latter, and 1.5 per cent of sales for public firms.

69. With the benefit of more hindsight than for Poland, experience in other OECD countries having undertaken wholesale privatisation confirms that privatisation *per se* tends to boost performance. This is documented for Mexico for example by La Porta and Lopez-de-Silanes (1997).

70. See for example the report on sugar holdings published by NIK (1997*c*), which documents the unjustifiably generous salaries benefiting managers and cases of lavish spending on company facilities despite the dismal financial situation of sugar mills.

71. Such measures would violate the Association Agreement with the EU.

72. Background information on this enterprise is provided in the previous Survey.

73. Data on the evolution of such arrears over time have been published earlier for a broader sample of enterprises (*Rzeczpospolita*, 3 September 1997). Much of the arrears are carried over from 1990-92. In the cases where they show a decline in the stock of arrears this sometimes reflects write-off operations rather than payments to the budget. Note further that the data shown for state aid in Table 13 are an understatement since they add up zlotys of different vintages without any allowance for inflation.

74. This sharp rise in imports led to the introduction of import permits in May 1998.

75. Imports currently supply about one quarter of the steel used in Poland.

76. However, the stepwise reduction in the import surcharge reduced the overall tariff barrier for steel from 14 to 9 per cent between 1995 and 1997.

77. Originally, the intention had been to entrust all aspects of social security reform to this agency, notably including health care. In the event, the scope of its work was confined to pensions.

78. Earlier retirement is also an option in some other cases (loss of job because of economic cutbacks, cessation of work to care for disabled children, war veterans, invalids).

79. Awkwardly enough, no such limits apply to military and police pensioners.

80. Individual entrepreneurs contribute at a rate of 40 per cent.

81. Figure 14 is based on a related but somewhat different definition of the replacement ratio, and pertains to 1995.

82. Part of the increase reflected a regularisation on account of a pension adjustment due but not effected in 1996.

83. The age of a new disability pensioner averaged 45 in 1996.

84. This parameter remains to be decided upon by Parliament. Using the wage bill rather than the average wage would safeguard against the risk of an unforeseen drop in employment.

85. The use of the population-wide horizon favours women, who have a longer life expectancy.

86. *Security through Diversity*, however, proposes some important changes to the functioning of KRUS which would be consistent with the needed restructuring of agriculture. Thus, subsidies to guarantee a minimum pension would only be granted on the basis of secured assets (land, buildings, machinery), and at the pensioner's death, a part of those assets proportional to the subsidies received would be transferred to the State.

87. Currently, retiring, say, at age 65 instead of age 64 increases the pension by at most 1.3 per cent (which by international standards is low); under the new system, it would increase the pension by 9 per cent. A similar improvement in incentives would come about as regards pension wealth (defined as the discounted value of expected old-age benefits minus the discounted cost of contributions): under current rules, the drop in pension wealth from continued work after 55 is significant (as is the case in some other OECD countries as well).

88. Investment in non-publicly traded securities or in any single issuer's assets would be capped at 5 per cent of the total portfolio. The same limit would apply to investment abroad (a threshold below what might be desirable on international risk diversification grounds). Investment in real estate, commodities or derivatives (except to cover foreign exchange rate risk associated with holdings of foreign-currency denominated assets) would be prohibited. From 2005, a distinction would be made between type A and type B funds. The latter would be open only to subscribers aged over 50 and invested exclusively in fixed-income securities.

89. The floor is defined as half of the average return for all funds over the last 24 months or 4 percentage points below that average, whichever is lower.

90. Sectoral pension plans may serve to partly offset the impact on workers of the abolishment of some industry-specific privileges.

91. It ought to be recalled that in Hungary, in a similar context, the Constitutional Court ruled that workers have the right to stay with the first pillar.

92. As noted by Diamond (1997), however, individual accounts can also entail significant permanent administrative costs.

93. Roseveare *et al.* (1996) offer estimates for a number of other OECD countries. Such estimates are very sensitive to the calibration of the parameters. For instance, in the case of Poland and over a horizon of several decades, the use of an annual discount rate of 3 per cent implies a debt more than twice as high as the use of a 7 per cent discount rate.

94. See for instance Shah (1997) or Mitchell and Barreto (1997).

95. The split would be 50/50 for pensions, while only employees would contribute to the sick-leave benefit fund and only employers to the accident insurance fund.

96. The general trend is the same for the economically more meaningful measure based on the quarterly labour force survey (LFS), which only started to be compiled, however, from May 1992 (the definition of registered unemployment has been narrowed since 1994, which exaggerates the drop since that year).

97. See OECD (1994*a*, *b*; 1995*b*).

98. The lessons so far are drawn *inter alia* in OECD (1995*c*, 1996*e*, 1997*a*, *c*, 1998*b*).

99. Unless noted, the figures mentioned in this section are based on the LFS.

100. A large share of labour market transitions, however, do not involve any unemployment spell, as they involve job-to-job moves (Lehmann and Wadsworth, 1997) or direct transitions from employment to non-participation or *vice versa*.

101. The geographical characterisation of unemployment relies on registered data, as the LFS sample is too small to allow for a meaningful disaggregation along those lines.

102. Along the lines of Alogoskoufis *et al.* (1995).

103. The sharp rise of agricultural employment in 1996 is a statistical artefact associated with the census conducted in that year.

104. See Annex III of the previous Survey. This estimate includes most of the 100 000 or more foreigners working in Poland. Net labour migration is oriented in the opposite direction, however, with some 200 000 Poles working in Germany alone.

105. The modalities of wage formation in the early stages of transition are analysed in the previous Survey.

106. A first regional wage agreement was recently signed, which concerned medical employees in public enterprises in three voivodships in the north-west of Poland.

107. Regarding working conditions, it should be noted that a collective agreement may offer some assurance that regulations on safety and health hazards are effectively followed – which is otherwise often not the case.

108. Nominal wages in industry are deflated here by the industrial producer price index (IPPI), since productivity should be compared to the product wage. The CPI has increased more since 1993 than the IPPI, meaning that consumption wages rose less than product wages. As noted in Chapter I, information is available on Poland's international productivity ranking

for 1993, making this a pertinent benchmark period. For the economy-wide measure, the GDP deflator is used as a price index.

109. Such comparisons should be interpreted with caution, since they abstract from non-wage benefits and since wages in the enterprise sector are presumably less precisely measured than in the budgetary sphere.

110. In the process, the expenditures of the poorest quintile of workers' households, a share of remuneration for work in income, and inflation are taken into consideration.

111. The ratio of the minimum wage to the average wage of a manual worker in industry would be similar, since the latter is very close to the economy-wide average wage.

112. Anecdotal evidence points to cases where workers earn less than the minimum wage. In some of those cases, however, part of their income may not be declared.

113. The previous Survey discussed income inequality and poverty at some length. The evolution of the Gini coefficient for total household incomes has followed a broadly similar path, staying in the neighbourhood of 0.30 in 1994-96.

114. The legal foundation for the functioning of the labour market is set out in the Constitution, the 1974 Labour Code (last amended on a large scale in 1996) and specific laws, including the 1989 employment law on redundancy dismissals, three 1991 laws dealing with trade unions, employers' organisations, and the settlement of collective disputes, and two 1994 laws on collective bargaining and on employment and counteracting unemployment.

115. In 1989, the weekly ceiling was 46 hours in the private sector and 42 hours in the public sector.

116. No recent data on shifts are available, however, as the Central Statistical Office stopped monitoring them in 1992 (Kabaj, 1997).

117. The law gives the trade union(s) the right to negotiate as to the necessity of dismissing the whole group of people, and the manner in which the dismissal is to be effected. At the same time, it deprives the union of the right to examine and negotiate each individual case.

118. In addition, firms with over 50 employees of which less than 6 per cent are registered as disabled have to pay the State Rehabilitation Fund for the Disabled an annual Zl 427 per person falling short of that norm.

119. The government is considering changing the indexation base to prices, which would be more in line with practice in many other OECD countries.

120. Family safety nets, which are traditionally important in Poland, are abstracted from here (Cox *et al.*, 1997). So is the help provided by the 6 500 non-governmental organisations engaged in some form of social assistance in Poland.

121. Benefit ineligibility does not *ipso facto* discourage registration, as the latter offers some advantages such as access to public health care for the unemployed and his family members.

122. For instance, lone parents can receive benefits indefinitely, workers dismissed in group layoffs are entitled to 75 per cent of previous earnings, and an unemployed with a dependent child up to 15 years old and an unemployed spouse who does not receive any unemployment benefit can receive benefits for a period of 18 months.

123. Collective agreements in a number of cases stipulate that 100 per cent of pay is guaranteed during sick leave.

124. See also the econometric analysis by Scarpetta (1996).

125. The Labour Fund also supports some job-club and enterprise incubator schemes.

126. In 1994, half of subsidised employment participants and two thirds of public work participants who had not received benefits before entering the scheme were paid benefits after leaving it (Gora, 1996). The doubling of the minimum employment spell required for benefit eligibility, to 12 months, somewhat weakens this motivation (which remains, however, in the case of extended subsidised employment).

127. It should be borne in mind that most of the in-depth empirical studies of ALMP effectiveness available to this day are based on data that are already several years old, which in a rapidly evolving context is a major problem. Moreover, some indirect benefits, such as possibly lower crime rates, are hard to measure.

128. Employment councils are advisory, quadripartite bodies composed of representatives of local governments, trade unions, employers and the state administration.

129. Echoing the post-war baby-boom, the share of youth in the population has increased from 14.1 per cent in 1990 to 16.2 per cent in mid-1997. It is projected to reach 16.9 per cent in 2000 but to decline to 15.6 per cent in 2005.

130. This macro-level picture is corroborated by microeconometric analyses (see Scarpetta and Cazes, 1997). Education attainments are not a full-proof protection against unemployment, however (Boeri, 1997).

131. The net return is also positive for the State: the Ministry of Education estimates that the cost of higher education borne by the budget is repaid three times over during his worklife by the individual who benefited from it, in the form of higher tax income.

132. Only one third of Polish households have direct access to a phone line (and 7 per cent in rural areas).

133. The maximum annual rent equals 3 per cent of the building's replacement value as assessed by the local authorities.

134. See also Table 10 in Chapter III.

135. See Polish Foundation for Small and Medium Enterprises Promotion and Development (1997).

136. Cross-country comparisons should be interpreted cautiously, as measurement norms are not fully harmonised. Moreover, indirect forms of support such as tax concessions are excluded from GERD.

137. See also Helpman (1997).

Bibliography

Abarbanell, Jeffrey and John Bonin (1997), ''Bank Privatization in Poland: The Case of Bank Slaski'', *Journal of Comparative Economics*, Vol. 25, No. 1, pp. 31-61.

Alogoskoufis, George, Charles Bean, Giuseppe Bertola, Daniel Cohen, Juan Dolado and Gilles Saint-Paul (1995), *Unemployment: Choices for Europe*, Monitoring European Integration, 5, CEPR, London.

Andrews, Emily and Rashid Mansoora (1996), ''The Financing of Pension Systems in Central and Eastern Europe: An Overview of Major Trends and their Determinants, 1990-1993'', World Bank Technical Paper No. 339, Washington, D.C.

Bednarski, Marek, ed. (1996), *Active Forms of Counteracting Unemployment in Poland*, Institute of Labour and Social Studies, Warsaw (in Polish).

Bailliu, Jeanine and Helmut Reisen (1997), ''Do Funded Pensions Contribute to Higher Aggregate Savings? A Cross-Country Analysis'', OECD Development Centre Technical Paper No. 130, Paris.

Boeri, Tito (1997), ''Heterogeneous Workers, Economic Transformation and the Stagnancy of Transitional Unemployment'', *European Economic Review*, Vol. 41, pp. 905-14.

