COUNTRY REVIEWS

OECD Economic Surveys

Poland

ECONOMICS



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OECD ECONOMIC SURVEYS

1999-2000

POLAND

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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BASIC STATISTICS OF THE REPUBLIC OF POLAND

(1998 unless noted)

THE LAND

Area (sq. km)	312 680
Arable land (in per cent of total area)	59

THE PEOPLE

Population (million, mid-year)	38.7	Employment (million, 30 September 1998)	15.9
Projected population growth rate, per annum (1996-2000)	0.2	Employment by sector (percentage of total)	
Rural population (percentage of total)	38	Agriculture	27
Life expectancy at birth:		Industry (including construction)	29
Male	67.8	Services	44
Female	76.8		
Infant mortality (per thousand)	9.5		

Registered unemployment (percentage of the labour force)	10.0
Labour force survey unemployment (percentage of the labour force)	10.6
Number of pensioners (million)	9.4

PARLIAMENT

Bicameral Parliamentary system	
Sejm membership (lower house)	460
Senate membership (upper house)	100
Number of political parties in Sejm (elections of September 1997)	6
Share of seats in Sejm held by governing coalition (per cent)	53.5

PRODUCTION

GDP (Zl billion, current prices)	551
GDP per capita (US$, market exchange rate)	4 082
Gross fixed capital formation (percentage of GDP)	26

PUBLIC FINANCE

General government budget balance (percentage of GDP)	–2.5
General government revenues (percentage of GDP)	40.9
General government expenditures (percentage of GDP)	43.3
Public debt (end-year, percentage of GDP)	43.1

FOREIGN TRADE AND FINANCE

Exports of goods and services (percentage of GDP)	26
Imports of goods and services (percentage of GDP)	30
Gross foreign exchange reserves (US$ billion, end-1998)	27.4
Gross external debt (US$ billion, end-1998)	42.7

CURRENCY

Monetary unit: zloty (redenominated in January 1995)		Currency units per US$	
		Average 1998	3.49
		End of November 1999	4.33

This Survey is based on the Secretariat's study prepared for the annual review of Poland by the Economic and Development Review Committee on 22 November 1999.

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After revisions in the light of discussions during the review, final approval of the Survey for publication was given by the Committee on 10 December 1999.

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The previous Survey of Poland was issued in June 1998.

Assessment and recommendations

After ten years of efforts to introduce a market economy, Poland is considered as one of the most successful economies in central and eastern Europe

Ten years after launching an ambitious programme of economic transformation, Poland is seen in many respects as one of the most successful economies in central and eastern Europe. Unlike other countries, Poland has not encountered a mid-course depression, its currency has not been subject to speculative attacks, and the economy has slowed down only moderately in the aftermath of the Russian crisis. The success of Poland's economic transformation comes from a well-orchestrated combination of sound financial policies and perseverance with structural reforms. This Survey reviews the factors behind this achievement and recommends a number of policy actions to make it last. Chapter I provides an overview of recent macro-economic developments and a summary of the short-term outlook. Chapter II reviews monetary and fiscal policies and discusses budgetary problems that need to be tackled urgently. The progress made since the last Survey to address structural problems in the areas of unemployment, pension liabilities, banking system restructuring, privatisation, and enterprise restructuring is summarised in Chapter III. Reform of the healthcare system is assessed in Chapter IV. Finally, Chapter V reviews tax policies, including the courageous tax reform that was recently partially adopted.

Poland's robust economic growth reflects a dynamic private sector and large inflows of foreign direct investment

During the last four years, output has expanded at robust rates of 6 to 7 per cent, inflation has declined gradually and living standards have improved. This achievement largely reflects the dynamism of the private sector, as opposed to the mediocre results of the bloated state-owned enterprises. Deregulation and small-scale privatisation have led to the emergence of a vibrant sector of small and medium-sized enterprises. More than two million entrepreneurs now

operate in such sectors as retail trade, construction, and light manufacturing industry. They make an important contribution to output growth and job creation and form a new class of consumers. Inward foreign direct investment, the largest in central and eastern Europe in absolute dollar terms, is also an important factor behind the successful transformation. Foreign investors initially focussed on the domestic market, which is the largest in the region, and labour-intensive sectors, but they are likely to step up exports to western markets and to be involved increasingly in activities with a higher technological content.

After slowing down in 1998-99, the economy appears poised for a rebound, and the outlook is favourable

The economy decelerated sharply in the wake of the Russian crisis in August 1998, but started to rebound in mid-1999 with a strong impulse from domestic demand. After reaching a trough of 1.5 per cent year-on-year growth in the first quarter of 1999, output growth rebounded to 3 per cent in the second and 4.9 per cent in the third, suggesting that the economy is poised for a return to robust growth. Barring unexpected developments, and despite some tightening of macroeconomic policies, output growth should gather momentum and reach some 5 to 6 per cent in the next two years. The expansion is expected to be broadly-based. Private consumption is projected to grow unabated as Polish consumers enjoy strong increases in real disposable incomes and continue to adjust to an environment where consumer goods are plentiful and new services emerging. Business fixed investment is also projected to grow at healthy rates, as Polish enterprises continue to modernise and foreign direct investors bring in more capital. With the expected revival of activity in Europe, which now accounts for two-thirds of Poland's foreign trade, exports should return to double-digit growth rates. The projected economic recovery should foster job creation, but the number of unemployed will decline only gradually in the next two years as large groups of new school leavers will join the work force and increase the number of job-seekers.

To make the robust growth last Poland should meet two challenges: first, to keep inflation under check, which will be helped by the recent monetary tightening

Sustaining this generally favourable performance, however, requires Poland to address two macroeconomic challenges, the first of which is to keep inflation under control. In the recent past, the monetary authorities have well established their ability to dodge the risks of inflation. They dealt with the overheating of the economy in 1997 and the first half of 1998 with pre-emptive interest rate hikes that led to a soft-landing of the economy. They dealt successfully with the contagion effect of the Russian financial crisis, with an aggressive easing of monetary policy from September 1998 until January 1999. These timely actions helped establish the credibility of the Monetary Policy Council (MPC) of the National Bank of Poland (NBP), the independent body in charge of formulating monetary policy. However, this has been threatened by the sudden acceleration of the CPI above the inflation objective established for December 1999. While this acceleration has been due in part to exceptional factors-such as increases in fuel and food prices, it is worrying in that it takes place at the early stage of the economic recovery and against the background of rapid increases in monetary aggregates driven by consumer credit and loans to the general government. The MPC was therefore right to react by raising its intervention rate by 100 basis points in September 1999 and 250 basis points in November 1999.

Direct inflation targeting will help convergence toward EU inflation level

Over the medium term, Poland's further integration with the European Union means that consumer price inflation will need to fall to within the 0 to 2 per cent band considered by the European Central Bank as synonymous with price stability. To achieve inflation convergence, the MPC has introduced a new policy framework based on direct inflation targeting. Under this framework, central banks typically announce inflation targets to the public, and then adjust their monetary policy stance whenever inflation is projected to deviate from the objective. Direct inflation targeting, once it becomes credible, can have a powerful influence on inflationary expectations. In Poland, where the tradition of backward-looking wage indexation is deeply-rooted, this may help set wages on the basis of future rather than past inflation. The National Bank has announced a cautious medium-term inflation target of below 4 per cent in 2003,

fearing that under-achieving the inflation target would result in a loss of credibility. The central bank was right in being prudent in this regard, given possible shocks. But there is a risk that markets may misinterpret the MPC position as being ready to trade off inflation gains against other objectives. Indeed, in explaining some of its recent decisions it has referred to concerns other than inflation, notably the current account deficit. The NBP should therefore more expressly focus on achieving its inflation targets and adopt practices which are common among central banks that follow an inflation targeting approach, such as giving prominence to measures of core inflation, publishing inflation reports regularly and releasing to the public both its inflation forecasts and the MPC meeting minutes.

The second challenge is to ensure sustained financing of the current account deficit through appropriate policies

The second challenge that needs to be addressed in order to achieve sustained high growth is to ensure that the large current account deficit continues to be financed. The deficit has widened in the last few years because of higher imports, a reflection of the strong domestic demand. Exports have also been growing, but not fast enough to prevent a rising trend in the trade deficit. The balance of services has also deteriorated. OECD projections are for the current account deficit to reach 6 to 7 per cent of GDP in 1999 and remain roughly at that level in the near future. However, a large current account deficit may be less a cause of concern if it results from capital formation. In that respect, it is reassuring that the bulk of the trade deficit is in the category of investment goods, reflecting the ongoing transformation of the industrial sector which is assisted by strong inflows of foreign direct investment. While there is no specific level of the current account deficit which is considered as unsustainable, a larger deficit does mean a greater degree of exposure to unexpected events. Thus, it is important that financial markets remain reassured that the authorities are committed to appropriate macroeconomic and structural policies. In this regard, it is particularly important to maintain a business friendly environment that is conductive to profitable investments, a task, which will require continued efforts to pursue structural reforms. Increased government savings can also contribute importantly to the

sustainability of the current account deficit, reinforcing the need to improve public finances over the medium term.

Fiscal consolidation should be pursued with greater determination

After several years of deficit cutting policies, fiscal consolidation has been interrupted. In 1998, the total deficit of the general government came down only marginally from 2.8 per cent of GDP to 2.5 per cent on a cash basis. In addition, sizeable payment arrears were incurred, including the non-payment of medical equipment and supplies by hospitals. The 1999 budget envisaged a tighter fiscal stance that would have reduced the overall deficit to 2.3 per cent of GDP. In the event, however, deficits have emerged in the social security funds, state enterprises have incurred arrears on their social contributions, and local governments have increased their borrowing. As a result, the general government deficit is estimated to have reached 3.5 per cent of GDP for the whole year. This was one of the largest general government deficits in the OECD area. Fiscal consolidation should therefore be resumed with greater energy. The Budget Law for 2000 sets a general government budget deficit of 2.75 per cent of GDP. There are therefore good prospects that the budget deficit will be reduced in 2000. Nonetheless, several questions need to be addressed to resolve the current budgetary difficulties. First, actions need to be taken to stop the accumulation of arrears by state enterprises on social security contributions and taxes. If loss-making state enterprises cannot pay their social security contributions and taxes, they should be restructured more actively. The current tax and social contribution arrears constitute a disguised form of subsidy, which reduces the transparency of budgetary operations and provides adverse incentives. Second, the tax reform recently adopted needs to be implemented effectively to assure a revenue base that is consistent with the budget assumptions. Finally, the authorities should take steps to make the budgetary system more transparent, and bring greater discipline over the extra-budgetary funds. Recent decisions have obscured the exact magnitude of the general government deficit, in particular by hiding the deficit outside the scope of the central government budget. Transparency can be improved by providing regular reports on the financial

situation of the general government in an internationally accepted accounting framework.

Structural reforms on a wide front should help consolidate public finance and boost potential growth

Efforts to pursue fiscal consolidation need to be underpinned by structural measures to improve the quality of public spending and reduce the excessively high tax burden. In the years prior to 1999, the budgetary sphere was generally less touched by the reform effort than the enterprise sector. Few reforms were put in place until recently to modernise the central administration, decentralise responsibilities to local government and improve health care and education services. Moreover, little was done to adapt the social safety net to the needs of a market economy, and a wide-spread abuse of the system made Poland one the most profligate welfare states in the region. This has resulted in an excessively high tax burden, some crowding-out of the enterprise sector on the capital market, and the diversion of public resources from areas where they could boost potential growth, such as public infrastructure. The authorities have begun to address these problems, and a range of specific structural reform efforts have been initiated. A medium-strategy adopted recently by the Council of Ministers provides a good framework for furthering reforms.

Responsibilities have been devolved to local governments, but greater autonomy should be provided in tax policy decisions

An important structural reform introduced in the recent past is the devolution of responsibilities to local governments. Decentralisation brings decision-making closer to those affected by public decisions and in principle improves the quality of public spending. Local governments have been divided into three layers – communes (gminas), counties (poviats), and regions (voivodships) – and each level has been provided with well-defined areas of responsibilities. Local governments, however, have been given little autonomy in tax policy decisions and must rely on subsidies and transfers from the central government to finance their budgets. In due course, increased autonomy should be given to localities in tax decisions, so that they are able to build their own tax base over time. At the same time, adequate safeguards, such as a "golden rule" requiring that borrowing be authorised only to finance investment or some form of "internal stability part", will be needed to prevent local governments from running excessive deficits. The formulae

for allocating tax revenues to local and regional governments are largely based on their shares in generating total taxes without significant redistribution. In order to reduce income gaps between regions, a system of equalisation funds has been introduced, which nonetheless appears to leave significant gaps in income distribution across regions. More may therefore need to be done to level the playing field.

The old-age pension system reform needs to be complemented by cuts in early-retirement privileges and abuse of disability pensions

A carefully designed and comprehensive reform of the old-age pension system was introduced in early 1999. The new pension system will take many years to come into full effect but will eventually put the system on an actuarially sound footing and ensure that pension liabilities are fully financed. The new system is based on defined contributions which accumulate in individualised accounts and consists of three pillars two of which are compulsory. Returns on first pillar contributions are indexed to 75 per cent of real wage growth, while returns on the second pillar depend on the performance of investment funds. There have been some "teething" problems in the transition to the new pension system, but these are likely to be resolved over time without long-lasting damage. On the other hand, decisions need to be taken to reduce the abuse of disability and sickness pensions, which are the most generous in the region, and to reduce early-retirement privileges in the old system which still applies to those born before 1 January 1949. Without such decisions, the overall pension system will continue to rely on state subsidies and payroll taxes will remain excessively high, thereby discouraging work in the formal economy.

The tax burden is higher in Poland than in many other OECD countries

Tax reform should also play an important role in consolidating public finances and boosting potential growth. The Polish tax system has some commendable features, in particular a capacity to generate strong revenue on a continuous basis. This has allowed the government to finance public expenditure in full, including in the social area, reduce the budget deficit, and avoid recourse to excessive borrowing. Nonetheless, the system also had less desirable features and, as it stood, could have hampered growth in the future and come under increased criticism both domesti-

cally and internationally. These features included excessively high personal income tax rates, which represent disincentives to work, a vast array of tax exemptions and allowances, which reduce tax revenue and disproportionately benefit high-income taxpayers, and corporate income tax rates well above those of other transition countries. A reform of the system was therefore unavoidable, not only in preparation for European Union membership, but also to improve the entrepreneurial climate. After a year-long public debate, an overhaul of the tax system was adopted in November 1999.

The tax reform lowers tax rates on corporate incomes and harmonises indirect taxes with EU rules

The reform cuts the tax rates on corporate incomes, broadens the tax base, and raises indirect taxes to EU levels. The corporate income tax rate will be cut in steps from 34 per cent in 1999 to 22 per cent in 2004. Companies will lose capital allowances and investment-linked tax concessions, but depreciation schedules will be made more favourable. Finally, VAT and excise taxation will be harmonised with the EU Sixth Directive on indirect taxes, implying higher VAT rates on unprocessed foodstuffs, municipal services, and construction materials as well as higher excise tax rates on tobacco and alcohol. The reform is expected to have a positive impact on budgetary revenue.

A new reform of personal income taxation could be proposed to Parliament

A reform of the personal income tax which would have lowered the tax rates and eliminated exemptions was vetoed by the President of Poland. A reform along these lines is still needed. The government could seize the opportunity to submit to Parliament a proposal that would encompass a number of new issues related to the tax/benefit system. One such issue relates to the labour tax wedge, which is particularly high in Poland and leads, together with the rigid labour market, to a low employment rate and an oversized underground economy. Cutting payroll taxes will be possible once social expenditure will have been rationalised, including by reducing abuse of disability pensions, sickness leave and early-retirement pensions. In addition, the state should stop allowing the non-payment of social security contributions by loss-making enterprises. Self-employed individuals should also pay their contributions based on their actual income, rather than on an excessively low pre-

sumed income. If payroll taxes cannot be lowered, there are other options that can be considered to make work in the official economy more rewarding, such as a small income tax credit for low income families with one working adult, or a more generous flat income deduction than currently.

Other taxation reforms are needed

In addition, a number of tax-related issues not covered by the government proposal would still need to be addressed. First, as already noted, an autonomous tax base needs to be built for local governments, mainly by putting property taxes on an ad-valorem basis. Local property taxes are currently based on the size of premises and therefore need to be kept very low to avoid imposing an excessive burden on poor families. In contrast, taxes based on the value of properties, as registered in a new system of cadaster, would constitute a genuine local government tax base. At the same time, the stiff tax of 5 per cent on housing market transaction needs to be cut in order to foster mobility inside the country. Second, in view of the future costs of bringing environment regulations in line with EU standards, Poland should introduce charges on products that are damaging for the environment, such as coal, fertilisers, and leaded gasoline. Third, Poland should not at this stage try to bring the entire agricultural sector into the VAT tax net because this would entail high compliance costs for a large number of subsistence farms, would distract tax administration from more important priorities, and would raise virtually no new tax revenue. Instead, a threshold based on the size of farm land plots should be established, below which farms would not be required to keep books, register under the VAT system, and pay taxes. Over time, the threshold could be lowered towards the EU level. A similar approach could be adopted for the application of income tax to the farming sector. Finally, the various tax rates on capital incomes should be unified in order to reduce possible distortions in the allocation of savings and in the way investments are being financed.

Healthcare reform has advanced but some key details remain to be worked out,...

Important steps have been taken in the area of health care. The healthcare system is one of the few areas where reform efforts have been lagging behind others, probably reflecting its complexity and the absence of an obvious model to imitate. The Polish system offers universal coverage at a reasonable level of spending. But, like the command-and-control system in the United Kingdom before the major reform about a decade ago, the Polish system has suffered from creeping inefficiencies and absence of cost consciousness, and public dissatisfaction has grown. The latest reform introduced a national insurance scheme operated through regional health funds, split the purchaser and provider functions so as to promote competition among health service providers and assigned family doctors a role of gate-keeper for access to higher levels of care. While the basic ideas are sound, the success of the reform depends on certain key details being handled properly. The lack of clarity about these details is perhaps responsible for the rather negative public reception of the reform. One of these is payment arrangements, which, as international experience shows, bear importantly on quality, quantity and cost of services provided but are left for each regional funds to determine. It is hoped that in determining the payment arrangements lessons from other countries' experience will be drawn on with due attention paid to the effects of any given payment method on incentives of both consumers and providers of medical services. Another key detail missing in the reform is a clear operational definition of what constitutes a minimum guaranteed package of benefits, without which it is difficult to design a contract between the funds and service providers and to ensure equity across regional funds. A comprehensive law on health care currently under consideration needs to provide clarity on these issues.

... including ways to enforce a hard budget constraint on health funds

A major concern from the point of view of spending control is how to impose a hard budget constraint on regional health funds. Even though they are required to balance revenue and spending, there is currently no mechanism to ensure that they meet that requirement given that some of the payment arrangements are bound to be fee-for-service based. A stylised approach to enforce financial discipline is to introduce competition. The original reform proposal

envisaged allowing new funds to be set up and all funds to compete for members from 2001. But it is widely accepted that where insurance premia do not reflect the risk of illness for each individual – which is the case for social insurance – competition among insurers can only result in a waste of resources in attracting those with low risk. Hence, implementing this proposal is not recommended. Ways should be found to make the management team of the fund accountable for financial results and consumer satisfaction, for example through incentive-based remuneration and sanctions in the event of poor performance. Beyond this, an overall spending cap could be considered at the level of each fund, which means writing into a contract a provision for retroactive repayment by service providers in the event of spending overruns.

Public enterprises need to be restructured, particularly in the coal mining, steel industry, and railroad sectors

In central and eastern Europe, the fate of public finances is closely linked to the reform of public enterprises, because loss-making state companies are frequently a costly burden on the budget. Great efforts have been made to restructure state enterprises in the last ten years. The renowned problems of the shipyards have now been resolved, and most banks are by now restructured, re-capitalised and privatised. Thanks to these efforts, an important part of the related budgetary cost has already been paid, and enterprise restructuring is further ahead than in many other transition countries. Nonetheless, there are several sensitive sectors where the state as an owner has imposed insufficient budget discipline, tolerated excessive wage increases, and allowed companies to default on their taxes and social security obligations. The authorities have now drawn up plans to complete enterprise restructuring in the coal mines, the steel mills, the railroads and the defence industry, even though many such plans were made in the past and their implementation has been slow at best. It is the propitious time to implement adequate restructuring plans as they can be facilitated by the large privatisation proceeds expected in the near future, notably from the sale of state firms in the telecommunication and transportation sectors. Further delays would only increase the total cost for the budget for these restructuring and would continue to impose an undue burden on profitable firms.

Privatisation needs to be completed

After liberalising prices and foreign trade, Poland has stepped up its privatisation programme since 1998. Entire sectors of the economy have been restructured and transferred to private hands. The private sector now accounts for about 60-70 per cent of value-added. Nearly 95 per cent of the food-processing sector was in private hands at the end of April, a considerable increase from just 5 per cent ten years ago. Recent studies show that, following privatisation, Polish firms have typically increased efficiency and output. The recent acceleration in the privatisation programme therefore bodes well for the future. In 1998, the largest privatisation revenue came from the sale of a stake in Poland's national telecommunication operator TP SA. In 1999, privatisation efforts turned to the banking system, with deals concluded for Pekao Bank and Bank Zachodni, which leaves only two big state banks to be privatised. The government is speeding up work to complete privatisation in the insurance sector (with the sale of the large insurance company PZU), the energy sector (with the sale of power generation and electricity distribution firms), and transportation (with the sale of Polish airline LOT). Despite these significant privatisation efforts, the state still owns some 3 000 enterprises, including 120-130 large companies (above 500 employees). State enterprises dominate many sectors of the economy, from vodka distilleries to coal mines. The authorities have formulated a privatisation strategy until 2001, which calls for selling 70 per cent of the state assets through various channels. Stakes in state enterprises have also been set aside to finance the partial restitution of properties to owners expropriated between 1944 and 1962. A draft bill submitted to parliament in September 1999 proposes a legal framework for this process. The rapid settlement of previous owners' claims will clarify which assets can be privatised and which must be restituted.

Labour market rigidities should be reduced further

The labour market remains a dark spot in the generally bright picture. While the registered jobless rate declined to 10 per cent at the end of 1998, this improvement has been reversed by the recent economic slowdown and Poland currently has the highest unemployment rate among the central European OECD countries. Private sector estimates put the NAIRU (the rate of unemployment at which inflation

stabilises) at the relatively high level of 10 per cent, in view of the well-established tradition of wage indexation and the role played by the minimum wage. The arrival of the second wave of baby-boomers on the labour market, the labour retrenchment in sectors undergoing restructuring, and the problem of hidden unemployment in the rural areas will prevent a sharp decline of unemployment in the near future. This calls for policies that would foster job creation. The previous Survey provided a list of recommendations within the framework of the OECD Jobs Strategy to improve labour market conditions. It was noted that the high tax wedge has a pervasive impact on the labour market, because it reduces workers' earnings and increases labour costs. Steps were also recommended to make the labour market more flexible, to revisit employment protection policies, and to restructure active labour market policies. Only mixed progress has been made to implement these recommendations. The pension fund reform introduced this year goes in the direction of making work pay more. It should therefore encourage greater labour market participation, eventually leading to wage moderation and improved labour market conditions. Nonetheless, more needs to be done to reduce payroll taxes. Measures have also been taken to foster business dynamism, and the reform of the education system could lead in the long run to a better match of skills. The authorities are considering a new law on minimum wages, which would differentiate it across regions to better reflect differences in local labour markets, as recommended earlier by the OECD. On the other hand, wages are higher on average in the state sector, including loss-making firms, than in the private sector and greater wage discipline should be introduced in the budgetary sphere and in state-owned enterprises. Finally, active labour market policies have been high on the government's policy agenda, and the related spending has been increased. However, much remains to be done to increase evaluation and monitoring of programmes so as to make them more cost effective. In recognition of the seriousness of labour market problems, the government has formulated a "National strategy for employment and human capital development" for 2000-2006, so as to implement the OECD Jobs Strategy recommendation more fully.

Education reform can contribute to better job prospects

Education reform has just started to be implemented. It aims at closing the gap in secondary and university education with the EU. The reform aims at offering a better system of education and vocational training to the young people from underprivileged social groups in order to reduce poverty and high unemployment. It releases resources from programmes and institutions where demographic changes reduce education needs and redirects them to achieve a shift from quantity to quality. Private education is also liberalised under the reform. It is too early to judge at this stage how effective such reforms will be but, if successful, they will also make an important contribution to raising the quality of public expenditure.

A more cautious macroeconomic policy stance and consistent structural reforms will help the integration into the European Union

Poland has already reached a considerable degree of integration with the EU, as reflected in the large share (two-thirds) of its trade with the Union and the massive direct investment flows originating from European countries. Indeed, Poland now records a larger share of its trade with the EU than either Greece or Italy. Active discussions are taking place on the conditions of Poland's accession. On the authorities' side, a target accession date of 31 December 2002 has been established. The government is working toward this target and has set up a national programme for adoption of the "acquis communautaire". With the exception of unregulated sales of agricultural land to non-residents, the authorities have decided not to seek long transition periods for the implementation of EU rules. This should facilitate the negotiations. On the EU side, no target date for accession has been established, but significant progress has been made in the screening process for compliance with EU rules. The European Commission already regards Poland as a functioning market economy, which should be able to cope with competitive pressure and market forces within the Union in the medium term. The Commission has notably praised Poland for the efforts made in the areas of privatisation, banking system reform, and macroeconomic stabilisation. In contrast, further progress is requested in other areas including industrial restructuring, control of state aide, measures to prevent corruption and preparation for the internal market (certification, standardisation, public procurement, and liberalisation of

capital movements). Progress is also requested in environmental standards, which will require costly investments in air and water clean-up equipment. Accession to the EU is a goal that mobilises the entire country and creates a unique window of opportunity for the determined implementation of structural reforms accompanied by strengthened macroeconomic policy discipline. Signs of "accession fatigue" are, however, emerging and Poland is therefore right to aim at a swift integration.

The convergence towards EU inflation levels bodes well for future membership in ERM2 and EMU

An important medium-term target is to fulfil the conditions required to participate in the Economic and Monetary Union (EMU). This will require efforts in the fields of public finance, inflation, and exchange rate stability. The authorities envisage to adopt the euro in 2006. For this purpose, Poland would have to join the new exchange rate mechanism (ERM2) in 2004, one year after the planned accession to the European Union and peg the zloty against the euro within the prevailing fluctuation margins (currently ± 15 per cent). A period of two years in the ERM2 without devaluing against another currency, as well as fulfilling the other convergence criteria, would be required. Such a strategy of rapid entry into EMU is not without risk. It would entail a loss of autonomy in monetary and exchange rate policy at a time when more independence might be necessary to mitigate asymmetric shocks. Fiscal policy would also be severely constrained at a time when Poland would have to finance the cost of fulfilling single-market requirements. But, if successful, this strategy would bring great benefits in terms of credibility, financial discipline and, after joining EMU, long-lasting monetary stability.

Summing up

Ten years after having embarked on an ambitious programme of economic transformation, Poland has established itself as one the most successful transition economies. Efforts to stabilise the economy, put the public finances in good order, conduct a sound monetary policy, unleash market forces and implement structural reforms on a broad front have been well rewarded. Having weathered the economic slowdown in the wake of the Russian crisis, the main challenge of the authorities is now to ensure that the incipient recovery is transformed into lasting high

growth. This will require prudent monetary policies to reduce inflation, further efforts to consolidate public finances and increase domestic savings, exchange rate flexibility to facilitate adjustment to external shocks, and rapid progress to privatise state-owned enterprises so as to maximise the economy-wide benefits of increased efficiency. These, together with further structural reforms to stimulate competition in product markets, reduce rigidities in labour markets and improve the functioning of capital markets, are the best ways to guarantee that Poland can stay on the fast track to join the European Union while also strengthening market confidence in Poland's underlying fundamentals.

I. Recent economic trends and prospects

After the initial contraction of output that followed the launch of its economic transformation programme, Poland enjoyed a long period of robust economic growth during 1992-98. By 1995, real GDP had reached the pre-transition output level, and in 1998 it had exceeded it by about 20 per cent[1] (Table 1 and Figure 1). The rapid expansion was driven foremost by the manufacturing sector.[2] The volume of manufacturing output doubled since its trough in 1991 and, even though it accounts for only one-fifth of GDP, the manufacturing sector contributed two-thirds of the increase in value-added. Within the manufacturing sector, impressive sectoral shifts occurred: spectacular growth was recorded in consumer electronics (television sets), electrical appliances, cars, and car components. In contrast, the mining sector has on average contracted, construction grew only slightly above average, performance of agriculture was uneven, and market services contributed much less than industry (Table 2). The surprisingly weak record of the service sector reflects in part the large share of unrecorded activities in this sector, although substantial efforts have been made to include their estimates in the national accounts.

The economy slowed down in 1998 and the first half of 1999

The economy slowed in 1998 and the first half of 1999 (Figure 2). Three main factors were at the origin of the slowdown. First, the National Bank of Poland (NBP) tightened the monetary conditions in 1997 in view of the emerging signs of overheating, which it feared might rekindle inflationary pressures (see Chapter 2). Second, the Russian financial crisis of August 1998 adversely affected exports as well as business and consumer confidence. Third, the economic slowdown in the EU during the winter of 1998-99, most notably in Germany, also significantly reduced exports. As a result, unemployment increased for the first time since 1994 while the external accounts deteriorated further.

The economic slowdown in 1998 (real GDP growth of 4.8 per cent) and the first quarter of 1999 (1.5 per cent year-on-year) was broadly based (Figure 3). Real private consumption growth moderated from about 7 per cent in 1997 to 5 per

Table 1. **Summary economic indicators**

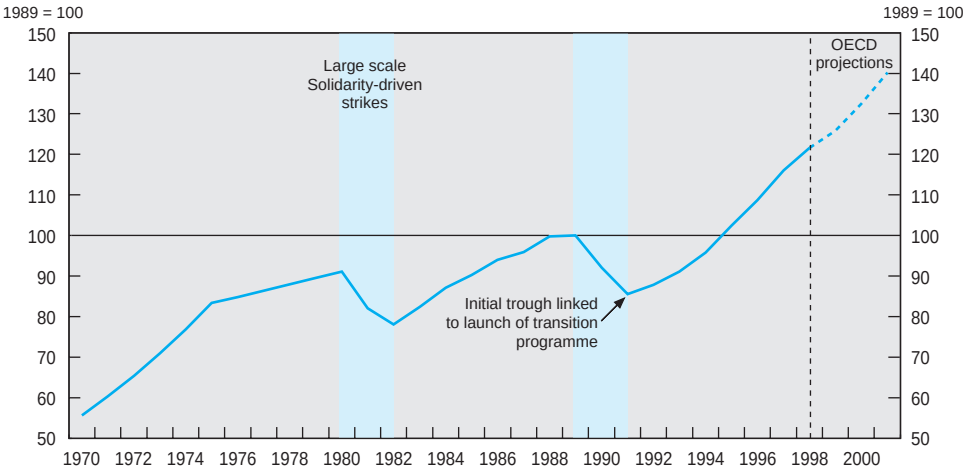
	1995	1996	1997	1998	1999 Q1	1999 Q2
Real sector						
GDP (Zl billion)	306.3	385.4	469.4	551.1	133.2	148.3
Real GDP (change YoY in %)	7.0	6.0	6.8	4.8	1.5	3.0
Real private consumption (change YoY in %)	3.3	8.3	6.9	4.9	4.2	4.8
Real gross fixed investment (change YoY in %)	16.5	19.7	21.7	14.5	6.0	6.7
Sold industrial production (n.s.a., change YoY in %)	9.7	8.3	11.5	4.6	–3.1	1.2
Consumer prices (change YoY in %)	27.8	19.9	14.9	11.8	6.2	6.4
Average monthly wages (change YoY in %)[1]	32.1	26.9	21.4	16.1	12.2	10.6
Employment (thousand, n.s.a.)[2]	5 883	5 845	5 915	6 025	5 999	5 969
Unemployment rate (registered, n.s.a.)	15.2	14.3	11.5	10.0	11.8	11.7
Monetary indicators (change YoY in %)						
M2 (end of period)	34.9	29.3	29.1	25.1	27.6	22.9
Short-term interest rate (3 month Treasury bills) (average)	25.6	20.3	21.6	19.1	12.7	12.3
Long-term interest rate (Treasury bills, 52 weeks) (average)	..	..	22.1	18.7	11.7	12.1
External indicators in convertible currencies (in terms of US dollars, billion)						
Exports of goods[3]	22.88	24.45	27.23	30.12	7.01	6.27
Imports of goods[3]	24.79	32.63	38.55	43.84	9.83	9.64
Trade balance[3]	–1.91	–8.18	–11.32	–13.72	–2.82	–3.37
Current account[3] (incl. unclassified transactions),	5.31	–1.37	–4.31	–6.86	–2.24	–2.77
in per cent of GDP	4.2	–1.0	–3.0	–4.3	–6.3	–7.4
Gross official reserves ($ billion)	15.0	18.0	20.7	27.4	26.6	25.8
External debt (end of period, $ billion)[4]	–	47.4	48.9	56.9	56.0	57.4
Ratio of debt to annual exports of goods (%)	–	193.7	179.6	188.8	199.6	228.6

1. Gross wage in the enterprise sector of the economy adjusted for the grossing-up in January 1999 following the payroll tax reform.
2. In the enterprise sector, annual average.
3. BOP basis. Cashed based.
4. Total external debt (government, banking system and other sectors).

Source: Central Statistical Office, Ministry of Finance and OECD.

cent in 1998 and just 4 per cent in the first quarter of 1999 (year-on-year). The tightening of monetary conditions and weak business confidence brought about a slowdown in gross fixed capital formation from 22 per cent in 1997 to 14 per cent in 1998 and only 6 per cent in the first quarter of 1999 (year-on-year). Total exports at constant prices fell by 5.3 per cent in the first two months of 1999 compared to the same period of the previous year.[3] Hit by the Russian crisis in the winter of 1998-99, exports to countries of central and eastern Europe shrunk by 29 per cent. Exports to EU countries were negatively influenced by the economic

Figure 1. **GDP at constant prices, 1970-2001**[1]



1. For 1970, 1975 and 1980, World Bank estimates in *Working Paper* No. 776 (1985); for 1981 to 1998, CSO Statistical Yearbooks; for 1999 to 2001, *Economic Outlook*.

Source: Central Statistical Office, World Bank and OECD.