Boeri, Tito and Scott Edwards (1997), ''Long-Term Unemployment and Short-Term Unemployment Benefits: The Changing Nature of Non-Employment Subsidies in Central and Eastern Europe'', mimeo, OECD, Paris.

Boleslawski, Lech (1997), *Household Projection 1996-2020*, Demographic Stastistics Division, Central Statistical Office, Warsaw (in Polish).

Caplen, Brian (1998), ''A Strange Way to Win a Mandate'', *Euromoney*, April, pp. 28-31.

Carbajo, José and Steven Fries (1997), ''Restructuring Infrastructure in Transition Economies'', European Bank for Reconstruction and Development Working Paper No. 24, London.

de Combrugghe, Alain (1997), ''Wage and Pension Pressure on the Polish Budget'', World Bank Policy Research Working Paper No. 1793, Washington, D.C.

Committee for European Integration (1997a), *National Strategy for Integration*, Warsaw, January.

Committee for European Integration (1997b), *Position of the Government of the Republic of Poland Regarding the Commission's Opinion on Poland's Application for Membership of the European Union*, Warsaw, October.

Cox, Donald, Emmanuel Jimenez, and Wlodek Okrasa (1997), ''Family Safety Nets and Economic Transition: A Study of Worker Households in Poland'', *The Review of Income and Wealth*, Series 43, No. 2, pp. 191-210.

Diamond, Peter (1997), ''Macroeconomic Aspects of Social Security Reform'', *Brookings Papers on Economic Activity*, No. 2, pp. 1-87.

Durjasz, Pawel and Ryszard Kokoszczynski (forthcoming), ''Financial Inflows to Poland'', *Empirica*, Vol. 25, No. 2.

European Commission (1997), *Agenda 2000 - Commission Opinion on Poland's Application for Membership of the European Union*, Brussels, 15 July.

Foreign Trade Research Institute (1997*a*), *Polish Foreign Trade in 1996 – Annual Report*, Warsaw.

Foreign Trade Research Institute (1997*b*), *Foreign Investment in Poland*, Warsaw.

Frydman, Roman, Cheryl Gray, Marek Hessel and Andrzej Rapaczynski (1997), ''Private Ownership and Corporate Performance. Some Lessons from Transition Economies'', World Bank Policy Research Working Paper No. 1830, Washington, D.C.

Gomulka, Stanislav (1997), ''Managing Capital Flows in a Transition Economy: The Case of Poland'', paper presented at a seminar on managing capital flows in Central and Eastern Europe held in Brighton, 26 March.

Gora, Marek (1992), ''Labour Hoarding and its Estimates in Central and Eastern European Economies in Transition'', Polish Public Research Group, Warsaw University, Discussion Paper No. 18.

Gora, Marek (1998), ''Steady-state Unemployment in Poland'', *Revue d'Études Comparatives Est-Ouest*, forthcoming.

Gora, Marek, Hartmunt Lehmann, Mieczyslaw Socha and Urszula Sztanderska (1996), ''Labour Market Policies in Poland'', in *Lessons from Labour Market Policies in the Transition Countries*, OECD Proceedings, CCET, Paris, pp. 151-76.

Grabowski, Maciej and Stephen Smith (1995), ''The Taxation of Entrepreneurial Income in a Transition Economy: Issues Raised by Experience in Poland'', CEPR Discussion Paper No. 1166, London.

Gray, Cheryl W. and Arnold Holle (1996a), ''Bank-Led Restructuring in Poland: An Empirical Look at the Bank Conciliation Process'', World Bank Policy Research Working Paper No. 1650, Washington, D.C.

Gray, Cheryl W. and Arnold Holle (1996b), ''Bank-Led Restructuring in Poland: Bankruptcy and its Alternatives'', World Bank Policy Research Working Paper No. 1651, Washington, D.C.

Grosfeld, Irena and Jean-François Nivet (1997), ''Wage and Investment Behavior in Transition: Evidence from a Polish Panel Data Set'', CEPR Discussion Paper No. 1726, London.

GUS (1997a), ''Economic Activities of Small Enterprises in 1996'', Information and Statistical Papers, Central Statistical Office, Warsaw (in Polish).

GUS (1997b), *Labour Market 1997*, Central Statistical Office, Warsaw (in Polish).

GUS (1997c), *Labour Costs in 1996*, Information and Statistical Papers, Central Statistical Office, Warsaw.

Hanson, Philip (1982), ''The End of Import-Led Growth? Some Observations on Soviet, Polish, and Hungarian Experience in the 1970s'', *Journal of Comparative Economics*, Vol. 6, pp. 130-47.

Helpman, Elhanan (1997), ''R&D and Productivity: the International Connection'', NBER Working Paper No. 6101.

Hübner, Danuta (1997), ''A Strategy for SMEs in Poland'', in *Entrepreneurship and SMEs in Transition Economies. The Visegrad Conference*, CCET/LEED, OECD, Paris, pp. 65-76.

Hryniewicz, Janusz, Bohdan Jalowiecki and Agnieszka Mync (1997), *The Brain Drain from Sciences and Universities in Poland, 1994-96*, European Institute for Regional and Local Development, University of Warsaw, Regional and Local Studies.

International Monetary Fund (1997), *Poland-Recent Economic Developments*, IMF Staff Country Report No. 97/33, Washington, D.C.

James, Estelle (1997), ''New Systems for Old Age Security: Theory, Practice, and Empirical Evidence'', World Bank Policy Research Working Paper No. 1766, Washington, D.C.

Kabaj, Mieczyslaw (1996), ''Programmes and Strategies for Counteracting Unemployment and the Promotion of Productive Employment in Poland'', ILO-CCET Report 15, International Labor Office, Budapest.

Kabaj, Mieczyslaw (1997), ''Jobless or Employment-oriented Growth Strategy? Searching for Dual Model of Development of the Polish Economy (1996-2000)'', in *European Space-Baltic Space-Polish Space*, ARL, Hannover and Warsaw.

Kalaska, Malgorzata, Stanislawa Kostrubiec, Janusz Witkowski (1996), *Non-registered Labour in Poland in 1995*, Studies and Statistical Analyses, Central Statistical Office, Warsaw (in Polish).

Kalaska, Malgorzata and Janusz Witkowski (1997), *Labour Market in Poland in 1996: Continuation of Positive Trends*, Central Statistical Office, Warsaw.

Keune, Maarten (1997), ''Youth Unemployment in Hungary and Poland'', Paper prepared for the Action Programme on Youth Unemployment, Budapest.

Kierzkowska, Danuta (ed), *The Polish Labour Code* (as of 15th April 1997), Tepis Publishing House, Warsaw.

Kolodko, Grzegorz and Mario Nuti (1997), ''The Polish Alternative: Old Myths, Hard Facts and New Strategies in the Successful Transformation of the Polish Economy'', WIDER, Research for Action No. 33.

Konopielko, Lukasz (1997), ''Reserve Requirements as an Implicit Tax: the Case of Poland and Hungary'', *Communist Economies & Economic Transformation*, Vol. 9, No. 2, pp. 209-18.

Kostrubiec, Stanislawa and Anna Kowalska (1997), *Effectiveness of Labour Market Policy*, Central Statistical Office, June (in Polish).

Krajnyak, Kornelia and Jeromin Zettelmeyer (1997), ''Competitiveness in Transition Economies: What Scope for Real Appreciation?'', IMF Working Paper No. 97/149, Washington, D.C.

Kwiatkowski, Eugeniusz (1996), ''Remarks on the Role of Active Labour Market Policies in Poland'', Institute of Economics, University of Lodz, mimeo.

La Porta, Rafael and Florencio Lopez-de-Silanes (1997), ''The Benefits of Privatization: Evidence from Mexico'', NBER Working Paper No. 6215.

Lehmann, Hartmut and Jonathan Wadsworth (1997), ''New Jobs, Worklessness and Households in Poland'', *European Economic Review*, Vol. 41, pp. 915-23.

Marczewski, Krzysztof (1997), ''Selected Aspects of Competitiveness of Polish Exports'', Foreign Trade Research Institute Discussion Paper No. 70, Warsaw.

Milesi-Ferretti, Gian Maria and Assaf Razin (1996), ''Current account sustainability'', *Princeton Studies in International Finance*, No. 81.

Ministry of Finance (1997), *Polish Treasury Securities – Annual Report 1996*, Warsaw.

Ministry of Finance (1998), *Medium-Term Financial Strategy 1999-2001*, mimeo, 11 March, Warsaw (in Polish).

Ministry of National Education (1996a), *Education in a Changing Society*, 2nd edition, Warsaw.

Ministry of National Education (1996b), *Development of Education in Poland*, Warsaw.

Ministry of National Education (1998), *Reform of the Education System: A Preliminary Concept*, Warsaw, January.

Ministry of the Treasury (1997), *Guidelines for the State Asset Privatisation Programme until 2000*, Warsaw.

Mitchell, Olivia and Flávio Atabila Barreto (1997), ''After Chile, What? Second-Round Pension Reforms in Latin America'', NBER Working Paper No. 6316.

Montes-Negret, Fernando and Luca Papi (1997), ''The Polish Experience with Bank and Enterprise Restructuring'', World Bank Policy Research Working Paper No. 1705, Washington, D.C.

National Bank of Poland (1996a), *Foundations of Monetary Policy for 1997*, Warsaw, October (in Polish).

National Bank of Poland (1996b), *Inflation report*, Warsaw, December (in Polish).

National Bank of Poland (1997), *Annual Report 1996*, Warsaw.

National Labour Office (1995), *Promotion of the Youth Vocational Activity*, Warsaw, June.

NIK (1996), *Extra-budgetary Funds in the State Budget System. Information on the Outcomes of NIK Controls in 1991-1996*, Supreme Board of Inspection, Warsaw, November (in Polish).

NIK (1997*a*), *Information on the Outcomes of Controls on the Execution of the State Budget in 1996. Central Investment Projects*, Supreme Board of Inspection, Warsaw, July (in Polish).

NIK (1997*b*), *Information on the Outcomes of Controls in the Field of Ownership Transformation in the National Economy in 1996*, Supreme Board of Inspection, Warsaw, September (in Polish).

NIK (1997*c*), *Information on the Outcomes of Controls on the Implementation of the Law on Sugar Market Regulation*, Supreme Board of Inspection, Warsaw, October (in Polish).

Nivet, Jean-François (1997), ''Les spécificités de la grande privatisation en Pologne'', *Économie Internationale*, No. 70, pp. 79-97.

Norregaard, John (1997), ''The Tax Treatment of Government Bonds'', IMF Working Paper No. 97/25, Washington, D.C.

OECD (1992), *Economic Survey of Poland*, CCEET, Paris.

OECD (1993), *The Labour Market in Poland*, CCET, Paris.

OECD (1994*a*), *The OECD Jobs Study: Facts, Analysis, Strategies*, Paris.

OECD (1994*b*), *The OECD Jobs Study: Evidence and Explanations*, Paris.

OECD (1995*a*), *Economic Survey of Poland*, CCET, Paris.

OECD (1995*b*), *The OECD Jobs Study: Taxation, Employment and Unemployment*, Paris.

OECD (1995*c*), *The OECD Jobs Study: Implementing the Strategy*, Paris.

OECD (1996*a*), *Economic Survey of Poland*, Paris.

OECD (1996*b*), *Reviews of National Science and Technology Policy: Poland*, CCET, Paris.

OECD (1996*c*), *Reviews of National Policies for Education – Poland*, CCET, Paris.

OECD (1996*d*), *Systems for Financing Newly Emerging Private Enterprises in Transition Economies*, OECD Proceedings, CCET, Paris.

OECD (1996*e*), *Enhancing the Effectiveness of Active Labour Market Policies*, Paris.

OECD (1997*a*), *Implementing the OECD Jobs Strategy: Member Countries' Experience*, Paris.

OECD (1997*b*), *Economic Survey of Hungary*, Paris.

OECD (1997*c*), *Making Work Pay: Taxation, Benefits, Employment and Unemployment*, Paris.

OECD (1997*d*), *Agricultural Policies in OECD Countries: Monitoring and Evaluation 1997*, Paris.

OECD (1997*e*), *Employment Outlook*, Paris.

OECD (1997*f*), *Education at a Glance: OECD Indicators*, Paris.

OECD (1997*g*), *The Macroeconomics of Ageing, Pensions and Savings: A Survey*, ECO/CPE/WP1(97)10, Paris.

OECD (1997*h*), *Joint ILO-OECD Workshop: Development and Reform of Pension Schemes, a World Bank Perspective on Pension Reform*, DEELSA/ILO(97)11, Paris.

OECD (1997*i*), *Literacy Skills for the Knowledge Society: Further Results from the International Adult Literacy Survey*, Paris.

OECD (1998*a*), *The Retirement Decision in OECD Countries*, ECO/CPE/WP1(98)2, Paris.

OECD (1998*b*), *Employment Outlook*, Paris, forthcoming.

OECD (1998*c*), *Economic Survey of the Czech Republic*, Paris.

Office for Competition and Consumer Protection (1997), *1996 Activity Report*, Warsaw (in Polish).

Office of the Government Plenipotentiary for Social Security Reform (1997), *Security Through Diversity: Reform of the Pension System in Poland*, Warsaw, May.

Polish Foundation for Small and Medium Enterprise Promotion and Development (1997), *A Report for the Years 1995-1996*, USAID-GEMNI PEDS Project, Warsaw.

Puhani, Patrick (1996), ''Poland on the Dole: Unemployment Benefits, Training, and Long-Term Unemployment during Transition'', Zentrum für Europäische Wirtschaftsforschung Discussion Paper No. 96-30, Mannheim.

Puhani, Patrick (1998), *What Works? An Evaluation of Active Labour Market Policies in Poland during Transition*, mimeo, University of Munich.

Punahi, Patrick and Viktor Steiner (1997), ''The Effectiveness and Efficiency of Active Labour Market Policies in Poland'', *Empirica*, Vol. 24, pp. 209-31.

Research Centre for Economic and Statistical Studies of the Central Statistical Office and the Polish Academy of Sciences, and Statistical Office in Katowice (1997), *Gross Domestic Product by Voivodships for 1995: Experimental Calculations*, Warsaw, August.

Roseveare, Deborah, Willi Leibfritz, Douglas Fore and Eckhard Wurzel (1996), ''Ageing Populations, Pension Systems and Government Budgets: Simulations for 20 OECD Countries'', OECD Economics Department Working Paper No. 168, Paris.

Rutkowski, Jan (1996), ''High Skills Pay Off: The Changing Wage Structure During Economic Transition in Poland'', *Economics of Transition*, Vol. 4, No. 1, pp. 89-111.

Rutkowski, Jan (1997), ''Low Wage Employment in Transitional Economies of Central and Eastern Europe'', *MOCT-MOST*, Vol. 7, No. 1, pp. 105-30.

Saganowska, Elzbieta and Teresa Smilowska (1996), ''Estimates of GDP by voivodships in the years 1992-1994'', *RECESS Research Bulletin*, Vol. 5, No. 3, pp. 45-69.

Shah, Hemant (1997), ''Toward Better Regulation of Private Pension Funds'', World Bank Policy Research Working Paper No. 1791, Washington, D.C.

Scarpetta, Stefano (1996), ''Assessing the Role of Labour Market Policies and Institutional Settings on Unemployment: A Cross-Country Study'', *OECD Economic Studies*, No. 26, pp. 43-98.

Scarpetta, Stefano and Sandrine Cazes (1997), ''Labour Market Flows and Unemployment Duration in Transition Countries: Evidence from Bulgarian and Polish Micro-Data'', Delta Working paper No. 97-31, Paris.

UNDP (1996), *Poland '96 Habitat and Human Development*, Warsaw.

Van Ark, Bart, Erik Monnikhof and Marcel Timmer (1996), ''Prices, Quantities and Productivity in Industry: A Study of Transition Economies in a Comparative Perspective'', Paper presented at an NBER Conference on Research in Income and Wealth, Washington, D.C., 15-16 March.

Van Wijnbergen, Sweder (1997), ''On the Role of Banks in Enterprise Restructuring: The Polish Example'', *Journal of Comparative Economics*, Vol. 24, pp. 44-64.

Wasilewski, Leslaw, Stefan Kwiatkowski and Jan Kozlowski (1997), ''Science and Technology in Poland in the 1990s: Context, Measures, Tendencies'', mimeo, Warsaw, June.

World Bank (1997), *Poland Country Economic Memorandum: Reform and Growth on the Road to the EU*, Report No. 16858-POL, Washington, D.C.

Zienkowski, Leszek, ed. (1996), *Small and Medium Sized Enterprises' Contribution to the Development of the Polish Economy*, Research Centre for Economic and Statistical Studies of the Central Statistical Office and the Polish Academy of Sciences, mimeo (in Polish).

Annex I

How large is foreign direct investment?

Compared with other central European countries, Poland's record in attracting foreign direct investment (FDI) lagged behind its macroeconomic performance during the first half of the 1990s. In 1996-97, however, inflows accelerated spectacularly, and Poland started to close the gap it had accumulated *vis-à-vis* these countries.[1] This annex provides some information on the size and composition of FDI.[2]

The use of different types of statistics to describe FDI trends is a potential source of confusion. A frequently cited measure pertains to investment projects as monitored by the Polish Agency for Foreign Investment (PAIZ). The corresponding flows, however, do not all take place in the year PAIZ registers the investment. The National Bank of Poland publishes monthly series for net FDI inflows which reflect transactions inasmuch as they are mediated by banks. Those data, however, exclude contributions in kind and reinvested earnings. The annual, accruals-based balance of payments statistics do include those components alongside the cash inflows, and are thus a more comprehensive measure of FDI inflows.[3]

All measures point to a clear acceleration of inflows around the mid-1990s (Table A1). FDI inflows have dwarfed portfolio inflows, a positive feature of the financing of the current account deficit. A large portion of FDI has consisted of the purchase of shares, notably in the context of capital privatisation.

According to the PAIZ, the largest foreign investors as of end-1997 included Fiat (with a stock of $1 142 million), Daewoo ($1 011 million), the European Bank for Development and Reconstruction ($617 million), the Polish-American Enterprise Fund ($505 million), Pepsi ($412 million), IPC ($370 million), ING ($350 million), Coca-Cola ($285 million), ABB ($282 million), Philip Morris ($282 million), the World Bank's International Financial Corporation ($277 million), and Nestlé ($248 million).

While Poland has become the first destination of FDI in the region in absolute terms, the stock of FDI per capita in Poland was still only one-third of that in Hungary at the end of 1997. On that measure, Slovenia and the Czech Republic have also remained clearly ahead of Poland. The privatisation of some large Polish enterprises scheduled for 1998-99, however, may help Poland to catch up with these countries.

Table A1. **Foreign direct investment flows and stocks**

	1994	1995	1996	1997
Flows ($ million)				
Inward				
PAIZ statistics				
Projects of over $1 million	1 493	2 512	5 196	5 678
Estimated total projects	..	..	..	6 600
Balance of payments statistics				
Cash-based, gross	542	1 132	2 768	3 077
Accruals-based, gross	1 875	3 659	4 498	..
of which: Purchased shares	884	1 807	2 845	..
Reinvested earnings	382	888	244	..
Loans from foreign shareholders	397	666	1 095	..
In-kind contributions	212	298	314	..
Outward				
Accruals-based, gross	29	42	53	..
Memorandum item: Net porfolio inflows [1]	–624	1 171	241	2 098
End-period stocks ($ billion)				
Foreign direct investment in Poland				
PAIZ statistics				
Projects of over $1 million	4.3	6.8	12.0	17.7
Estimated total projects	..	..	14.0	20.6
Commitments	4.9	5.3	7.9	10.8
NBP statistics	3.8	7.8	11.5	..
of which: Equity and reinvested earnings [2]	2.8	6.1	8.7	..
Polish direct investment abroad	0.5	0.5	0.7	..

1. Cash-based balance-of-payments data.
2. Includes contributions in kind and excludes loans.

Source: Polish Agency for Foreign Investment (PAIZ); National Bank of Poland (NBP).

Polish direct investment abroad is still very limited. At the end of 1996, the stock thereof represented only 6 per cent of the stock of foreign direct investment in Poland. It essentially consisted of government stakes in foreign institutions ($274 million) and Polish banks' stakes in branches and companies abroad.

Notes

1. The underlying reasons were discussed in the previous Survey.
2. A wealth of details can be found in FTRI (1997*b*).
3. Yet another source on FDI are the statistics compiled by the Central Statistical Office, which provide useful information on the activities of resident companies with foreign participation.

Annex II

Devolution

During the first half of the 1990s, some responsibilities were devolved from the central to lower levels of government (notably with respect to education and health care). Proposals involving deeper decentralisation and re-organisation were debated during the previous legislature, but apart from a pilot programme entrusting 46 large cities with more autonomy, no agreement was reached on further, large-scale devolution. The coalition agreement signed last fall by the parties now in government includes a commitment to push ahead with devolution.

As of March 1998, a package of bills was under preparation providing for the creation of two new levels of government. The present structure comprises three echelons: the central government; 49 provinces, or *voivodships*; and close to 2 500 communes, or *gminas*. The new arrangement would introduce an additional echelon, in the form of slightly over 300 counties, or *powiats*, while the existing provinces would be merged into 12 or more larger regions.* The governors of the latter would play a supervisory role, and much of the executive power would rest with elected regional assemblies. *Powiat* officials would be locally elected.

From the fiscal standpoint, this reform would involve significant further decentralisation of public finances. Regions, *powiats* and *gminas* would be assigned a share of the personal and/or corporate income tax receipts collected within their boundaries. Transfers would be paid from the central budget to the poorer regions. Regions would be in charge of such areas as police and economic development (including enterprise subsidies). They would play an important role in the allocation of financial assistance from the European Union. *Powiats* would administer health, secondary education (primary education remaining a communal responsibility), cultural institutions and roads. *Gminas* would retain their current responsibilities and a new cadastral real estate tax, based on property value rather than on square meters, would be one of their main sources of funding.

* In a formal sense, the reform would represent a return to the set-up prevailing until the mid-1970s, which featured 330 *powiats* and 17 large *voivods* (at the time, however, those sub-national echelons had little autonomy). The envisaged seats for the new large regions, if there were to be no more than 12, were Bialystok, Krakow, Gdansk, Katowice, Lublin, Lodz, Olsztyn, Poznan, Rzeszow, Szczecin, Warsaw and Wroclaw.

The envisaged set-up is intended to improve public management by a more systematic application of the principle of subsidiarity and by enhancing the accountability of local officials. It also aims at streamlining Poland's heavy administrative apparatus. Politically, however, the redistribution of powers entailed by the reform is causing strong resistance on the part of a number of areas where residents fear to lose out. Moreover, the success of the reform will depend on how effectively such a wholesale re-restructuring is implemented. The fate of some of the most important sectoral reforms – *e.g.* in health care and education – is directly linked to that of devolution.

Annex III

Selected large privatisations

The era of large privatisations has dawned in Poland. This annex provides background information on some of the larger deals that have been recently completed or are in the works (Tables A2 and A3). It illustrates the diversity of privatisation modalities and the difficulties that were encountered in some cases.