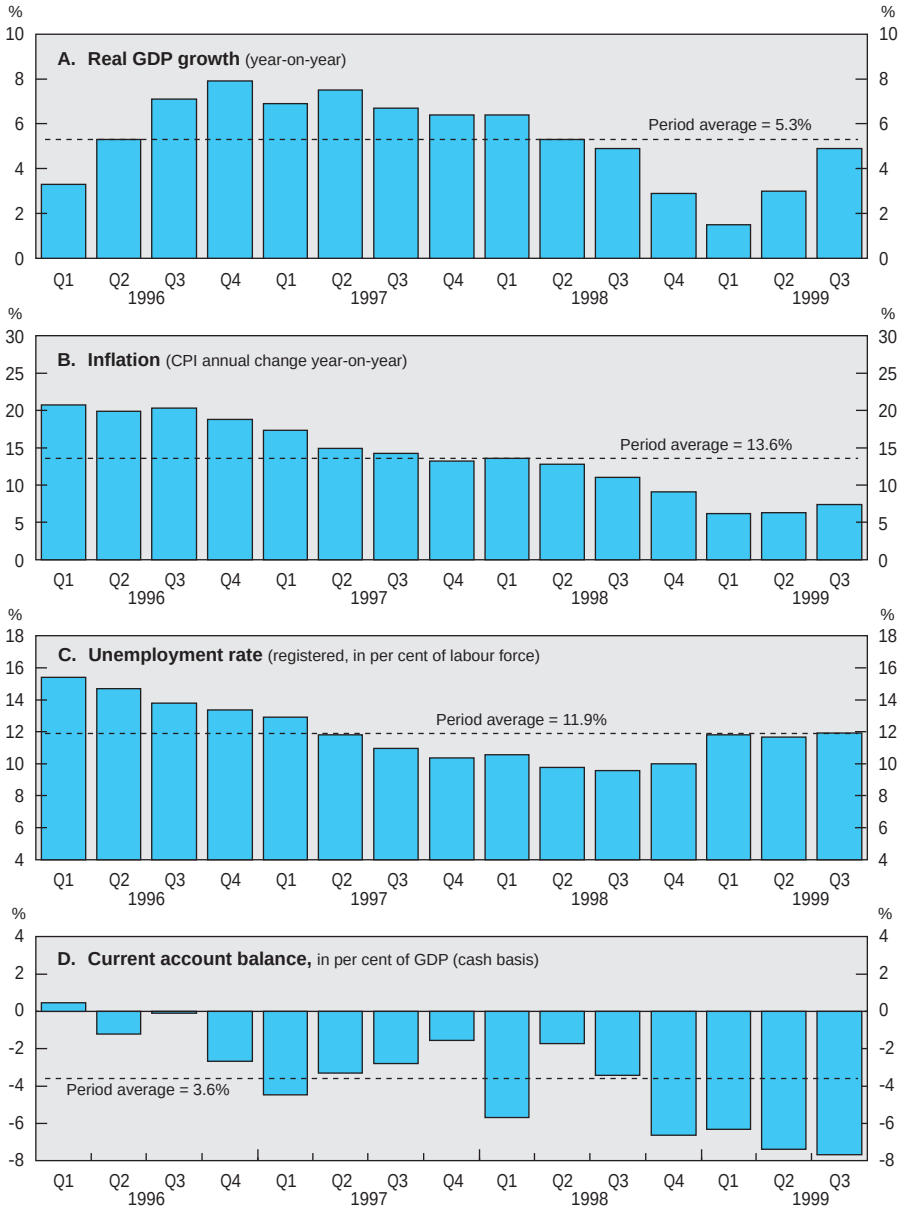
Table 2. **Growth of value-added by sector**

In per cent

Specification	Share in GDP 1998	1995	1996	1997	1998
GDP	**100.0**	**7.0**	**6.0**	**6.8**	**4.8**
Gross value-added		6.7	5.3	6.5	4.5
Agriculture, hunting, forestry	**4.2**	**10.4**	**2.4**	**1.1**	**6.1**
Industry	**24.3**	**10.4**	**7.6**	**10.3**	**4.3**
of which:					
Mining and quarrying	2.5	1.5	4.7	–4.3	–11.6
Manufacturing	18.9	13.7	8.8	14.4	7.6
Electricity, gas and water supply	2.9	2.1	3.5	0.6	–1.0
Construction	**7.4**	**5.8**	**2.8**	**13.6**	**9.1**
Market services	**45.4**	**4.8**	**5.3**	**4.4**	**4.7**
Trade and repair of consumer goods	17.9	5.0	6.1	8.1	5.1
Hotels and restaurants	0.9	6.5	16.8	7.3	8.4
Transport, storage and communication	5.6	2.3	5.4	5.6	6.3
Financial intermediation	1.3	21.4	11.3	2.9	6.6
Real estate and business activities	11.5	5.8	0.9	–0.7	4.0
Non-market services					
Public administration and defence	4.7	4.2	4.4	5.9	1.6
Education	3.5	1.5	1.4	0.9	2.7
Health care and social work	3.4	1.6	1.5	0.8	1.5
Other	3.1	0.7	6.9	–6.8	1.0

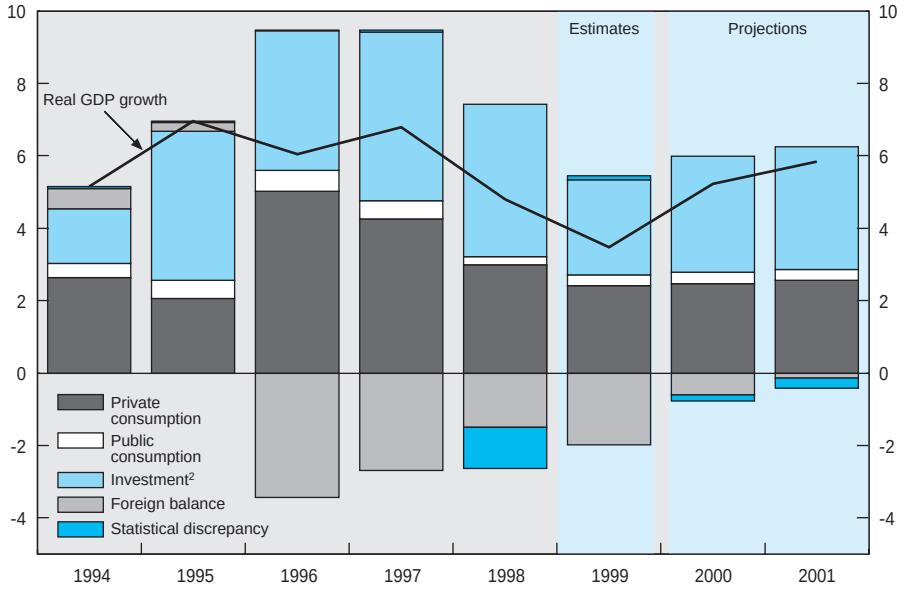
Source: Central Statistical Office.

Figure 2. **Key indicators**



Source: Central Statistical Office, National Bank of Poland and OECD.

Figure 3. **Contributions to real GDP growth**[1]



1. Changes as a percentage of real GDP in the previous period.
2. Including stockbuilding.

Source: Central Statistical Office and OECD.

slowdown in Europe and declined by 2.3 per cent. The total volume of imports of goods fell by 1.2 per cent in January-June 1999 (year-on-year), not enough to compensate the export decline.

Industry was affected more than other sectors by the overall degradation. Value-added in industry slowed markedly in 1998 and eventually fell in the first quarter of 1999 compared to the previous year, reflecting the downward trend of exports. Among industrial branches, basic industries suffered the largest declines, in particular mining, metallic products, and chemical products. Textile industries also suffered from the decline of exports to Russia. In contrast, enterprises in the motor vehicle assembly sector resisted relatively well, thanks to the strong sales of cars in Poland and in Western Europe. Outside the industrial sector, value-added in market-services performed better than the rest of the economy, particularly in the network sector where demand for high technology services was strong. Value-added in the construction sector grew at about the average rate, the slowdown in business fixed investment being compensated by the demand for housing renovation work.

The economic slowdown has contributed to rising unemployment...

The economic slowdown has taken its toll on the labour market. The sharpest drop in employment was observed in the mining sector and electricity, gas and water supply. The drop in public works and training programmes also contributed to the picture. The registered unemployment rate attained a floor of 9.5 per cent in August 1998, before creeping up almost uninterruptedly thereafter to reach 11.6 per cent in June 1999 (Figure 4). Another measure of unemployment, which is based on quarterly survey of households, showed an increase in the rate of unemployment from 10.2 per cent at the end of 1997 to 10.6 per cent at the end of 1998. This disappointing outcome reflected not only the slowdown of the economy, but also the arrival of large groups of baby boomers on the labour market. The entry into force of new regulations in January 1999 changing the eligibility criteria for health insurance of unemployed persons also led discouraged workers to register with employment offices in order to guarantee their health insurance coverage.

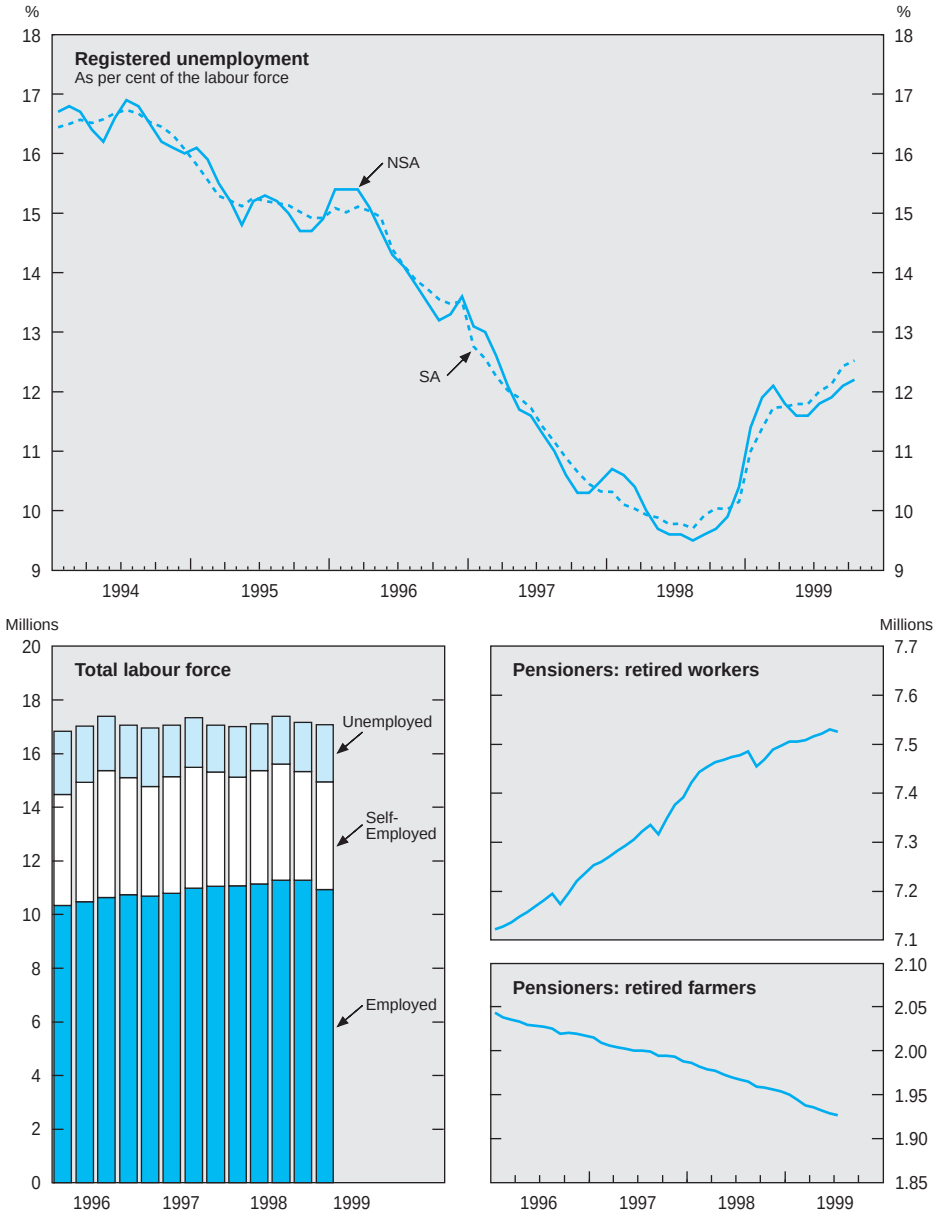
... And, together with other factors, to further disinflation

Consumer price inflation entered the one-digit zone in the middle of 1998 and dropped to 8.6 per cent year-on-year in December 1998 (Figures 5 and 6). Inflation fell further in the early months of 1999 and reached a record low of 5.6 per cent in February 1999, less than generally expected. To a large extent, this was due to temporary factors, including the weakening of business activity, low food prices, and sharply lower commodity prices on international markets (notably for energy). Once the impact of these factors dissipated in the spring of 1999, inflation crept up slowly and reached 8 per cent in September 1999. A measure of core inflation obtained simply by filtering short-term fluctuations also shows a trend of disinflation in 1997-98, followed by a slight increase in early 1999 (see Chapter 2).

Nonetheless, the external deficit widened

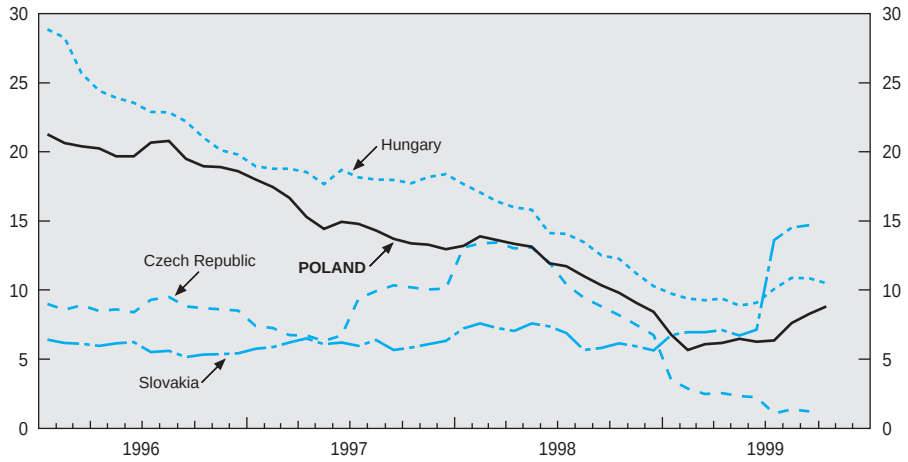
The current account deficit has increased almost uninterruptedly since 1996 and is expected to reach $12 billion in 1999, the equivalent of about 7 per cent of GDP (Figure 7). To a large extent, this trend reflected a strong increase of imports, particularly from EU countries, which were stimulated by the vigorous domestic demand, the reduction of trade barriers, and the comparatively low quality of domestic products. As a result, the trade deficit with the EU alone reached $11.8 billion in 1998. The recent deterioration was also due to a sudden drop of exports to Russia, which previously was a major market for Polish food

Figure 4. **Labour force indicators**



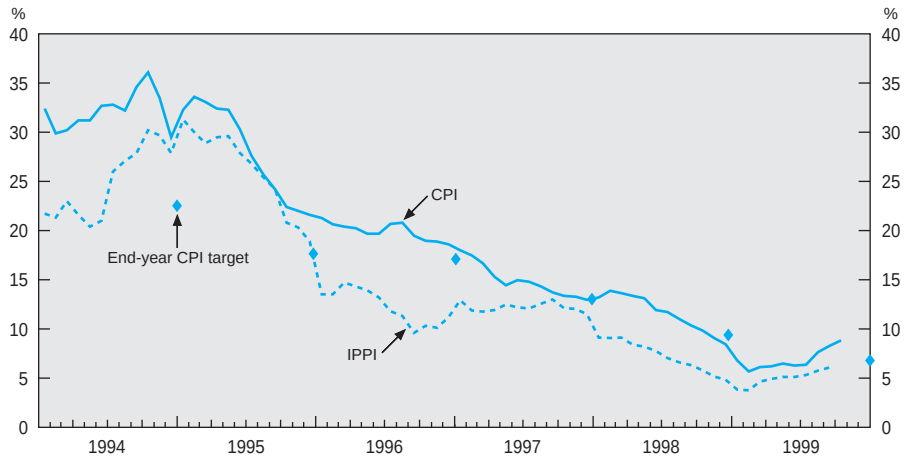
Source: Central Statistical Office and OECD.

Figure 5. **Inflation: international comparison**
Percentage change in CPI over twelve months



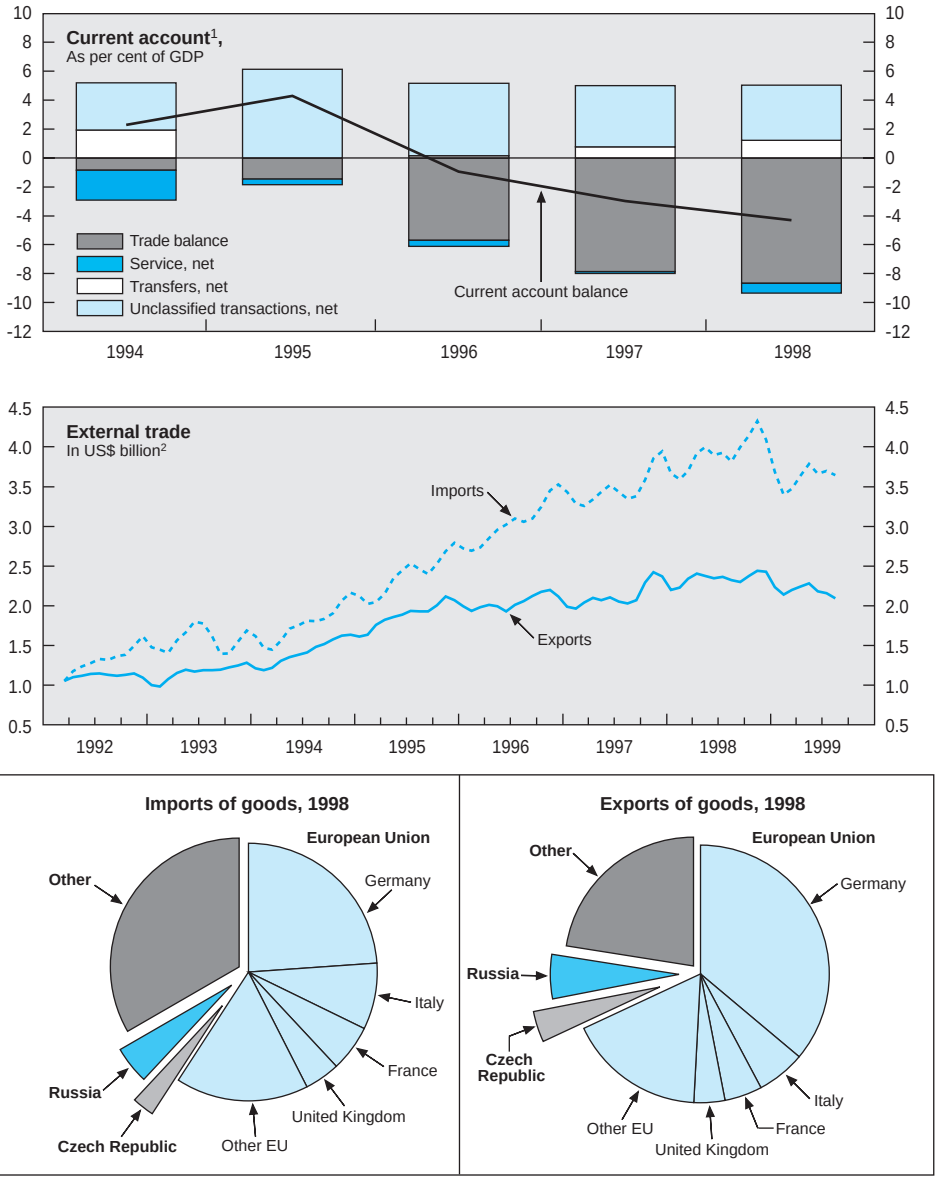
Source: OECD.

Figure 6. **Disinflation**
Consumer and industrial producer price indices[1]



1. 12-month percentage changes.
Source: Central Statistical Office.

Figure 7. **Foreign trade developments**



1. From the balance of payments on cash basis.
2. Three-month moving average for imports and exports.

Source: National Bank of Poland, GUS and OECD.

products, notably meat and sugar. As regards trade by commodity groups, the largest deficits occurred in 1998 in machinery and transport equipment ($10.2 billion), chemicals ($4.5 billion) and other manufactured goods ($2.6 billion). Hence, a substantial part of the import demand was related to the restructuring of the domestic industry and the inflow of foreign direct investment.

The drop of the surplus in "unclassified transactions" also contributed to the widening current account deficit in 1999.[4] Unclassified transactions cover "suitcase" trade both on the German and eastern borders, where foreign consumers take advantage of the lower prices in Poland than in their own countries. Until 1998, the surplus on these unclassified transactions was an important element offsetting the trade deficit. However, the advantageous relative prices that attracted eastern shoppers all but disappeared after the sharp currency depreciation experienced by Russia, Ukraine, and Belarus in mid-1998. At the same time, higher excise taxes (notably for alcohol, fuel products, and tobacco) reduced trade on the German border. Finally, these transactions were affected by new restrictions, such as the tightening of licensing requirements or stricter visa requirements for aliens coming from ex-Soviet Union countries. These factors considerably reduced the surplus on unclassified transactions, which in the first six months of 1999 dropped to $1.6 billion compared to $2.9 billion in the same period of the previous year.

The increase in the current account deficit also reflected changes in the balances on non-factor services and net income from abroad. The balance of non-factor services fell into a deficit of $509 million in 1998, compared to a surplus of $305 million in the previous year. The deficit on net income from abroad has been rising in line with the inflow of foreign capital. The largest deficit was observed in "other services", which includes financial and engineering services. In contrast, the balance on current transfers recorded a surplus of $1.9 billion, of which 20 per cent were official transfers mainly from the European Union assistance programs, and the remainder was largely composed of remittances of Polish workers emigrated abroad to their families at home.

The current account deficit has been largely financed by inward foreign direct investment

To a large extent, the current account deficit mirrored the stream of inward foreign direct investment (FDI). In recognition of Poland's sound fundamentals, foreign direct investment has been sizeable since the mid-1990s (Table 3). In 1998, Poland attracted 40 per cent of all FDI flows to central and Eastern Europe and the Baltic States (EBRD Transition Report,[5] 1998). Measured by the balance of payments on an accruals basis, the cumulated stock of FDI stock since 1990 reached $23 billion, the equivalent of $600 per capita.[6] According to

Table 3. **Foreign direct investment in OECD emerging economies, 1996-98**

	1996	1997	1998	1996	1997	1998
	$ million			In per cent of GDP		
Foreign direct investment flows						
Czech Republic	1 429	1 301	2 540	1.0	0.9	1.6
Hungary	1 983	2 085	1 935	4.4	4.6	4.0
Mexico	9 185	12 478	10 238	2.8	3.1	2.5
Poland	4 498	4 908	6 365	3.1	3.4	3.5
Turkey	722	805	940	0.4	0.4	0.5
Cumulative FDI flows involving OECD countries since 1990						
Czech Republic	7 626	9 055	10 356	5.3	6.3	6.6
Hungary	13 125	15 108	17 193	29.1	33.0	35.9
Mexico	46 913	56 098	68 576	14.1	14.0	16.0
Poland	13 503	18 001	22 909	9.4	12.6	14.6
Turkey	5 816	6 538	7 343	3.2	3.4	3.7

Source: OECD Direct Investment Database.

the Polish Agency for Foreign Investments (PAIZ), the largest investments were made in food processing (Nestle, Pepsi, Coca-Cola), tobacco (Philip Morris), car assembly (Fiat, Daewoo, General Motors), financial services (Hypo and Vereinsbank AG, ING, Commerzbank, Citibank), and retail trade (Métro, Carrefour, Leclerc). Foreign investors initially focussed on the Polish domestic market, which is the largest in the region. For instance, cars produced by foreign manufacturers in Poland have essentially been designed for the domestic market. Large investments have also been made in the retail trade sector – 200 giant foreign supermarkets employing 10 000 workers can be found in the suburbs of major Polish cities – essentially to take advantage of the fast growing private consumption. Initially, FDI inflows have therefore contributed to a larger trade deficit. But, there are indications that foreign investors are now planning to use Poland as an export platform towards Western Europe (Fiat, Toyota). Integration with the European Union will bring further impetus to this trend. There are also signs that foreign investment is expanding beyond labour-intensive industries to sectors with higher technological content (Isuzu) and to financial services. Over time, foreign investment should therefore contribute to a more balanced foreign trade.

Signs of recovery emerged most recently...

After slowing markedly in the winter 1998-99, the economy bounced back in the second quarter of 1999 with year-on-year real GDP growth gathering speed

to reach 3 per cent. This was led by industrial production which, after having declined at the turn of 1998, picked up momentum in the spring and continued to expand during the summer months. Several factors were at the origin of this revival. First, aggressive interest rate cuts made by the National Bank of Poland at the turn of 1998-99 led to a credit boom, although the cost of credit remained high in real terms. Consumers in particular significantly increased their borrowing, notably of instalment credits and mortgage loans, and also reduced their holdings of bank deposits, which together led to a marked decline in the household savings rate. Lower interest rates also stimulated a recovery of business fixed investment. Second, a relatively loose fiscal policy, in the form of strong increases in real terms of pensions and social benefits boosted domestic demand. The authorities also provided budgetary support to loss-making sectors to help them cope with the slowdown. Third, households real disposable incomes were boosted by lower-than-expected inflation, as nominal wages grew in the first six months of 1999 at an annual pace of 10-12 per cent, while consumer price inflation had already dropped to 6-7 per cent. Fourth, important structural reforms were implemented and privatisation quickened, which boosted the confidence of domestic and foreign investors. Foreign direct investment inflows therefore remained unabated. Finally, the business sector also appears to have rebuilt inventories, which had been brought down in the expectation that the economy might go through a severe contraction. All these indicators suggest that domestic demand has bottomed out and that the economy is poised for a return to robust economic growth, despite the ongoing drag from foreign trade.

... Paving the way for an improved economic outlook...

The short-term outlook for Poland is a favourable one. After moderate growth in 1998 and 1999, the OECD Secretariat projects that the economy will recover and gather momentum in 2000 and 2001. The projection of an economic recovery hinges crucially on the pick up of exports towards Western Europe. The Secretariat projects that growth in Western Europe gathered speed in the second half of 1999, and will accelerate in the following two years. Outside Europe, world trade should be boosted by the recovery of both Japan and East Asia. The US economy, though slowing, is projected to continue to contribute positively to the expansion of world trade. Oil-exporting countries are regaining purchasing power thanks to the sharply higher crude oil price and should therefore expand their imports. Altogether, Poland should benefit from a much better international environment in 2000 and 2001 than previously.

The projection presupposes that macroeconomic policy remain vigilant and that measures are taken to weather the threats arising from both the widening current account deficit and the uptick in inflation. Recent decisions by the Council

of Ministers and the NBP confirm that the authorities are taking these risks seriously. As noted in the following chapter, the government has adopted a draft budget for 2000 that aims at cutting the deficit of the general government. It has also adopted ambitious privatisation targets for the year 2000, which will provide the necessary financing of the budget deficit. The Monetary Policy Council of the NBP raised its interest rate in September and November 1999, proving its determination to combat inflation. A further interest rate hike is not excluded if inflation does not show signs of abating.

On the assumption that the international environment improves and macroeconomic policies are cautious, real GDP is projected to grow by about 5 per cent in 2000 and close to 6 per cent in 2001 (Table 4). Output growth will be

Table 4. **Summary of outcomes and projections for 1999-2001**

Year-average real percentage change, unless noted

	1996	1997	1998	1999[1]	2000[1]	2001[1]
GDP	6.0	6.8	4.8	4.0	5.2	5.8
Level, in $ billion at market exchange rate	143	143	158			
Household consumption	8.3	6.9	4.9	3.9	4.0	4.2
Government consumption	3.4	3.2	1.5	2.0	2.0	2.0
Gross fixed investment	19.7	21.7	14.5	10.0	11.0	11.5
Total domestic demand	9.7	9.3	6.5	5.1	5.6	5.8
Exports of goods and services	12.0	12.2	10.3	–2.0	6.5	10.0
Imports of goods and services	28.0	21.4	13.7	4.0	7.0	8.5
Unemployment (LFS, year-average, in per cent of the labour force)	12.3	11.2	10.6	11.4	10.8	10.3
Employment (LFS, per cent increase)	1.2	1.4	1.2	0.0	1.5	1.3
Consumer price inflation (year-on-year, in per cent)	19.9	14.9	11.8	7.2	7.1	5.4
General government (cash basis, in per cent of GDP)[2]						
Revenue[3]	42.6	42.0	41.0	41.1	41.2	. .
Expenditure	45.7	44.9	43.5	44.6	43.9	. .
Balance[3]	–3.1	–2.9	–2.5	–3.5	–2.7	. .
Broad money (nominal increase, end-year)[4]	29.2	29.1	25.2	19.6	. .	. .
Nominal interest rate on 3-month Treasury bills (annual average)	20.3	21.6	19.1	13.1	12.5	11.3
Current account balance[5]						
In $ billion	–3.3	–5.7	–6.9	–10.8	–10.7	–10.8
In per cent of GDP	–2.3	–4.0	–4.4	–7.1	–6.7	–6.3

1. OECD estimates and forecasts, except for budget estimates of 1999 and 2000 which are based on the authorities' budget.
2. Overdue taxes and arrears on government expenditures are excluded.
3. Privatisation receipts are excluded from revenue and treated as deficit finance.
4. Including foreign exchange deposits.
5. Accruals-based balance of payments.

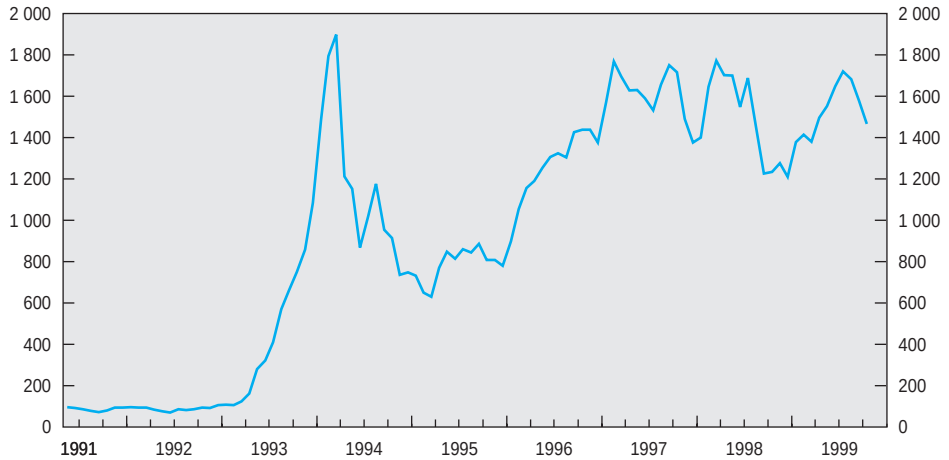
Source: Ministry of Finance, National Bank of Poland and OECD.

led by domestic demand, and most notably by private consumption, which is supported by strong increases in real disposable income throughout the projection period. Gross capital formation should also return to healthy growth rates, after the slowdown experienced in the aftermath of the Russian crisis. Exports are projected to return to double-digit growth rates by the end of the projection period, after the sharp fall in 1999 that followed the contraction of suitcase trade. The projected economic recovery should foster job creation, and the number of unemployed is projected to decline again at the turn of 1999. A rapid decline in joblessness is unlikely, however, because large groups of baby boomers are entering the labour market. Consumer price inflation is expected to accelerate slightly in 2000 owing to scheduled increases in excise taxes and VAT rates to bring them to EU levels. The return to more rapid growth is also likely to reinstate some of the inflationary pressures previously experienced. In these circumstances, consumer prices should increase by about 7 per cent in 2000. Determined actions of the central bank should help reduce inflation to an annual rate of close to 5 per cent by 2001. With renewed strong export performance, the current account deficit is expected to decline slightly to 6 per cent of GDP by 2001, from a peak of around 7 per cent in 1999.

... Although some uncertainties remain

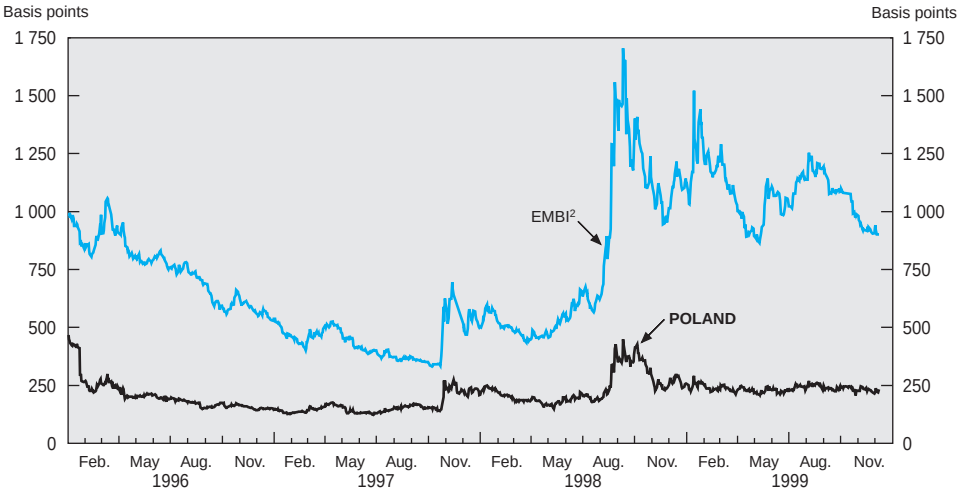
The main threat to the projection comes from a possible shift in market sentiment against Poland. For the time being, although a considerable increase in the current account deficit has raised some concern, market sentiment has not shifted and remains positive overall with respect to the Polish outlook. Financial markets are re-assured that about two-thirds of the current account deficit are financed by inflows of foreign direct investment and by equity purchases, which do not create additional debts. The strong track record of Poland, the credibility of its central bank, and the restructuring of the banking sector should also reassure them. This confidence is reflected in the good performance of the stock market and the small and stable spread of Polish Eurobond yield over Libor (Figures 8 and 9). The large foreign exchange reserves of the central bank are also there to reassure the international financial markets (Figure 10). More fundamentally, the bulk of the deficit is due to imports of capital goods which reflect an investment boom, rather than a surge in private consumption. When new production capacity comes on stream, and so long as investments are being made in competitive and profitable sectors, an upsurge of both output and exports, and an improvement in the current account, are likely to occur. Other successful transition economies, such as Estonia, have also registered a high current account

Figure 8. **WIG all shares index**
16 April 1991 = 100



Source: OECD.