One of the two largest privatisations since the onset of transition took place in **banking**. The sale of Bank Handlowy raised Zl 1.6 billion (equivalent to 0.4 per cent of 1997 GDP and 25 per cent of the privatisation receipts channelled to the state budget in 1997).[1] In June 1997, 85 per cent of the stock was floated, in four tranches: individual investors, institutional investors, ''stable'' investors, and employees, with the Treasury retaining 5 per cent as a reserve for restitution. The Treasury also received a pack of convertible bonds issued by Bank Handlowy, representing 25 per cent of the bank's total capital (stock plus convertible bonds), which are to be set aside for the financing of pension system reform. Demand from individual investors was thrice the allotted amount, and demand from institutional investors 17 times, enabling the Treasury to reduce the proportion of stock going to non-residents.

In October 1997, a public offering was held of 70 per cent of the shares of another sizeable bank, Powszechny Bank Kredytowy (Warsaw), following the cancellation of an earlier tender. This was the third largest 1997 deal. The State retained 5 per cent as a reserve for restitution and 10 per cent on account of pension system reform.

The Pekao group of state-owned banks (including apart from Pekao bank itself Powszechny Bank Gospodarczy in Lodz, Bank Depozytowo-Kredytowy in Lublin and Pomorski Bank Kredytowy in Szczecin) was to be privatised in 1999 but in late 1997 the new government decided to accelerate the process and to carry out privatisation in 1998. Current plans foresee a public offer of 15 per cent of Pekao group's shares, the attribution of up to 15 per cent to its employees, and the search for one or a group of strategic investors who would buy 35 per cent of the shares. Bank Zachodni (Wroclaw), the last Treasury-owned commercial bank, is to be privatised in 1998 as well.

Furthermore, the process of ownership transfer of the agricultural bank, Bank Gospodarki Zywnosciowej, and of the state savings bank, Powszechna Kasa Oszczednosci BP, is to get underway in 1998. However, further restructuring is to take

Table A2. **Selected large enterprises subjected to privatisation**

Firm	Sector	Employment end-1996	Assets end-1996[1]	Revenues in 1996[1]	Gross profits in 1996[1]
Privatised					
Bank Handlowy	Banking	4 365	14 676	1 617	747
KGHM	Copper producer	25 837	4 346	3 995	455
Elektrocieplownia Krakow	Energy and heating plant	786	404	259	50
Orbis	Travel/hotel services	10 524	748	528	55
PBK	Banking	5 942	9 244	1 218	368
Polfa Poznan	Pharmaceuticals	1 316	222	371	112
ZPT Krakow	Tobacco	4 121	782	2 134	33
DT Centrum	Chain of department stores	5 744	164	407	7
Undergoing privatisation					
TP	Telecommunications	73 506	11 016	6 433	1 500
Group Pekao	Banking	23 487[3]	42 276	2 611	565
Bank Zachodni	Banking	6 787	5 045	849	207
Huta Katowice	Metallurgy	20 332	3 771	3 345	–261
Huta Sendzimira	Metallurgy	17 486	2 837	2 633	19
Ruch	Press distribution chain	13 535	497	2 432	19
LOT	Transportation	4 265	1 257	1 304	–41
CPN	Petrol distribution network	10 243	1 211	12 544	263
Petrochemia Plocka[2]	Oil sector	8 126	4 628	9 304	381
Rafineria Gdanska[2]	Oil sector	1 667	1 184	3 161	72
PZU	Insurance	14 396	2 188	3 527	–177
ZE PAK	Energy	4 422	734	882	46
ZE Bedzin	Energy	409	93	79	9

1. In zloty millions.
2. Part of the holding company Nafta Polska.
3. Year-average.

Source: Ministry of Treasury; companies.

place before privatisation, meaning that the latter cannot become effective immediately. Privatisation will have to be accompanied by the termination of the preferential deposit guarantee regime enjoyed by those banks, which has thus far enabled them to offer lower deposit rates (Committee for European Integration, 1997*b*).[2]

Alongside Bank Handlowy, the other very large privatisation in 1997 was that of the giant **copper and silver** producer KGHM Polska Miedz, which raised Zl 1.3 billion. Demand for shares was higher than planned, leading to an increase in the proportion of stock offered to small domestic investors. The State retained 52 per cent of the stock. In early 1998, the largest in-house trade union manifested its opposition to further state divestiture.

A plan for the restructuring and privatisation of the **oil** sector was approved by the government in mid-1995. In May 1996, a holding company, Nafta Polska, was set up embracing majority stakes in all the publicly owned refineries. The state-owned petrol

Table A3. **Privatisation modalities and outcomes**

Firm	Date of commercialisation	Date of privatisation	Method	Proportion of shares offered for sale (per cent)	Budget revenue (Zl million)	Ownership structure after privatisation in per cent				
						State	Employees	Strategic investor(s)	Institutional investors	Individual investors
Privatised										
Bank Handlowy	n.a.	Jul. 97	IPO	85	1 647.2	7.9	7.1	0.0	56.0	29.0
KGHM	9 Sep. 91	Aug. 97	IPO	36	1 348.4	52.1	15.0	0.0	0.0	32.9
Elektrocieplownia Krakow	13 Feb. 92	Oct. 97	Trade sale	55	79.8	30.0	15.0	55.0	0.0	0.0
Orbis	1 Sep. 91	Nov. 97	IPO	27	91.2	69.8	15.0	0.0	0.0	15.2
PBK	25 Nov. 91	Oct. 97	IPO	70	1 006.6	18.3	15.0	0.0	44.1	22.7
Polfa Poznan	7 Jan. 95	Jan. 98	Trade sale	80	770.3	5.0	15.0	80.0	0.0	0.0
ZPT Krakow	27 Oct. 93	Jan. 96	Trade sale	65	579.7	5.0	30.0	65.0	0.0	0.0
DT Centrum	23 Jul. 93	Feb. 98	Trade sale	80	106.0	5.0	15.0	80.0	0.0	0.0
Undergoing privatisation (modalities envisaged as of early 1998)										
TP	4 Dec. 91	1998	IPO + new share issue	10 + 10[2]		68.2	13.6	0	← 18.2 →	
Group Pekao	16 Sep. 96[1]	1998	IPO/trade sale	50		35	15	35	← 15 →	
Bank Zachodni	11 Aug. 91	1998	No advisor yet	..		..	..	..	..	..
Huta Katowice	24 Jul. 91	1998-99	JV with strategic investor	..		..	..	..	0	0
Huta Sendzimira	5 Jan. 97	1998	JV with strategic investor	..		..	..	..	0	0
Ruch	24 Mar. 92	1998	Trade sale	Up to 80		5 or more	15	Up to 80	0	0
LOT	30 Nov. 92	1998-99	No advisor yet	..		..	..	..	..	..
CPN	12 Jan. 95	1998	Merger with Petrochemia Plocka							
Petrochemia Plocka	7 Jan. 93	1998	IPO	30		55	15	0	← 30 →	
Rafineria Gdanska	18 Sep. 91	1998	Trade sale	At least 50		Up to 35	15	At least 50	0	0
PZU	23 Dec. 91	1998-2000	No advisor yet	..		..	..	..	..	..
ZE PAK	29 Dec. 94	1998	Trade sale	20 + 30[2]		50	11.5	38.5	0	0
ZE Bedzin	23 Feb. 93	1998	IPO	25 + up to 50[2]		At least 40	10 to 15	0	← Up to 50 →	

Note: IPO stands for initial public offering, JV for joint-venture and n.a. for not applicable.

1. Date of consolidation.
2. New share issue.

Source: Ministry of the Treasury; companies.

distribution network CPN, however, objected to this scheme because it would have involved splitting up CPN, and undertook legal action against it in the course of last year. In spring 1998, the government updated the programme. It called for the absorption of CNP by Petrochemia Plocka by the summer of 1998 and for setting up an oil corporation that would float 30 per cent of its stock on the Warsaw Stock Exchange and abroad in 1999. Rafineria Gdanska would be privatised this year by selling a majority stake to a foreign strategic investor who would be invited to also purchase 200 filling stations from CPN. Nafta Polska itself would co-ordinate the restructuring and privatisation of oil sector companies and be dissolved in 2001. How rapidly and effectively those plans would be implemented remained rather uncertain, even though the need to push ahead was clear enough, not least because import tariff protection is scheduled to end in 2000.[3]

The first foreign investor to penetrate the Polish **power industry** was Électricité de France (EDF), which in the autumn of 1997 bought 55 per cent of the stock of the Elektrocieplownia Krakow combined heat-and-power plant, one of the largest among the 11 such generators in Poland.[4] EDF outbid a US and a Turkish competitor, and paid about 50 per cent over their book value for the shares. EDF reportedly intends to increase its stake in the company in the near future through a new stock issue, which would help finance the plant's modernisation (in contrast to the payment for the acquisition, which went to the Treasury).

Currently under preparation are the sale to strategic investors of up to 50 per cent of the stock of the large Patnow-Adamov-Konin group of power plants, and the flotation on the Warsaw Stock Exchange of up to 75 per cent of the stock of the Bedzin power plant.[5] As of early 1998, the Ministry of the Treasury was considering grouping the other power plants into six to eight consortia before privatising them. The outcomes of future privatisation deals in this sector also hinge on the government's policy with respect to electricity prices, which remain regulated for the time being.

In the **transportation** sector, the privatisation of the national airline, PLL LOT, has been delayed several times over the past few years. It now features among the prominent deals scheduled for 1998. In early 1998, however, the Ministry of the Treasury considered that LOT should first undergo financial restructuring, arguing that this would raise the price at which it can be privatised. This could delay the completion of the deal into 1999.

The privatisation of the **telecommunications** giant Telekomunikacja Polska scheduled for this year will be by far the largest ever in Poland. The selection of an advisor started in December 1997.[6] At that time, the government's stated intention was to proceed in the second half of 1998 with the flotation of about 20 per cent of the company's stock,[7] of which one third on the Warsaw Stock Exchange and the rest abroad (in the form of general depository receipts). The search for a strategic investor would take place over the next few years.

The privatisation of Poland's largest **insurance** company, PZU (Powszechny Zaklad Ubezpieczen) did not proceed as planned. In late 1996, the principle was endorsed of a new share issue which would have allowed a group of outside investors to take control over 19 to 34 per cent of the company's capital, thereby strengthening the weak capital basis of the loss-making PZU. However, the end-November 1997 deadline lapsed without any issue having taken place, even though at least one consortium of investors put in a bid.[8] In early 1998, the government was working on a new restructuring and privatisation scheme for PZU.

Large privatisation deals in other sectors include the sale of 15 per cent the stock of Orbis, Poland's largest **tourist agency** and hotel chain, in late 1997. The State, however, retained 70 per cent of the shares. Among the more lucrative divestiture operations were also the privatisations of six **tobacco** companies since 1995. Western producers bought 65 per cent of the shares in four of those plants (ZPT Cracow and WWT Poznan tobacco companies, and Augustow and Radom cigarette plants), in which the Treasury retains a golden share until 2005. In **pharmaceuticals**, an agreement was reached in January 1998 on the sale of 80 per cent of the stock of Polfa Poznan, the second largest enterprise in this sector, to a British firm. The latter pledged to inject fresh capital into the company and to guarantee employment for four years to the incumbent employees. The Treasury retained a golden share, however. The privatisation of a chain of **department stores**, Domy Towarowe Centrum, which includes 31 retail outlets in various localities, was recently completed, after three and a half years of proceedings. A consortium led by Bank Handlowy purchased 80 per cent of the enterprise's shares. A preliminary agreement on the sale of the **press** distribution network Ruch to a group of Polish publishers allied with the French company Hachette was annulled by the Treasury Minister in March 1997, causing a dispute currently awaiting a settlement in court.

Forthcoming is the privatisation of a large **steel** mill, Huta Sendzimira. The latter was commercialised in May 1997 and a tender was organised in early 1998 to select a strategic (possibly foreign) investor. The company's heavy debt reflects the considerable investments it has undertaken to modernise its production apparatus, including from an environmental point of view. It counts on an outside investor, as well as on the forthcoming issue of a eurobond, to finance further investments.[9]

Notes

1. For further analysis of bank restructuring and privatisation in Poland, see Gray and Holle (1996*a*, *b*), OECD (1996*a*) and Abarbanell and Bonin (1997).
2. Besides the above operations, one should note the sale of the State's residual shares in some banks (effected in 1997 for Bank Slaski, and scheduled in 1998 for Bank Przemyslowo-Handlowy and the Polski Bank Rozwoju).
3. As argued for instance by the director of the Gdansk refinery, in whose view the survival of the enterprise beyond 2005 requires an upfront infusion of outside capital and therefore hinges on prompt privatisation (*Rzeczpospolita*, 30 December 1997).
4. The process of ownership transfer had started as far back as in May 1991 in the case of this company, when it applied to the Ministry of Privatisation for commercialisation. In September 1991, the firm was about to sign a joint-venture agreement with a US partner. The Ministry, however, decided that the firm would undergo capital privatisation (with EDF already considered as a potential strategic investor). In the meantime, the mayor of Krakow requested from the regional authorities that the enterprise be municipalised. This request was rejected and the case went to court. Judicial proceedings, until the final decision of the Supreme Administrative Court in November 1995, precluded any privatisation decisions. In September 1996, the Ministry resumed negotiations with EDF (see NIK, 1997*b*).
5. Including, respectively, an issue of 30 and 50 per cent of new shares.
6. On the problems that arose during this selection process, see Caplen (1998).
7. Those 20 per cent would include some existing shares and some new ones.
8. PZU's supervisory board reportedly found the bid too low, while PZU's management board held the opposite view. In the end, the Treasury Minister decided to reject it.
9. In early 1998, the government took the position that only one strategic investor should be allowed to participate in the privatisation of the two largest mills, Huta Sendzimira and Huta Katowice, calling for some synchronisation between the two deals.

Annex IV

Chronology of main economic events and policy measures

1996

September

An agreement is signed on the delivery of 250 billion cubic meters of Russian natural gas to Poland over a period of 25 years, linked to the construction of a transit pipeline connecting Russia with Germany through Poland.

October

Some provisions of the August 1996 law on commercialisation and privatisation of state enterprises come into force (the others becoming effective in March 1997).

The gross monthly minimum wage is raised to Zl 370.

November

The distribution of investment certificates in the context of the mass privatisation programme ends, with 96.1 per cent of the eligible citizens having retrieved their certificate.

Poland officially becomes an OECD Member.

The personal income tax law is amended, with rates for 1997 lowered to 20, 32 and 44 per cent (against 21, 33 and 45 per cent). The scope for tax-deductible donations is reduced and the system of deductions associated with housing investment is changed.

The corporate income tax law is amended: the rate is to be cut by 2 percentage points per annum, from 40 per cent in 1996 to 32 per cent by 2000. Depreciation rules are changed.

December

An over-the-counter stock market is launched.

1997

January

The residual 3 per cent import surcharge is abolished, and a number of customs duties are cut by 20 per cent in line with the Association Agreement with the European Union and with the provisions of the Central European Free Trade Association.

The ceiling for the corporate income tax allowance granted to exporters on account of investment outlays is reduced from 50 to 40 per cent.

The Sejm restores a 10 per cent duty on grain imports.

Central heating and warm water prices are increased by 10 per cent, the price of electricity by 17 per cent and that of natural gas by 18 per cent.

A Ministry of the Economy starts operating, merging the former ministries of Foreign Economic Relations and of Industry and Trade.

The government endorses a *National Integration Strategy*, a roadmap to European Union accession.

The gross minimum monthly wage is raised to Zl 391.

February

Deputy Premier and Minister of Finance Grzegorz Koldoko resigns and is replaced by Marek Belka.

The Ministry of Finance frees liquid fuel prices.

The budget law for 1997 is signed by the President. It targets a deficit of 2.8 per cent of GDP for the state budget and of 3.0 per cent for the general government (counting privatisation receipts as revenue). It is based on a projected 5.5 per cent increase in real GDP. The objective for December-on-December consumer price inflation is 13 per cent.

The NBP increases required reserves rates from 17 to 20 per cent for demand zloty deposits and from 2 to 4 per cent on foreign exchange deposits.

Parliament passes a health insurance law.

March

Pensions are increased by 7.5 per cent.

April

The gross monthly minimum wage is raised to Zl 406.

The government approves the creation of three new special economic zones, in Legnica, Lodz and Walbrzych.

A law on the compensation for the non-indexation of public sector wages and loss of certain increases and allowances to old-age and disability pensioners becomes effective.

May

The NBP increases required reserve rates from 9 to 11 per cent for zloty time deposits and from 4 to 5 per cent for foreign exchange deposits.

The press reports that the Ministry of Finance has repurchased Brady bonds, reducing Poland's external debt by over 4 per cent.

Mass privatisation certificates start to be exchanged for national investment fund shares.

A new constitution is approved in a nation-wide referendum (coming into effect in October 1997).

June

Bank Handlowy is privatised.

Poland issues a $400 million 10-year and a $100 million 20-year bond on the US market.

National investment fund shares start to be quoted on the Warsaw Stock Exchange.

July

Shares of the copper producer KGHM Polska Miedz are floated on the Warsaw and London stock exchanges.

The European Commission publishes its opinion on the readiness of the eleven countries applying to join to EU. Poland is one of those deemed best prepared.

Devastating floods sweep through the South and South West of Poland.

NATO member states invite Poland, alongside Hungary and the Czech Republic, to join the Organisation.

A law on securities and guarantees by the State Treasury and by certain legal persons enters into force.

August

The NBP raises the rediscount rate by 2½ per cent, to 24½ per cent, and the Lombard rate by 2 per cent, to 27 per cent.

A law is passed amending the 1997 budget in order to provide various forms of assistance to the victims of the floods.

A law is passed establishing a central commercial register.

The Tripartite Commission fails to set norms for the growth of wages in 1998.

September

Pensions are increased by 5.2 per cent.

The NBP starts to offer households term deposits with attractive interest rates.

The government approves the creation of 9 new special economic zones, in Starachowice, Kamienna Gora, Tarnobrzeg, Olsztyn, Slupsk, Kostrzyn-Slubice, Czestochowa, Zarnowiec and Tczew.

Parliamentary elections are held on 21 September. Solidarity Election Action receives 33.8 per cent of the vote, the Democratic Left Alliance 27.1 per cent, Freedom Union 13.4 per cent, the Peasant Party 7.3 per cent and the Movement for Reconstruction of Poland 5.6 per cent.

October

The gross monthly minimum wage is raised to Zl 450.

Powszechny Bank Kredytowy is privatised.

The European Investment Bank grants Poland a ECU 300 million credit line for the rebuilding of infrastructure destroyed by the floods.

The government approves the creation of 2 additional special economic zones, in Krakow and Modlin.

A new coalition government, headed by Jerzy Buzek and including Leszek Balcerowicz as Deputy Premier in charge of Finances, is sworn in.

November

An amended draft budget law for 1998 is sent to Parliament.

The new Minister of the Treasury unveils a new scheme of national enfranchisement funds.

December

The European Commission bans imports of Polish milk and dairy products following some on-site inspections.

The World Bank grants Poland a $200 million loan for the repair and construction of roads and bridges.

A law on industrial funds formally is to come into force, but the project is on hold following the change in government.

Poland signs an agreement with a number of other members of the World Trade Organisation on the liberalisation of financial services.

A new energy law comes into force.

The Ministry of Economics issues an ordinance setting out the rules to govern imports of car parts for assembly in Poland in 1998.

1998

January

Two new banking laws take effect: the banking law and the law on the National Bank of Poland.

A new securities law enters into force, *inter alia* easing some registration requirements and expanding the role of brokerage houses.

A new law on investment funds takes effect, allowing the creation of closed-ended funds.

A new bankruptcy law comes into force.

A new law on mortgage bonds and mortgage banks comes into force, which is intended to boost housing loans and housing construction.

The ceiling for the corporate income tax allowance granted to exporters on account of investment outlays is reduced from 40 to 30 per cent.

A new tax code comes into force.

Reserve requirements on non-resident bank deposits in resident banks are introduced.

New lien regulations take effect requiring the Justice Ministry to establish a central lien register which is to make it easier for lenders to check whether some piece of property is used as a collateral.

Personal income tax rates are cut to 19, 30 and 40 per cent.

A number of customs duties are cut by 20 per cent in line with the Association Agreement with the European Union and with the provisions of the Central European Free Trade Association.

A new customs code comes into effect.

Stock index futures start to be traded on the Warsaw Stock Exchange.

February

The VAT rate on telecommunication services is raised from 7 to 22 per cent.

The gross monthly minimum wage is raised to Zl 500.

The newly installed Monetary Policy Council decides to widen the exchange rate band to ±10 per cent and to slow down the monthly rate of crawl of the central parity to 0.8 per cent.

The budget law for 1998 is signed by the President. It targets a deficit of 2.8 per cent of GDP for the state budget and of 3.2 per cent for the general government (excluding privatisation receipts from revenue). It is based on a projected 5.6 per cent increase in real GDP. The objective for December-on-December consumer price inflation is 9.5 per cent.

March

Pensions are increased by 5¾ per cent.

The Council of Ministers discusses a medium-term financial strategy (1999-2001).

European Union accession negotiations start.

April

The Council of Ministers endorses a draft foreign exchange law loosening some of the existing restrictions.

The government unveils a new restructuring plan for the coal sector.

The Council of Ministers endorses a package of bills spelling out the powers of sub-national governments once decentralisation comes into effect.

May

The Council of Ministers endorses a draft law on public finances.

STATISTICAL ANNEX AND STRUCTURAL INDICATORS

Table A. **Selected background statistics**

	Average 1991-97	1991	1992	1993	1994	1995	1996	1997[1]
A. Percentage change from previous year[2]								
Private consumption	5.5	6.6	2.6	5.4	4.4	3.6	8.7	7.0
Public consumption	4.7	10.2	6.4	3.8	2.8	2.9	3.4	3.3
Gross fixed capital formation	9.9	–4.4	2.3	2.9	9.2	16.9	20.6	21.9
Exports of goods and services	10.9	–1.7	10.8	3.2	13.1	23.6	12.5	15.0
Imports of goods and services	18.7	29.6	1.7	13.2	11.3	24.3	28.0	22.7
GDP	3.5	–7.0	2.6	3.8	5.2	7.0	6.1	6.9
GDP price deflator	30.5	55.3	38.5	30.5	28.4	28.2	18.5	14.4
Industrial production	5.8	–8.0	2.8	6.4	12.1	9.7	8.3	10.8
Employment[3]	–1.5	–5.9	–4.2	–2.4	–1.6	0.9	1.2	1.4
Compensation of employees (current prices)	39.3	64.8	59.3	27.2	35.2	38.8	28.3	21.4
Productivity (GDP/employment)	5.5	–0.6	7.2	6.3	8.0	6.5	5.4	5.5
Unit labour costs (compensation/GDP)	35.4	77.1	55.2	22.6	28.5	29.7	20.9	13.5
B. Percentage ratios								
Gross fixed capital formation as per cent of GDP at current prices	17.8	19.5	16.8	15.9	16.2	16.9	19.0	20.8
Household saving as per cent of disposable income	13.0	16.3	15.0	12.5	11.8	13.9	10.4	10.8
Unemployment as per cent of total labour force (LFS)				14.0	14.4	13.3	12.3	11.2
C. Other								
Current account balance (billion dollars, accruals basis)		–2.1	–3.1	–5.8	1.0	0.9	–3.3	

1. Preliminary.
2. Volumes for components of GDP and industrial production.
3. LFS from 1994.

Source: OECD.