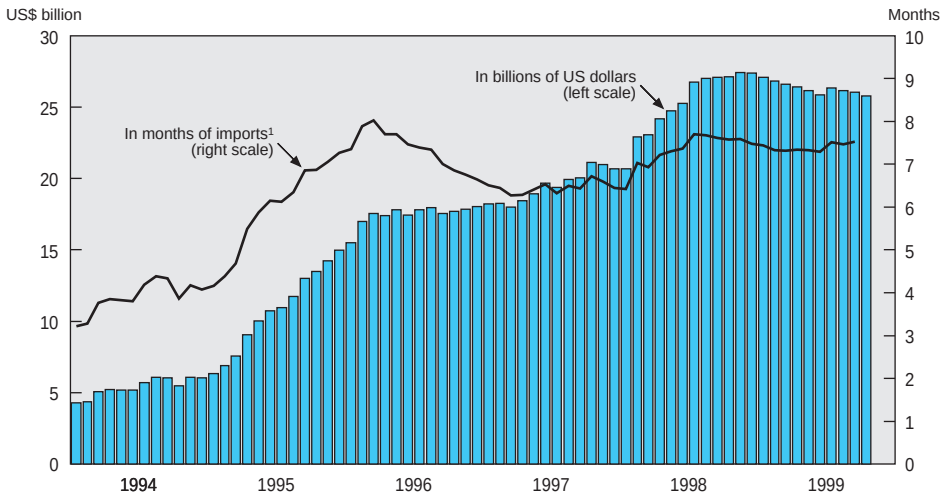
Figure 9. **Interest rate spread on Eurobonds**[1]



1. Spread of Eurobonds yields over LIBOR.
2. EMBI is a weighted average of emerging market bonds compiled by J.P. Morgan.

Source: ABN AMRO.

Figure 10. **Gross official foreign exchange reserves**



1. Moving average of monthly imports (Bop cash basis) over the last 12 months.
Source: National Bank of Poland and Central Statistical Office.

deficit without a currency crisis. Nevertheless, this trend should be carefully monitored given that large current account deficits have contributed, among other factors, to financial crises in other emerging economies. Reducing the current account deficit overtime needs to be one of the important goals for the policy makers.

II. Macroeconomic policies

In 1997-99, the authorities took important decisions to introduce institutional reforms and formulate their macroeconomic policies in the context of medium-term frameworks. In the area of monetary policy, steps were taken to strengthen the independence of the National Bank of Poland with the establishment of a Monetary Policy Council. This Council took decisions, which helped establish its credibility, and formulated a medium term strategy based on direct inflation targeting. In the fiscal area, an important Act on Public Finances was adopted by parliament to clarify the responsibilities of various agencies, impose discipline on the general government budget, and improve transparency. The authorities also put their fiscal policy in a medium term framework to consolidate the public finances and contribute to long term economic development. These institutional reforms and new policy frameworks have helped Poland to cope well with the challenging environment created by the Russian crisis in mid-1998 and the Western European slowdown in the winter 1998-99. Nonetheless, a number of difficulties need to be addressed in the near term, including the recent degradation of the social insurance office's financial situation, the pickup of inflation at an early stage of the recovery, and the widening current account deficit.

Monetary management

The adoption of an inflation targeting framework

The adoption of the new Polish Constitution and the Act on the National Bank of Poland (NBP) in 1997 were important steps to strengthen the independence of the central bank. The Constitution provides that the NBP has the exclusive right to formulate and implement monetary policy. Under the Act, monetary policy is formulated by the Monetary Policy Council (MPC), an independent body composed of ten members. The Governor of the NBP, who is appointed for six years by the lower chamber of parliament upon proposal by the President of the Republic of Poland, chairs the MPC. The nine other members are appointed in equal proportions by the President, the lower chamber, and the upper chamber

of Parliament. Members of the Council are appointed for a non-renewable term of six years, cannot be removed from their posts in normal circumstances,[7] and must limit their outside professional activities to academic work, teaching or writing. The Council determines the general monetary policy framework and makes decisions concerning interest rates, exchange rate policy (in consultation with Ministry of Finance), open market operations, required reserves, and NBP loan and credit facilities.[8]

One of the first decisions of the MPC was to adopt a new monetary policy framework. Until 1997, the National Bank of Poland was using money supply growth as the official intermediate monetary policy target. This policy was abandoned in 1998 because the correlation between the monetary aggregate and inflation was becoming increasingly less stable and predictable. This was primarily a consequence of the development of financial markets and the progress made in macroeconomic stabilisation, two factors that led to a rise in money demand. In addition, the policy was abandoned because the central bank's control of the money supply was impeded by the exchange rate arrangement. To a large extent, the central bank was trying to pursue two objectives (a monetary target and an exchange rate anchor) with only one instrument, which frequently led to monetary policy dilemmas. A common dilemma occurred when the central bank had to intervene on the exchange market to prevent an appreciation of the exchange rate, but at the same time had to take actions to bring money supply within the announced target. To achieve the two objectives simultaneously, the central bank had to resort to large-scale sterilisation operations, which were costly for the banking system and increasingly difficult to put in place. A new framework was therefore required to re-organise the priorities of monetary policy and limit the number of objectives.

In September 1998, the MPC adopted a framework of direct inflation targeting.[9] Under this framework, central banks typically announce inflation targets to the public, make regular forecasts of future inflation, and then adjust the monetary policy stance whenever inflation is projected to deviate from the objective. Direct inflation targeting has the advantage of revealing the central bank's inflation objective, which in turn can have a powerful influence on inflationary expectations. The MPC decided at the same time to abandon monetary targeting and, in early-1999, considerably widened the exchange rate fluctuation band. Under the new approach, the Polish monetary authorities base their decision on inflationary developments, after a careful analysis of all factors influencing inflation.

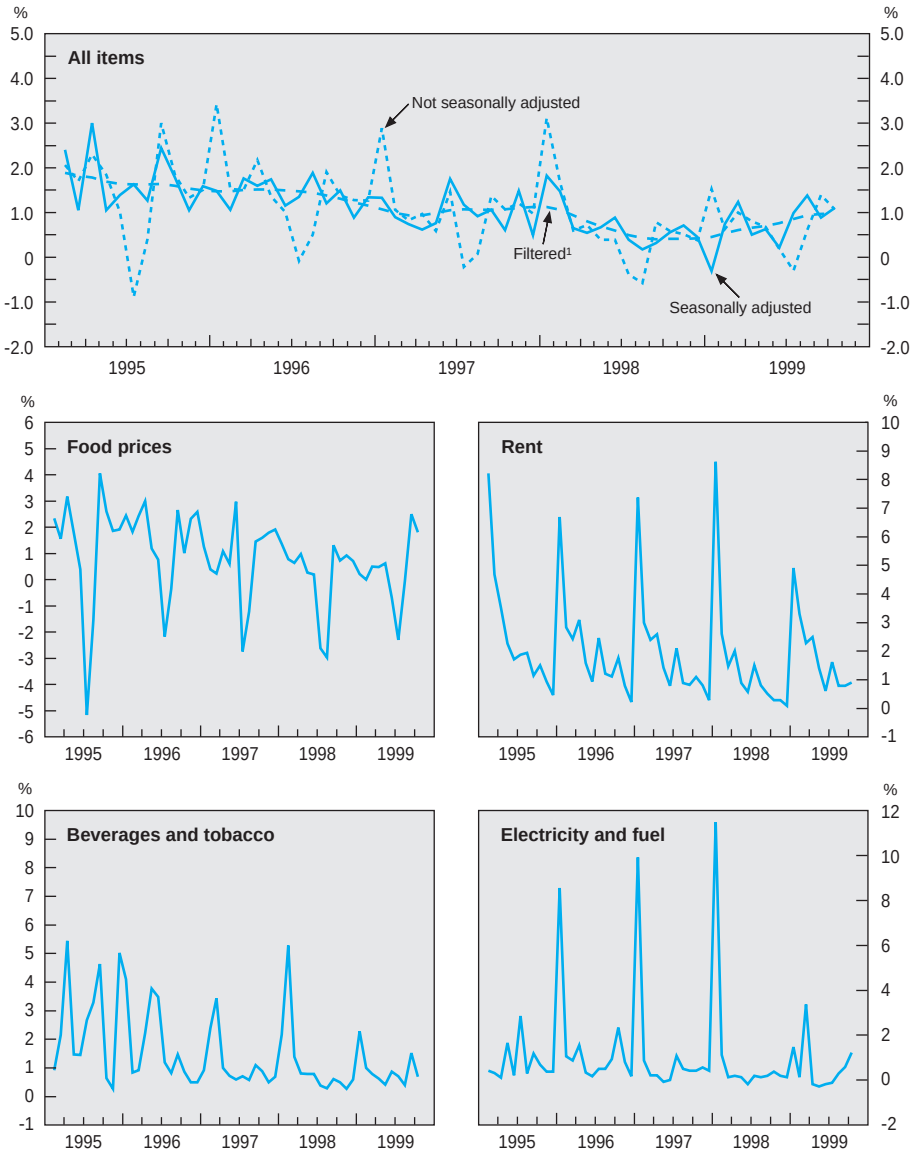
The centrepiece of Poland's direct inflation targeting strategy is to lower inflation to below 4 per cent by 2003. Because missing the medium-term inflation target would undermine the central bank's credibility, the MPC exercised a great degree of caution in establishing it. The target was on purpose set at a level that

should be relatively easy to achieve, even in case of an unexpected shock. In the absence of such a shock, inflation should therefore fall well below 4 per cent by 2003. Although this approach has the merit of being cautious, it risks being interpreted as a sign that the central bank is not serious about achieving price stability. To combat such a perception, the MPC also adopts annual inflation targets that aim at fast progress toward the medium-term objective.[10]

Based on the experience of other OECD member countries,[11] Poland appears to have some of the characteristics required for direct inflation targeting. First, the 1997 Act provides the NBP with the independence needed to achieve low inflation. The irrevocability of MPC members for six years reinforces such independence. Second, the NBP Act explicitly forbids central bank credit to the government and thus eliminates the risk of inflationary financing of the budget deficit. Third, the inflation target appears to be supported by the general public and to be coherent with the government's overall economic strategy of integration with the EU.

Other criteria required to make inflation targeting work do not, however, appear to be entirely fulfilled. Inflation targeting requires some ability to forecast inflation and some degree of knowledge about the relationship between the instrument and the target. Many central banks are using core inflation indices to better assess inflationary trends. The NBP is using the overall CPI, which does not follow a stable trend and is subject to discrete policy decisions (Box 1). In addition, the NBP has not announced publicly that it was developing a model to forecast inflation and to better understand how monetary policy instruments affect inflation. Hence, the NBP should do more to inform the public about its inflation forecasts, how these forecasts are made, and how policy actions influence price developments. Periodic inflation reports are already made available to the public, covering the recent period, but they could also include short-term inflation forecasts. Inflation targeting also requires that the central bank focuses exclusively on inflation and abandon other concerns. The MPC, however, appears to base its monetary policy decisions not only on inflationary developments, but also on other developments, such as consumer credit growth, the current account deficit, and the state of public finances. In the absence of explicit linkages of these variables to inflation outcomes, this may confuse the public as to whether the central bank is fully committed to inflation targeting. If these shortcomings were corrected, the inflation targeting approach would gain credibility, which should bring new benefits. In particular, given Poland's deeply rooted tradition of wage indexation and backward-looking price expectations, credible inflation announcements by the central bank could help set wages at more appropriate rates than currently.

Figure 11. **Consumer price indices**
Monthly percentage changes



1. Hodrick-Prescott filter.
Source: Central Statistical Office and OECD.

Box 1. Core inflation

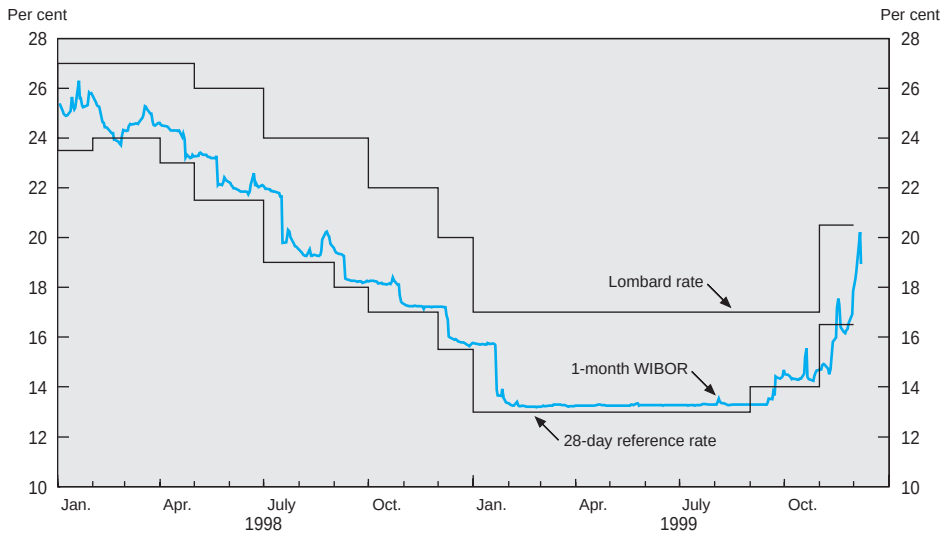
The National Bank of Poland has introduced direct inflation targeting as its main monetary policy strategy. The success of direct inflation targeting crucially hinges on the ability to understand, analyse, and predict inflation. In transition economies, however, repeated increases in administered prices, changes in the structure of relative prices, and decisions to introduce and change VAT and excise taxes tend to dominate inflation development. Food prices, which have a heavy weight in the Polish CPI, are also subject to seasonal fluctuations. Services subject to administered prices (bus transportation, electricity, heating and hot water, basic medicines, postal services, railway transportation, telecommunication, radio and television), and goods subject to frequent changes in excise taxes (fuel, gas, tobacco, spirit beverages) altogether account for a quarter of the CPI basket (Christoffersen and Wescott, 1999). These discrete changes make inflation more volatile and less sensitive to underlying factors, such as the level of demand, monetary growth or the exchange rate. Over time, as prices are raised sufficiently to ensure full cost recovery and as excise taxes and VAT rates reach EU levels, the volatility resulting from discrete policy decisions will tend to diminish. Meanwhile, understanding the inflationary process requires being able to extract a measure of "core" inflation from the change in the overall consumer price index. Figure 11 shows a simple smoothing-out of the consumer price index using a moving average which highlights the volatility of the index. The authorities are in the process of developing a core index indicator to better appraise underlying inflation.

Interest rate developments

The central bank influences short-term interest rates mainly by issuing money market bills (so called "NBP bills") on the interbank deposit market. The MPC determines the minimum yield on the 28-day money market bills, which it considers to be the most effective instrument to influence overall monetary conditions. In doing so, the central bank controls to a large degree the monetary market rates and thereby impacts on the lending rates offered by commercial banks.[12] Indeed, although the determination of rates of return on instruments with maturities longer than 28 days is left to the market, these rates respond closely to the signals sent by the central bank. Long-term interest rates are also correlated to short-term rates.

In 1997 and early-February 1998, in reaction to signs that the economy was overheating, the NBP raised its intervention rate several times, up to a maximum of 24 per cent (Figure 12). In April 1998, as inflation was slowing, the stance of monetary policy shifted toward easing, and the MPC started to cut its intervention rates (Table 5). In the second half of 1998, the MPC judged that the Russian crisis would have a depressing impact on the economy that would, by

Figure 12. **Interest rates**



Source: National Bank of Poland and Bloomberg.

itself, accelerate the fall in inflation. It therefore decided on new interest rate cuts, in particular in December 1998 (150 basis points) and January 1999 (250 basis points). Altogether, the intervention rate was cut from 24 per cent to 13 per cent between April 1998 and January 1999. Thereafter, interest rates remained unchanged until September 1999, when the MPC decided to increase the intervention rate from 13 to 14 per cent in view of the pick-up of inflation, the rapid increase in the growth of consumer credit, and the internal imbalances that had led to a growing current account deficit. The MCP raised the intervention rate once more in November 1999 from 14 to 16.5 per cent in view of the acceleration of consumer inflation.

In real terms, short-term interest rates increased in 1998, following the tightening of monetary policy, but fell from about 8 per cent to close to 5½ per cent in the first half of 1999. Taking into account the pre-announced rate of crawl of the central parity, the uncovered interest rate differential also declined in the recent past to about 3 per cent in the first six months of 1999. Long-term interest rates followed a similar pattern.

Table 5. **Monetary policy decisions in 1998 and 1999**

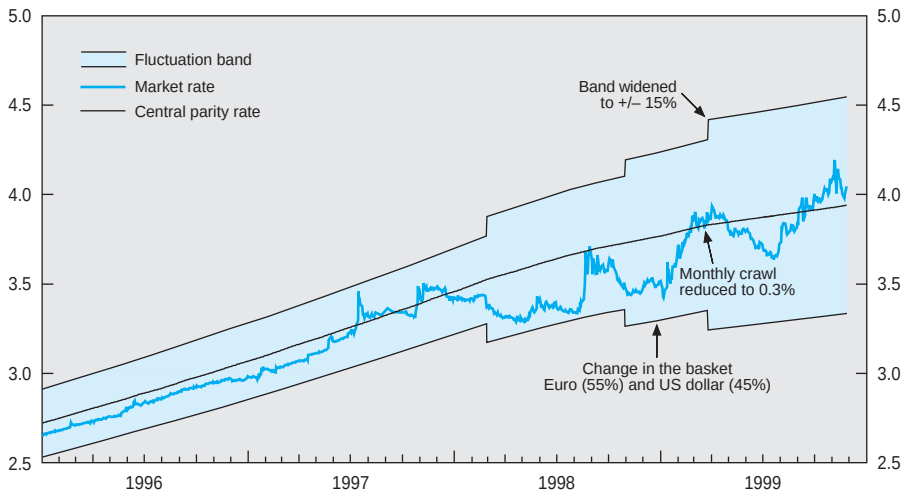
Date of change	Instruments
	Interest rate
February 25, 1998	The reference rate used for 28-day open market operations was increased from 23.5 to 24 per cent.
April 23, 1998	The reference rate used for 28-day open market operations was lowered from 24 to 23 per cent.
May 21, 1998	The basic refinancing rate was lowered from 28 to 27 per cent. The rediscount rate was lowered from 24.5 to 23.5 per cent. The lombard rate was lowered from 27 to 26 per cent. The reference rate used for 28-day open market operations was lowered from 23 to 21.5 per cent.
July 17, 1998	The basic refinancing rate was lowered from 27 to 25 per cent. The rediscount rate was lowered from 23.5 to 21.5 per cent. The lombard rate was lowered from 26 to 24 per cent. The reference rate used for 28-day open market operations was lowered from 21.5 to 19 per cent.
September 10, 1998	The reference rate used for 28-day open market operations was lowered from 19 to 18 per cent.
October 29, 1998	The basic refinancing rate was lowered from 25 to 23 per cent. The rediscount rate was lowered from 21.5 to 20 per cent. The lombard rate was lowered from 24 to 22 per cent. The reference rate used for 28-day open market operations was lowered from 18 to 17 per cent.
December 10, 1998	The basic refinancing rate was lowered from 23 to 21 per cent. The rediscount rate was lowered from 20 to 18.25 per cent. The lombard rate was lowered from 22 to 20 per cent. The reference rate used for 28-day open market operations was lowered from 17 to 15.5 per cent.
January 21, 1999	The basic refinancing rate was lowered from 21 to 18 per cent. The rediscount rate was lowered from 18.25 to 15.5 per cent. The lombard rate was lowered from 20 to 17 per cent. The reference rate used for 28-day open market operations was lowered from 15.5 to 13 per cent.
September 23, 1999	The reference rate used for 28-day open market operations was increased from 13 to 14 per cent.
November 11, 1999	The reference rate used for 28-day open market operations was increased from 14 to 16.5 per cent
	Exchange rate
February 25, 1998	The monthly pace of exchange rate crawl was lowered from 1 to 0.8 per cent. The crawling band was widened from ±7 to ±10 per cent.
July 17, 1998	The monthly pace of exchange rate crawl was lowered from 0.8 to 0.65 per cent.
September 10, 1998	The monthly pace of exchange rate crawl was lowered from 0.65 to 0.5 per cent.
October 29, 1998	The crawling band was widened from ±10 to ±12.5 per cent.
March 25, 1999	The monthly pace of exchange rate crawl was lowered from 0.5 to 0.3 per cent. The crawling band was widened from ±12.5 to ±15 per cent.
June 7, 1999	Trading at fixing has ended, and the fixing rate started to be used for reference purposes only.
	Other
September 30, 1999	The new regulations on mandatory reserves came into force. The reserve requirements on zloty demand deposits was lowered from 20 to 5 per cent, and from 11 to 5 per cent on zloty time deposits.

Source: National Bank of Poland

Foreign exchange market

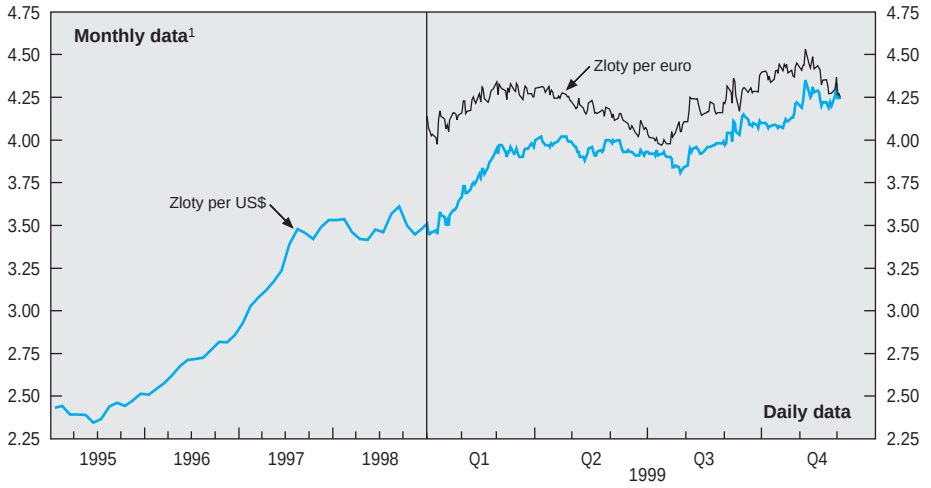
Exchange rate policy was amended on several occasions in the direction of greater flexibility over the last two years. The exchange rate fluctuation band was widened in steps from ± 7 per cent around the central parity in 1997 to ± 15 per cent in 1999 (Figure 13). In December 1998, foreign exchange transactions between commercial bank and the NBP were limited. In June 1999, the NBP cancelled the daily foreign exchange fixing at which it was establishing an official exchange rate. The rate of crawl of the central parity in the fluctuation band was progressively reduced from 1 per cent a month in early-1997 to 0.3 per cent in March 1999, so that the attainment of the inflation objective could be facilitated. The exchange rate generally fluctuated in the appreciation side of the band in 1998. At the turn of the year, however, following the aggressive monetary easing decided by the MPC, and reflecting other market developments, the zloty fell from Zl 3.5 to Zl 4 per US$ (Figure 14). In real effective terms, the exchange rate stabilised following a long period of appreciation. This reflected both the nominal depreciation of the zloty in early-1999 and the deceleration of inflation (Figure 15).

Figure 13. **Zloty basket exchange rate**



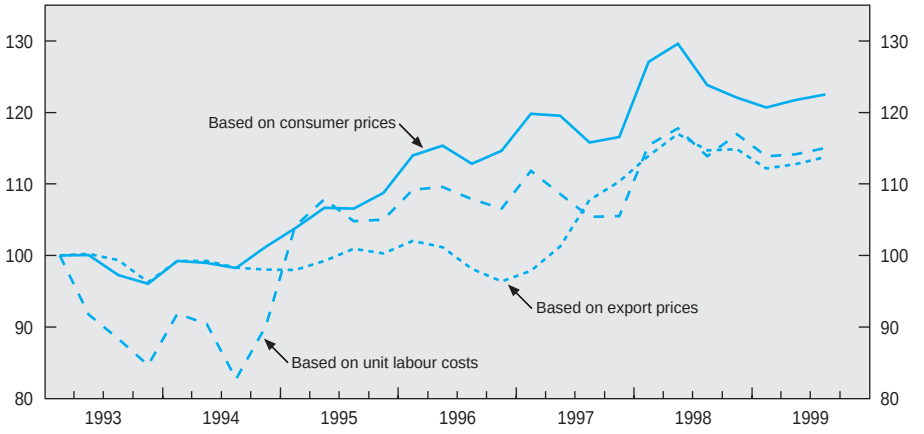
Source: National Bank of Poland.

Figure 14. **Nominal exchange rates**



1. Monthly averages.
Source: OECD.

Figure 15. **Real effective exchange rates**[1]
1993 Q1 = 100



1. An increase in the index (calculated with forty countries) shows a real exchange rate appreciation.
Source: OECD.

Box 2. Liberalisation of capital movements

At the time of accession to the OECD, Poland made legally binding commitments to liberalise capital movements under the Codes of Liberalisation. In particular, the Polish authorities formally committed to eliminating all restrictions inconsistent with the Codes of Liberalisation by 1 January 2000. The legal framework enabling capital movement liberalisation is the new Foreign Exchange Law that entered into force on 12 January 1999. Under this law, restrictions were removed on foreign exchange transactions for resident portfolio investments, investment in OECD issued securities, and operations in negotiable securities, including collective investment securities. Some exceptions were kept, however, including transactions in debt instruments with maturities of less than one year and derivatives. Although the law authorises the authorities to take further liberalisation measures, it also contains safeguard clauses under which the government is entitled to re-establish extensive, but temporary, restrictions in exceptional circumstances, such as an extraordinary risk for the stability and integrity of the financial system.

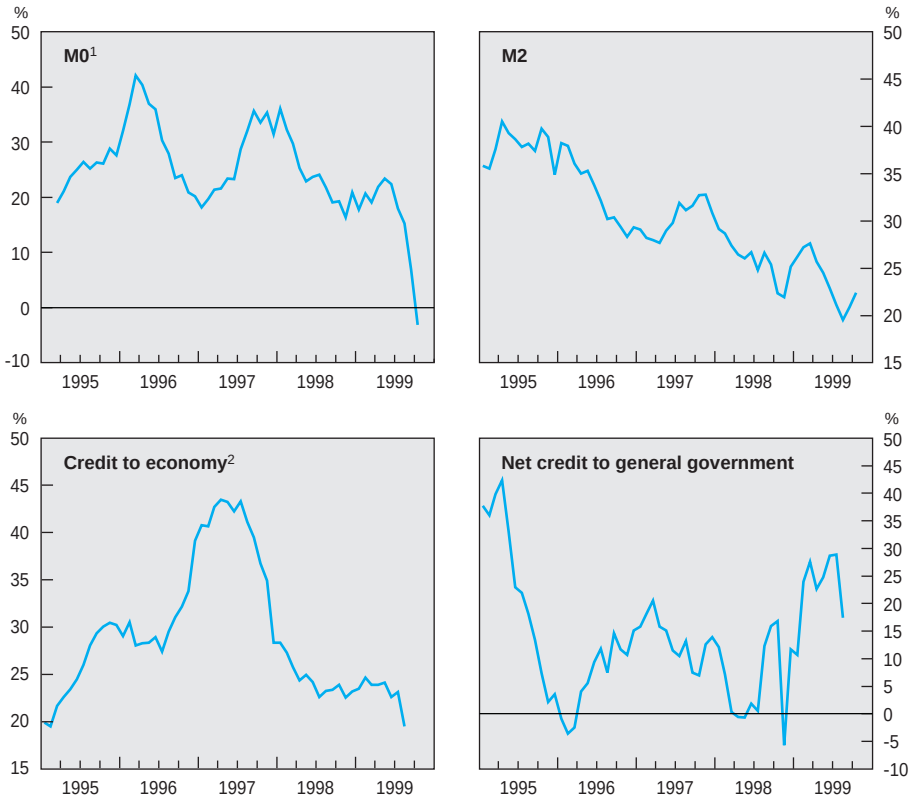
By 1 January 2000, Poland's remaining restrictions on capital movements, other than foreign direct investment flows and short-term capital flows, should be limited to real estate investment abroad and in Poland. The current foreign direct investment restrictions include: foreign acquisitions of certain categories of real estate, indirect ownership of Polish insurance companies, air and shipping transport, broadcasting, certain telecommunication services, and gaming. Looking ahead, the liberalisation is expected to apply to currently restricted short-term capital flows, such as selected operations in securities on capital and money markets, negotiable securities, financial credits, securities, guarantees and financial back-up facilities, and operations on deposit accounts.

Overall, the authorities have successfully moved away from a rigid nominal anchor to a more flexible arrangement. They have used successively a peg to the dollar, a peg to a basket, a narrow fluctuation band with a rapidly crawling central parity, and a wide fluctuation band with a slowly crawling central parity. Logically, the NBP has announced that its next step will be to float the zloty in 2000 and let the currency find its equilibrium level before applying for participation in the European Exchange Rate Mechanism (ERM2) and subsequently EMU. Although a floating exchange rate arrangement does not guarantee that the market will find the right equilibrium exchange rate, the authorities intend to correct possible misperceptions and influence market developments toward what they consider to be the right level for the currency.

Money and credit

During 1998, broad money (M2) increased by 25 per cent (Figure 16) more rapidly than nominal GDP,[13] reflecting a strong demand for monetary assets in real terms that led to a decline in the velocity of circulation. Demand increased

Figure 16. **Monetary aggregates and credit to the economy**
Year-on-year percentage change



1. Three-month moving averages.
2. Excluding credit to general government.
Source: National Bank of Poland.

particularly rapidly for non-cash settlement instruments (notably among consumers) and banking savings vehicles. On the credit side of the monetary situation, banks extended large amount of loans to the non-financial sector, with the bulk going to the corporate sector. Bank credit to households expanded significantly as well, in particular instalment credit lines for the purchase of household appliances. Similar trends were observed in the first half of 1999 and, as a result, M2 slowed down only marginally to 23 per cent year-on-year in July 1999. The rapid growth in credit to non-financial institutions, especially to the household sector and housing loans, including mortgage facilities, continued to fuel monetary expansion. A new and worrying development in the first half of 1999 was the rapid

expansion of commercial bank loans to the general government sector, reflecting large borrowing made by the Social Security Fund to solve its liquidity problems.

Reserve money (M0) grew by Zl 11 billion during 1998. The net foreign assets of the NBP increased by Zl 23 billion as a result of large-scale exchange market interventions made by the central bank to prevent an appreciation of the zloty. This was partially offset by sterilisation operations undertaken by the monetary authorities to mop up excess liquidity in the banking sector, including with higher required reserves and sales on money market bills. Thanks to these operations, net domestic assets declined by Zl 12 billion in 1998, thus limiting the increase in reserve money. The rapid expansion in net foreign assets has led to a situation where the central bank gross foreign exchange reserves cover reserve money nearly twice. This forced the central bank to have large liabilities to the banking system in the form of commercial bank deposits, required reserves, and money market bills. Steps were taken by the authorities to disentangle this situation in 1999.[14] Reserve money slowed down markedly in the first half of 1999 year-on-year. This reflected the virtual interruption of exchange market official interventions and confirmed that the new monetary framework – direct inflation targeting along with a large degree of exchange rate flexibility – appeared to bear fruit. To sustain this outcome, however, monetary policy had to be supported by a tight fiscal policy.

Fiscal stance

The Public Finance Act

A new institutional framework was introduced for the management of public finances in 1998. This framework was adopted by parliament in November 1998 in the form of an Act on Public Finances. The Act clarifies the responsibilities of the various actors in the budgetary sphere, sets measures to improve transparency in public finances, establishes rules for local governments, and prepares for accession to the EU. In addition, the Act establishes procedures to be followed if total public debt, including expected payments resulting from state and local authorities guarantees, exceeds 50 per cent of GDP. Tighter procedures are called for if the total public debt reaches 60 per cent of GDP. The Act also calls on the government to prepare a public debt medium-term strategy.

The fiscal strategy

The authorities consider that the state of public finance is not satisfactory. The general government budget deficit has stayed between 2½ and 3 per cent of GDP during 1994-98, despite robust economic growth (Table 6). The most dynamic increase in public expenditure has been in social transfers – in particular

Table 6. **Consolidated general government operations, 1995-2000**[1, 2]

	1995		1996		1997		1998		1999 estimate		2000 draft budget	
	Zl million	Per cent of GDP	Zl million	Per cent of GDP	Zl million	Per cent of GDP	Zl million	Per cent of GDP	Zl million	Per cent of GDP	Zl million	Per cent of GDP
General government revenue	**132 376**	**43.2**	**164 070**	**42.6**	**197 677**	**42.1**	**225 209**	**40.9**	**250 270**	**41.1**	**278 498**	**41.2**
Direct taxes	37 058	12.1	44 636	11.6	52 972	11.3	61 112	11.1	49 003	8.0	50 596	7.5
PIT	27 710	9.0	33 282	8.6	38 938	8.3	45 436	8.2	33 819	5.6	35 625	5.3
CIT	9 348	3.1	11 354	2.9	14 034	3.0	15 676	2.8	15 184	2.5	14 971	2.2
Indirect taxes	34 097	11.1	45 327	11.8	57 145	12.2	65 612	11.9	75 398	12.4	87 596	12.9
Social security contributions	27 387	8.9	35 313	9.2	42 954	9.2	50 969	9.2	62 326	10.2	70 313	10.4
Other taxes and non-tax revenue	33 834	11.0	38 794	10.1	44 606	9.5	47 516	8.6	67 976	11.4	85 446	11.9
General government expenditure	**140 526**	**45.9**	**176 122**	**45.7**	**210 732**	**44.9**	**238 800**	**43.3**	**271 769**	**44.6**	**297 079**	**43.9**
Current expenditure	129 999	42.4	160 997	41.8	192 446	41.0	216 290	39.2	252 485	41.5	276 328	40.8
Goods and services	46 513	15.2	60 593	15.7	71 889	15.3	82 351	14.9				
Transfers and subsidies	69 662	22.7	86 119	22.3	104 352	22.2	115 891	21.0				
Interest payments	13 824	4.5	14 285	3.7	16 205	3.5	18 048	3.3	20 048	3.3	18 417	2.7
Capital expenditure	8 432	2.8	11 929	3.1	16 748	3.6	20 397	3.7	19 284	3.2	20 750	3.1
Lending minus repayments[3]	2 095	0.7	3 196	0.8	1 538	0.3	2 113	0.4				
Balance	**–8 150**	**–2.7**	**–12 052**	**–3.1**	**–13 055**	**–2.8**	**–13 591**	**–2.5**	**–21 499**	**–3.5**	**–18 580**	**–2.7**
Memorandum items:												
Nominal GDP (Zl million)	306 300		385 400		469 400		551 100		608 999		676 655	
Privatisation revenue (Zl million)	2 642		3 750		6 296		7 069		13 350		20 100	

1. Privatisation receipts are calculated in this table as a below the line item.
2. Excluding public sector payment arrears.
3. Excluding privatisation receipts.

Source: Ministry of Finance (based on Government Finance Statistics – GFS definition, except 1999 and 2000 figures, which are based on the national methodology) and OECD.

old age, disability, and sickness benefits – and the welfare state has therefore become one of the most profligate in the region. In particular, disability pensions are among the largest in the OECD countries in proportion to total expenditure. Meanwhile, development-related expenditure, such as public infrastructure or education, has changed little as a proportion of total budgetary spending. The authorities view budgetary savings as insufficient, investment too limited, the tax burden as too heavy, and budgetary expenditure as too skewed towards social transfers.