Table B. **Long-run evolution of consumer and producer prices**

Average percentage change

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Consumer prices (CPI)	60.2	251.1	585.8	70.3	43.0	35.3	32.2	27.8	19.9	14.9
Food	49.4	320.1	574.7	46.1	36.9	33.6	33.0	27.0	18.6	12.6
Alcoholic beverages	68.2	247.9	388.7	87.6	36.5	23.6	29.2	28.6	25.4	13.7
Other goods	65.3	226.7	591.2	75.8	36.5	36.8	31.4	27.3	20.7	14.0
Services	63.5	170.9	780.7	131.5	67.6	38.1	32.5	29.3	20.1	19.3
of which:										
Residential rents[1]	67.8	155.6	724.2	124.1	59.6	33.5	29.6	52.5	29.8	27.7
Central heating and hot water supply	90.9	54.4	1203.5	222.8	222.5	68.4	65.9	31.3	17.1	22.0
Electricity and gas	79.1	85.2	1297.0	217.0	94.6	34.2	34.7	26.7	17.1	15.5
Health	61.6	196.5	410.3	169.4	77.7	40.3	36.9	23.5	17.5	13.1
Public urban transport	96.0	292.7	720.7	120.9	59.8	48.4	34.0	27.3	27.4	21.6
Producer prices (PPI)[2]										
Total industry	59.8	212.8	622.4	40.9	34.5	31.9	25.3	25.4	12.4	12.2
Mining	68.5	104.2	850.6	77.8	31.2	48.0	40.5	22.9	11.8	16.4
Manufacturing	59.2	222.6	610.1	39.6	26.8	29.3	24.2	25.9	10.7	8.7
Electricity, gas and water supply	..	..	..	40.5	86.7	40.1	23.6	27.1	15.1	11.3

1. Including cold water supply charge.
2. Index modified in 1991 and 1994.

Source: Central Statistical Office.

Table C. **Monetary survey**

Million zlotys, end year

	1993	1994	1995	1996	1996[1]	1997[1]
Total money stock	55 924	77 302	104 255	134 796	136 662	176 445
Zloty money supply	39 834	55 243	82 955	111 518	113 270	145 605
Notes and coins in circulation (excluding vault cash)	9 982	12 274	19 529	23 563	23 564	27 256
Vault cash	2 201	2 506	2 880	3 681	3 681	3 819
Zloty deposits of non-financial sector	29 851	42 969	63 426	87 995	89 706	118 349
Personal	16 266	22 100	39 673	57 396	57 418	80 889
demand deposits	1 406	2 290	4 471	8 410	8 489	12 062
time deposits	13 711	18 364	33 160	46 312	46 330	65 793
savings accounts	1 149	1 446	2 042	2 675	2 599	3 034
Corporate	13 586	20 870	23 753	30 559	32 288	37 460
demand deposits	8 259	12 888	13 353	17 318	17 680	19 359
time deposits	5 327	7 982	10 400	13 241	14 608	18 101
Foreign currency deposits of non-financial sector	16 091	22 059	21 300	23 278	23 393	30 840
Personal	15 431	20 906	19 712	20 469	20 465	25 255
Corporate	660	1 152	1 588	2 809	2 927	5 585
Net foreign assets	17 314	26 527	49 241	61 501	61 524	82 978
Net domestic assets	38 610	50 775	55 013	73 295	75 138	93 467
Lending to non-financial sector	33 196	41 562	56 213	80 037	81 085	108 240
Personal loans	2 259	3 344	5 621	11 672	11 777	18 395
Corporate loans	30 936	38 218	50 592	68 365	69 308	89 845
Net general government debt	30 029	40 471	41 775	46 832	48 241	55 209
Excluding Treasury bonds denominated in US dollars	18 111	23 401	31 745	33 105	34 317	36 523
Balance of other items (net)	–24 614	–31 258	–42 975	–53 574	–54 187	–69 981

1. New format. The definition of the corporate sector was modified to include all nonbank financial institutions (instead of insurance companies only). Banks' claims on the corporate sector were supplemented with debt securities issued by the sector and held by banks. Moreover, claims and liabilities of corporate and general government sectors include repurchase agreement transactions. Prior to redefinitions, the above items were included in ''other items (net)''.

Source: National Bank of Poland.

Table D. **Balance of payments**[1]

Million US$

	1993	1994	1995	1995[2]	1996[2]	1997[2]
A. Current account	**–2 329**	**–944**	**–2 299**	**5 455**	**–1 352**	**–4 268**
Merchandise exports	13 585	16 950	22 878	22 878	24 420	27 229
Merchandise imports	15 878	17 786	24 705	24 705	32 574	38 498
Trade balance	–2 293	–836	–1 827	–1 827	–8 154	–11 269
Services: credit	1 846	2 100	3 190	3 190	3 383	3 724
Services: debit	1 477	2 043	3 040	3 040	3 592	3 419
Services: net	369	57	150	150	–209	305
Income credit	539	494	1 023	1 023	1 471	1 433
Income debit	3 963	2 575	1 651	1 651	1 837	1 898
Income net	–3 424	–2 081	–628	–628	–366	–465
Unrequited transfers: credit	7 874	7 200	6 046	6 046	5 401	4 889
Private	5 676	6 309	5 755	5 755	5 328	4 787
Official	2 198	891	291	291	73	102
Unrequited transfers: debit	4 855	5 284	6 040	6 040	5 177	3 789
Unrequited transfers: net	3 019	1 916	6	6	224	1 100
Private	821	1 025	–285	–285	151	998
Official	2 198	891	291	291	73	102
Unclassified transactions, net				7 754	7 153	6 061
B. Capital and financial account	**575**	**1 812**	**10 513**	**2 759**	**4 779**	**7 589**
Capital account					**90**	**95**
Financial account	**575**	**1 812**	**10 513**	**2 759**	**4 693**	**7 494**
Direct investment: net	580	542	1 134	1 134	2 741	3 041
Portfolio investment		–624	1 171	1 171	241	2 098
Long-term credits extended	11	–11	29	29	–32	–110
Long-term credits received	–471	–1 043	132	132	–211	416
Drawings	922	894	702	702	819	1 189
Repayments due	1 393	1 937	570	570	1 030	771
Due and paid	923	1 697	503	503	964	711
Due but not paid	470	240	67	67	66	62
Rescheduled	0	4	4	4	4	3
Converted	42	38	63	63	58	56
Arrears	428	198	0	0	0	0
Credit from IMF	–138	610	–1 400	–1 400	0	0
Short-term credits extended	21	–21	–22	–22	–5	–60
Short-term credits received	–74	–32	88	88	85	592
Other short-term capital	646	2 391	9 381	1 627	1 874	1 517
Changes in other assets	–401	–1 620	1 006	1 006	757	–755
Changes in other liabilities	–158	124	480	480	521	197
Other financial transactions	–545	676	141	141	596	2 075
Purchase/sale of foreign currencies	1 750	3 211	7 754			
C. Errors and omissions	**589**	**–228**	**–27**	**–27**	**480**	**468**
D. Exceptional financing	**1 376**	**690**	**17**	**17**	**5**	**3**
Rescheduled obligations	0	6	17	17	5	3
Changes in arrears	1 376	684	0	0	0	0
E. Valuation changes	**–217**	**418**	**731**	**731**	**–846**	**–1 155**
Official reserves	–106	235	503	503	–571	–954
Other assets and liabilities	–111	183	228	228	–275	–201
F. Change in gross official reserves	**6**	**–1 748**	**–8 935**	**–8 935**	**–3 070**	**–2 637**

1. On a cash basis, convertible currency operations (since 1991 all settlements abroad have been in convertible currency). Excludes unrecorded exports and imports.
2. New format. A new item ''Unclassified transactions, net'' was introduced in the current account. It corresponds to the previous ''Purchase/sale of foreign currencies'' item heretofore presented in the financial account ''Other short-term capital''.

Source: National Bank of Poland.

Table E. **Direction of trade**

Customs basis, US$ million

	1992	1993	1994	1995	1996	1997
Imports						
Total	15 913	18 834	21 569	29 050	37 137	42 308
Developed countries	11 516	14 371	16 212	21 595	27 326	31 107
of which:						
EU	8 446	10 785	12 403	18 781	23 738	26 998
EFTA	2 065	2 103	2 443	901	939	1 045
Other	1 005	1 483	1 366	1 913	2 649	3 064
Central and Eastern Europe	2 589	2 531	3 063	4 476	5 776	6 325
of which:						
CEFTA	647	677	919	1 625	2 161	2 652
Others	1 942	1 854	2 144	2 851	3 615	3 673
Developing countries	1 808	1 932	2 294	2 979	4 035	4 876
Exports						
Total	13 187	14 143	17 240	22 895	24 440	25 751
Developed countries	9 475	10 630	12 992	17 189	17 535	17 792
of which:						
EU	7 632	8 951	10 805	16 036	16 196	16 526
EFTA	1 363	1 108	1 410	359	535	395
Other	480	571	777	794	804	871
Central and Eastern Europe	2 026	1 869	2 499	3 954	5 010	6 249
of which:						
CEFTA	669	682	823	1 245	1 481	1 738
Others	1 357	1 187	1 676	2 709	3 529	4 512
Developing countries	1 686	1 644	1 749	1 752	1 895	1 710

Source: Central Statistical Office.

Table F. **Foreign trade by commodity group**

Customs basis, US$ million

	SITC group	1992	1993	1994	1995	1996	1997
Imports							
Food and live animals	0	1 531	1 838	1 876	2 339	3 143	2 894
Beverages and tobacco	1	162	146	186	217	250	299
Crude materials, inedible, except fuels	2	861	866	1 111	1 562	1 737	1 762
Mineral fuels, lubricants and related materials	3	2 674	2 346	2 253	2 651	3 389	3 710
Animal and vegetable oils, fats and waxes	4	106	117	159	189	216	239
Chemicals and related products	5	2 145	2 507	3 168	4 340	5 120	5 839
Manufactured goods classified by material	6	1 882	3 482	4 354	6 266	7 455	8 283
Machinery and transport equipment	7	4 743	5 568	6 226	8 688	12 272	15 228
Miscellaneous manufactured articles	8	1 642	1 912	2 133	2 701	3 435	3 950
Commodities and transactions, not classified elsewhere	9	167	52	103	97	120	104
Exports							
Food and live animals	0	1 686	1 410	1 735	2 100	2 461	3 026
Beverages and tobacco	1	75	136	240	164	131	103
Crude materials, inedible, except fuels	2	1 128	788	810	1 029	825	820
Mineral fuels, lubricants and related materials	3	1 413	1 374	1 566	1 870	1 675	1 719
Animal and vegetable oils, fats and waxes	4	20	18	20	35	38	42
Chemicals and related products	5	1 134	964	1 163	1 774	1 887	2 027
Manufactured goods classified by material	6	3 585	3 745	4 742	6 314	6 316	6 830
Machinery and transport equipment	7	2 523	2 966	3 411	4 828	5 719	5 560
Miscellaneous manufactured articles	8	1 547	2 739	3 542	4 772	5 379	5 611
Commodities and transactions, not classified elsewhere	9	76	3	11	9	9	13

Source: Central Statistical Office.

Table G. **Equities market**

	1991	1992	1993	1994	1995	1996	1997
Main market, Warsaw Stock Exchange							
Number of listed companies (end-period)	9	16	21	36	53	66	96
Average capitalisation (Zl million)	79	307	1 962	8 928	9 030	19 351	33 601
in per cent of GDP	0.1	0.3	1.3	4.2	3.1	5.3	7.6
Average capitalisation ($ million)	75	225	1 081	3 928	3 725	7 167	10 242
Number of sessions	36	100	152	188	249	250	249
WIG (end-period)	919	1 041	12 439	7 473	7 586	14 343	14 668
Number of orders per session	1 423	3 119	17 323	52 974	26 475	25 704	30 106
Turnover value per session ($ million)	0.8	1.7	28.1	53.0	20.2	37.9	44.1
Number of companies on other market segments (end-period)							
Parallel market			1	8	12	17	29
NIFs							15
Over-the-counter market						2	13

Source: Warsaw Stock Exchange, CeTO, Central Statistical Office.

Table H. **Size and breakdown of public social spending**

In million zlotys

	1991	1992	1993	1994	1995	1996	1997
Total	25 251	38 737	50 807	72 083	98 447	121 238	..
Social insurance	10 980	18 017	25 077	35 982	47 752	59 533	76 263
of which: Pensions	10 183	16 784	23 194	33 230	44 369	54 975	67 144
Family benefits	1 553	2 128	2 218	2 254	2 576	2 902	3 383
Education (including higher education)	4 195	6 244	8 368	13 124	17 701	20 126	20 543[2]
Health care	4 198	6 138	7 735	10 813	14 643	18 652	21 367[2]
Labour Fund spending	1 358	2 468	3 118	4 346	6 207	7 418	6 585
Social assistance	923	1 727	2 338	3 231	6 774	9 056	11 306[2]
Culture and recreation	577	704	935	1 334	1 814	2 332	3 084[2]
Price subsidies[1]	1 567	1 312	1 019	999	980	1 219	..

1. Price subsidies include subsidies on food, coal, public transport, housing maintenance and advances on cars.
2. Preliminary.

Source: Central Statistical Office, OECD.

Table I. **Finances of the Main Social Insurance Funds**

Million new zlotys, cash basis

	1991	1992	1993	1994	1995	1996		1997		1998
						Law	Outcome	Law	Outcome	Law
Social Insurance Fund (FUS)										
Revenues	11 170	18 521	24 937	34 049	41 983	51 039	52 198	61 113	66 386	70 973
of which: Transfers from the state budget[1]	2 206	4 951	6 605	8 297	6 000	5 926	6 031	5 838	7 000	6 793
Expenditures	11 516	18 208	24 583	33 919	41 191	51 256	51 218	62 279	67 571	71 315
of which: Pensions	8 832	14 744	19 763	27 701	35 547	44 768	44 082	53 609	54 244	61 672
Social Insurance Fund for Farmers (KRUS)										
Revenues	1 507	2 317	3 299	5 026	6 498	8 021	8 095	9 178	10 069	11 305
of which: Transfers from the state budget	1 362	2 247	3 085	4 722	6 102	7 545	7 550	8 634	9 444	10 652
Expenditures	1 552	2 294	3 288	5 014	6 483	8 008	8 018	9 218	10 170	11 304
of which: Pensions	1 371	2 065	2 999	4 642	6 173	7 621	7 656	8 745	9 466	10 448
Labour Fund										
Revenues	1 222	2 309	3 096	4 478	6 270	6 786	7 540	8 192	7 011	6 772
of which: Transfers from the state budget	750	1 626	1 990	2 800	4 024	3 931	4 621	4 808	3 402	2 719
Expenditures	1 269	2 279	3 041	4 346	6 207	6 755	7 418	8 192	6 585	6 772
of which: Unemployment benefits	1 115	1 970	2 677	3 672	5 275	5 742	6 381	7 148	4 572	4 780
Total										
Revenues	13 899	23 147	31 332	43 552	54 751	65 846	67 833	78 483	83 466	89 050
of which: Transfers from the state budget	4 318	8 824	11 680	15 819	16 125	17 402	18 202	19 280	19 846	20 164
Expenditures	14 337	22 781	30 912	43 279	53 881	66 019	66 654	79 689	84 326	89 392
of which: Pensions	10 203	16 809	22 762	32 343	41 720	52 389	51 738	62 354	63 710	72 120

1. The rules governing this subsidy changed on March 1, 1995.
Source: Ministry of Finance.

BASIC STATISTICS:

INTERNATIONAL COMPARISONS

BASIC STATISTICS: INTERNATIONAL COMPARISONS

	Units	Reference period [1]	Australia	Austria	Belgium	Canada	Czech Republic	Denmark	Finland	France	Germany	Greece
Population												
Total	Thousands	1996	18 289	8 060	10 157	29 964	10 316	5 262	5 125	58 380	81 877	10 465
Inhabitants per sq. km	Number	1996	2	96	333	3	131	122	15	106	229	79
Net average annual increase over previous 10 years	%	1996	1.3	0.6	0.3	1.3	0	0.3	0.4	0.5	3	0.5
Employment												
Total civilian employment (TCE)[2]	Thousands	1996	8 344	3 737 (94)	3 675 (95)	13 676	4 918	2 593	2 087	21 951	35 360	3 824 (95)
of which: Agriculture	% of TCE	1996	5.1	7.2 (94)	2.5 (95)	4.1	6.3	4	7.1	4.6	3.3	20.4 (95)
Industry	% of TCE	1996	22.5	33.2 (94)	26.7 (95)	22.8	42	27	27.6	25.9	37.5	23.2 (95)
Services	% of TCE	1996	72.4	59.6 (94)	71.4 (95)	73.1	51.7	69	65.3	69.5	59.1	56.4 (95)
Gross domestic product (GDP)												
At current prices and current exchange rates	Bill. US$	1996	398.9	228.7	268.2	579.2	56.2	174.9	125.1	1 536.6	2 353.5	91.2 (95)
Per capita	US$	1996	21 812	28 384	26 409	19 330	5 445	33 230	24 420	26 323	28 738	8 722 (95)
At current prices using current PPPs[3]	Bill. US$	1996	372.7	172.4	222	645.1	..	118	96.7	1 198.6	1 736.1	133.5
Per capita	US$	1996	20 376	21 395	21 856	21 529	..	22 418	18 871	20 533	21 200	12 743
Average annual volume growth over previous 5 years	%	1996	3.9	1.6	1.2	2.2	2	2.2	1.6	1.2	1.4	1.3 (95)
Gross fixed capital formation (GFCF)	% of GDP	1996	20.3	23.8	17.3	17.7	33	16.7	16.1	17.4	20.6	17 (95)
of which: Machinery and equipment	% of GDP	1996	10.2 (95)	8.8 (95)	7.5 (95)	6.6	..	7.9 (95)	6.4 (95)	7.8	7.6	7.7 (95)
Residential construction	% of GDP	1996	4.6 (95)	5.9 (95)	4.6 (95)	5.4	..	3.2 (95)	3.5 (95)	4.4	7.3	3.3 (95)
Average annual volume growth over previous 5 years	%	1996	5.6	2.1	0.3	2.2	9.4	2	–4.1	–1.5	0.2	0.5 (95)
Gross saving ratio[4]	% of GDP	1996	18	21.9	22.2	17.8	..	17.6	19.6	18.7	20	16 (95)
General government												
Current expenditure on goods and services	% of GDP	1996	17	19.8	14.5	18.7	21.5	25.2	21.9	19.4	19.8	20.8 (95)
Current disbursements[5]	% of GDP	1995	35.6	48.6	52.2	45.8	..	59.6	55.9	50.9	46.6	52.1
Current receipts	% of GDP	1995	34.9	47.4	49.9	42.7	..	58.1	52.8	46.9	45.9	45
Net official development assistance	% of GNP	1995	0.36	0.33	0.38	0.38	..	0.96	0.32	0.55	0.31	0.13
Indicators of living standards												
Private consumption per capita using current PPPs[3]	US$	1996	12 596	12 152	13 793	12 959	..	12 027	10 282	12 506	12 244	9 473
Passenger cars, per 1 000 inhabitants	Number	1994	460	433	416	466	282	312	368	430	488	199
Telephones, per 1 000 inhabitants	Number	1994	496	466	449	576	209	604	551	547	483[8]	478
Television sets, per 1 000 inhabitants	Number	1993	489	479	453	618	476	538	504	412	559	202
Doctors, per 1 000 inhabitants	Number	1995	2.2 (91)	2.7	3.7 (94)	2.2	2.9	2.9 (94)	2.8	2.9	3.4	3.9 (94)
Infant mortality per 1 000 live births	Number	1995	5.7	5.4	7.6 (94)	6.3 (94)	7.7	5.5	4	5.8 (94)	5.3	8.1
Wages and prices (average annual increase over previous 5 years)												
Wages (earnings or rates according to availability)	%	1996	1.7	5.2	2.7	2.4	..	3.2	3.8	2.6	4.2	11.8
Consumer prices	%	1996	2.4	2.9	2.2	1.4	11.9	1.9	1.5	2	3.1	11.6
Foreign trade												
Exports of goods, fob*	Mill. US$	1996	60 288	57 870	170 223[7]	202 320	21 910	51 030	40 576	288 450	521 263	11 501
As % of GDP	%	1996	15.1	25.3	63.5	34.9	39	29.2	32.4	18.8	22.1	12.9 (95)
Average annual increase over previous 5 years	%	1996	7.5	7.1	7.6	9.7	..	6.2	12.1	6.3	5.4	5.8
Imports of goods, cif*	Mill. US$	1996	61 374	67 376	160 917[7]	170 931	27 721	44 987	30 911	271 348	455 741	27 402
As % of GDP	%	1996	15.4	29.5	60	29.5	49.3	25.7	24.7	17.7	19.4	30.4 (95)
Average annual increase over previous 5 years	%	1996	9.7	5.9	5.9	7.7	..	5.6	7.3	3.9	3.3	6.6
Total official reserves[6]	Mill. SDRs	1996	10 107	15 901	11 789[7]	14 202	8 590	9 834	4 810	18 635	57 844	12 171
As ratio of average monthly imports of goods	Ratio	1996	2	2.8	0.9	1	..	2.6	1.9	0.8	1.5	5.3

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. End of year.
7. Data refer to the Belgo-Luxembourg Economic Union.
8. Data refer to western Germany.
9. Including non-residential construction.
10. Refers to the public sector including public enterprises.