In order to prepare for a reform of public finances, the government has adopted a coherent medium-term public finance and economic development strategy[15] for the next ten years, which lays the ground for a "pro-active" scenario. This scenario calls for modernising public expenditure, improving the quality of public services, and investing more than in the past. The four structural reforms currently underway (decentralisation, pension, healthcare, and education) are seen by the authorities as important, not only to boost growth, but also to contribute to fiscal consolidation. The tax reform, which would be implemented over a number of years, is also aimed at providing greater private sector incentives and fostering job creation. Assuming that the strategy is put in place, the government hopes that a small budget surplus will emerge in 2003.

The 1998 budget outcome

As in previous years, progress in fiscal consolidation was limited in 1998. On a cash basis, the overall deficit of the general government was 2½ per cent in 1998, marginally less than in the previous year. In addition, substantial payment arrears were incurred, particularly in the health care sector, which increased the general government deficit measured on an accrual basis by about ½ per cent of GDP. In part, the lack of fiscal consolidation resulted from the accumulation of arrears on taxes and social security contributions, which reduced government revenue by a sizeable amount. The central government accounted for slightly more than half of total general government revenue and expenditure, but incurred the bulk of the deficit (Table 7). It devoted approximately half of its resources to the wage bill, interest payments, and capital expenditure. The other half was spent on transfers and subsidies to other levels of governments (see Annex IV). The social security agencies accounted for close to 40 per cent of the general government revenue and expenditure. Their revenues were essentially in the form of payroll taxes, and the largest part of expenditure was made on old-age and disability pension outlays. The social security office had its entire financing need covered by transfers from the central government. Local governments and extra-budgetary agencies accounted for the rest of revenue and expenditure. Local governments incurred a small deficit, whereas extra-budgetary funds had a small surplus.

Table 7. **Consolidated general government operations,[1] 1998**

	Central government		Local government		Social security		Extra-budget. accounts (central + local)		Consolidated general government	
	Zl million	% of GDP	Zl million	% of GDP	Zl million	% of GDP	Zl million	% of GDP	Zl million	% of GDP
Revenue and grants	**126 526**	**23.0**	**45 686**	**8.3**	**87 540**	**15.9**	**30 094**	**5.5**	**225 209**	**40.9**
Current revenue	126 478	23.0	24 617	4.5	66 936	12.1	19 194	3.5	221 348	40.2
Tax revenue	120 016	21.8	18 686	3.4	65 849	11.9	2 319	0.4	191 469	34.7
Non-tax revenue	6 462	1.2	5 931	1.1	1 087	0.2	16 875	3.1	29 879	5.4
Grants	0	0.0	18 400	3.3	20 604	3.7	9 756	1.8	0	0.0
Other revenue	48	0.0	2 669	0.5	0	0.0	1 144	0.2	3 861	0.7
Expenditure	**139 691**	**25.3**	**47 062**	**8.5**	**88 167**	**16.0**	**28 743**	**5.2**	**238 800**	**43.3**
Goods and services	46 266	8.4	26 434	4.8	2 852	0.5	21 679	3.9	82 351	14.9
Subsidies and transfers	66 006	12.0	9 606	1.7	84 605	15.4	3 305	0.6	115 891	21.0
Interest	17 877	3.2	166	0.0	0	0.0	5	0.0	18 048	3.3
Capital expenditure and net lending	9 542	1.7	10 856	2.0	710	0.1	3 754	0.7	22 510	4.1
Balance (excluding privatisation receipts[2])	**–13 165**	**–2.4**	**–1 376**	**–0.2**	**–627**	**–0.1**	**1 351**	**0.2**	**–13 591**	**–2.5**
Financing	**13 165**	**2.4**	**1 376**	**0.2**	**627**	**0.1**	**–1 351**	**–0.2**	**13 591**	**2.5**
Foreign	1 003	0.2	0	0.0	0	0.0	0	0.0	1 003	0.2
Domestic	12 162	2.2	1 376	0.2	627	0.1	–1 351	–0.2	12 588	2.3
Bank	–2 262	–0.4	977	0.2	804	0.1	–677	–0.1	–1 158	–0.2
Non-bank	7 355	1.3	399	0.1	–177	0.0	–674	–0.1	6 677	1.2
Privatisation	7 069	1.3							7 069	1.3
Memorandum items:										
Nominal GDP (Zl million)	551 100									
Privatisation revenue (Zl million)	7 069									

1. Excluding public sector payment arrears.
2. Excluding privatisation receipts (central and general government only).

Source: Ministry of Finance (based on Government Finance Statistics – GFS definition), and OECD.

The 1999 budget

The central government budget for 1999 adopted by parliament foresaw a deficit similar to that of the previous year. The central government deficit was projected to reach Zl 12.8 billion (2.5 per cent of GDP) on a cash basis, compared to Zl 13.2 billion (2.4 per cent of GDP) in the previous year. Privatisation revenue were to cover the bulk of the budget deficit. The budget law contained several important decisions on central government expenditure. First, the central government was to make a transfer to the Social Insurance Fund of Zl 9.6 billion to finance the pension system reform and offset the loss of revenue arising from the establishment of fully funded pension schemes (see Chapter 3). A large part of this transfer was to be financed with privatisation revenue. Second, restructuring the coal-mining sector was estimated to cost Zl 1.5 billion in 1999, out of which Zl 950 million to finance the restructuring of coal mines, and Zl 150 million to make severance payments. Third, the cost of restructuring of the army was projected at Zl 1.4 billion, out of which a special reserve was introduced to finance integration in NATO. Fourth, the budget included a transfer of Zl 600 million from the central government to local governments to finance the decentralisation of administrative responsibilities. Finally, the budget called for a subsidy of Zl 150 million to the new health care funds.

Important changes in central government taxes were decided in the context of the 1999 budget. The corporate income tax rate was cut from 36 per cent to 34 per cent to reduce the tax burden on the enterprise sector and in response to the tax cuts made in other central European countries. A portion of the personal income tax, equivalent to 7.5 per cent of taxable income, was transferred to the new health funds created under the healthcare reform (see chapter 4). This transfer of revenue was to be offset by the shift of healthcare spending responsibilities to health funds. Hikes in indirect taxes were also decided for 1999, mainly on VAT and excise taxes on petroleum products.[16] Overall, central government revenue was projected to increase by 2 per cent in 1999, significantly less than the expected average inflation rate of 8.5 per cent.

The execution of the budget proved to be extremely challenging, with the central government deficit growing rapidly in the first two months of the year, when large central government transfers were made. In addition, nominal GDP grew less than expected, leading to a revenue shortfall for the whole year. As a result, by mid-year, the central government deficit had already reached 97 per cent of the amount planned for the whole year. The financial situation of the central government, however, improved in the second half, as expenditure were brought back under control and indirect tax hikes came into effect. For the whole year, the central government deficit was therefore expected to remain within the limit established by parliament.

However, unlike in the previous year, deficits emerged in the finances of the social security. The social security office (ZUS) ran a sizeable deficit in the first half of the year, which had to be covered, as noted, by a commercial bank loan. A large loan from the budget of Zl 4 billion, financed by privatisation revenue, was also made to the ZUS in the second half of the year to resolve acute liquidity difficulties that could have undermined the timely payment of pensions. These financial difficulties of the social security office were due to three main factors. A legal anomaly in the new tax legislation resulted in a one-month loss of social security contributions. Social security contribution arrears accumulated at a faster speed than expected, in particular because the government allowed loss-making coal mines to suspend their payments to ZUS. Most importantly, the old contribution system was phased out before the new system was fully operative. Altogether, ZUS revenue losses were estimated to reach ¾ per cent of GDP. In addition to running a deficit, ZUS also accumulated large arrears on its transfers to private pension funds. These slippages will result in a larger general government deficit than expected in 1999. The authorities estimate that the general government deficit reached 3.5 per cent of GDP in 1999.

The 2000 budget

The authorities submitted to Parliament a draft budget for 2000 that foresees central government spending of Zl 154 billion, revenue of Zl 141 billion, and a deficit of Zl 12.8 billion (about 2 per cent of GDP). As in the previous year, this is expected to be largely financed by privatisation revenues. The largest items on the expenditure side of the budget are the transfers to social insurance funds (notably to the Social Insurance Office and to the Farmers' Insurance Fund) of Zl 42 billion. An additional subsidy of Zl 8.3 billion, together with a budget loan of Zl 2 billion, are foreseen for the Social Insurance Office to fill the gap created by shifting a part of old-age contributions to second pillar accounts. For the first time, the budget incorporates euro 1 billion in pre-accession funds from the EU, which are to be used to boost spending on transport infrastructure (+35 per cent), rural development (+49 per cent), and other programmes. Spending on export credit subsidies is also raised by 100 per cent. Following a Supreme Court decision, the budget foresees payments to budgetary employees and pensioners to compensate them for lost incomes during the high inflation period of the early 1990s. A first compensation payment of Zl 3.5 billion planned for 2000 is classified by the budget as the retirement of a government debt, which does not increase the budget deficit. Nonetheless, such a payment provides current income to workers and pensioners and therefore should be treated as current expenditure in a national accounts framework. After this correction, the central government budget deficit would reach the equivalent of 2½ of GDP.

Box 3. Extra-budgetary funds

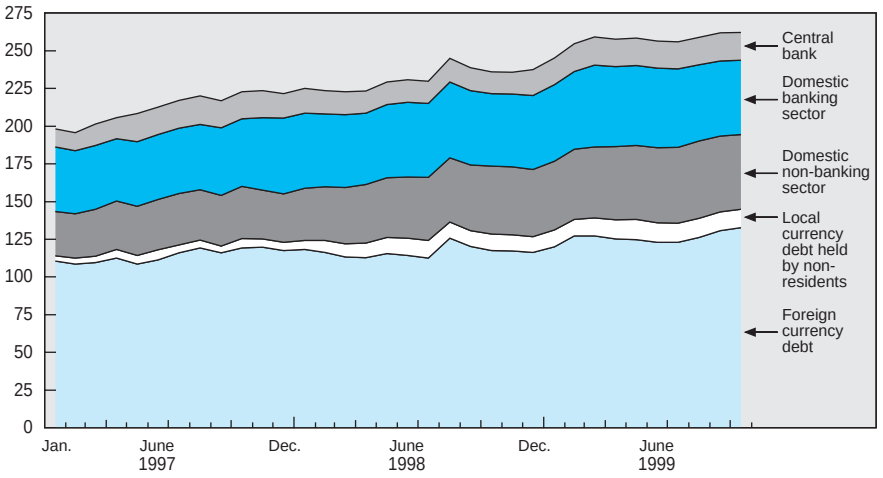
State and local extra-budgetary funds have multiplied continuously in recent years and become a frequently used tool for softening fiscal constraints. By some estimates, there are several hundred extra-budgetary funds established by ministries, state agencies, and local governments. Reported spending in 1998 amounted to Zl 29 billion, the equivalent of 12 per cent of total government spending. Many of these institutions enjoy a large degree of independence encouraged by lack of central spending control. A striking example is the emergence of environmental funds created at the central, regional and local levels, which receive environment-related fees and fines, and establish their own spending and lending programmes in the environment area. The authorities have reviewed the practices of extra-budgetary funds and found that they frequently misreport their financial resources, their assets and liabilities, or deliberately underestimate their revenue and expenditure. Extra-budgetary funds have a limited transparency in their procurement procedures, which can be linked to the corruption of government officials or the financing of political parties. In addition, the vast majority of funds granting credits have not worked out effective methods for debt collection. Some funds perform well, which would call for lower subsidy; some would not be able to survive without a capital injection from the budget.

A tax reform was proposed to parliament in parallel with the submission of the 2000 budget (see Chapter V). The main goal of the tax reform was to cut income tax rates, broaden the tax base by eliminating exemptions, and bring the VAT into line with EU rules. The personal income tax rates were assumed to be cut and tax exemption to be curtailed. The corporate income tax rate was assumed to be cut from 34 per cent to 30 per cent, investment incentives to be repealed, and depreciation allowances to be simplified and brought closer to economic depreciation. Changes were also assumed for the VAT system to bring rates in closer harmony with the European directive and to extend the tax net to the agricultural sector. Excise taxes were projected to increase on liquid fuels, tobacco, and alcohol to bring them to EU levels. In the first year, the tax reform was expected to have a positive impact on revenue collection on a net basis, mainly coming from higher VAT and excise rates. Eventually, the corporate income tax and the VAT reforms were passed into law, but the personal income tax reform was stopped by a presidential veto. The authorities amended the draft budget accordingly.

Debt and debt service

The central government debt stock has declined significantly as a share of GDP over the last few years thanks to official and private debt relief, the real exchange rate appreciation, and the rapid increase in real GDP (Figure 17 and Table 8). The central government debt stock fell from the equivalent of 68 per

Figure 17. **State budget outstanding debt**
Billion zlotys



Source: Ministry of Finance.

cent of GDP in 1994 to 43 per cent of GDP at the end of 1998. As it stands, the central government gross debt ratio to GDP compares favourably to that of most developed countries. General government gross financial liabilities in OECD countries averaged about 68.4 per cent of GDP in 1998, and 76 per cent of GDP in EU member countries. Nevertheless, the Polish debt stock needs to be adjusted to take into account the financial liabilities of other levels of governments (particularly local governments) and guarantees extended by the state. The new Act on Public Finances requires that the government publishes these numbers and a greater degree of transparency and comparability can therefore be expected in the near future. Debt servicing has remained at a relatively low level both in relation to government expenditure (12 to 13 per cent) and GDP (3 to 4 per cent of GDP), and foreign debt servicing represents a sustainable proportion of exports of goods and services.

In both 1998 and 1999, the budget deficit was largely financed with privatisation revenue. In view of the large privatisation proceeds earned by the government, a planned government euro-bond flotation of euro 400 million was postponed several times and eventually cancelled, as it became no longer necessary. It is therefore not surprising that Ministry of Finance bonds were popular on the domestic and international financial markets. This appetite was augmented

Table 8. **State debt and debt service**

Nominal value in Zl million

	31/12/95	31/12/96	31/12/97	31/12/98
	Stock			
Total debt in per cent of GDP	**54.6**	**48.2**	**47.2**	**43.1**
Total debt	**167 267**	**185 603**	**221 650**	**237 400**
1. Domestic debt	66 160	79 609	104 058	121 182
TS on domestic markets	61 443	74 042	87 966	101 565
Active Treasury securities	41 246	52 377	60 147	73 427
Passive Treasury securities	20 197	21 665	27 820	28 138
2. Other domestic debts	4 717	5 567	16 092	19 618
3. Foreign debt	101 107	105 994	117 592	116 218
TS on international markets	19 719	23 437	24 074	21 392
Foreign bonds	617	1 181	2 778	2 801
Brady bonds	19 102	22 255	21 297	18 591
Credits	81 231	82 550	93 517	94 826
Paris Club	68 866	76 094	85 300	86 928
Guaranteed outside Paris Club	404	278	196	105
World Bank	3 535	4 710	5 484	5 720
Other	7 437	1 468	2 537	2 074
In non-convertible currencies	989	0	0	0
Liquidation of clearing balances	157	7	0	0
Total debt service	**14 202**	**14 391**	**16 271**	**17 911**
Domestic	10 940	11 021	12 588	14 141
Foreign	3 263	3 370	3 683	3 770
In per cent of budget expenditures	15.6	13.2	12.9	12.8
In per cent of GDP	4.6	3.7	3.5	3.2

Source: Ministry of Finance.

by repeated rating agency upgrades. In October 1999, both Moody's and S&P rated Poland's sovereign debt in the lower investment grade category (respectively Baaa1 and BBB) with positive outlook. This was roughly comparable with the ratings of Estonia, Hungary, the Czech Republic, and slightly lower than the ratings of Israel and Slovenia. As a sign that the quality of Polish bonds is appreciated on international markets, the price of these bonds was not seriously affected by the Russian crisis.

Assessment of macroeconomic policies

The period 1998-99 was particularly challenging for policy makers in Poland. The economy faced a number of adverse developments, both domestic

(overheating, fiscal slippage) and external (Russian financial crisis, EU slowdown). In this difficult situation, the authorities conducted well-orchestrated macroeconomic policies that dodged the contagion impact of the Russian crisis, reduced inflation, and paved the way for an economic revival. As a result, unlike other transition economies, Poland has been able to avoid a mid-course depression and has kept a generally stable financial situation. For this outcome, Poland has gained respect in the international arena. Nonetheless, a number of issues need to be addressed without complacency. The recent increase of inflation at an early stage of the economic recovery shows that the fight against inflation is not yet won and that more needs to be done to reach price stability. The medium-term monetary policy framework adopted by the central bank in 1998 will help in this respect, but particular caution will have to be exercised in the near term. The prompt reaction of the MPC in September and November 1999 to inflationary pressures suggest that the authorities are committed to cautious policies both in the short and the medium term. More interest rate increases may be needed to bring inflation under control. Another development that calls for careful monitoring is the widening of the current account deficit. Although this is in part due to the depressed situation of foreign markets, the fundamental problem comes from the relative strength of imports. There is no specific level of the current account deficit that can be considered as dangerous or unsustainable, especially when the deficit reflects large imports of capital goods made by foreign investors, as it is the case in Poland currently. Nonetheless, a larger current account deficit implies a greater degree of risk in case of a sudden shift in market sentiment. With its large external imbalance, Poland is exposed to possible capital flow volatility in case of an unexpected negative event. The best way to reassure the financial markets is to continue to pursue a set of policies that is seen to be appropriate. Fiscal policy has a crucial role to play in this regard, and should aim at larger savings in the medium term. Structural reforms are also called for to boost the production potential of the economy and generate private savings in the context of long-term pension schemes.

III. Progress in structural reform

The long economic expansion of Poland has been underpinned by several waves of structural reforms. Starting with price and trade liberalisation in the early-1990's, this was followed by large-scale privatisation and product market deregulation starting in 1998, and the launch of four important structural reforms related to public finances (public administration, pensions, education, and health care) in 1999. This chapter starts with the implementation of the OECD Jobs Strategy in Poland, which was discussed in the 1998 *Survey*. It then examines some other structural issues, including the implementation of the 1998 pension reform, the privatisation of Polish firms, and developments in the banking sector.

The labour market

The labour market situation has been distinctly deteriorating since mid-1998. The decline in registered unemployment came to a halt during the summer of 1998, attaining a floor of 9.5 per cent in August, before creeping up almost uninterruptedly since then. This disappointing outcome reflected not only the slower economic growth, but also several structural factors that have influenced labour market conditions: 1) demographic pressures arising from baby boomers joining the workforce, with net labour force increase averaging 200 000 in 1999; 2) the entry into force of new regulations in January 1999 changing the eligibility criteria for health insurance of unemployed persons; and 3) corporate restructuring process involving important group dismissals.

Unemployment in Poland is unevenly distributed. Compared to the OECD average, the relative shares of long duration unemployment and youth unemployment in total unemployment remain high; the ratio of female to male unemployment is also above OECD average. On the other hand, the proportion of low-skilled unemployment is below the OECD average, reflecting in part a limited shift in labour demand from low to high-skilled workers. This distribution of unemployment among groups of population has not significantly changed since the last *Survey*, except in respect of the youth unemployment rate which has deteriorated substantially, reaching 30 per cent in early 1999.

Considerable differences across regions also exist in Poland. While the rate of registered unemployment dropped in all regions between 1994 and 1998, the pattern of regional unemployment and the geographical dispersion tended to persist. In part, these regional disparities reflect different specialisation in economic activities with rural areas experiencing difficult restructuring of former state farms and limited mobility of labour supply. In May 1999, the unemployment rate ranged from 8.3 per cent in Slaskie region to 21.1 per cent in Warminsko-Mazurskie region.

Implementation of the OECD Job Strategy recommendations

The previous *Survey* noted that, thanks to robust economic growth, unemployment steadily declined in Poland between 1994 and 1997. But it also stressed that structural shortcomings in labour market policies made it unlikely that unemployment could continue to decline in the future. It highlighted that the tax wedge on labour costs was high and was driving activities underground. The generosity of some social benefits, such as the social assistance and child benefits, together with the prevailing payroll and income taxes, made returning to work a costly decision and therefore reduced labour market participation. It was also highlighted that the wage-bargaining process had been ineffective as a policy to impose wage discipline in the state enterprise and budgetary sector. The Survey noted that the minimum salary, although not particularly high by international standards, could impair the employability of the least qualified and should therefore not be increased by more than inflation. It was also noted that active labour market policies should be oriented more towards the training of workers, and that a better co-ordination between providers and users of training was needed. The *Survey* concluded that deep reforms in labour market policies were required and that, without these reforms, an increase in unemployment was predictable.

Unfortunately, the implementation of these recommendations has been mixed (Table 9) and unemployment has, as predicted, increased in the second half of 1998 and in the first half of 1999 (Figure 18). While higher unemployment was in part due to the economic climate, the lack of flexibility in the labour market made it vulnerable to the sudden drop in production. Reducing the shortcomings in labour market policies is made all the more important by future demographic trends. The authorities recognise that 3 to 4 million new jobs will be needed in the next ten years to absorb the baby boomers entering the labour market while cutting in half open and hidden unemployment from the present figure of approximately 20 per cent of the potential workforce (Council of Ministers, 1999). Labour supply will increase by the 500 000 to 600 000 baby boomers per annum between 1999 and 2010. In addition, agricultural restructuring will cut the number of jobs in rural areas by about 500 000 in total during the next ten years. Finally, more jobs will be lost as a result of industrial restructuring in the

Table 9. **Implementing the OECD Jobs Strategy: an overview of progress**

Recommendations	Measures since the last Survey	OECD comments
Increase wage and labour cost flexibility		
Decentralise wage-setting.	None.	Follow recommendation.
Ensure that the minimum wage does not price out low-skilled labour.	None.	Follow recommendation.
Reduce the tax wedge.	None.	Consider broadening the base of the social security contributions and re-examining special exemptions.
Reform unemployment and related benefit systems		
Reconsider unemployment benefit rules.	No action	Proceed with reforms.
Tighten the rules applying to working pensioners.		
Tighten the regime of sickness benefits.	Pending legislation to tighten medical screening and creating central register.	Implement new law.
Reform employment protection legislation and increase working-time flexibility		
The regulations governing fixed-term contracts should be eased.	None.	A further easing of job protection legislation is needed.
The period over which the maximum average weekly number of hours is calculated should be lengthened.	None.	Should be taken into account.
Enhance active labour market policies		
The effectiveness of ALMPs needs to be monitored on an on-going basis.	None.	Accelerate the computerisation of the public employment services to help evaluate the effectiveness of ALMPs.
Need to de-emphasise public works and subsidised employment; improve the content of training programme; and strengthen the targeting of high-risk groups.	More emphasis to active measures has been given. Reorientation of active spending towards more cost effective measures such as loans and the new "Graduate 1998" programme. Important reduction of public works scheme. Credit lines for SMEs creating jobs for unemployed workers in rural areas and long-term unemployed have been set up.	Reduce further the weight of subsidised work schemes which have large dead-weight losses and substitution effects. Continue the efforts to better target and tailored measures for high-risk groups and monitor and assess the results.

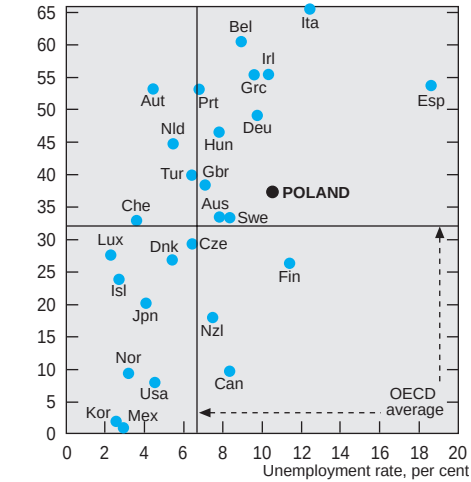
Table 9. **Implementing the OECD Jobs Strategy: an overview of progress** *(cont.)*

Recommendations	Measures since the last Survey	OECD comments
Improve education and training		
Continue to widen access to tertiary education.	Introduction of financial support for students in the form of low interest rate loans and credits.	Consider way to further improve access in rural areas.
Continue to reorient the curricula of vocational schools towards the needs of enterprises.	Development of "key abilities" within the new core curricula including foreign languages and computer skills and training skills helping to start a business.	Fully implement these reforms and monitor the developments of the new core curricula. The authorities could initiate further efforts concerning apprenticeship training through reinforced education-industry partnership.
Improve the entrepreneurial climate		
Lower the overall tax rate faced by registered enterprises; and streamline tax and regulatory frameworks.	Rate of lump-sum taxation for individual entrepreneurs has been lowered and the threshold for lump sum tax payment has been increased.	Continue to examine regulatory impediments and improve procedures.
Enhance product market competition		
Encourage competition in the network sectors.	Telecommunications, energy and electricity liberalisation proceeding.	Consider further efforts to accelerate the pace of liberalisation to promote effective competition.
Enhance the independence of the Office for Competition and Consumer Protection.	Expansion of responsibilities to conduct investigations and bring cases before the anti-monopoly court.	The OCCP should be better resourced and efforts should be continued to increase its independence.
Accelerate enterprise privatisation.	Privatisation of large scale enterprises was accelerated in 1998-99 notably in the banking and telecommunication sectors.	

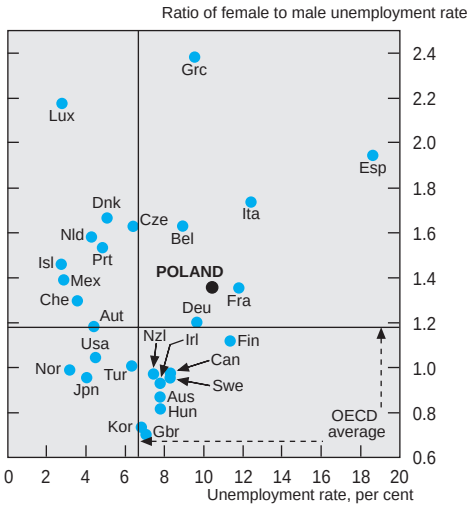
Source: OECD.

Figure 18. **Unemployment rates: international comparison**[1]

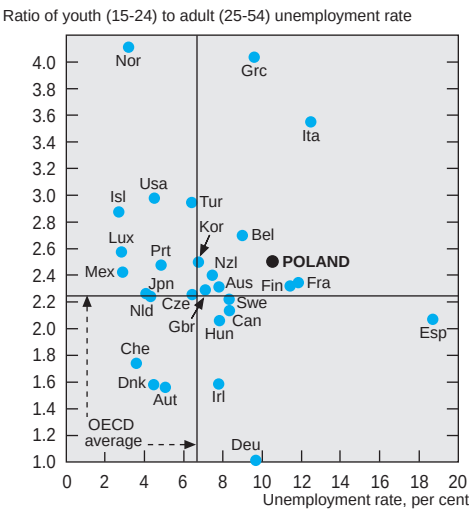
A. Incidence of long-term unemployment[2]



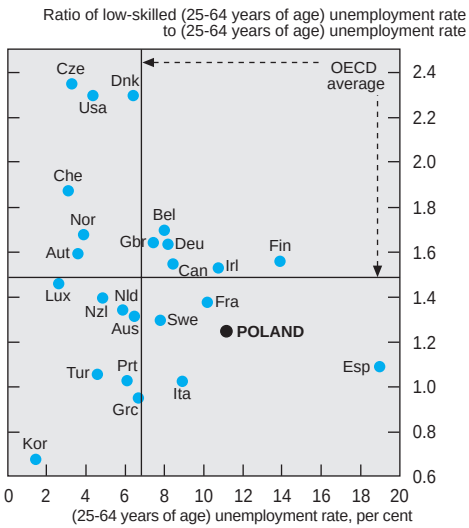
B. Female/male unemployment rate



C. Youth/adult unemployment rate



D. Low-skilled/unemployment rate, 1995



1. In 1998 or 1997; OECD averages are for 1997 except for panel D (1995).
2. The incidence is defined as the ratio of long-term unemployment (12 months and over) to the total number of unemployed.

Source: OECD, *Labour Force Statistics, Employment Outlook, Education at a Glance.*

coal mining, steel, railway, and defence sectors. Greater labour market flexibility, a tax/benefit system which makes work pay more,[17] and a return to robust production growth will all be indispensable ingredients to avoid a sharp increase of unemployment. In recognition of these long-lasting labour market problem, the authorities have drafted a "National Strategy for Employment Creation and Human Capital Development" for 2000-06, which reflects the Jobs Strategy recommendations.

Increasing labour cost flexibility

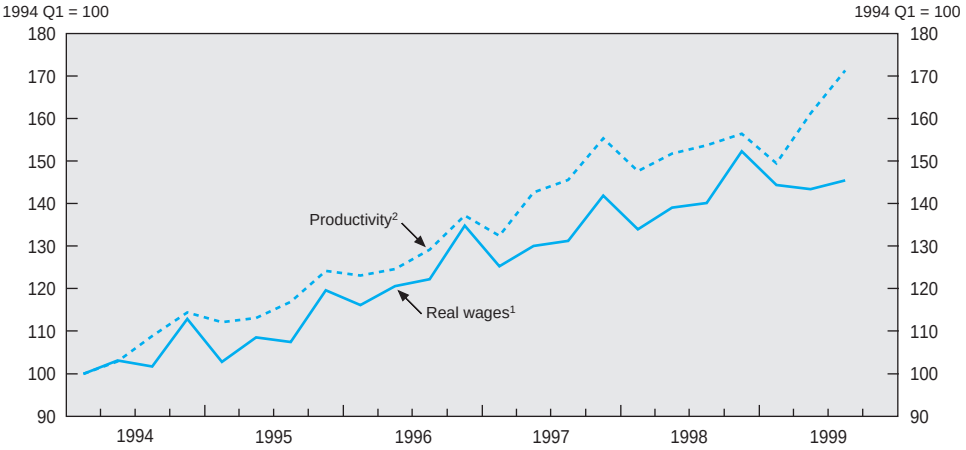
The system of wage bargaining in the budgetary sphere and in state-owned enterprises has been ineffective in imposing wage discipline. The system involves three-way bargaining under the auspices of a Tripartite Commission. As in 1997, the Commission failed in 1998 to reach an agreement and the government unilaterally decided the norm for budgetary wage rates at above 2 per cent above projected inflation[18] (Figure 19). State-owned enterprises have, however, been given *de facto* a large degree of autonomy in determining wages rates because sanctions applicable to managers granting excessive wage increases have not been applied. This has led to excessive wage increases, even in firms reporting poor financial results and, as a result, state enterprises on average pay higher wages than private firms. For instance, coal mines with the largest financial losses have often offered the highest wages in the sector.

The minimum wage in Poland continues to be generously indexed. The real minimum wage rose by close to 4 per cent in 1998. Compared to other OECD countries, the Polish minimum wage has been remarkably stable relative to the average wage (Figure 20). At 45 per cent of the average wage, it appears to be around the average of Member countries but well above that in countries with similar per capita income levels. The authorities have prepared a draft new law, according to which minimum wages would no longer be negotiated, but fixed on a regular basis for every voivodship.

Employment protection legislation

Although the last Survey recommended a general easing of employment protection legislation, no significant changes have been made in this area. The Ministry of Labour and Social Policy submitted a draft bill to the Council of Ministers in June 1999, however to increase the cumulative duration of successive fixed-term contracts. Currently, fixed-term contracts can only be renewed twice before being automatically transformed into indefinite duration contracts. More flexible employment contracts would facilitate in particular the operation and development of small and medium-sized enterprises. Other proposed changes to the Labour Code include a reduction in the working week by 2 hours to 40 hours and an increase in the maximum allowable overtime hours.

Figure 19. **Real wages and productivity**

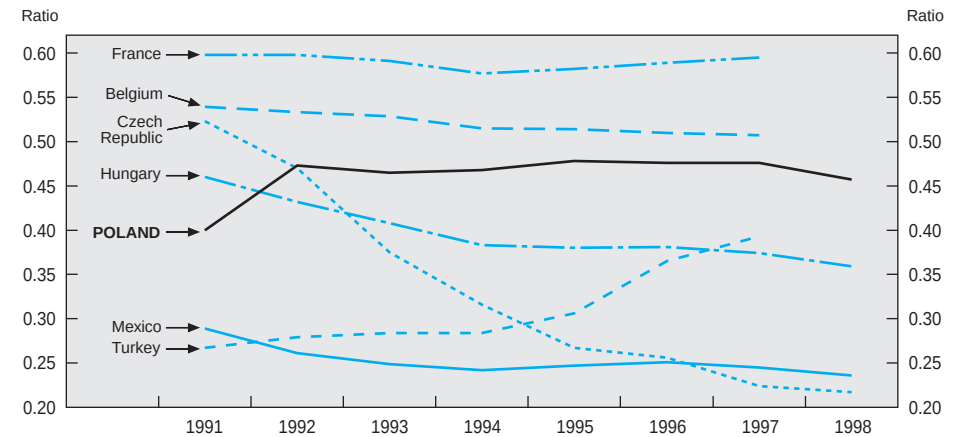


1. Gross wage in industry, adjusted for the grossing-up in January 1999 following the payroll tax reform and deflated by the industrial producer price index.
2. Industrial output per employee in industry.

Source: Central Statistical Office and OECD.

Figure 20. **Minimum wages**

Ratio of minimum wages to average wages[1]



1. Average wages refer to median earnings for full-time workers. For Mexico and Turkey, they refer to mean earnings of manufacturing workers.

Source: OECD, *Employment Outlook.*

A new Civil Service Act came into force in July 1999. The Act aims to establish an open, competitive career system. It provides for the introduction of the principles of transparent recruitment of civil servants,[19] competitive terms and procedures for nomination to posts in the civil service, and a re-examination of the remuneration system of civil servants. Preparatory work on several areas important for the implementation of the law is underway, notably on qualification requirements, competition procedures, recruitment, and remuneration. The new Act will allow a transition to a professional civil service where selection will be competitive and based on personal merits.

Active labour market programmes

The 1998 *Survey of Poland* recommended a closer evaluation of active labour market policies. It encouraged a shift in emphasis from public works and subsidised employment to training, so as to improve the content of the programmes as well as the targeting on high-risk groups and to strengthen the job-brokerage function of the public employment services (Table 10). Recent steps to improve the targeting on the youth unemployed included the introduction, by the National Labour Office, in June 1998, of the "Graduate 98" programme. Under this scheme, high school graduates register voluntarily at local employment offices to receive professional counselling and orientation services, vocational training, and subsidised or non-subsidised jobs. Its objective is to provide tools and encouragement to graduates in their job search efforts. By the end of 1998, 166 800 graduates were participating in labour offices activities with 45 per cent of them in subsidised job programmes, 32 per cent in non-subsidised jobs, 15 per cent in

Table 10. **Composition of expenditure on active labour market measures**

In Zl million

	1996	1997	1998	1999[1]
Active labour market expenditures	**806.1**	**1 168.4**	**1 241.8**	**1 160.5**
Percentage of total expenditure on active measures	10.9	17.7	25.8	19.9
Training and retraining	86.1	108.9	115.1	122.5
Intervention works	277.2	319.0	355.6	340.0
Public works	238.2	414.6	334.7	200.0
Loans	78.3	153.1	177.7	110.0
Graduates programme	126.3	160.2	229.4	367.7
Total spending of Labour Fund	**7 418**	**6 585**	**4 816**	**5 839**

1. Estimate.
Source: National Labour Office.

workshops devoted to training in skills which would help in finding a job, and 8 per cent in vocational training.