Sources: Population and Employment: OECD, *Labour Force Statistics.* GDP, GFCF and General Government: OECD, *National Accounts*, Vol. I and *OECD Economic Outlook*, Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators.* Foreign trade: OECD, *Monthly Foreign Trade Statistics*, Series A. Total official reserves: IMF, *International Financial Statistics.*

BASIC STATISTICS: INTERNATIONAL COMPARISONS *(cont'd)*

	Units	Reference period [1]	Hungary	Iceland	Ireland	Italy	Japan	Korea	Luxembourg	Mexico	Netherlands	New Zealand
Population												
Total	Thousands	1996	10 193	270	3 621	57 473	125 864	45 545	418	96 582	15 494	3 640
Inhabitants per sq. km	Number	1996	77	3	52	191	333	458	161	48	380	14
Net average annual increase over previous 10 years	%	1996	–0.3	1.1	0.2	0	0.4	1	1.3	2	0.6	1.1
Employment												
Total civilian employment (TCE)[2]	Thousands	1996	3 605	142	1 307	20 036	64 860	20 764	212 (95)	32 385 (95)	6 983	1 688
of which: Agriculture	% of TCE	1996	8.4	9.2	10.7	7	5.5	11.6	2.8 (95)	23.5 (95)	3.9	9.5
Industry	% of TCE	1996	33	23.9	27.2	32.1	33.3	32.5	30.7 (90)	21.7 (95)	22.4	24.6
Services	% of TCE	1996	58.6	66.2	62.3	60.9	61.2	55.9	66.1 (90)	54.8 (95)	73.8	65.9
Gross domestic product (GDP)												
At current prices and current exchange rates	Bill. US$	1996	43.7 (95)	7.3	70.7	1 214.2	4 595.2	484.8	17	329.4	396	65.9
Per capita	US$	1996	4 273 (95)	27 076	19 525	21 127	36 509	10 644	40 791	3 411	25 511	18 093
At current prices using current PPPs[3]	Bill. US$	1996	..	6.3	68.8	1 148	2 924.5	618.5	13.5	751.1	324.5	63.6
Per capita	US$	1996	..	23 242	18 988	19 974	23 235	13 580	32 416	7 776	20 905	17 473
Average annual volume growth over previous 5 years	%	1996	–2.4 (95)	1.5	7.1	1	1.5	7.1	4.8	1.7	2.3	3.7
Gross fixed capital formation (GFCF)	% of GDP	1996	19.3 (95)	17.5	17.2	17	29.7	36.8	20.8	18	19.7	20.9
of which: Machinery and equipment	% of GDP	1996	..	6.7	5.5 (95)	8.8	10.1 (95)	13	..	8.8	9.4	10
Residential construction	% of GDP	1996	. .	3.9	4.9 (95)	4.5	5.3 (95)	7.6	..	4.7	5	5.6
Average annual volume growth over previous 5 years	%	1996	–0.9 (95)	–1.4	6	–1.4	1.3	6.9	0.2	–0.7	2.2	9.6
Gross saving ratio[4]	% of GDP	1996	..	15.6	21.7	20.5	31.4	34.2	37.5	22.7	25.7	16
General government												
Current expenditure on goods and services	% of GDP	1996	24.9 (95)	20.8	14.1	16.4	9.7	10.6	13.6	9.7[10]	14	14.4
Current disbursements[5]	% of GDP	1995	..	35.1	39.2 (94)	49.5	28.5	15.1	..	..	51.8	..
Current receipts	% of GDP	1995	..	36	39.3 (94)	44.5	32	25.1	..	..	50	..
Net official development assistance	% of GNP	1995	..	..	0.29	0.15	0.28	0.03	0.36	..	0.81	0.23
Indicators of living standards												
Private consumption per capita using current PPPs[3]	US$	1996	..	14 244	10 020	12 224	13 912	7 354	17 811	5 045	12 477	10 895
Passenger cars, per 1 000 inhabitants	Number	1994	212	434	264	517	342	115	544	91	383	457
Telephones, per 1 000 inhabitants	Number	1994	170	557	350	429	480	397	564	93	509	470
Television sets, per 1 000 inhabitants	Number	1993	427	335	301	429	618	215	261	150	491	
Doctors, per 1 000 inhabitants	Number	1995	3.4	3.9 (94)	3.4	3.0 (94)	1.7	1.6 (92)	1.8 (94)	1.1	2.2 (93)	1.6
Infant mortality per 1 000 live births	Number	1995	11	6.1	6.3	6.6 (94)	4.3	9	5.3 (94)	17 (94)	5.5	7.2 (94)
Wages and prices (average annual increase over previous 5 years)												
Wages (earnings or rates according to availability)	%	1996	..	..	3.7	3.5	1.8	..	..	–1.6	2.4	1.5
Consumer prices	%	1996	23.2	2.6	2.2	4.5	0.7	5.3	2.4	19.7	2.5	2
Foreign trade												
Exports of goods, fob*	Mill. US$	1996	15 674	1 891	48 416	250 842	411 067	129 715	..	96 000	203 953	14 316
As % of GDP	%	1996	35.9	26	68.5	20.7	8.9	26.8	..	29.1	51.5	21.7
Average annual increase over previous 5 years	%	1996	8.9	4	14.8	8.2	5.5	12.5	..	17.6	8.9	8.2
Imports of goods, cif*	Mill. US$	1996	18 105	2 032	35 763	206 904	349 149	150 340	..	89 469	184 389	14 682
As % of GDP	%	1996	41.4	27.9	50.6	17	7.6	31	..	27.2	46.6	22.3
Average annual increase over previous 5 years	%	1996	9.6	3.4	11.5	2.5	8	13.9	..	12.4	7.8	11.8
Total official reserves[6]	Mill. SDRs	1996	6 812	316	5 706	31 954	150 663	23 670	..	13 514	18 615	4 140
As ratio of average monthly imports of goods	Ratio	1996	..	1.9	1.9	1.9	5.2	..	..	1.8	1.2	3.4

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. End of year.
7. Data refer to the Belgo-Luxembourg Economic Union.
8. Data refer to western Germany.
9. Including non-residential construction.
10. Refers to the public sector including public enterprises.

Sources: Population and Employment: OECD, *Labour Force Statistics.* GDP, GFCF and General Government: OECD, *National Accounts,* Vol. I and *OECD Economic Outlook,* Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators.* Foreign trade: OECD, *Monthly Foreign Trade Statistics,* Series A. Total official reserves: IMF, *International Financial Statistics.*

BASIC STATISTICS: INTERNATIONAL COMPARISONS *(cont'd)*

	Units	Reference period[1]	Norway	Poland	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States
Population											
Total	Thousands	1996	4 370	38 618	9 935	39 270	8 901	7 085	62 695	58 782	265 557
Inhabitants per sq. km	Number	1996	13	123	108	78	20	172	80	240	28
Net average annual increase over previous 10 years	%	1996	0.5	0.3	–0.1	0.2	0.6	0.8	2	0.3	1
Employment											
Total civilian employment (TCE)[2]	Thousands	1996	2 110	14 977	4 475	12 394	3 963	3 803	20 895	26 088	126 708
of which: Agriculture	% of TCE	1996	5.2	22.1	12.2	8.7	2.9	4.5	44.9	2	2.8
Industry	% of TCE	1996	23.4 (95)	31.7	31.4	29.7	26.1	27.7	22	27.4	23.8
Services	% of TCE	1996	71.5 (95)	46.2	56.4	61.6	71	67.4	33.1	71	73.3
Gross domestic product (GDP)											
At current prices and current exchange rates	Bill. US$	1996	157.8	117.9 (95)	103.6	584.9	251.7	294.3	181.5	1 153.4	7 388.1
Per capita	US$	1996	36 020	3 057 (95)	10 425	14 894	28 283	41 411	2 894	19 621	27 821
At current prices using current PPPs[3]	Bill. US$	1996	106.7	..	130.1	587.2	171.4	180.6	383.3	1 095.5	7 388.1
Per capita	US$	1996	24 364	..	13 100	14 954	19 258	25 402	6 114	18 636	27 821
Average annual volume growth over previous 5 years	%	1996	4.1	2.2 (95)	1.5	1.3	1	0.1	4.4	2.2	2.8
Gross fixed capital formation (GFCF)	% of GDP	1996	20.5	17.1 (95)	24.1	20.1	14.8	20.2	25	15.5	17.6
of which: Machinery and equipment	% of GDP	1996	8.4	..	11.7 (93)	6.1 (95)	7.9	9.3	11.9	7.6	8.3 (95)
Residential construction	% of GDP	1996	2.6 (94)	..	5.2 (93)	4.3 (95)	1.9	11[9]	8.4 (95)	3	4.1 (95)
Average annual volume growth over previous 5 years	%	1996	2.8	5.4 (95)	2.2	–1	–2.6	–0.8	6.9	1.3	6.9
Gross saving ratio[4]	% of GDP	1996	29.9	..	21.6	20.7	16	27.1	22.3	14.6	16.6
General government											
Current expenditure on goods and services	% of GDP	1996	20.5	16.9 (95)	18.5	16.3	26.2	14.3	11.6	21.1	15.6
Current disbursements[5]	% of GDP	1995	45.8	..	42.5 (93)	41.2	63.8	47.7	..	42.3 (94)	34.3
Current receipts	% of GDP	1995	50.9	..	39.8 (93)	37.9	57.5	53.8	..	37.2 (94)	32.1
Net official development assistance	% of GNP	1995	0.87	..	0.27	0.24	0.77	0.34	0.07	0.28	0.1
Indicators of living standards											
Private consumption per capita using current PPPs[3]	US$	1996	11 593	..	8 522	9 339	10 096	15 632	4 130	11 865	18 908
Passenger cars, per 1 000 inhabitants	Number	1994	381	186	357	351	406 (93)	451	47	372	565
Telephones, per 1 000 inhabitants	Number	1994	554	131	350	371	683	597	201	489	602
Television sets, per 1 000 inhabitants	Number	1993	427	298	190	400	470	400	176	435	816
Doctors, per 1 000 inhabitants	Number	1995	2.8	2.3	3	4.1 (93)	3.1	3.1 (94)	1.2	1.6 (94)	2.6 (94)
Infant mortality per 1 000 live births	Number	1995	4	13.6	7.4	6 (94)	4	5	46.8 (94)	6.2 (94)	8 (94)
Wages and prices (average annual increase over previous 5 years)											
Wages (earnings or rates according to availability)	%	1996	3.2	..	..	5.8	4.8	..	..	4.9	2.7
Consumer prices	%	1996	1.9	..	5.6	4.7	2.7	2.2	81.6	2.7	2.9
Foreign trade											
Exports of goods, fob*	Mill. US$	1996	49 576	24 417	24 614	102 067	84 836	79 581	23 301	259 941	625 075
As % of GDP	%	1996	31.4	20.7	23.8	17.5	33.7	27	12.8	22.5	8.5
Average annual increase over previous 5 years	%	1996	7.8	..	8.6	11.2	9	5.3	11.1	7	8.2
Imports of goods, cif*	Mill. US$	1996	35 575	37 185	35 192	121 838	66 825	78 052	43 094	287 033	795 289
As % of GDP	%	1996	22.5	31.5	34	20.8	26.5	26.5	23.7	24.9	10.8
Average annual increase over previous 5 years	%	1996	6.9	..	6.1	5.5	6	3.2	15.1	6.5	10.3
Total official reserves[6]	Mill. SDRs	1996	18 441	12 409	11 070	40 284	13 288	26 727	11 430	27 745	44 536
As ratio of average monthly imports of goods	Ratio	1996	6.2	..	3.8	4	2.4	4.1	3.2	1.2	0.7

* At current prices and exchange rates.
1. Unless otherwise stated.
2. According to the definitions used in OECD *Labour Force Statistics*.
3. PPPs = Purchasing Power Parities.
4. Gross saving = Gross national disposable income minus private and government consumption.
5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.
6. End of year.
7. Data refer to the Belgo-Luxembourg Economic Union.
8. Data refer to western Germany.
9. Including non-residential construction.
10. Refers to the public sector including public enterprises.

Sources: Population and Employment: OECD, *Labour Force Statistics.* GDP, GFCF and General Government: OECD, *National Accounts,* Vol. I and *OECD Economic Outlook,* Historical Statistics. Indicators of living standards: Miscellaneous national publications. Wages and Prices: OECD, *Main Economic Indicators.* Foreign trade: OECD, *Monthly Foreign Trade Statistics,* Series A. Total official reserves: IMF, *International Financial Statistics.*

OECD PUBLICATIONS, 2, rue André-Pascal, 75775 PARIS CEDEX 16
PRINTED IN FRANCE
(10 98 34 1 P) ISBN 92-64-15995-9 – No. 50241 1998