Unemployment in rural areas and agriculture remains a serious problem, and total rural unemployment (registered and hidden) is estimated at 1.7 million people (Council of Ministers, 1999). Recent actions undertaken to support this population include the following: *i)* financial support to small and medium enterprises creating non-agricultural jobs in rural areas, with low-interest loans and interest free loans offered depending on the length of employment contracts; *ii)* implementation of an agricultural settlement programme creating an opportunity to utilise part of the land owned by the Agricultural Property Agency of State Treasury for young people prepared for running farms, who come from overpopulated family farms, and for graduates of the secondary agricultural schools or universities; and *iii)* preparation of the guidelines for the programme supporting agri-tourism which may contribute to developing the regions and provide a source of additional income to farms. Reflecting a new social dialogue between the National Labour Office and social partners, an agreement was signed with the Agency for Restructuring and Modernising Agriculture in 1998 to establish a credit line aiming at creating 1 000 new posts. The National Labour Office also signed a similar agreement with the European Fund for Restructuring Polish Rural Areas in order to finance the development of small and medium enterprises in rural areas with the aim to target long-term unemployed. Additionally, financial support in the form of reduced social security contributions or allowances for commuting and housing costs are being made available to employers creating new jobs for long-term unemployed in all areas.

Limited progress has been made since the last *Survey* in evaluating the effectiveness of current active labour market policies. The computerisation of the National Labour Office network, which could help produce a comprehensive evaluation of policies, has started. Nevertheless, the implementation process is expected to last until 2004.[20] At the same time Poland took action to strengthen job broking by developing a database on the unemployed and on job offers, which is available through the internet. The system is being implemented across the country.

The public administration reform will affect the network of employment offices. By 2000, there will be 16 main offices at the regional level and 322 at the *poviat* (country) level, with the remaining network of offices becoming subsidiary units.[21] These offices will be financed by the central government, but spending decisions will be made by local authorities, in accordance with the Revised Act on Employment and Unemployment. The central office will hold responsibilities with respect to standardisation of practices and training of officers and will also perform some contracting tasks with local offices.

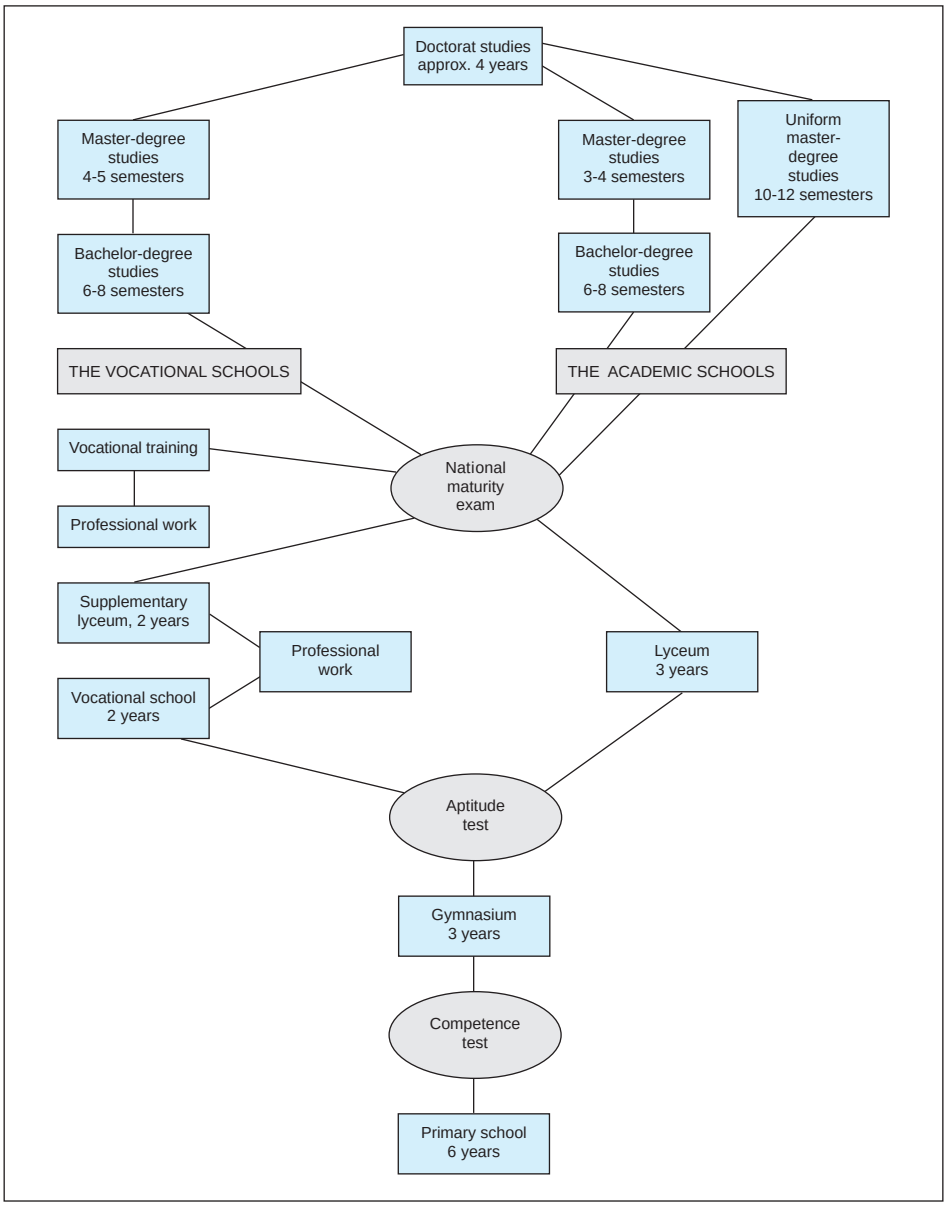
Education and training

Many of the shortcomings of the Polish education system were outlined in the previous *Survey*. These included limited access to tertiary education, the lack of vertical and horizontal integration both between secondary and tertiary education, and within and across university and technical and vocational school programmes, and weak connection of vocational curricula to the needs of enterprises. Moreover, Polish education institutions are not well equipped with modern learning and communication tools.[22] Some of these factors may have contributed to relatively low levels of tertiary education attainment.

The Polish authorities have recently taken a number of measures to overcome these shortcomings. Taking advantage of the overall reform of the educational system to improve vertical integration between secondary and tertiary education, the authorities proposed an active role for representatives of the higher education sector in the activities of the Central Examination Commission responsible for the development of a new curriculum for secondary schools (Figure 21). Moreover, recent changes in the orientation of curricula of vocational schools have led to new core curricula including lists of skills directly connected with a given vocation, and lists of "key abilities" required on the labour market such as computer skills, ability to start a business, and foreign languages. With a view to widening access to tertiary education and increasing the number of students from rural areas, a system of financial assistance was put in place in 1998. It consists of credit lines with low interest rates and state scholarship offered to students.

In summer 1998, the basic principles of reform of the educational system amending the 1991 Educational System Act were adopted. The new Act includes provisions on new school structures, the reallocation of management responsibilities to regional and local authorities, the redistribution of financial resources, and the decentralisation of education management. The necessity to decentralise the administration and supervision of education,[23] the demographic decline in the population of 6-7 year olds which will reach its minimum in the years 2001-02, and the increasing need to cope with the market economy have contributed to the introduction of a comprehensive reform. The reform is aimed at increasing participation in secondary and tertiary education, improving the development of practical skills rather than just transferring knowledge, raising access to education for the rural population, better adapting vocational education to business needs, and improving the financial situation of the education system through an increase in budget expenditures and in schools' own resources. Regarding teachers' remuneration, the reform should provide for pay increases to take place within the next three years. Increases will be more closely linked to the improvement of qualifications and to teachers fulfilling new functions.[24]

Figure 21. **The reformed education structure**



Source: Ministry of Education.

The reformed structure of the education system will include a 6-year primary school and a 3-year gymnasium or junior high school. New third level schools of either 3 years for specialised lyceum or 2 years vocational lyceum will be established as of September 2002. Compulsory education starts at the age of 7 and continuing until 18 years of age. At the end of each level, pupils will take a leaving exam. The reformed "Matura" exam to be taken after the 3 years lyceum is expected to replace university entrance exams. New syllabuses have been established at all school levels. Training programmes for teachers have been set up. The basic programme covers 80 per cent of class activities, with the remaining 20 per cent being left to the school's choice. The implementation process will start in September 1999 and should be terminated by 2004.

Fostering entrepreneurial activity

As noted in the previous *Survey* of Poland, entrepreneurial activity has been a significant factor driving economic growth, and measures have been taken to foster the entrepreneurship climate in Poland. The programme "Direction of the Government's actions towards small and medium-sized enterprises until the year 2002" aims at improving the financing of entrepreneurial activities by easing access to borrowed funds. A National Credit Guarantee Fund managed by state-owned Bank Gospodarstwa Krajowego (in liaison with 43 banks across the country), started its activity in 1995. The Fund was initially endowed with equity of Zl 45 million by the state budget. Currently the Fund's capital exceeds Zl 95 million. Subject to a number of eligibility criteria, the Fund guarantees commercial bank credits to small and medium enterprises from all sectors. The Fund is allowed to guarantee up to 70 per cent of the amount of credits extended by commercial banks, with the remaining risk being assumed by commercial banks themselves. By mid-1999, the Fund had issued 365 guarantees for a total amount of Zl 108 million. Another element of the state policy towards small and medium-sized enterprises is to encourage the use of leasing as a form of investment financing through the introduction of various forms of contracts into the Civil Code.

More generally, a draft Law on Business Activity, which is to replace the Economic Activity Act and the Law on Companies with Foreign participation, has been approved by the Parliament in November 1999. The new legislation sets up the legal framework for entrepreneurial activities in Poland and, in particular, restricts the scope for state interventions in the life of small businesses. The Act introduces new definitions for permits and licences as well as transparent rules for their issuance and withdrawal. The number of sectors where a licence would be required is reduced from 28 under current legislation to 8.[25] The remaining sectors would only be subject to permits which are automatically granted if some basic requirements are fulfilled.

Box 4. Examples of innovative Polish firms

Frequently, foreign firms are seen as being successful in Poland, while Polish firms are – inaccurately – seen as concentrated in loss-making sectors, such as coal-mining, railroad, or steel. In fact, there is an increasing number of Polish firms that have successfully invested in innovative sectors and are able to gain market shares domestically and abroad. This box gives a few examples of such firms.

Amica Wronki S.A. is the largest domestic "white goods" manufacturer, with a history dating back to 1921. The company produces cookers, ovens, and the whole range of refrigerating and washing equipment. Amica sells its products both on the domestic and Western European markets. Exports account for 30 per cent of sales, of which the majority is carried out on the German market. Since 1997 the company has been listed on the Warsaw Stock Exchange (WSE). The revenue from sales reached euro 172 million in 1998. Amica Wronki S.A has been awarded numerous Polish industrial prizes, including the Industrial Prize awarded under the patronage of the President of the Republic of Poland to the best Polish enterprise.

ComputerLand S.A. started its activity in 1991. Initially the company dealt with the sale of brand name computer equipment. It expanded subsequently in the design, delivery and implementation of information networks. The company is one of the leading information system integrators in Poland providing information technology solutions for businesses. In 1995 the company successfully made its debut on the WSE. In 1996, it was named the best company on the WSE and awarded the SEC Chairman's prize for the largest increase in share price.

Slaska Fabryka Kabli S.A. is operating since 1928, and is a nationally recognised cable and wire manufacturer. It was among the first five Polish companies to go private and place their shares on the WSE, and the very first Polish company to gain a strategic investor. To meet the market demand Slaska Fabryka Kabli S.A. implemented and now maintains a quality assurance system in compliance with the ISO 9001 Standards. In February 1999 S.F.K. S.A. became a member of the new European Cable Group. In this way the fourth cable group, in respect of turnover, has been created in the European Union employing approximately 4 000 people.

Softbank S.A. is the largest Polish software house specialising in automation of banking operations, and one of the largest hardware suppliers. The company was established in 1989 and from the very beginning of its existence concentrated on business in the banking and financial sector, and providing consultancy in hardware selection. Softbank S.A. closely co-operates with the major players on the global market. The company has been listed on the WSE since June 1998, and is one of the highest ranked listed companies by investors. It has been awarded the "Best Stock-Market Debut in 1998" prize. In the second half of 1998, the company's stock gained 108.6 per cent, which was the largest price increase among the companies listed on the WSE.

Veri Service is a producer and an importer of modern food processing and packaging machinery and equipment for the Polish market. The company was established in 1991. Since its creation the company has been operating in the field of food processing machines and technologies, such as production of alcoholic and soft drinks, fruits and vegetables processing and packaging (aseptic method), and imports of foreign machines and equipment. Veri Service was among the first companies to introduce tax-stamp applying technologies in Poland. Currently the company has a well-established position in Poland and in other countries of central and eastern Europe.

Enhancing product market competition

Poland is continuing to bring its competition laws and policies into line with those prevailing throughout the European Union. A new competition statute is expected to come into force in mid-2000. Moreover, the Office for Competition and Consumer Protection (OCCP), charged with enforcing Poland's competition statute, was very much involved in formulating the new law on state aids scheduled to come into force early in 2000. That new law is intended once again to bring Polish law nearer to the regulations prevailing in the EU. The future law will provide for monitoring of state aid, including its effects on competition. The OCCP is expected to be given that monitoring role.

In the case of electricity, the opening of the market to competition is well advanced. Consumers' charges have started to come down and can be expected to continue falling reflecting enhanced competition. Poland will adapt to the European Union directive in 2003 by enabling large corporate consumers to choose their suppliers anywhere in Europe. The directive stipulates that 25 per cent of the market must be opened to competition in 2000, and 33 per cent in 2010. Tariffs for electricity and heating are no longer established by the Ministry of Finance. They are set by producers and approved by a new regulatory body, the Energy Regulation Office (URE). In January 1998, the prices for heat energy were liberalised and a schedule for the liberalisation of electricity prices began on January 1999. Measures are expected to be taken to deregulate natural gas prices from January 2000.

The performance of the telecommunications sector as a whole has been lagging behind that in most OECD countries, despite progress made with the abolition of the monopoly of the Polish Telecom company (TPSA) on local connections. Network investment and penetration were among the lowest in the OECD in 1997. Price levels were the second highest in the area, pointing to the need for further progress in implementing a pro-competitive regulatory regime. Furthermore, the Office for Competition and Consumer Protection has recognised as monopolistic practices the excessively high fees for long-distance connections and the maintenance of a structure of charges not justified by the costs of specific telecommunication services. The authorities have submitted to Parliament a new draft Telecommunication Law, which establishes an independent regulatory body, the Telecommunications Regulatory Office, and eliminates some restrictions on licences such as for the supply of telephone services in communes, on Internet services and on long-distance segments of the market. The draft law also aims at improving access to universal telecommunications services. A new Fund for Universal Services will be established to develop universal services and telecommunications in areas of low profitability, such as rural areas, with financing through fees paid by operators. Current restrictions on international connections would be eliminated at the end of 2002. The law has yet to be discussed by

parliament but the authorities are hopeful that it could come into force by the end of 2000. The mobile network has developed progressively with about 2 million subscribers (*i.e.* 5 per cent of the population), with three operators covering a territory where about 90 per cent of the population lived in 1998.

Other sectors have also been opened to competition or are under consideration since the previous *Survey*. In the postal service, a draft Postal Law, which should come into effect no later than the year 2001, will introduce conditions for extending access to the postal services as well as to further demonopolise and liberalise the postal sector. The draft law also provides for an independent regulatory body in postal services to be created, the Office for Postal Market Regulation. Gradual phasing out of rent control in the housing market is also underway. At the end of 1997, rent controls applied to 25.5 per cent of the housing stock, down from 28 per cent in 1996. The regulated housing rents are mainly applied to houses owned by enterprises. Full liberalisation of rent in the private sector is not envisaged before 2004.

Scope for further action

Few reforms in line with the OECD *Jobs Strategy* recommendations have been adopted since the last *Survey* and there is therefore a need for further and faster progress. An important step is to impose greater wage discipline in the state enterprise sector. The excessively generous wage increases granted in these firms are not sustainable and will eventually penalise employment in the dynamic private sector through a higher tax burden. A particularly unhealthy situation is the combination in some state enterprises of high wages, arrears on taxes and social security contributions, and subsidies from the budget. Fast progress in privatisation and enterprise restructuring will eventually resolve this problem; meanwhile representatives of the State Treasury sitting at the executive boards of such firms need to play a more active role in imposing wage discipline. The authorities are considering a new way to set the minimum wage, which would no longer be subject to negotiations, and the introduction of lower minimum wage in regions with high unemployment. Consideration should be given as well to differentiation between youth and adult minima in order to reduce negative employment effects. The new Civil Service Act could provide a useful clarification of rules pertaining to the recruitment, career, and remuneration of civil servants. Particular caution must be exercised, however, before granting life-time job contracts to civil servants, at a time when many OECD countries are trying to move away from rigid labour contractual arrangement in their budgetary sectors.

Active labour market policies are high on the government agenda and their share in total labour market expenditure has risen since 1997. However, further efforts are needed to effectively integrate the newly unemployed population and minimise substitution and displacement effects of various measures. The

evaluation and monitoring of the programmes will be all the more essential to understand these adverse effects and to further improve their efficiency. The effectiveness of the Public Employment Service as a job broker will be enhanced if a rapid computerisation of its network is accomplished.

The Polish authorities recognised the necessity to carry out changes in the educational system following the framework set out by the OECD *Jobs Strategy*. The effectiveness of the educational reform will, however, depend to a large extent on its implementation. The decentralisation of the system should give communes and regions more flexibility in the development of new curricula and closer evaluation by regional institutions would help co-ordinate the changes. However, the full implementation of these commitments will require many years, as it has to wait a complete cycle of new students in higher education for example. Consequently it is still too early to evaluate their effectiveness. Close monitoring will be essential to assess the results.

Product markets have evolved considerably since the last *Survey*. Competition is intensifying in the network sectors and the effects are already being passed on to consumers in lower prices and a wider range of services offered. However, more progress towards the liberalisation of the telecommunication market is required. Fast implementation of the draft Telecommunication Law should be a priority.

The need to foster entrepreneurship has been recognised by the government. The establishment of a legal framework for the National Credit Guarantee Fund in liaison with the 1998 banking law has extended the credit base nationwide for the provision of guarantees to small and medium-sized enterprises. Care needs to be exercised in the allocation of guarantees, however, to make sure that risks are properly assessed and that banks share the lending risks. More fundamentally, fostering small business activities calls for an easier access to equity capital, rather than to bank lending.

Pension reform

A new old-age pension system entered into force on 1 January 1999. The reform addressed the fundamental weaknesses in the previous defined benefit pay-as-you-go system, and established a new defined contribution multi-pillar system.[26] The first pillar is a new public pension system that, unlike the previous one, involves a direct link between contributions and future pensions, so as to provide a strong incentive to retire later rather than earlier. The second pillar capitalises individual contributions and is mandatory for the younger generations (people born after December 31, 1968). Private pension funds have been established to manage the resources contributed under this pillar. The third pillar is

voluntary and consists of company plans and other savings vehicles. The new system also guarantees a minimum level of benefit co-financed from central government revenue. The previous *Survey of Poland* described the reform in detail and concluded that, if successful, it would help ensure the financial sustainability of the pension system in the long run in view of growing demographic pressure. The new system was also seen as favourably influencing compliance, public and private savings, as well as labour and asset markets.[27]

Several challenges for the implementation of the reform were foreseen by the previous *Survey* (Table 11). First, the existing sectoral pension privileges were seen as potentially conflicting with the reform. The new system does not provide privileges in terms of early retirement age and, if some of these privileges were to be maintained, budgetary financing would have to be provided in a transparent manner. This also applied to the farmers' pensions which is not covered by the reform. Second, a major overhaul of the Social Insurance Office (ZUS) bureaucracy was seen as urgent, in particular of its computer system, to avoid becoming a bottleneck in the new system. Third, the transition from the previous to the new system was deemed to carry potential risks, because the shift of financing to the second pillar deprived the existing system of resources to pay current pensioners. Faster privatisation was advised to provide financing in the interim. Finally, maximum transparency was thought to be necessary in the accreditation of new private pension funds and in their management, so as to avoid the pitfalls encountered in the countries that preceded Poland in the move to funded pensions.

The launching of the second pillar was quite successful. The 21 funds accredited by the Pension Fund Supervision Office began their formal operations in April 1999. By mid-November 1999, they had registered approximately 8.9 million people. After fierce marketing battles, three of these funds gathered more than half a million members each, leaving the others with relatively small market shares.

As feared, however, the social security bureaucracy and its lack of adapted computers and software proved to be a major bottleneck in the transition. Under the new system, employers are responsible for depositing all contributions each month on the ZUS accounts at the National Bank of Poland. Afterwards, ZUS registers contributions in individual pension records before channelling the required portion to the contributors' pension funds. However, in the first months of the entry into force of the new system, significant problems were experienced in the transition to the new system. The problems of ZUS included computerisation difficulties, non-payment of social security contributions and a legal anomaly in the texts of the social security reforms. This complex situation led to a loss of transparency on the exact origin of the difficulties faced by ZUS. If not corrected rapidly, the failure of the social security office to channel

Table 11. **Implementing the OECD selected recommendations on structural policies: an overview of progress**

Recommendations	Measures since the last survey	OECD comments
Privatisation		
The pace of state divestiture needs to be stepped up, notably in the financial and network sectors (telecommunications, energy, and transportation).	The new "Privatisation programme till 2001"has been adopted. The privatisation is proceeding in telecommunication industry, power generating, metallurgy and financial sector. Privatisation of natural gas, energy and oil industry is expected to start soon. The national telecom company TP SA was floated on the stock exchange in 1998. In 1999 Bank Zachodni S.A and PKO S.A. were privatised.	Proceed with the current reform. Speed up privatisation in energy and transportation sectors.
Restructuring of the enterprise sector needs to be speeded up.	The modified plan for restructuring of the mining sector is expected to be implemented soon. Restructuring of gas, coal mining and electricity sectors continues.	Launch restructuring in steel, defence and railroad sectors.
Corporate governance		
Debt relief should be more strictly conditional to restructuring programmes.	Debt relief mechanisms are not yet strictly conditional to introduction of restructuring programmes in steel and railroad sectors.	Follow recommendation.
Pension reform		
Continued active legislative support is required if implementation of the pension reform is to start on schedule, in January 1999.	The reform started according to the schedule with the complete set of legislation being implemented simultaneously.	Proceed with the current reform.
Setting up of a single minimum retirement age of 62 for both genders is highly desirable.	The Polish authorities kept divided the minimum retirement age for men (65) and women (60).	Follow recommendation.
Technological upgrading and institution-building work needs to be accomplished.	The ZUS computer system in use since the beginning of 1999 was unable to identify those employers that failed to pay their social insurance premiums. The new system is expected to be activated by the end of November 1999. The new pension supervisory authority has been established (UNFE).	Follow recommendation (ZUS computer system). Rationalise supervisory activities.

Table 11. **Implementing the OECD selected recommendations on structural policies: an overview of progress** *(cont.)*

Recommendations	Measures since the last survey	OECD comments
The existing social insurance bureaucracy needs to adapt rapidly in order to perform its new duties appropriately.	The adaptation proceeds slowly so that the effect is hardly visible now.	Follow recommendation.
Accreditation procedures for new pension funds should ensure maximum transparency.	The supervisory authority ensured transparency for accreditation proceedings.	Proceed with the current reform.
The rules governing pension funds' portfolio composition need to be established.	A complete set of legislation governing pension funds' portfolio composition has been put in place.	Proceed with the current reform.
The speed of change to a pension multi-pillar system needs to be calibrated so that the ensuing fiscal impact can be broadly offset by savings in the first pillar and privatisation receipts.	Privatisation receipts were sufficient to finance fiscal impact and speed of change was well adapted to available financing.	Proceed with the current reform.
The farmers' pensions need to be rationalised.	The farmers are not covered by the present pension regulations.	Follow recommendation.
The pension reform needs to be complemented by other social security reforms.	The pension reform was accompanied by the health care reform.	Reform disability pensions and sickness benefits.
Banking		
Banking supervision needs to be tightened.	Banking supervision arrangements were tightened. A new Banking Supervision Commission was set up. Banking secrecy provisions have been amended, and new provisions to fight money laundering have been introduced.	Continue with the current action.

Source: OECD.

the required funds risks undermining the credibility of the entire reform. The long-term benefits in the form of higher national savings, greater labour market participation, a smaller underground economy and deeper asset markets will emerge only if contributors trust that their future pension rights will be honoured. Prompt action is therefore required to re-establish credibility in the system.

Box 5. The new pension formula

The 1998 *Survey of Poland* described the old pension formula prevailing in the previous system. In the previous system, old-age pensions were expressed as a fraction (24 per cent) of the economy-wide average wage, adjusted for the number of years of contributions, the level of contributions, and other criteria.

In the new system, the old-age pension is calculated according to an entirely different formula (Chlon, Góra, and Rutkowski, 1999):

$$P_n = \frac{\sum_{i=k}^{n} \left\{ c_i \prod_{j=i}^{n} (1 + r_j) \right\}}{G_n} \text{ , where:}$$

P_n old-age pension at age n
c_i contribution in year i
r_j rate of return in year j
k age of entering to social security
G_n average life expectancy at retirement age in the calendar year of retirement

The formula simply determines the pension-benefit as the cash value of compounded contributions divided by the life expectancy at the retirement age. Hence, the formula adjusts the level of benefits both to the value of contributions paid during the entire working career and life expectancy at the retirement age. The formula still redistributes between men (living shorter) and women (living longer) by using the unisex life expectancy tables.

Due to the actuarial calculation of the benefit, the new system has stronger incentives to continue work after the minimum retirement age than the old system. Each additional year of work and contributions will be rewarded with a clear increase in the net present value of pension benefits, as the accumulated capital increases and life expectancy decreases.

A draft law on a "bridging" pension scheme is being discussed with social partners. This new law is intended to provide compensation for the loss of early retirement privileges by certain categories of employees.[28] Although the normal retirement age is 60 for women and 65 for men, early pension privileges have been granted liberally and, as a result, the average retirement age was 55 for women and 59 for men in 1998. The new system does not foresee early retirement. Additional contributions would be paid by employers or the government during the period from the early retirement age to the standard retirement age. These would cover "bridging pension" provisions for a list of jobs that are deemed unhealthy by a medical Committee, compensation for workers who are on the list formerly benefiting from an early retirement scheme, and retraining plans for future workers in hazardous jobs. Given the already high burden of early retirement contributions, it would seem desirable to strictly limit early retirement

in the future to workers in activity included in the medical Committee list and to explicitly foresee their financing by employers.

Privatisation and enterprise restructuring

The divestiture of state assets in Poland proceeded slower in Poland than in other countries, but is now rapidly accelerating, helping to attract foreign capital flows to the balance of payments and bringing financial resources to reduce the state indebtedness. Privatisation picked up pace in 1998-99, following the authorities' decision to sell very large and profitable state enterprises, in particular in the banking sector. As a result, in 1998, about 65 per cent of value-added was generated in the private sector, and about two-thirds of jobs were in private companies (Table 12). Nonetheless, the state enterprise sector remains large and many state enterprises continue to accumulate financial losses due to inherited overstaffing and high salaries and a lack of restructuring in the transition period. Challenges lie ahead for the restructuring and the eventual privatisation of enterprises, notably in the coal mining, steel industry, railway transport,

Table 12. **Sectoral employment shares**

As of 30 September

	Total employment (in thousands)		Per cent of total	Share of private employment in the sector	
	1997	1998	1998	1997	1998
Agriculture	4 365	4 344	27.4	97.8	98.0
Industry	3 761	3 650	22.9	63.7	70.1
Mining and quarrying	326	297	1.9	4.5	6.9
Manufacturing	3 177	3 100	19.5	74.5	81.5
Electricity, gas, water supply	258	253	1.5	5.4	5.7
Construction	948	932	5.9	87.7	91.3
Trade and repair	2 061	2 117	13.2	96.1	97.3
Hotels and catering	202	207	1.4	84.5	86.7
Transport, storage and communication	865	853	5.4	32.9	34.9
Financial intermediation	305	327	2.1	42.0	49.9
Real estate and business activities	688	723	4.7	69.8	73.3
Public administration and defence	432	431	2.7	0.3	0.2
Education	902	904	5.7	3.5	4.2
Health and social work	1 029	1 021	6.4	6.2	6.4
Other municipal services	371	366	2.2	60.3	58.2
Total	15 940	15 886	100.0	68.2	70.7

Source: Central Statistical Office.

defence, and other sectors. On the other hand, the portfolio of enterprises is also an important asset of the general government sector which, if successfully liquidated, will bring large revenue that can be used to retire some of the government liabilities or finance infrastructure development. At the end of 1998, the net value of state enterprises companies owned by the State Treasury with positive equity was about Zl 105 billion, of which Zl 42 billion for enterprises fully owned by the state, and Zl 63 billion for companies partially owned by the treasury. This compared with central government financial liabilities of Zl 237 billion.

Sales of state enterprises in 1998-99

Despite the Russian economic crisis and its contagion throughout the region, privatisation picked up pace in 1998. The total budgetary revenue from privatisation amounted to Zl 7.1 billion in 1998 (1.3 per cent of GDP) the largest amount of privatisation proceeds ever recorded in Poland. The bulk of privatisation revenue came from the sale of companies corporatised in previous years. These sales were made through public invitation of strategic investor, initial public offering, or written tender. About half of the proceeds from this track came from the initial public offering of 15 per cent of Telekomunikacja Polska, the giant Polish telecommunication monopoly. Other large sales included 15 per cent of the commercial bank Pekao via initial public offering, and 70 per cent of Polfa Poznan sold to a strategic British investor. In addition, the direct privatisation of 156 enterprises was made either through contribution to a company or leveraged leasing buy-outs. Finally, 74 state enterprises were liquidated.

Encouraged by the successful pick-up in the speed of privatisation in 1998, the Council of Ministers adopted guidelines for 1999 calling for more ambitious targets than in the previous year. It was decided to accelerate privatisation, despite the less favourable economic climate, in particular in the banking and telecommunication sectors which had been relatively unharmed by contagion effects stemming from the Russian crisis. Privatisation proceeds were anticipated to increase to Zl 15 billion, more than double the amount realised in the previous year, and were to be allocated to different uses defined under separate legislative decisions. Over 70 enterprises were scheduled for direct privatisation in 1999, including companies that would just enter in the first stage, and companies that would be entirely sold. By November 1999, the largest privatisations realised in 1999 were the sale of stakes in Pekao Bank (Zl 4.2 billion), PZU Insurance (Zl 3 billion), Bank Zachodni (Zl 2.3 billion), Patnow-Adamow-Konin power station (Zl 0.4 billion) and LOT Polish airline (Zl 140 million) – which all were sold to foreign investors. Other large sales expected for 1999 or 2000 include stakes in Telekomunikacja Polska, PKN, district power stations, and pharmaceutical factories.

The number of state-owned banks is rapidly shrinking following large privatisation made in 1998 and 1999. The largest bank privatisation ever made in Poland was the sale of a 52 per cent stake in Pekao, in June 1999, to a combined group of foreign investors (Unicredito Italiano and Allianz) for the equivalent of euro 1 billion. The bank's employees also received a stake of 15 per cent and the State Treasury kept a 15 per cent stake. At the same time, the treasury sold a stake of 80 per cent in Bank Zachodni (a leading regional bank) to Allied Irish Bank. Following these and other sales, the number of banks with state participation was reduced from 13 to 7. The state fully owned only two large, financially troubled, banks: the Polish Savings Bank (PKO BP) and the Bank for Food Economy (BGZ). PKO-BP is a very large traditional savings deposit bank with a large network of branches. It alone holds 18 per cent of the banking system's assets. This bank, however, has a large pre-1989 portfolio of bad housing loans which prevents a rapid privatisation. The authorities would like to privatise PKO-BP nevertheless and will take a decision on the best course of action in 2000. BGZ, which traditionally lends to the agricultural sector, is subject to a restructuring programme in co-operation with the European Bank for Reconstruction and Development. The authorities intend to privatise BGZ following its restructuring in 2000-01.

The most sensitive sector for privatisation is the coal mining industry, which includes many loss-making mines, covers a large number of employees, and presents acute social problems. Progress is, nonetheless, being initiated with two profit-making mines slated for privatisation in 1999, with financial and technical aid from the European Union and World Bank. The January 1999 law on adjustment in the hard coal mining sector sets a framework for restructuring in the sector and establishes the social rights of coal miners. Other sensitive sectors where privatisation is making progress include the steel industry (with two companies slated for privatisation in early-2000), electricity generation (privatisation of power plans started in 1997), sugar plants and the liquor sector.

Enterprise restructuring

Some progress has been made in enterprise restructuring in the last ten years. For instance, the Polish shipyards once renowned for their financial and social troubles, have by now been restructured and privatised. Several sectors are nonetheless still in need of further restructuring efforts, notably in the sectors of coal mines, steel industries, and railroads. Restructuring is needed not only to make firms viable in the long-run, but also to reduce the negative impact of firms' losses on the public finances and to comply with EU rules on state aid to public firms.

The coal mining sector is the most challenging restructuring priority of the government. As in many other countries of the regions, coal mines are suffering

from a falling demand for hard coal, high production cost, and excessive production capacity. In the early-1980s, Poland had a production capacity of 180 million tons a year, although production had fallen to 100 million tons a year. Several restructuring programmes ran into trade unions' opposition and failed to significantly reduce the production capacity and the financial losses of the sector. Against this background, the Council of Ministers adopted in June 1998 a "Reform of hard coal mining industry in Poland in the years 1998-2002" and parliament adopted the "Law on Adjustment of the hard coal mining industry to operations in a market economy and the powers and tasks of mining communities". These plans called for a gradual reduction in the production capacity, liquidation of loss-making mines, privatisation of profit-making enterprises, and reduction in the workforce accompanied by severance pay financed by the central government budget. Some progress was made in 1998, with a decline in the workforce from 243 000 to 208 000. Nonetheless, the sector incurred net financial losses of Zl 4.3 billion in 1998 (about 1 per cent of GDP) and total liabilities increased to Zl 16 billion. The sharp fall in the price of hard coal on international markets deepened the financial difficulties of the sector in 1999 and called for more rapid restructuring. In October 1999, the government prepared an updating of the restructuring plan with the objective of reaching a profitable position for the overall sector in 2002. Financial help was committed by the World Bank for this purpose. The programme envisages the liquidation of technology obsolete mines, and the privatisation of cost-effective ones. It also foresees the reduction in the workforce by half. Important unresolved issues include the size of the budgetary support to the program, the early-pension privileges for miners, and the amount of severance pay for miners being laid-off. The authorities also envisage a vertical integration of lignite mines and electricity generation plants where power plants are the main consumer of the mines. The combined firms would be offered as a single privatisation package.

Little progress has been made towards the restructuring of the state-owned railway company (PKP) since the last *Survey* of Poland. The government has drafted a law for this purpose with the intention to open the rail sector to foreign carriers by end-2005. The railway infrastructure is, however, obsolete and requires urgent upgrading. On its own assessment, PKP has a 30-year technological lag behind Western European rail carriers, has run into financial difficulties since 1998 and has a total debt of Zl 4.7 billion. The company is the subject of a draft law covering its restructuring, commercialisation, and privatisation. The government has submitted to Parliament a law that would transform PKP into a Treasury-owned company from the beginning of 2000. Activities not directly related to rail transportation would be sold and the company would be split into three separate "daughter" firms (transportation of passengers, cargo, and infrastructure). Part of the passenger traffic system, primarily its Inter City, Euro Night and Euro City lines, would also be privatised. Under the government's proposal, employment

would be reduced by one-third, and the company's debt would be repaid. Government guaranteed bonds would finance the restructuring cost. Parliament began to discuss the draft law in October 1999.

In June 1998, the authorities also adopted a restructuring plan for the steel industry. The plan aimed in particular at bringing state aid to the sector into line with EU rules. It envisaged the privatisation of all steel mills until end-2001, including the largest ones in 1998-99. The deteriorated market environment following the Russian crisis altered, however, the entire prospect for the privatisation of the sector. The sale of the two main steel mills (Huta Katowice and Huta Sendzimira) has therefore failed for the time being, but the authorities hope to be able to privatise them in 2000 based on recently submitted offers.

Implications for corporate governance

In general, the State Treasury cannot seek to perform an active shareholder role because it owns 2 790 state enterprises. In order to maintain some degree a financial discipline, however, companies owned by the state are required to submit quarterly and annual information. Wage discipline is followed closely and wage increases must not, in principle, deviate from the guidelines issued by the Tripartite Commission. Although some progress has been made toward greater wage discipline, employees in state companies earn on average 20 per cent more than private sector employees. Privatisation is seen as the best way to improve corporate governance and improve the performance of companies. Studies of the microeconomic effects of privatisation show that it significantly affects the financial standing of companies and their performance. The analyses find that the return on equity (ROE) was always higher for privatised companies. They also show that privatised companies are more cost-efficient because they are able to get rid of all redundant assets and make a proper use of the remaining property. Foreign capital, know-how and expertise play an important role in this regard as privatised companies with foreign capital participation showed even better results. Liquidity is better in privatised companies, as shown by the ratios of liquid assets to liabilities. Polish privatised companies are well placed in terms of indebtedness. Finally, privatised companies are more export-oriented.

Assessment

At the end of 1998, the residual stock of state enterprises' assets was valued at Zl 105 billion (based on book values). This implies that, at the current pace of Zl 7-8 billion in privatisation per year, it could take 10-15 years to complete the process. Although the government has entirely disengaged from a few sectors (such as cement, tobacco, meat processing, light chemicals, and the car industry), it remains extensively engaged in most other sectors. The state still

owns small vodka distilleries, steel mills and coal mines. For these and other enterprises that are considered as important for the national economy or as politically sensitive, the authorities prefer to adopt privatisation programmes that follow a gradual approach. While this approach may maximise the value of privatisation for the state and minimise social disruption, it unnecessarily delays the transfer of these companies to private hands. By many indicators (productivity, employment, output) the overall performance of state enterprises has been weaker than the performance of privatised firms. A faster pace of privatisation is therefore needed to improve corporate performance and provide appropriate incentives to managers and employees. In sectors where no major difficulties are expected (such as banking, insurance, telecommunications, electricity generation and distribution, energy, and agro-industry), the state should aim at disengaging as fast as possible.

The banking system

The 1996-97 *Survey of Poland* recognised that the Polish banking system had become much healthier following the ambitious programme of bank recapitalisation and loan restructuring introduced by the authorities. A strengthened system of bank supervision, which went into effect in 1998, was also found to have led to a distinct improvement in the banks' prudential ratios. Nevertheless, some banks were seen as too fragile, and the number of banks owned by the state too important. A speed-up in bank privatisation was advised in order to build a banking system that would support further economic growth and would be relatively immune to unexpected financial turbulence. Since then, much progress has been made in developing, strengthening, and privatising the banking system (IMF, 1999).[29] As a result, the banks have been relatively unharmed by the contagion effect of the Russian crisis.

Structural changes underway

Since the early 1990s, the banking system has undergone considerable transformation. State banks were privatised, small loss-making banks were merged into larger banks, foreign financial institutions established branches or took stakes in Polish banks, and steps were made towards improving the solvency of most banking institutions. At the end of September 1999, the Polish banking system (including cooperatives) had Zl 369 billion in assets, or 58 per cent of GDP. There were 79 commercial banks and 819 co-operative banks (Table 13) which together had about 175 000 employees.[30] Apart from the National Bank of Poland, the banking system consists of four main segments: the state-owned banks, the banks owned or controlled by foreign institutions, the banks in Polish private hands, and the small co-operative sector.

Table 13. **Indicators of banks' health and performance**

Excluding co-operative banks and banks undergoing liquidation or bankruptcy

	1993	1994	1995	1996	1997	1998
Number of banks	87	82	81	81	83	83
Solvency						
Below required 8 per cent level	18	18	13	8	8	5
of which: Negative solvency ratio	13	15	11	7	6	4
Profitability						
Number of loss-making banks	24	20	11	11	7	9
Gross profit/income (in per cent)						
All banks	6.0	6.0	16.9	19.4	14.7	8.3
Banks with majority state equity	5.9	5.2	15.2	18.9	12.5	5.3
of which: Directly owned by the Treasury	6.6	5.7	16.0	20.2	13.7	9.7
Private banks	6.7	9.6	21.0	20.5	17.3	10.0
of which: With majority Polish equity	0.5	5.8	21.0	21.3	19.8	12.0
With majority foreign equity	32.3	17.9	20.9	19.7	13.6	9.1
Non-performing loans (in per cent of total loan portfolio)						
Substandard	7.1	5.7	5.4	4.1	3.9	4.1
Doubtful	6.0	5.3	3.5	1.7	1.2	1.8
Lost	17.9	17.7	12.0	7.4	5.4	4.7
Total	31.0	28.7	20.9	13.2	10.5	10.6
Actual provisioning (in per cent of loan portfolio in the category)						
Substandard (required 20.0)	16.3	25.8	26.1	27.0	25.9	22.2
Doubtful (required 50.0)	25.0	55.4	59.3	53.4	52.5	53.0
Lost (required 100.0)	87.1	100.1	100.2	99.7	99.7	99.8
Total	82.6	103.1	104.1	103.1	103.3	101.5
Total amount of provisions (Zl billion)	4.6	6.9	7.4	6.7	6.2	6.8

Source: National Bank of Poland, General Inspectorate for Banking Supervision (data as of 7 May 1999).

Foreign institutions play an increasingly important role in the banking system. The authorities have opened the door to foreign investors and allowed the transfer of banks to foreign hands, reflecting the commitments made to the OECD and the European Union to liberalise financial services. Foreign banks have purchased large stakes in Polish banks, particularly at the time of their privatisation, in addition to establishing local banks that they fully own (such as Citibank or Société Générale). Foreign banks actively involved in Polish banks include ING Bank (Netherlands), which owns a stake in Bank Slaski; Bayerishe Hypo und Vereinsbank AG, which owns a share of BPH; Commerzbank (Germany), which owns a stake in BRE Bank; Deutsche Bank (Germany), which owns part of Big Bank Gdanski, and KBC (Belgium) which has a stake in Kredyt Bank. Some foreign

institutions have combined their efforts to invest together or are acting in concert with the European Bank for Reconstruction and Development. Foreign investors hold about 60 per cent of the Polish commercial banks' share capital. This makes the Polish banking sector one of the most internationalised in the OECD. This also makes banking the most open sector in Poland. Most banks listed on the Warsaw Stock Exchange have majority foreign shareholders.

Other than foreign owners, the Polish private sector has a majority stake in 33 commercial banks. Generally these banks are small or specialised, although two medium-sized private banks have emerged as a result of mergers in the sector. Co-operatives are small and going through a process of consolidation. The co-operative sector has traditionally supported the small scale agricultural sector, which has itself encountered serious financial and economic difficulties. Co-operative banks employ about 15 per cent of all banking sector employees but hold only 4 per cent of net assets.

Strengthening supervision

During 1993-96, the Law on Financial Restructuring of Enterprises and Banks helped banks deal with their problem of non-performing loans. The programme gave commercial bankers responsibility to work out troubled loans in co-operation with borrowers. Banks were given a fixed three-year period (until March 1996) to recover what they could from bad loans through rescheduling, concessions, debt-equity swaps, or secondary market trading. Banks that successfully resolved their bad loan problem were endowed, in exchange, with internationally funded re-capitalisation bonds to increase their capital. This plan forced bankers to establish new loan recovery departments, to build management information systems, and to acquire skills in credit risk management. In contrast to schemes implemented in other countries (notably in Hungary, the Czech Republic, and Slovenia), the Polish programme dealt successfully with the bad loan problem at a limited cost. Non-performing loans now account for only 10 per cent of total portfolios and are entirely provisioned. Banks are no longer burdened by troubled loans and credit has started to grow again.

The cleaning-up of balance sheets opened the door to further consolidation in the banking system and to privatisation. The total number of banks has declined from 87 to 83. In addition, in the last few years 40 banks have been liquidated or merged and a number of new banks have been opened.

As in other transition economies, the profitability of the banking system has followed a downward trend. Competition for market shares is fierce and banks have had to reduce their interest rate spreads to attract more customers. Lower spreads, declining yields on securities, provisions related to the Russian crisis, investments in retail networks, and upgraded computer equipment have all burdened the banks' profitability in 1998. Banks have done little to reduce labour

costs and many banks remain overstaffed. Banks' revenues will, however, be boosted in 2000 by the change in the regulation on required reserves, with the newly inflation-indexed securities replacing non-remunerated reserves (see Chapter II).

The new Banking Act introduced in 1998 brought Poland's supervision regime into line with EU and international standards. The newly created Commission for Banking Supevision (CBS) is responsible for supervising banks and their branches, licensing new banks, issuing prudential regulation, and imposing sanctions. It consists of the NBP President, the head of General Inspectorate of Banking Supervision (GIBS), the representative of the President of Poland and representatives from the Ministry of Finance, the Securities and Exchange Commission, and the Bank Guarantee Fund. The GIBS acts as the executive body of the Commission and is responsible for carrying out on-site inspections and for analysing banking sector developments. The new Banking Act requires that banks maintain a capital base representing no less than 8 per cent of risk-weighted assets and off balance sheet commitments. In September 1999, 8 commercial banks had a capital inferior to the required ratio, of which 4 had actually a negative capital and were undergoing a rehabilitation programme. The authorities do not disclose the name of these banks. In line with EU standards, banks must have the equivalent of a minimum of euro 5 million in capital. All banks are required to contribute to the Bank Guarantee Fund, which provides deposit guarantees for customers and technical and financial assistance for troubled banks.

Next steps

Despite the privatisation activity and entry of foreign investors, the banking system remains relatively undeveloped. Only a half of Poles have bank accounts. By several measures (deposits in relation to GDP, outstanding credit per working individual, or number of bank branches per capita), the banking system is less developed than in Hungary, the Czech Republic, or the Slovak Republic. The capital of the entire Polish banking system is no more than half the capital of one large western European bank. The under-banking of Poland is in part explained by a history of high real interest rates and expensive interest rate spreads. Now that interest rates are lower, credit is expanding rapidly. The development potential is particularly important in the areas of consumer credit, long-term corporate lending and mortgage financing. Foreign institutions have provided incentives to develop the retail banking market by offering a new range of products and services. Instalment credits, car loans, and credit cards are all growing rapidly. A new mortgage bank law, effective since January 1998, establishes the legal framework for establishing subsidiaries specialised in mortgage banking activities.

A healthy and dynamic banking sector is an essential ingredient for the continued rapid growth of the Polish economy. Since the last *Survey*, sizeable progress has been made to privatise, strengthen, and liberalise the banking system. Privatisation of large state banks to foreign investors, although with some delay, brought outside expertise and greater competition in the sector. The authorities should now take measures to restructure the remaining state banks and transfer them to private hands. Adequate steps were also taken to strengthen the supervision of the banking system and take actions against troubled banks. The improved health of commercial banks has helped them to weather the contagion effect of the Russian crisis. Continued vigilance will be required as more intense competition will incite banks to take more risk in consumer and corporate lending. The entry of foreign institutions in the sector is bringing in new skills and a broad range of new services. This will help develop the credit market and, in particular, help small enterprises and households get access to credit lines, a facility that has been crucially missing in the transition process.

IV. The health care system

Introduction

The health care system that Poland inherited in 1990 from the communist era offered universal coverage with a comprehensive programme of health care benefits distributed through facilities owned and run by the state. Although the system provided universal health care coverage, it was over-centralised, over-specialised and did nothing to nurture cost awareness. Regional inequalities, rationing and misallocation of resources emerged, with growing unofficial payments to public health care providers. Increasingly, patients perceived the quality of health care offered by the system to be poor and the general public dissatisfaction has grown. Health care reform has figured high on the government's list of priorities in recent years. Some changes were introduced in the early 1990s, most notably as regards the public health care providers and the role of primary care physicians. A new general obligatory health insurance system entered into force on 1 January 1999. This and accompanying reforms marked a radical change from a centrally-controlled, budget-based system to a decentralised insurance-based system. Implementation of the new system has experienced certain difficulties and social pressures for further changes remain important. A comprehensive law on health care is currently under consideration.

This chapter first presents the on-going reform of the Polish health care system. The next section examines efficiency problems, cost issues and equity concerns that the reform is expected to address. The last section provides assessment of the reform and suggests policy options for further action.

Reforming the system

Background

The current setting of the Polish health care system (see Box 6 and Figure 22) is the result of several reforms since 1990 in the finance, management and organisation of the health sector (see Box 7), which have aimed at changing

Box 6. Institutional setting of the Polish health care system

The Polish health care system provides services through three tiers of a highly structured network, corresponding in part to the former administrative organisation of the country. The three tiers comprise the central level, the regional level (voivodship), and the communal level (gminas) with autonomous health care administration units (ZOZ). Parallel health services organised on corporatist lines operated independently. At the central level, the Ministry of Health (MH) is directly responsible for national health services and programmes, including hospitals associated with medical academies, medical research institutes, and education and postgraduate training of medical staff. Recent devolution of power to regions and communes, and increasing privatisation within the health care sector have reduced the role of the MH in the provision of health services. Moreover, with the introduction of health insurance, the financing role of the central government has been reduced.

At the regional level, hospitals provide acute care and hospitalisation and usually have an emergency unit. Outpatient health centres provide specialist and primary care. The autonomy of regions and their independence from the MH has been strengthened since 1992 with funding coming directly from the Ministry of Finance.

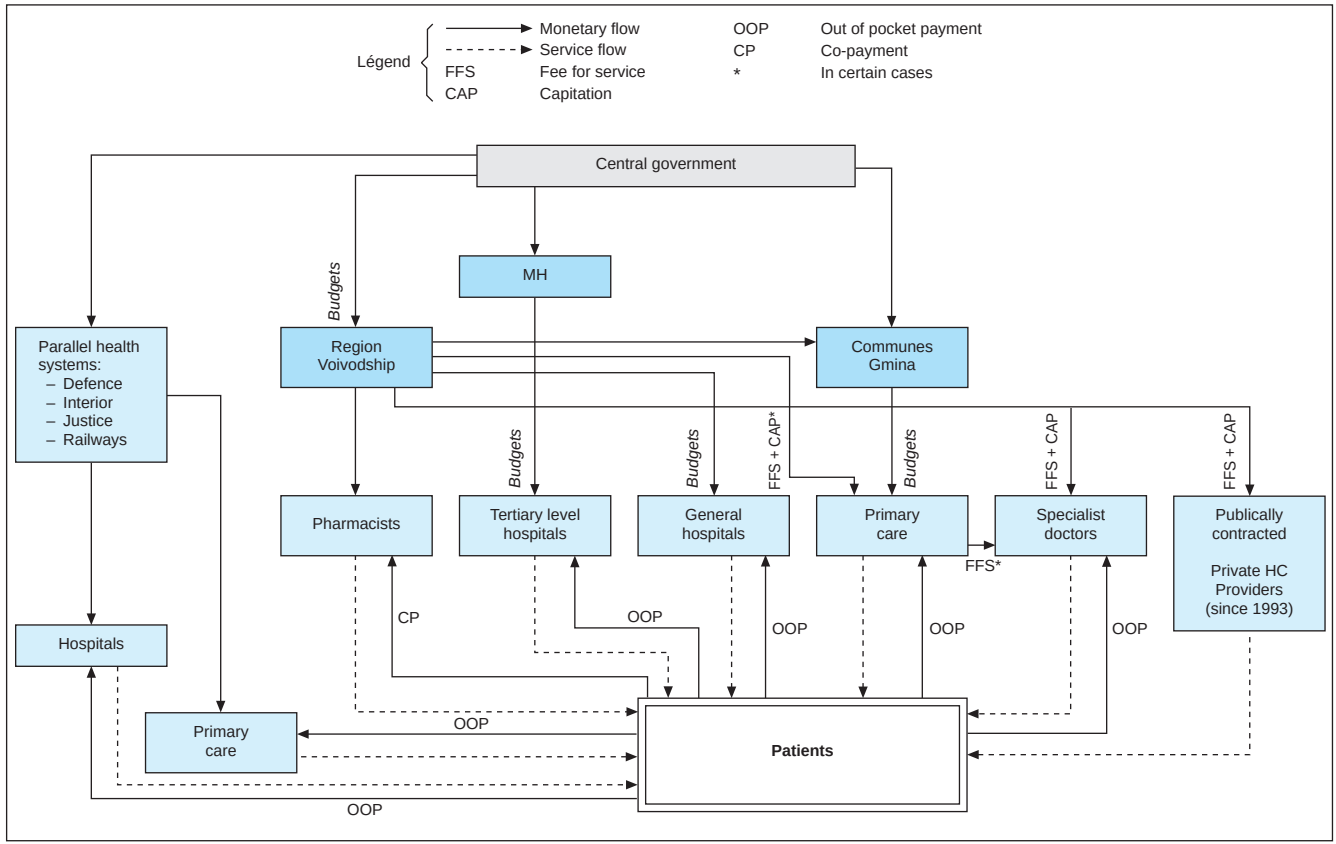
At the local level, autonomous health administration units (ZOZ) were established in the mid-1970s to provide basic health care. A single ZOZ serves a population of 30 000- 150 000 people. Primary and secondary care are vertically connected through ZOZs. Each ZOZ was expected to have at least one hospital, several ambulatory care facilities; however, in practice there are several facilities which only provide outpatient services. Long-term care is provided in both general hospitals and sanatoria. Local hospitals provide extensive outpatient care through specialist outpatient clinics, diagnostic and physiotherapy departments, and emergency services.

Certain government ministries (Defence, Interior, Justice, and Transport) operated parallel health care services for some of their employees and their dependants. These systems provide both ambulatory and hospital care. Expenditure on drugs and salaries are financed through the MH budget, and non-medical salaries, maintenance, and capital outlays are financed through the respective ministries. While these parallel systems offered an additional source of capacity with about 10 per cent of total hospital beds, lack of accountability towards the MH and poor national co-ordination resulted in duplication of facilities and excess capacity.

There is limited private health care provision in Poland, which has developed rapidly over the last years. Private medical practice which existed legally under communism increased sharply in 1988 with the enactment of the Law on Economic Activity and a number of private companies, mostly located in big cities, have opened facilities for ambulatory and hospital care. The majority of them operate on a "fee-for-service" basis. In the mid-1990s, there were several thousand private clinics and some private hospitals.

the nature of this sector and improving the efficiency and quality of care. They include: the abolishment of state monopoly in the health care sector, the decentralisation of ownership and financial and management responsibility to municipalities and regions, the development of a family doctors model, and the creation

Figure 22. **Organisation of the health care system: pre-reform**



Source: National Economic Research Associates, The Health Care System in Poland.

Box 7. A chronology of reform measures in health care

1988 The Act on Economic Activity enabled private practice

1990 Proposal for a National Health Programme aiming at preserving the features of the system that were being eroded, they included, guaranteeing equal rights for all citizens, access to immediate health care in case of emergency, the continuity of medical services, and the promotion of individual responsibility for health.

1990 Central government devolved ownership, financial, and management authority to local (mainly for primary care) and regional governments.

1991 Act on Health Care Institution abolishing state monopoly in the health care sector: health care institutions could be set up and financed by a wide range of entities.

Act on Payment for Drugs and Medical Materials and privatisation of pharmaceutical market.

1993 Amended National Health Programme.

Urban Pilot Programme: payment, contracting, and management at the local level.

Contracting and payment system experiments.

1994 The Ministry of Health and Social Welfare introduced the Strategy for Health programme aiming at improving the health status of the population, ensuring universal access to health care services, increasing the effectiveness and quality of services by shifting to a decentralised primary health care system, and ensuring stable sources of funding and control of expenditure.

Development of "family doctors", a new model of general practitioner for primary care delivery.

1995 Law on Large Cities and Public Services Zones delegates authority formerly held by the central administration and their provincial governors to municipalities over primary care providers (out-patient clinics, some hospitals).

1996 Amended Act on Health Care Institutions: first registration of independent unit operating according to the provision of Poland's commercial law allowing private facilities to have contracts with the government.

The National Health Programme voted in Parliament sets objectives for disease prevention and health promotion to be achieved by 2005.

1997 National Health Insurance Act provides new mechanisms for resource mobilisation, resource redistribution through and across the regional insurance funds and a new provider payment system. The new constitution granted equal access to health protection for every citizen.

1998 Amended National Health Insurance Act.

Initial steps to develop new patient-level information systems, new standardised cost accounting system for hospitals and clinics.

1999 National Health Insurance Act came into force 1st January.

of new payment and contracting methods. During that period, ownership of some 2 000 public health care establishments was transferred from central to local authorities. Regional governments own most big hospitals, and local authorities

polyclinics, specialist clinics, and a few hospitals. Conditions were set for private sector service provision, and by mid-1996 700 contracts for the supply of health services had been signed with medical practitioners in private practices (NERA, 1998). Pharmaceutical companies and pharmacies have been privatised.[31] These policy responses have prepared ground for creating an institutional structure which forms the basis for an efficient health care system. Nevertheless, there remained scope for further increasing the efficiency of health care provision, improving the system to deal with inevitable increases in cost pressures and reducing inequities in terms of access to quality care.

The 1999 reform

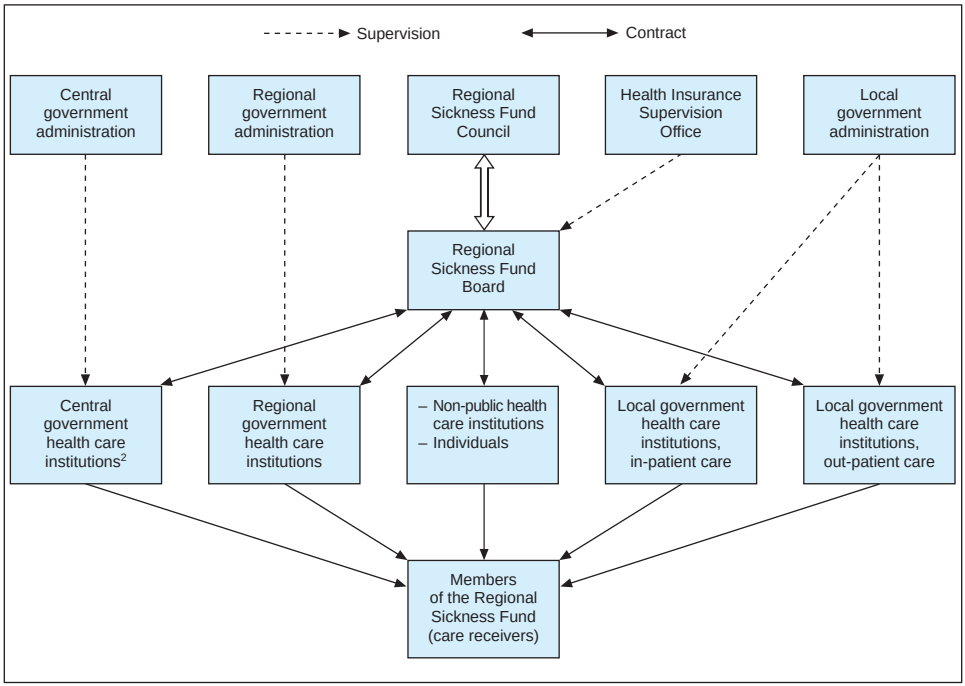
The new health insurance system which started on 1 January 1999 aims at providing a stable and transparent means to raise funds, through compulsory income-based health insurance premiums from the eligible population or from the state for those unable to make such contributions.[32] The insurance premium is set at 7.5 per cent of taxable income, deductible from personal income tax. Prior to 1999, health care services were funded by social security contributions, which covered all forms of social insurance without a clear demarcation.

Key responsibilities of the health system continue to rest with the Ministry of Health (MH),[33] such as essential decisions concerning the directions and priorities in health policy, regulatory decisions regarding prevention and treatment measures against the main health hazards, monitoring, assessment and analysis of the health of the population under projects such as the National Health Programme, and provision of certain specialised care.

The organisational structure consists of 16 regional health funds (covering at least one million insured each) corresponding to the new administrative division into 16 voivodships plus an additional branch fund[34] which operates nationwide. The branch fund was created to cover employees of the Defence, Interior, Justice and Railways sectors. These are non-profit organisations financed directly by insurance premiums collected by the social insurance office (ZUS) and the farmers' social insurance office (KRUS), a share of an equalisation fund, and any subsidies from the MH for specific programmes (see Figures 23 and 24). As of January 1999, residents of each region are automatically members of one sickness fund. There is no opt-out mechanism, but from January 2000 patients will be free to change funds including the branch fund. On their part, health funds will be allowed to register members living outside the fund's region, so that they are expected to compete with each other for members.

Competition between service providers is encouraged with each fund negotiating contracts with public and private hospitals, clinics, laboratories, doctors or other medical professionals following a bidding procedure. Such contract approach involves some form of prospective agreement with health care

Figure 23. **Regional health funds: institutional arrangements after the 1999 reform**[1]



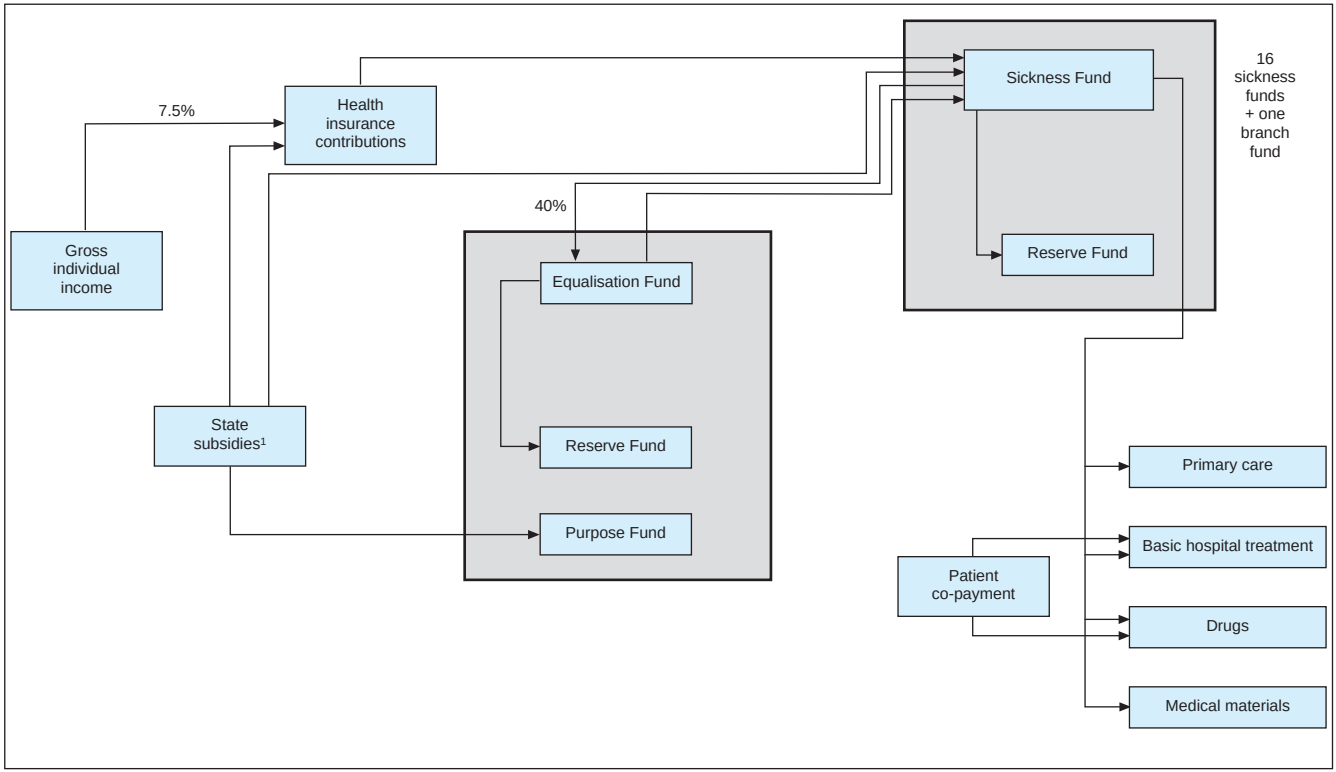
1. In addition, there is a fund which operates nation-wide.
2. Including teaching hospitals, hospitals run by Ministry of Defence and Interior.

Source: Jacek Ruszkowski, Medical Centre of Postgraduate Education, Warsaw.

providers, establishing the terms and conditions of payments for health services. However, specific payment methods are left to the discretion of the individual health funds. With such a variety of supply arrangements, there will be a need for significant effort to monitor and evaluate the effects of different payment regimes.

A supervisory Board which consists of representatives of the insured and of local and regional governments governs each regional health fund.[35] But the overall supervision of the financial management of health funds is the responsibility of the Health Insurance Supervisory Office. Its tasks include adopting the statutes and the resolutions cleared by the Boards of the funds, controlling contracts compliance between funds and providers, approving financial reports submitted by the funds, acting as an auditor, controlling premium collection and

Figure 24. **Financial flows after the 1999 reform**



1. The non-paying sector includes unemployed not receiving benefits, farmers not paying personal income tax, some students, persons receiving welfare annuity or allowance, serving soldiers, army, veterans, some pregnant women, children, pupils and students staying at a welfare home and clergymen who have no source of income. Also includes subsidies for specific programmes/projects.

Source: National Economic Research Associates, The Health Care System in Poland.

transfer of contributions from ZUS and KRUS, and developing and implementing a risk-adjustment procedure among funds. Funds are allowed to borrow under the control of the Supervisory Office and the regional authorities.

A package of benefits, including basic general and specialist treatment in clinics and hospitals, along with pharmaceuticals and medical materials, is covered by the insurance premium.[36] Co-payment regulations have started to be implemented, or are in preparation, for dental services, diagnostic examination, pharmaceuticals, orthopaedic devices and aids, and medical technical devices. For example, in the case of dental services, the co-payment may not exceed 50 per cent of the total cost, and there is free services for persons under 18 years of age, pregnant women and military invalids. Co-payments are important mechanisms for limiting inappropriate over-utilisation of scarce and expensive resources. If designed and implemented correctly, they can have a large impact on cost-containment, while at the same time avoiding adverse effects on equity.

A system oriented towards primary care services is being established, which strengthens the function of family doctors as gatekeepers. Outpatient services in specialist health care centres and hospital treatment are provided on the basis of a referral from a family doctor, with the exception of services provided by clinics such as gynaecology, mental health, drug addict rehabilitation and HIV carriers' care. Each family doctor should not have more than 2 500 patients. Patients are entitled to a choice of any service providers, private or public, registered as approved providers to a sickness fund.[37] However, patients going to private doctors or hospitals which have no contracts with the fund will be charged the cost of the health services provided. A new specialisation as a family doctor has been created, and training is made available both to currently practising physicians as well as to medical students.

Measures have been taken to limit the number of specialist on post-graduate training with a target of 50 per cent of specialist and 50 per cent of primary care doctors.[38] Substantial programmes of financial assistance (by PHARE, the World Bank and local governments) to enable family doctors to rent and furnish office space have been put in place. At the same time, the government has introduced family doctor experiments in several regions (see Box 8). While this project has helped to raise the profile of family doctors and encouraged patients to use them as gatekeepers to the health care system, attempts at rebalancing the proportion of specialist and generalist have so far been modest and piecemeal, and results in terms of the cost reduction ambiguous.

An equalisation fund has been created to address inequalities in income and health risks across individual health funds with the objective of making all potential members equally attractive in financial terms. In such a system, health funds would have less incentive to recruit members selectively, and all citizens would face similar opportunities of access to care. The Polish equalisation fund

Box 8. Primary care: Family doctor experiments in Krakow

Experiments to provide primary care through family doctors have been conducted in Krakow City.[1] The introduction of family practices in Krakow in 1996 was designed as a pilot exercise to promote family medicine by demonstrating that the quality of services can be enhanced by improved structures and processes. Family practices offer personalised and comprehensive primary and specialist consultation services, diagnostic and laboratory tests, nursing and rehabilitation services, and minor surgery in relatively well equipped clinics with friendly reception and registration services, and competent staff.[2] Contracts are signed between primary care doctors, specialist doctors and hospital departments and either the regional or local authorities. They involve a capitation-based remuneration scheme for doctors with an allowance made for the age structure of the population.[3] As in the United Kingdom, family doctors are fundholders on behalf on the municipality for most of outpatient services.

The number of referrals to specialists was expected to fall significantly. It did fall but slightly. Problems were encountered with the preparation and signing of contracts reflecting the limited knowledge of the process by doctors and administrators of contracts, due to the lack of model contracts, appropriate standards, general rules of execution, and limited financial support. Differences have also arisen in the interpretation of contracts by the contracting parties.

A recent study by Chawla *et al.* on the enrolment procedures of family practices in Krakow found evidence of "adverse selection" by physicians depending on the procedures followed. Two enrolment procedures were used to join a family practice. Initially, individuals were automatically enrolled, unless they notify their refusal. Then, the procedure was revised and individuals had to make a request to be enrolled. Comparison of the two procedures indicated that individuals making a request for enrolment used on average considerably more quantities of health care than those enrolled under the first procedure and that individuals more likely to fall ill signalled themselves by opting for the second enrolment procedure. As a result, physicians had an incentive to avoid enrolling such patients in their practices in order to limit costs they risk incurring in the context of a capitation-based remuneration system. This enrolment procedure may undermine efforts for promoting an effective and equitable primary care system.

These results highlight the importance of developing a capitation payment system carefully. In shifting to a capitation payment system, governments need to look closely at a variety of issues ranging from legal basis of capitation contracts to the determination of the payments, the risk-adjustment, the basket of services and the enrolment of prospective patients. The family doctor experiments offer some prospect for a more efficient primary care sector, but a more concerted effort and additional funding will be required before family doctors can act as effective gatekeepers to the higher levels of health care.

1. There have been experiments with family doctors in a few other regions of Poland including Suwalki, Pila and Zywiec.
2. A report published in 1998 by the Harvard School of Public Health presented the results of a survey on the quality of outpatient services in Krakow. The overall patient evaluation of the services was good, and patients tended to be satisfied with their own doctor.

(continued on next page)

(continued)

However, the waiting time for doctors on day of appointment was long, reaching 53 minutes on average.

3. Per capita rates are weighted by age-adjusters of 1.3 for every individual less than 7 years of age, 1.0 for every individual 7 to 59 years of age, and 1.8 for every individual 60 years of age or more.

amounts to 40 per cent of the income derived from health insurance premiums. The risk adjustment formula currently applied only allows for some basic correction for age and income of the population.[39]

Problems that need to be addressed by the reform

Improving efficiency

A key problem that the reform needs to tackle is inefficiency of the health care system. Increasing efficiency which is low by OECD standards would release resources to reduce waiting times, lower cost pressures and improve consumer satisfaction. Several factors affect the efficiency of the health care system. These include deficiencies in the running of hospitals, insufficient use of primary and preventive care, and remuneration structure which does not reflect performance.

Deficiencies in hospitals

The performance of the Polish health care delivery service is affected by inefficiency relating to poor control and management of labour and physical resources in hospitals. Hospital administrators are usually doctors with little or no training in health care management even though an increasing number of them (including non-doctors) are getting managerial training in academic centres and abroad.[40] As well, in the absence of long-term care hospitals, nursing homes or hospices both acute-care and long-term care patients are treated at the same hospitals, leading to considerable misallocation of resources and higher costs.[41] However, short and long-term care beds have been separated since the mid-1990s, which resulted in a decrease in the number of short-term care beds as well as the average number of beds per 10 thousand inhabitants (from 57.2 in 1990 to 54.1 in 1997). And, as in other OECD countries, the average length of hospital stay decreased from 12.5 days in 1990 to 10.1 in 1998, while the average occupancy rate of beds remained virtually unchanged over the last decade. Most of the 700 hospitals in Poland have inadequate capital infrastructure and minimal maintenance of existing building and equipment, which has resulted

from a long period of under-investment and was in part due to the failure to make adequate allowance for depreciation.[42] The limited control of stocks of material and the lack of investment in medical equipment over the years have contributed to a lower stock of hi-technology medical equipment than in most OECD countries, including Hungary and the Czech Republic. However, modern diagnostic and therapeutic tools are more easily available in some newly built hospitals, academic centres, regional hospitals and private clinics offering inpatient facilities.

The information necessary for effective decision-making in the hospital sector has been weak. The poor statistical support adds to the problems. Little is known about the relative costs of different medical treatments, their effectiveness or the costs of caring for individual patients.

Prior to 1999, hospital funding was mostly based on historical costs and capacity criteria (such as the number of beds) rather than on local population needs and has penalised efficient hospitals and put little pressure on inefficient ones to improve. Medical personnel are paid salaries, and the remainder of hospital spending is bulk funded. There are no penalties for overspending,[43] and hospitals have large debts mainly to suppliers as there are no spending caps imposed by the MH. Regional and local hospitals have been formally transformed into autonomous health administration units responsible for their own budget and more accountable for their expenditure.

Limited role for primary and preventive care

Primary care is important in increasing effectiveness of the health care system and controlling costs. Normally, the first contact with the health care system is with the primary doctor or nurse and they can resolve a wide range of health difficulties (OECD, 1995). Primary health care is not, however, well established in Poland, even though polyclinics provided primary care services. Polyclinics were staffed by paediatricians, internists, and several other basic specialists, with frequent use of referrals to other specialists after an initial consultation. But physician practice before the 1990s included no formal general practitioner (GP) in primary care. Despite the introduction of formal regulations on speciality in general medicine since 1993 and of educational programs, GPs are still in short supply. Although the number of physicians per population is comparable to the OECD average, incentives in place have created an over-supply of hospital-based doctors and other specialists accounting for 80 per cent of the total number of physicians,[44] and a severe shortage of primary physicians, particularly in rural areas[45] (see Table 14).

The very high figure of potential years of life lost in Poland (Figure 25) suggests that preventive care is narrowly focused and not as effective as it should be. Health status is largely determined by the interaction of many factors

Table 14. **Indicators of resource use in the health sector**

1996[1]

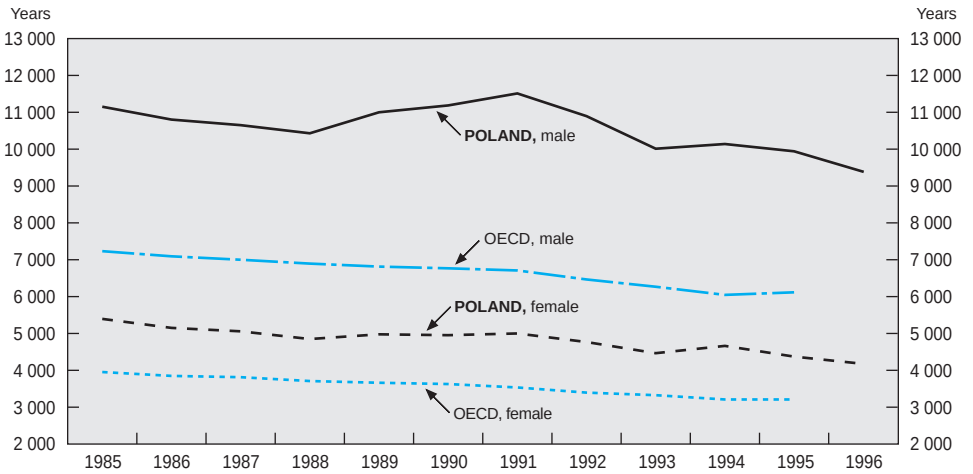
	Physicians per 1 000 inhabitants	Proportion of specialists	Beds for 1 000 inhabitants	Average bed occupancy (per cent)	Average length of hospital stay (days)
Poland	**2.4**	**78.9**[2]	**5.5**	**71.0**	**10.6**
United States	2.6	50.0	4.1	66.0	7.8
Japan	1.8	..	16.2	83.6	43.7
Germany	3.4	62.6	9.6	80.9	14.3
France	2.9	50.2	8.7	81.1	11.2
Italy	5.5	..	6.0	72.0	9.8
United Kingdom	1.6	..	4.5	80.6	9.8
Canada	2.1	42.4	5.1	84.2	12.0
Australia	2.5	36.4	8.7	82.9	15.5
Austria	2.8	54.4	9.2	78.8	10.5
Belgium	3.4	46.9	7.2	83.6	11.3
Czech Republic	2.9	74.4	9.5	77.6	12.8
Denmark	2.9	..	4.9	81.3	7.3
Finland	2.9	56.3	9.2	87.7	11.6
Greece	3.9	55.7	5.0	69.4	8.2
Hungary	4.2	64.4	9.3	76.5	10.8
Iceland	3.0	..	14.8	84.0	16.8
Ireland	2.1	..	3.7	83.2	7.2
Korea	1.2	63.2	4.6	69.6	13.0
Luxembourg	2.2	64.4	10.7	75.0	15.3
Mexico	1.5	45.8	1.1	68.6	4.1
Netherlands	2.6	35.8	11.2	88.7	32.5
New Zealand	2.1	30.4	6.8	57.3	6.5
Norway	2.8	62.9	15.0	82.2	9.9
Portugal	3.0	68.6	4.1	73.9	9.8
Spain	4.2	..	4.0	76.7	11.0
Sweden	3.1	71.1	5.6	81.9	7.5
Switzerland	3.2	35.7	20.6	82.6	25.2
Turkey	1.1	42.1	2.5	57.4	6.3
EU[3]	3.1	56.6	6.9	79.7	11.8
OECD[3]	2.8	54.2	7.8	77.4	12.9

1. Or nearest year available.
2. In 1995.
3. Unweighted average.

Source: OECD (1998), *Health Data.*

including genetic susceptibility, behaviour and lifestyle, socio-economic status and environmental conditions (OECD, 1995). Allowing for such factors broadens the scope of government policy to influence health. In particular, a good ability to monitor trends in diseases and sufficient support for the development of

Figure 25. **Potential years of life lost**[1]



1. It is a measure of premature mortality which provides an explicit way of weighting deaths occuring at younger ages, which are, a priori, preventable.

Source: OECD *Health Data 99.*

integrated programmes to deal with them is important. In addition, as in many OECD countries, the elderly dependency ratio is projected to rise steeply when the baby boom generations start to retire, implying increased need to provide health care to deal with different pattern of diseases, which often involves multidisciplinary teams. In belated recognition of these problems, the Polish authorities adopted in 1996 (6 years after the initial proposal was made) a 10 year National Health Programme aiming at greater disease prevention and health promotion including reducing smoking and alcohol consumption, and improving the early diagnostic of those at risk of heart disease.

Remuneration scheme not geared to performance

The remuneration of health workers is relatively low and provides little pecuniary incentives to work. Remuneration for medical professionals is poor not only in comparison with other sectors of the economy but also *vis-à-vis* the rest of the public sector. The average monthly salary in the health sector in 1996 was 84 per cent of the average salary for the public sector. Remuneration of doctors includes basic salary, as determined by the central threshold schedule, and bonuses for seniority and for additional duties such as activities related to health prevention and promotion. Ancillary staffs are remunerated on a similar basis.

Salaries are often supplemented by payments for private sector consultations and by unofficial out-of-pocket payments which constituted an important source of earnings for providers, increasing take home pay of all medical personnel by about 15 per cent on average, with a much higher impact on physicians' earnings, according to one estimate (see Chawla *et al.* 1998). According to the government statistical office, about 30 per cent of doctors practice privately. Many medical professionals seek supplementary employment to boost incomes.

The need for cost containment incentives

Health care costs seem low by international comparison, even after allowing for informal payments. But experience of other OECD countries shows that latent cost pressures are strong. The system before the current reform had neither incentive mechanisms for cost control nor good information about costs. A modern standard costing system was only beginning to be introduced in 1998. It is not surprising that the budget was repeatedly overshot, and the health sector incurred a rising indebtedness.[46] Moreover, cost-effectiveness concerns are not emphasised enough in the pharmaceutical system.

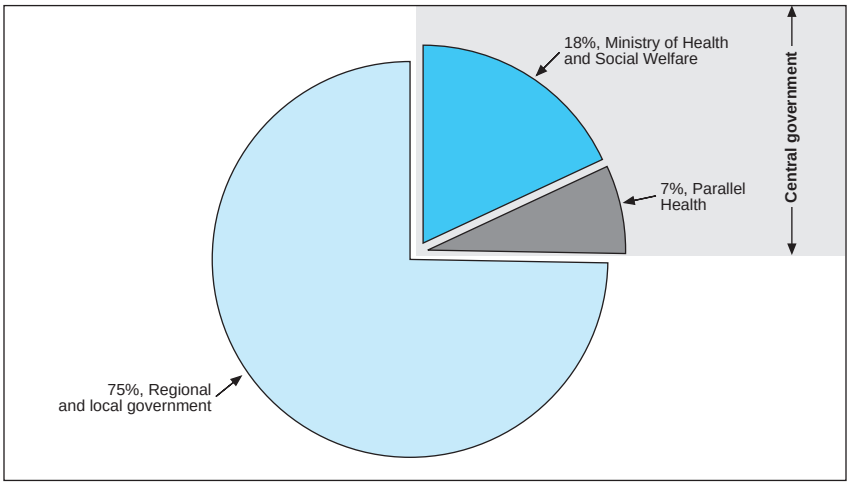
Spending level in international comparison

Total health spending in Poland at 5.2 per cent of GDP in 1997 is among the lowest in OECD countries. The share of public health spending in GDP has been relatively stable since the early 1990s at around 4.5 per cent. The central government budget accounted for about 25 per cent of total public outlays on health care. Since 1992, most of the health care programmes have been financed through the regional budgets, which fund the regional health authorities and a number of independent communes. The regions received their budgets directly from the Ministry of Finance accounting for 75 per cent of total spending in 1997 (see Figure 26).

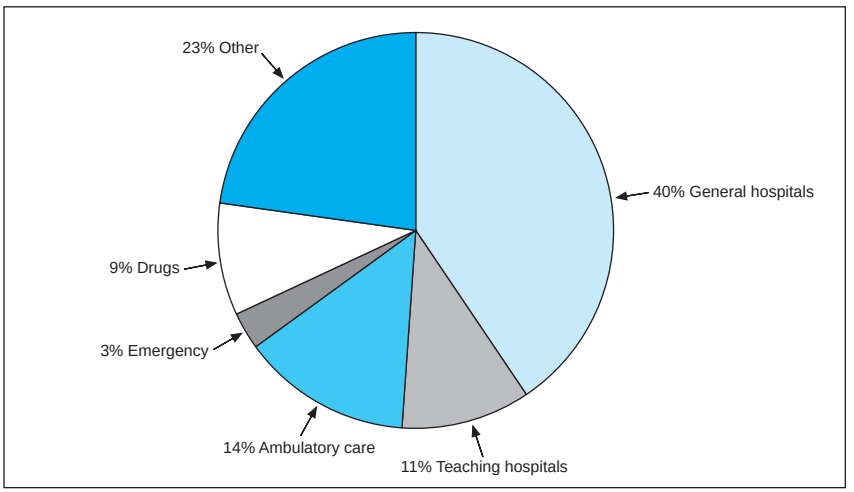
In real terms expenditure on health care rose steadily since 1990. Figure 27 presents per capita levels of national health spending and GDP in OECD countries in 1997, and a regression line relating the two variables. At around $390 per capita (PPP exchange rate), health expenditure in Poland was well below the OECD average and comparable to that in Mexico and Turkey, though it was in line with what might be expected given its level of per capita income.[47] International experience shows that no country is immune to pressures towards higher health care spending. As income levels rise, demand for better health care increases, which is reinforced by advancement in medical technology. Moreover, the ageing of population exerts upward pressure on health care costs.

Figure 26. **Allocation of public health care budget**
1997

A. By level of government

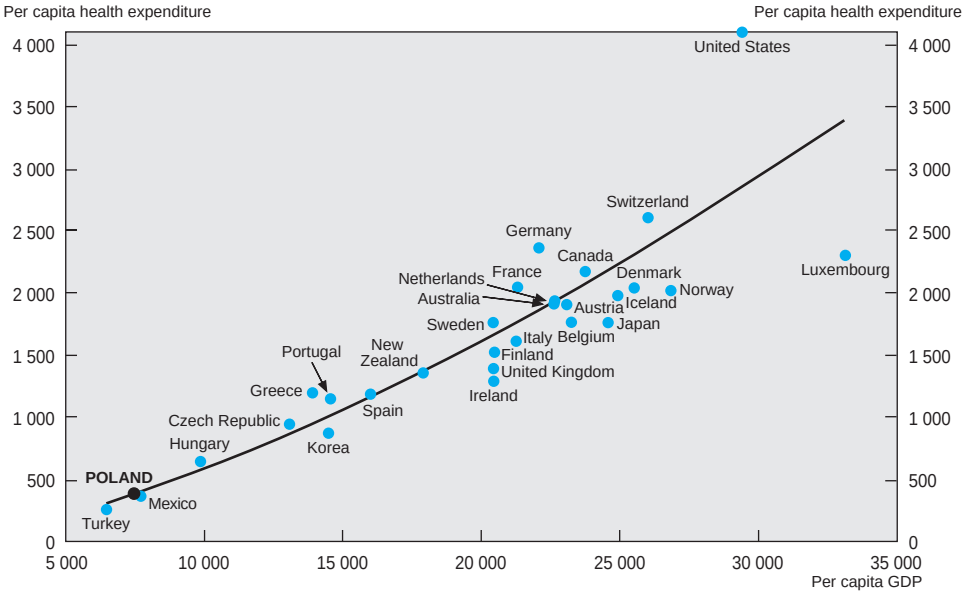


B. By programme



1. Parallel health care systems for some employees and dependants of certain government ministries.
Source: National Centre for Health System Management, *Health care in numbers*, 1998.

Figure 27. **Health expenditures and GDP per capita**
US dollars, converted using PPP's, 1997[1]



1. The equation of the regression line is the following:
LN (health expenditure per capita) = –6.80 + 1.43*LN (GDP per capita)
R squared = 0.93 T: (–9.17) (18.95)

Source: OECD, *National Accounts* and *OECD Health Data 99.*

Pharmaceutical spending

Polish public expenditure on pharmaceutical goods per capita (at PPP exchange rate) is fairly low compared to other OECD countries. As in other less developed countries, however, pharmaceuticals represent a higher relative burden, reflecting their higher prices relative to the costs of other medical inputs, notably wages.

The supply of pharmaceuticals to the health sector has been distorted by unequal treatment of drugs from domestic and foreign enterprises, and this may be reflected in a relatively low share of domestically manufactured medicines, which amounted to 37 per cent of total sales in 1997. The Ministry of Finance sets prices of domestically produced drugs, and determines wholesaler and pharmacist margins. Domestic medicines are estimated to be 3-6 times less expensive than foreign equivalent. Low profit margins contribute to reducing domestic man-

ufacturers' incentives to launch innovative products. The announcement by the Health Minister that the state would withdraw from controlling domestically produced drugs was expected to give an incentive to foreign producers to start manufacturing in Poland. A large anticipatory buying of drugs at the end of 1998 was caused by patients' uncertainty about the new organisation of health care at the beginning of 1999.

Regulatory and prescribing practices are not conducive to efficient utilisation of drugs. The registration process is slow and little use is made of cost-effectiveness information[48] (NERA, 1998). The reimbursement process is not fully transparent either. There are no written procedures for applying for inclusion on the MH reimbursement lists. Depending upon the drug, medication is reimbursed at a zero, 50, 70 or 100 per cent rate.[49] Moreover, doctors are fairly free to prescribe drugs: there were few guidelines to encourage greater standardisation in prescribing practices until the recent introduction of those on the use of antibiotics and generics.

Achieving equity objectives

The uneven availability of health care services across Poland suggests that the past financing arrangements and regional supply capacity have not been enough to ensure access for low-income earners or the elderly. In addition, the widespread practice of informal out-of-pocket payments tends to work against low-income earners. Both of these problems are not, however, unknown in Eastern European countries.

The regional structure of expenditure in Poland broadly reflected the institutional arrangements in place with a health service largely financed and supplied by the public sector. In theory, each region should receive a similar amount of funds per capita; however, important inequities in resource distribution exist. The budget allocation for medical services is largely funded retrospectively with less than 10 per cent of the funds going to capital investment. The share of expenditure on primary and secondary care in each region's budget varies. However, since 1995, improvement has been made with one quarter of the budget for drugs and ambulatory care being allocated on the basis of an index which takes into account the number of the population as well as other characteristics such as age, gender, morbidity and mortality.

The distribution of equipment, beds and medical personnel across regions is relatively uneven, and the concentration of resources in large cities is important, in particular in Warsaw, which has several research institutes and specialist hospitals. Indicators of bed used in the hospital sector show that while Poland is roughly in line with the average of EU and OECD countries (see

Table 14), there are considerable imbalances in the supply of hospital facilities throughout the country. Most hospitals are located near urban centres. The largest concentration of hospitals is found in Katowice (97), Warsaw (48), and Wroclaw (30) regions while Chelm, Konin, and Przemysl regions have only 3 to 4 hospitals. The supply of hospital beds varies significantly across regions ranging from 78 beds per 10 000 inhabitant in Wroclaw to 37 in Radom. The number of physicians per 10 000 inhabitants is about twice as high as the national average in Warsaw region. It frequently happens that a large number of medical specialists in the same field are employed within the same area. The supply of dentists and pharmacists is also uneven across regions with a concentration of resources being more pronounced in Warsaw, Wroclaw, and Lodz regions. By contrast, the supply of nurses appears to be more evenly distributed across the country. Patients in rural areas faced limited access to hospital care and to some specialised health services. Waiting lists have developed for some treatments which employ new technologies.

The widespread use of informal payments tends to accentuate inequitable access. While officially medical services were provided free of charge, patients started making informal payments to physicians from around the end of the 1970s in order to obtain faster and more personalised service. By the end of the 1980s, this practice became widespread. More than 25 per cent of patients are reported to feel obliged to make some form of payment when visiting a physician. These findings suggest that Polish health care may already be more privatised than it appears and that pecuniary incentives may be working to limit the supply of services at public hospitals available to low-income earners.

Assessment and recommendations

Health care is one area where the pace of reform has been slow and the approach piece-meal. To some extent the slow pace is understandable and might even be desirable where it inevitably takes time to nurture a new culture and develop certain capacity necessary for the proper functioning of the system, *e.g.* the development of a family doctor practice. The latest reform, which introduced a social insurance system operated through regional funds, split purchaser and provider functions and emphasised the role of family physicians, should provide a strong impetus to the reform process, despite some initial financial problems. It is regrettable that the lack of clear picture as to certain key details of the new health system as well as of apparent benefits of the reform has contributed to confusion and/or indifference among the public about the reform. The authorities are preparing a comprehensive health act which would provide a legal base for defining the missing key details. They should seize this opportunity to provide a clear account of what the reform is all about.

The introduction of multiple regional funds is consistent with the overall policy of decentralisation. Decentralised institutions have a number of advantages over centralised ones; they can be more flexible in responding rapidly to changing needs, more effective at identifying problems and opportunities, more innovative in the type of solution they adopt and generate stronger commitment and greater productivity in the workplace (Saltman and Figueras, 1997). However, decentralised arrangements are not without some weaknesses. These include the risks of high administrative costs[50] and regulatory difficulties with multiple funds, the inequities and financial difficulties arising from an inadequate equalisation mechanism, for which technical solutions may be insufficient, and the risk of weak governance of new funds. Few of these concerns have so far been answered as the process is still in its infancy.

A decentralised approach requires an overhead function in certain domains. In this, the MH has at least two roles to play; public health promotion and the definition of a basic healthcare package. Public health services should include an improved approach to environmental health, communicable diseases, and an intersectoral and multidisciplinary approach to health promotion with greater involvement in planning and evaluating services. Reforming the public health function will necessitate professional skills and investment in training. Another area of intervention for the MH concerns its contribution to developing regulatory measures. In order to enhance public confidence in health funds, regulations concerning the benefit package need to be clear. Requirements in terms of coverage could differ significantly from one sickness fund to the other. It is important that all funds provide at the minimum, the nationally defined Guaranteed Health Care Package (GHCP) with clearly defined conditions and treatments to assure comparability of benefits across health funds.

The central co-ordination role of the Health Insurance Supervisory Office is also crucially important for the well-functioning of the decentralised system and needs to be strengthened. One area of priority is the further development of risk adjustment mechanisms operating across regions. The risk adjustment formula currently applied in Poland is far from adequate. A crude indicator of the morbidity rate is used. It is measured solely by the age of the population with no allowance made for the gender. Adoption of an oversimplified formula, such as the one which is currently in use, could lead to a worsening of situation in certain regions. In order to increase further the effectiveness of the risk adjustment mechanism, account may also have to be taken of a number of additional variables. The cost of providing services to a member also depends on the number of dependants. It may also vary with the location of the members (rural or urban), their health status, and the number of facilities that have to be maintained as well as that of personnel. However, using all these variables may result in a very complex indicator which may be difficult to implement. A balance must be found

between the ease of implementation and the adequacy of risk adjustment since risks are far from being neutralised by any adjustment mechanism.

The reform correctly underlines the importance of strengthening primary care services with the help of strong enforcement of the gatekeeping role of family doctors. The high proportion of specialist doctors has resulted in distortions in the delivery system. Current family doctors experiments in several regions have proved to be largely successful in raising the profile of family doctors and in encouraging patients to use them as gatekeepers to the health care system. However, reform efforts so far have been isolated regional projects with limited overall effect. In order to attain the official target of 50 per cent of specialist and 50 per cent of primary care doctors, the family doctor network has to be extended with sufficient training capacities available for physicians to cover both those who are already practising and those newly qualified from Medical Academies. Transitory problems of insufficient supply of family doctors could be eased through the adoption, for example, of a scheme for primary care which provides patients with medical advice by telephone consultation with nurses, as in the United Kingdom. This scheme is intended to offer additional flexibility to a GP consultation by extending the primary care network and utilising limited resources in a more efficient manner. Given the shortage of family doctors in Poland, a phone advice service offered by highly trained nurses may reduce some of the burden on family doctors services.

An important input to hospital sector improvements is an adequate database and accounting system permitting all relevant participants to get accurate information on the situation. Poland has taken steps to develop and introduce some of the new information systems including a new standardised cost accounting system for hospitals and clinics, which calculates costs based on market prices and charges for depreciating capital items. A new patient-based record system is being tested allowing analysis of resource use and outcomes for individual episodes, and tracing the patient through different levels of the health care system. These efforts would facilitate the development of a Diagnostic Related Group (DRG) type payment system which has proved to be a potentially effective means of improving hospital efficiency in some countries. The computerisation of the health care system, however, is lagging the institutional and financial reforms, and more effort should be made to ensure that the information equipment is compatible across health funds.[51] Another major need for hospital efficiency in decision-making is the access to qualified managers, particularly with the ongoing decentralisation process of financial autonomy and their new role in contracting with health funds and services providers. Hospital management should be encouraged as a specific career, and posts of supervision should be made on the basis of a tender with remuneration linked to performance.

In January 1999, the MH introduced various cost-containment measures which included central purchasing (using tender) for medical equipment and certain drugs. Such purchasing decisions by hospital managers should be envisaged to take advantage of economies of scale. Another way to reduce costs in hospitals envisaged by the authorities is to establish day care facilities for certain treatments requiring minor intervention, diagnostic tests, and other procedures, which could result in a significant number of patients and resources shifting from in-patient care to day care. More targeted medical techniques could permit additional patients to be treated and a better quality of health care to be offered. In this vein, the conversion of some existing facilities into long-term care services would reduce the cost of such care and result in better reallocation of acute care resources currently used for providing these services. Private pay-beds as another source of revenue for public hospitals could be considered. The additional revenue could be invested in upgrading facilities and enhancing the standard of care in public institutions. Concomitantly, the private health care market would benefit from such an initiative.

The informal payment system represents an important source of inequity within the Polish health care system. A solution might be found in an increased funding for the public sector service providers to the extent that this problem emanates from insufficient supply capacity as well as inadequate remuneration for certain medical skills in the public system. The problem may also be alleviated by the development of private practices which could absorb some of the excess demand for those medical services for which unofficial payments have been a common practice. A well-established private sector with proper monitoring of referrals and prescribing practices could also contribute positively to the health care system by acting as a quality benchmark for public services and by providing an alternative supply of medical services. Contracts between public and private institutions could also enhance the effectiveness of the system by minimising duplication of resources and providing an important source of revenue.

A key thought behind splitting payers and providers has been to improve the delivery of services through competition among providers for contracts with payers. Experience in other countries amply demonstrates that payment arrangements matter a great deal in determining supply outcomes. In Poland specific payment arrangements are left for each health fund to decide. It is important that lessons from other countries be drawn on in making such a decision. As the reform in Czech Republic shows, fee-for-service payment tends to increase both quality, quantity and cost of services provided and makes the control of overall spending very difficult. The UK experience with fund-holding general practitioners, in contrast to non-fund-holders in Hungary, suggests incentives influence the effectiveness with which primary-care doctors play a gatekeeper role. In the absence of well-established primary care practice and appropriate incentives the

effectiveness would be weakened further by competition among primary-care doctors as quick referrals minimise their costs and are appreciated by patients if the supply of specialist services is relatively abundant, as in Poland. In some regions, however, current financial incentives provided by fund-holding prevent primary care doctors from overuse of specialist services.

The latest reform plan envisaged to allow the health funds (including new ones to be created) to compete for members as from 2001, but this needs to be reconsidered. Health funds are not profit-making insurance companies and are financed through a tax. It is therefore not clear what incentives health funds have to engage in such a competition. Even if they compete, it is not obvious what positive results are achieved. Given imperfect risk adjustment, the most likely outcome would be so-called cream skimming, *i.e.* it is more beneficial for a fund to attract low risk members since the implicit insurance premium does not reflect the risk fully.

If inter-fund competition is meant to introduce a hard budget constraint on the funds, it should be achieved through other means. Indeed, the funds are expected to balance revenue and spending, but it remains uncertain if the Health Insurance Supervisory Office has sufficient authority to ensure this, and the risk of the funds accumulating debt cannot be excluded. In these circumstances, it is important to make managers of funds accountable for financial results and consumer satisfaction through performance-based pay and fixed-term contracts. However, where underlying cost pressures stem from factors which are beyond the remit of control by fund managers, a capping on total ambulatory-care spending at the level of each fund could be considered. Like in Germany, this would involve a partial de-imbursement *ex-post* in case of spending overrun, written into contracts with service providers.

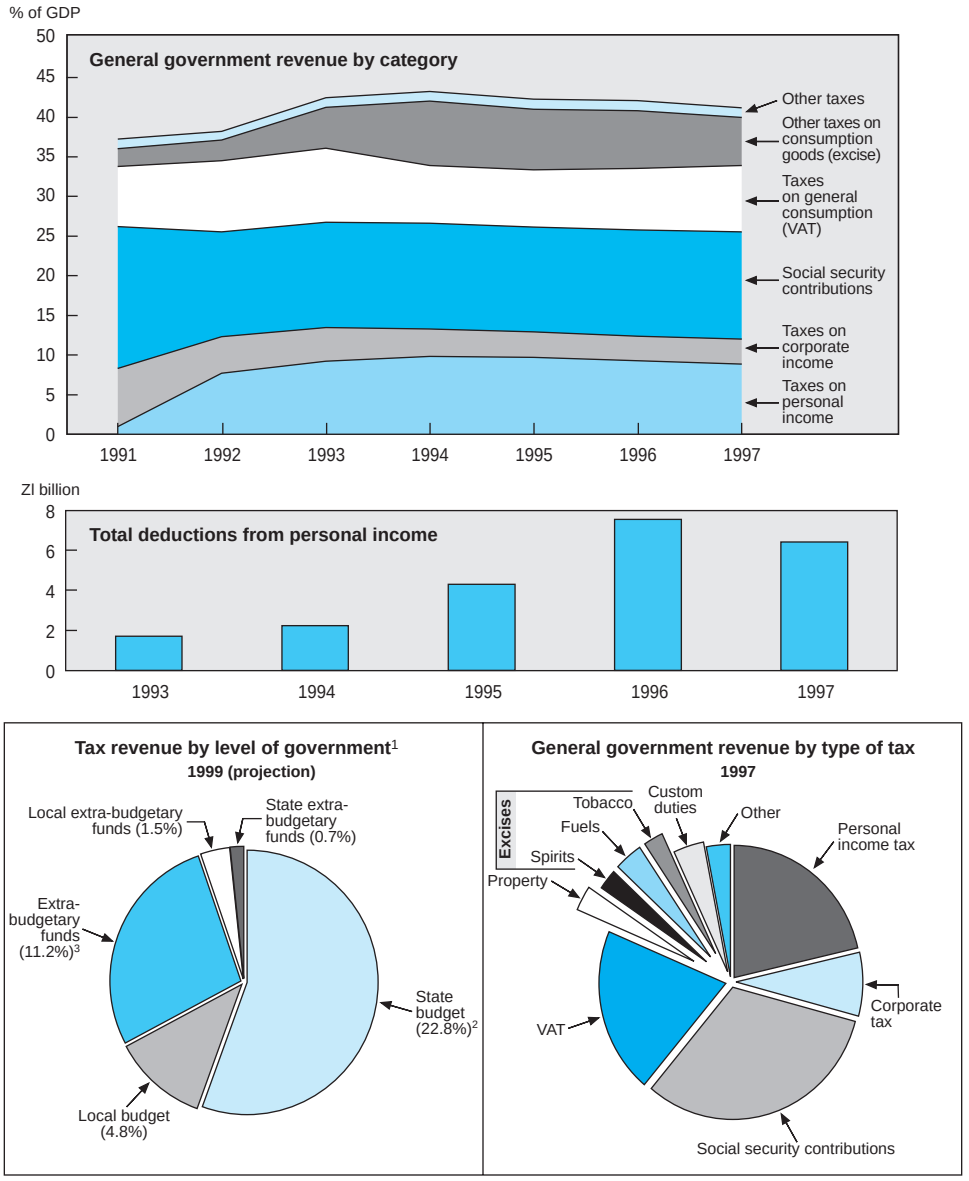
V. Reforming the tax system to boost economic performance

The Polish tax system has performed well in the last ten years. It has produced strong tax revenue on a continuous basis, helping to finance government spending and lower the budget deficit (Figures 28 and 29). With a well functioning tax system, Poland has been able to avoid the kind of fiscal crisis encountered by other transition economies. The tax system has also made an important contribution to the social cohesion of the country by providing the financing to ensure that vulnerable people – especially old-age pensioners – receive an adequate level of income and escape poverty. The tax regime does not appear to have been harmful to the business sector, which has been growing fast in the last ten years, and does not seem to have deterred foreign direct investors, who have entered the economy in large numbers.

Unfortunately, these trends are unlikely to continue in the future. Poland's tax system has a number of features, which could have undesirable effects in the future:

- First, there is evidence that Poland's high labour taxes are harmful to employment.[52] The combined impact of social security contributions and personal income taxes creates a large wedge between labour costs and workers' disposable income. The gross average tax rate reached 42 per cent of the labour cost for the average production worker in 1999 and the marginal tax rate was 45 per cent (Figure 30). Such a high tax wedge raises labour costs, discourages to work in the official economy, and contributes to high non-employment in the working age population.
- A second significant problem of the tax system is its lack of neutrality with respect to investment decisions. The personal income tax encourages construction of new residential buildings, corporate tax incentives favour investments in certain sectors, and tax exemptions encourage location in Special Economic Zones. While there is no evidence that these incentives improve economic efficiency, it is likely that they encourage tax avoidance and lead to decisions purely aimed at taking

Figure 28. **Key features of the tax system**



1. Per cent of GDP. Including privatisation receipts.
2. Excluding transfers.
3. Mainly ZUS, FUS and Labour fund.

Source: Ministry of Finance; OECD, Revenue Statistics of OECD Members.

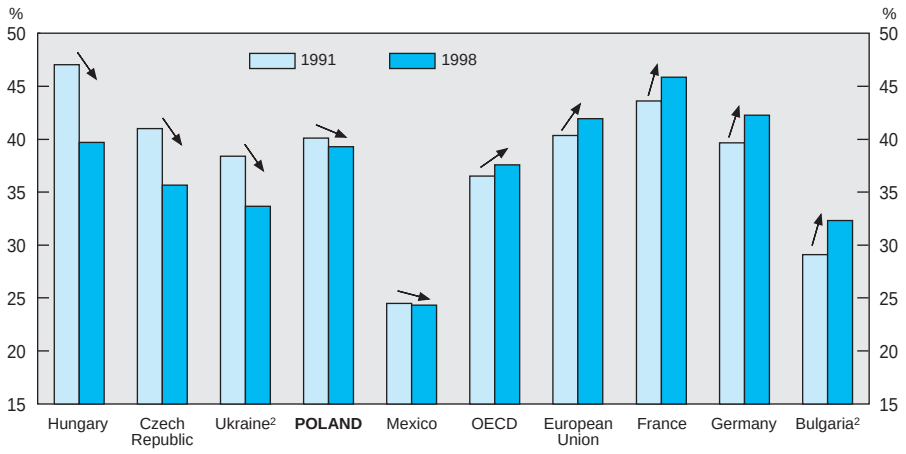
advantage of a tax relief. Some tax incentives can also have international ramifications and be seen as harmful by other countries trying to implement neutral tax regimes.

– A third problem is that the tax system has become increasingly complex. The tax code contains a considerable number of allowances and reliefs, and requires that the majority of taxpayers file a tax return for small amounts of taxes. Concomitantly, enforcing compliance is becoming increasingly challenging for the tax administration.

Because of these problems, Poland's tax system could have a negative incidence on economic growth in the future, lead to an erosion in the tax base, and come under growing criticism both domestically and internationally.

The Polish authorities are aware of these problems and have taken a number of steps to correct them. They have embarked on a comprehensive reform to establish a new tax system that would produce stable revenue without a negative incidence on economic growth. The present chapter begins with an overview of the broad characteristics of the tax system, comparing Poland with other OECD countries. Next, a number of challenges facing the tax system are analysed. The tax reform recently proposed by the government and partially enacted is summarised. Finally, recommendations for future tax reforms are outlined.

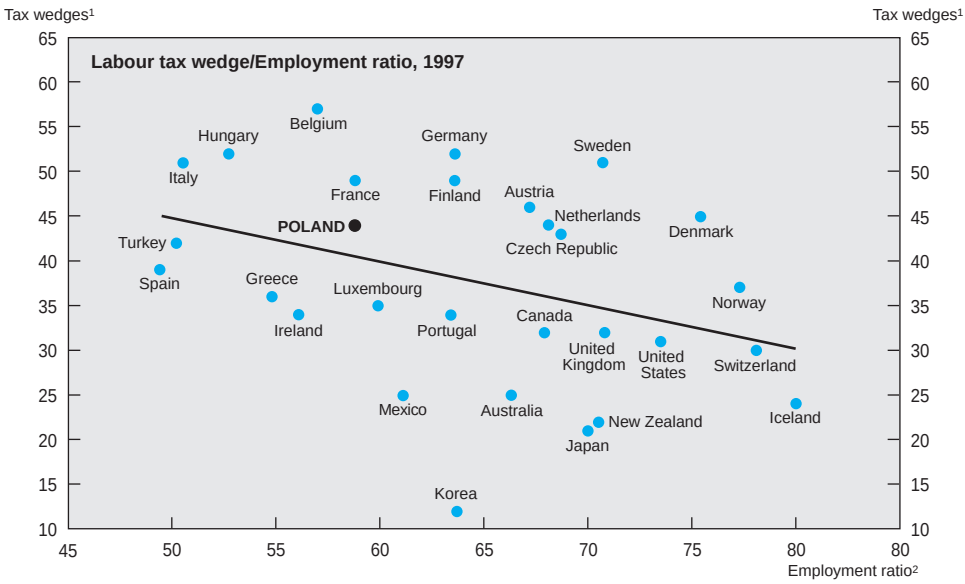
Figure 29. **Evolution of tax revenue 1991-98**[1]
In per cent of GDP

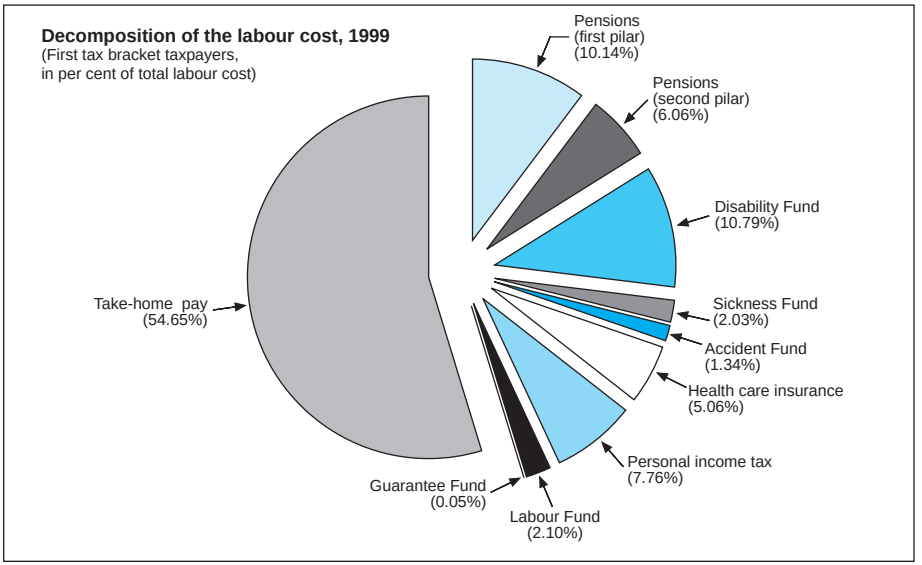


1. Direct and indirect taxes plus social security contributions. Unweighted average for OECD and EU.
2. 1991 data are for 1993 for Ukraine and 1995 for Bulgaria.

Source: IMF; OECD, *National Accounts,* and estimates.

Figure 30. **The labour tax wedge in Poland**





1. Income tax plus employees' and employers' social security contributions for single individual at the income level of the average production worker in per cent of labour costs (gross wage + employers' contributions).
2. Persons aged 15 to 64 in employment or in the labour force divided by the working age population.

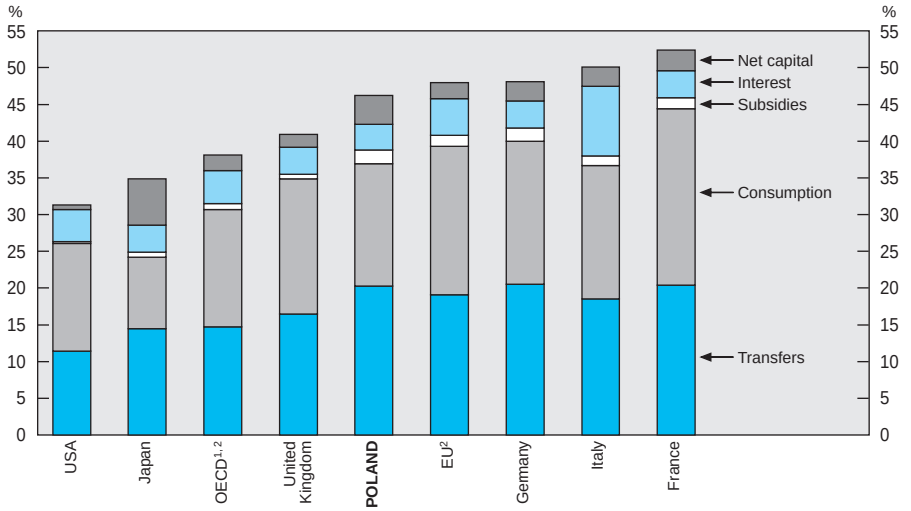
Source: Ministry of Finance and OECD. The Tax/Benefit Position of Employees and *Employment Outlook*.

The economic and social context influencing the design of the tax system

Poland has a high ratio of government revenue to GDP (41 per cent of GDP in 1998), a legacy from the years of central planning when state and extra-budgetary revenues were large in relation to GDP. Although the level of revenue in relation to GDP is similar to the levels in European Union countries, it is higher than in the United States, Japan, and other OECD countries. The ratio of government revenue to GDP has been stable over the last ten years in contrast to most other transition economies, where it has declined.

The level of tax revenue is largely explained by a history of high public spending, including through generous public pension schemes (Figure 31). Old-age and disability pensions have been heavy burdens since the early 1990s when generous indexation decisions were made and early-retirement schemes were provided to workers losing their jobs during the economic restructuring.[53] On average, workers retire five years earlier than the age stipulated by law. In addition, eligibility criteria for disability benefits are generous, and benefit levels are

Figure 31. **General government total outlays, 1997**
In per cent of nominal GDP



1. Excluding Hungary, Mexico, Poland, Switzerland.
2. Weighted average.
Source: OECD.

higher than in other countries of central and eastern Europe. As a result, approximately 9.5 million individuals received a pension in 1998, compared to about 7 million in 1990, of which about 4.8 million received a disability pension. Each pensioner is supported by 1.4 contributors, a low ratio by OECD standards. Retirement pensions were 67 per cent of the average salary in 1998, up from 53 per cent in 1989, and disability pensions were 51 per cent of salary. To finance these costs, social security contributions as a share of net wages were raised from 25 per cent in 1981 to 45 per cent in 1998. As a result, Poland devotes 14 per cent of GDP to pensions, well above the OECD average, compared to 6½ per cent in 1989. Disability pension expenditures alone correspond to 3½ per cent of GDP in Poland in 1998, compared for instance to 0.8 per cent of GDP in Germany in 1995. More public funds are spent on pensions than on education, research and development, and public investment (Cabinet of Ministers, 1999).

Given the high share of revenues devoted to pensions, budgetary outlays in other areas that would help raise potential output are correspondingly limited. Social spending and pension outlays are important to cement the cohesion of the country and raise popular support for the reforms. But spending in the areas of education, public infrastructure, justice, and enterprise restructuring are also important in supporting long term growth in the economy. In addition, Poland needs to finance its accession to the European Union and to upgrade its military equipment to NATO standards. Because the tax burden can no longer be increased, solutions need to found to make room for these growth-enhancing outlays.

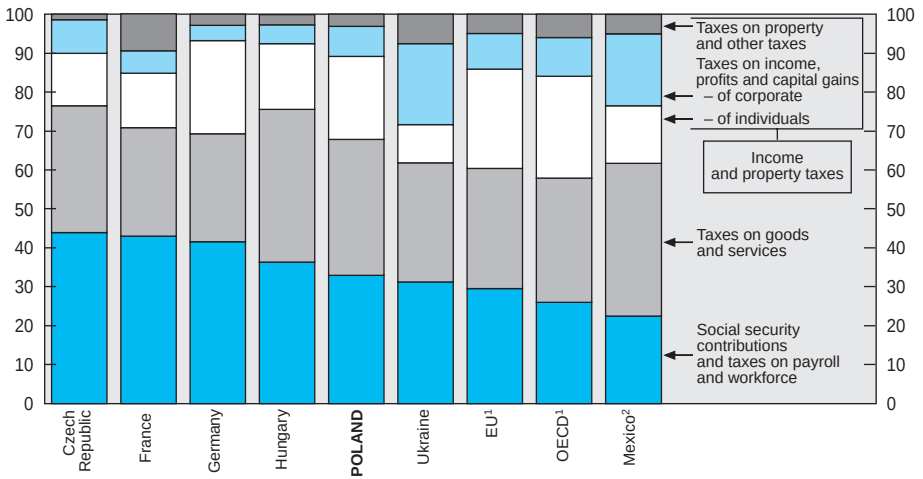
Cutting and restructuring public expenditure has thus become an important objective of the government. The "*Strategy of public finance and economic development*" for 2000-10 recently outlined by the government makes proposals in this direction. The strategy aims at giving the priority to expenditure on research and development, modernisation of roads, investment in the railways system, agricultural development, and restructuring programmes. The strategy also aims at reducing the overall level of spending in order to generate larger government savings and establish the conditions for lower taxes.

A substantial part of output and income goes unreported in Poland, as in other transition economies. The size of the "unofficial economy" is estimated to be 15-20 per cent of GDP.[54] This costs the government tax revenue which it must compensate by higher taxes on the official economy or by reduced spending in areas that might be essential for economic growth. In addition to hidden output, there is also anecdotal evidence that firms under-report salaries in order to evade payroll taxes. This may take the form of undeclared payments of wages in cash and in kind.

Main characteristics of the tax system

The Polish tax system has undergone significant changes in the last ten years as it was modernised to become closer to European Union standards (Annex I provides a detailed description of the tax system, and Annex II provides an international comparison of tax systems). The system has made the transition from one which relied on transfers from state-owned enterprises to one which is based on the taxation of a wide range of private sector incomes. A number of changes were made in tax policy in the last ten years: the corporate income tax was introduced in 1989 and the personal income tax was introduced in 1992; VAT replaced the turnover tax in 1993 and the general import surcharge was cancelled in 1997.[55] In 1999, a new pension fund system was established, the health insurance act was enacted, and fiscal resources were provided to local governments in the context of the public administration reform. Following changes in recent years, general government revenue is based on three broad categories of taxes (direct taxes, indirect taxes and social security taxes) that each produce approximately one-third of total revenue (Figure 32). Most direct and indirect taxes are collected

Figure 32. **Tax mix of selected countries, 1997**
As a percentage of total taxation



1. Unweighted average.
2. 1996.

Source: OECD, Revenues Statistics of OECD Member Countries; IMF.

Table 15. **The tax system in a nutshell, 1999**

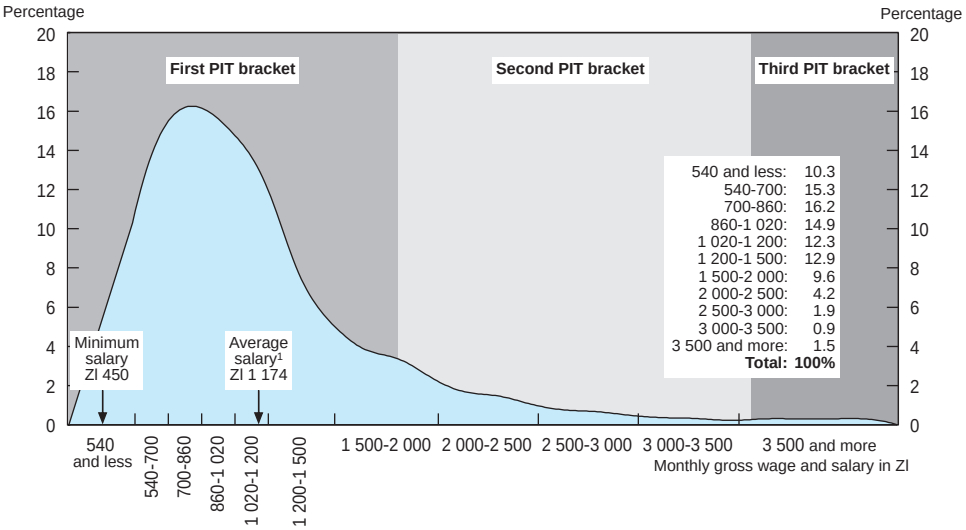
	1999 rates (%)	Tax base	Main allowances/ exemptions	Revenue to GDP (%)[1]
PIT	19, 30, 40	All income of individuals	Housing investment, donations, pensions and other permanent burdens, purchase of educational equipment, medical expenses, joint filing of spouses	5.6
CIT	34	Income generated by legal entities and selected entities without legal capacity	Investment, advertising, and representation expenses, income of selected economic activities	2.5
VAT	22, 7, 4, 0	Sale of taxable goods and services with the annual turnover above the taxable Zl 80 000 threshold	Unprocessed agricultural products, selected services, apartment rental, sales of land	12.4[2]
Social security	36.6 per cent of gross wages	Income of individuals except farmers, judges and prosecutors	Exemptions limited to a few professions and activities. Self-employed assessed on presumed income	10.2

1. Ministry of Finance estimates.
2. Total indirect taxes, including excise taxes.
Source: Ministry of Finance.

by the state to finance the general budget, while social security contributions are earmarked for large extra-budgetary social security funds (Social Insurance Fund, Health Fund, Pension Funds).

The personal income tax is based on the world-wide income of resident individuals, but treats earned income and capital income differently (Table 15). As of 1999, earned incomes (other than financial incomes) are taxed at 19, 30 or 40 per cent, depending on the income bracket (down from 21, 33, or 45 per cent in 1996). The income brackets are very wide so that, given the relatively narrow income distribution, most taxpayers fall into the first bracket (Figure 33). Although they have been tightened recently, many income deductions are still allowed. In addition to an automatic fixed income deduction, individual taxpayers are authorised to deduct from income expenses incurred in building apartments for rents, social security contributions, expenses on the disabled, fees to organisations and donations to non-profit institutions. A tax credit can also be obtained for investment in housing, renovation of houses, health insurance contributions,

Figure 33. **Distribution of income and PIT tax brackets**
Percentage of wage-earners in each income group, September 1997



1. Average monthly gross wage and salary in the enterprise sector.
Source: Central Statistical Office and Ministry of Finance.

education-related expenses, and some medical expenses. Spouses can file their incomes jointly, in which case the tax rate is determined based on half the combined income. With a standard rate of 22 per cent, VAT has been brought close to the European Union standards with two notable exceptions: two reduced rates (4 per cent and 7 per cent) prevail on a broad list of goods and services, and agricultural production is not subject to VAT. The corporate income tax is based on the "classical" system under which corporate income is fully taxed and distributed profits (dividends) are taxed again by way of withholding. The corporate income tax rate is 34 per cent in 1999, down from 40 per cent in 1996, but still slightly above the rates observed among Poland's neighbours in central and eastern Europe. Corporate tax liabilities can be reduced by a fraction of investments made in certain sectors and firms that the government intends to support (export-oriented firms, start-ups, fisheries). Exemptions from the corporate income tax are also granted in Special Economic Zones. Social security contributions have been recently split between employers (17.9 per cent of gross wages) and employees (18.71 per cent). These contributions finance the first and second pillars of the old-age pension system, the disability pension regime, and other social benefits (see Chapter III). Contributions are also due to the labour fund

Box 9. The taxation of self-employed

As a country with more than 2 million small businesses, Poland has recognised that small entrepreneurs require a special approach to taxation. The small business sector is unlikely to generate a significant portion of overall tax revenue but, since it represents a large population in numerical terms, it could consume a disproportionate part of the tax administration's activities. Trying to bring small businesses under the standard tax net is also prone to lead to significant compliance problems. For all these reasons, a system of presumptive taxation has been introduced in Poland, like in other countries. Presumptive taxation has two benefits: it simplifies small businesses' tax obligations; and it improves compliance through simplified bookkeeping and enhanced monitoring. Over 1 million enterprises use the system of presumed income taxation.

Flat-rate taxation

Independent small-scale activities can pay the personal income tax at a flat rate on registered revenue. Persons who receive income from small businesses and independent professions can opt for flat-rate taxation, provided that they started an activity independently or in the form of a civil partnership. Under this optional system, taxes are based on registered sales (without deducting costs). These taxpayers are not obliged to keep revenue and expenditure bookkeeping records, but must keep a simplified register of revenue. In 1999, this provision applies to entrepreneurs whose previous year turnover was no more than Zl 400 000. The tax rates are:

- 8.5 per cent for the provision of services and on agents' commission;
- 5.5 per cent for manufacturing, construction, transport and leasing;
- 3.0 per cent for commercial activities, catering businesses, and sea fishery.

Lump-sum taxation ("tax card")

Taxpayers paying lump-sum tax are not obliged to keep records. They do not have to document the actual revenues and costs. The amount of tax to be paid under this system depends on the location of the business, its type, and number of employees. Lump-sum taxes are pre-determined amounts to be paid at regular intervals over a period of time.

Exemption from VAT registration

To reduce administrative costs, Poland exempts small businesses from the obligation to register and pay VAT. Small businesses with an annual turnover of no more than Zl 80 000 (approximately euro 19 000) are exempt from VAT. This threshold is high by European standards (the Sixth Directive on indirect taxes prescribes a small business exemption threshold of only euro 5 000). Small businesses that choose not to register for the VAT cannot take a tax credit for the tax they pay on their purchases. As a result, the VAT increases the cost of their purchases. On the other hand, they do not have to charge VAT on their sales and do not have to keep books of account for VAT purposes.

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Social security contributions

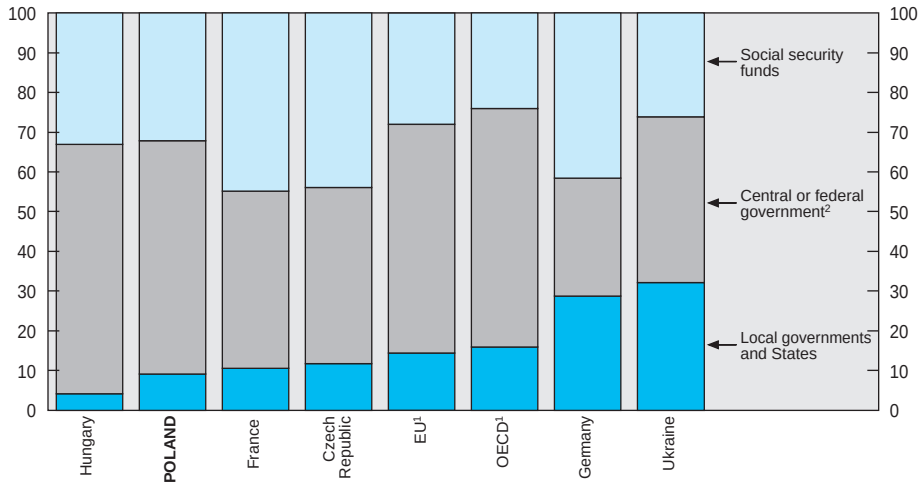
Small businesses are obliged to contribute to the disability pension and accident insurance schemes. They can opt for a presumptive tax base established at 60 per cent of the average salary, which they often choose in practice. Otherwise, the tax base is identical to the one use for the personal income tax.

(2.45 per cent) to finance unemployment benefits and active labour market policies. A contribution equivalent to 7.5 per cent of taxable income was introduced in 1999 to finance the newly created health funds (see Chapter IV). This latter contribution is fully deductible from the personal income tax.

Several key features characterise Poland's tax system.

- *First*, tax revenue tends to rely more on social security contributions than on average in the OECD, a feature shared also by Hungary, the Czech Republic, and several Western European countries. This is in part a legacy from the communist system, but also a sign that Poland has found labour easier to tax in terms of tax administration (social security taxes are directly withheld at a fixed rate and no deduction is allowed). Labour is also less mobile than capital and therefore may not escape taxes easily.
- *Second*, the tax system is less diversified than in other OECD countries. Small taxes – such as property, inheritance, or environmental fees and fines – produce virtually no revenue. Other countries have diversified their tax system to spread the burden across a broader category of income and assets, and to avoid high tax rates on limited tax bases, but Poland relies on a somewhat narrower range of tax instruments.
- *Third*, the bulk of tax revenue goes to the central government and to the social security institutions. Local taxes generate little revenue, and local governments receive only a very small portion of total revenue by OECD standards (Figure 34).
- A *fourth* specific feature of the tax system is the size of arrears on taxes and social security contributions (Table 16). At the end of 1998, total outstanding arrears amounted to Zl 15 billion (3 per cent of GDP), with the largest arrears stemming from state enterprises' late payments of social security contributions. Loss-making coal mines, steel mills, and the railway company were in particular all in arrears, with the implicit or explicit consent of the authorities. Social security contribution arrears were among the factors that triggered a liquidity problem at the Social Insurance Office (ZUS) in 1999.

Figure 34. **Tax revenue by level of government, 1997**
As a percentage of total tax revenue



1. Unweighted average.
2. Including supranational taxes.
Source: OECD, Revenues Statistics of OECD Member Countries; IMF.

Table 16. **Arrears on taxes and social security contributions**
In Zl million

	1995	1996	1997	1998
Taxes	5 196	5 271	4 922	6 723
VAT	1 578[1]	1 384	2 006	2 888
Excise duty	139	202	287	289
CIT	1 337	1 178	1 197	1 085
PIT	1 217	1 437	1 513	1 812
Other	925	1 070	919	650
Social security contribution	4 207	4 759	5 859	8 323
State enterprises	3 150	3 399	4 122	6 111
Private enterprises	1 057	1 360	1 737	2 212

1. Including outstanding turnover tax liabilities.
Source: Ministry of Finance.

A *fifth* specific feature of the tax system is the generosity of tax exemptions, which results from numerous decisions made in recent years. For instance, the personal income tax law was amended more than 30 times and the corporate income tax law more than 40 times. As a result, the personal income tax contains about 125 tax reliefs, 10 types of income deductions, and 14 types of tax credits. The most costly for the budget are the income deductions and tax credits allowed for housing-related expenditures (Table 17). These deductions are popular among high income earners. Another deduction is for the purchase of educational material, which is interpreted rather loosely (*e.g.* video cassette recorders are often treated by families as such and their cost is deducted from income). Affluent taxpayers tend to benefit more from income deductions because they can afford to make the expenses required to benefit from tax allowances (such as housing investment). In 1997, only 39 per cent of taxpayers in the lowest tax bracket claimed an income deduction, compared with nearly 90 per cent for those in the highest tax bracket. This is because well-informed and skilled taxpayers in the high income tax bracket could afford to buy real estate and claim the corresponding deductions. The system therefore benefited affluent taxpayers disproportionately. A costly feature for the budget is the tax exemption granted to small entrepreneurs hiring disabled workers and who file their income under the personal income tax. Such a tax exemption is difficult to administer and, therefore, there is scope for abuse.

The impact of tax allowances is shown by the difference between the theoretical and the observed average tax rates. Based on the official tax schedule, the average tax rate on personal income (weighted by the number of taxpayer in each tax bracket) should have been 15.5 per cent of income in 1998. The Central Statistical Office (GUS) survey of households for 1998 shows, however, that households only paid 12.5 per cent of their income in personal income taxes on average. Although the latter number should be interpreted with caution, it suggests that households avoid taxes by using tax deductions, and evade taxes by hiding income and wage payments from the authorities.

The corporate income tax also has generous exemptions. It has more than 40 investment allowances, 63 depreciation schedules, and investors enjoy 5-10 years of tax holidays in 17 Special Economic Zones. Although these exemptions cannot be cumulated, they are costly for the budget and make the tax system hard to understand and difficult to enforce. Similarly, a growing gap can be observed between the nominal rate of social security and labour fund contributions and the observed effective rate (Table 18). This is also to be interpreted with caution but reflects the use of loopholes in the existing legislation and the accumulation of arrears of contributions.

Table 17. **Budget revenue losses from PIT allowances, 1996-98**[1]

In Zl million

	1996	1997	1998
Total PIT allowances			
of which:			
From income	28 101	6 414	9 054
From tax	57	2 823	2 961
Total budget revenue loss	**6 323**	**4 409**	**5 053**
of which:			
In per cent of PIT	24.28	14.73	13.78
In per cent of GDP	1.65	0.94	0.91
Housing expenditure			
Revenue loss	2 729	2 712	3 117
In per cent of PIT	10.43	9.06	8.99
In per cent of GDP	0.71	0.58	0.57
Average allowance claimed by taxpayer (Zl thousand)	0.47	0.41	0.48
Lowest income bracket	0.25	0.31	0.33
Middle income bracket	0.74	0.87	1.00
Highest income bracket	4.61	1.92	3.22
Donations			
Revenue loss	1 820	218	153
In per cent of PIT	6.95	0.73	0.44
In per cent of GDP	0.47	0.05	0.03
Average allowance claimed by taxpayer (Zl thousand)	0.29	0.13	0.10
Social insurance contributions			
Revenue loss	260	322	363
In per cent of PIT	0.99	1.08	1.05
In per cent of GDP	0.07	0.07	0.07
Average allowance claimed by taxpayer (Zl thousand)	0.53	0.57	0.59
Purchase of educational equipment			
Revenue loss	67	80	64
In per cent of PIT	0.26	0.27	0.18
In per cent of GDP	0.02	0.02	0.01
Average allowance claimed by taxpayer (Zl thousand)	0.10	0.11	0.14
Other			
Revenue loss	1 447	1 077	1 356
In per cent of PIT	5.64	3.60	3.91
In per cent of GDP	0.38	0.23	0.25
Memorandum items:			
PIT revenue	26 172	29 942	36 664
Nominal GDP	385 448	469 372	555 100

1. In addition to these allowances, certain categories of income are exempt from PIT, *e.g.* income generated by employers hiring disabled workers.

Source: Ministry of Finance and OECD.

Table 18. **Social security taxes: statutory and effective rates**

In Zl million

	1995	1996	1997	1998
Social security contributions[1]	37 353	48 129	58 290	66 408
Gross wages and salaries[2, 3]	83 568	106 929	133 154	158 456
Statutory rate (in per cent of net wages)	48.0	48.0	48.0	48.0
Effective rate (contributions/gross wages and salaries) (per cent)	44.7	45.0	43.8	41.9

1. Contributions to ZUS and the Labour Fund.
2. Includes monetary wages, payments in kind, fringe benefits and distribution of profits.
3. Excludes Ministry of Defence and Ministry of Interior and Administration which are exempt from social contributions and pay their own pensions.

Source: GUS and OECD calculations.

Taxation and economic performance

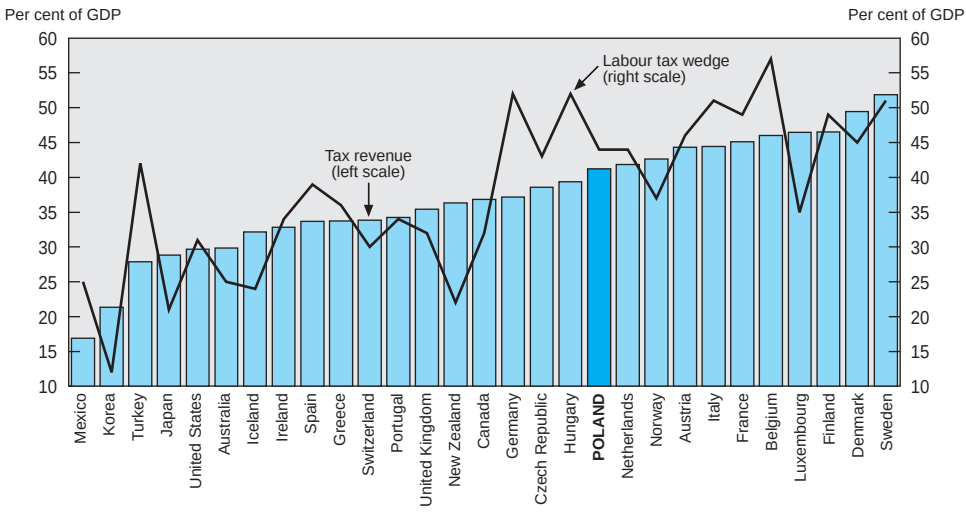
This section reviews the incidence of Poland's tax system on employment, investment, capital income, the property market, and the environment. Additional sections review the tax regime for local governments and the status of tax administration.

Taxation and the labour market

An important consideration for the tax system is its impact on the labour market. It is generally agreed that the marginal tax wedge[56] on labour may affect labour supply, labour demand or both. The labour tax wedge is particularly high in Poland (Figure 35). For the average wage single-income earner, the average tax rate (personal income tax + social security contributions) is 42 per cent in 1999, and the marginal tax rate 45 per cent[57] (Table 19). In Poland, where social benefits are relatively generous and early-pension an easily available option, the labour tax wedge is likely to reduce labour supply. In addition, the elasticity of labour-supply to the tax wedge in the official economy may be higher in Poland than in other OECD countries because, for wage-earners and self-employed, work in the unofficial economy can be a close substitute. Given these two constraints, Poland should have a lower tax wedge than other countries in order to have a well-functioning labour market, rather than the higher tax wedge it has currently.

Poland provides social benefits to the unemployed, means tested benefits for children, and a minimum living standard for low-income people. For the unemployed, living on social benefits (such as social assistance, childcare, or unemployment benefits) is an interesting alternative to working at the minimum

Figure 35. **Tax revenue and tax wedge in 1997**



Source: OECD, Revenue Statistics of OECD Member Countries and The Tax/Benefit Position of Employees.

salary, losing benefits, and paying taxes. These benefits are in general lost as soon as individuals accept a job, work longer hours, or in any other way improve their income. Combined with high tax wedges, the loss of benefits makes working a costly decision for certain groups. Calculation of marginal effective tax rates net of cash transfers suggest that the increase in net taxes can be as high as 120 per

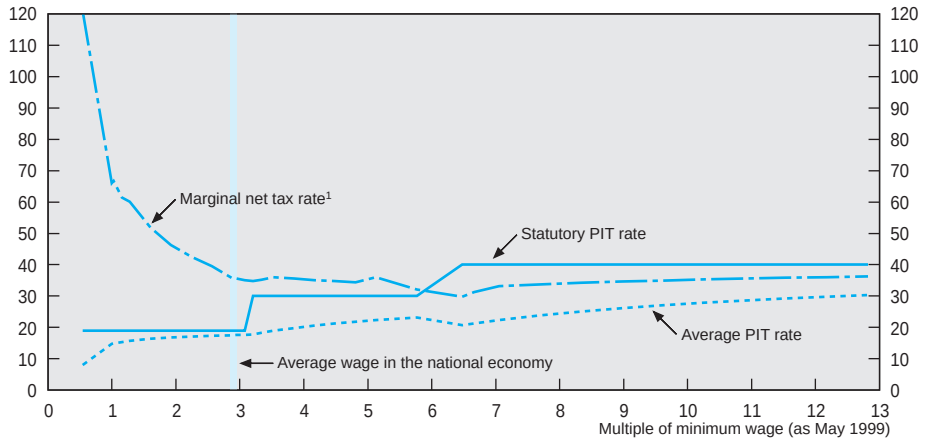
Table 19. **Estimated marginal and average personal income tax rates, 1999**

In per cent

			Minimum salary		Average salary		2 × average salary	
			Marginal	Average	Marginal	Average	Marginal	Average
	Personal income tax	(A)	15.4	8.2	16.1	12.6	24.4	14.3
(A) *plus*	Employee social security contribution	(B)	29.0	26.9	29.5	31.3	36.6	33.0
(B) *plus*	Employer social security contribution	(C)	44.1	38.0	44.7	41.7	51.7	43.2
(C) *minus*	Pension contributions	(D)	27.6	21.5	28.1	25.1	35.2	26.6

Source: OECD calculations.

Figure 36. **Marginal and average net tax rates on individual incomes**



1. Net of benefits (welfare and child benefit); including employee's social security contributions; no deductions and allowances applied.

Source: Ministry of Finance.

cent of income for individuals moving from unemployment to a job paid at the minimum wage (Figure 36). This may help in understanding why, in addition to the large number of registered unemployed (2.1 million in mid-1999), close to 1 million people are considered as "hidden unemployed" according to the 1996 survey of households and the agricultural sector. These are "discouraged" workers who have left the labour market, and fallen into the "unemployment trap", notably for a large number of redundant workers in the agricultural sector.

A first step toward reducing the pervasive effect of some benefits was taken in 1999 with the tightening of rules on sickness allowances. In Poland, as in other OECD countries, eligibility conditions for sickness allowances were often too lax and subject to abuse. The number of sickness benefit days has been rising in recent years, and related spending was more than doubled since 1995. In line with OECD recommendations, a new bill amending the current system of sickness benefits has been adopted by Parliament. The bill tightens eligibility criteria, mainly by reinforcing medical considerations. It includes a tighter control for the extension of the sickness benefit period, which must be provided only by a physician officially certified by the Social Insurance Office, and the creation of a central register of medical certificates. The bill came into effect on 1 October 1999.

Box 10. How to make work pay more?*

For people at the margin of the labour market, the combination of generous benefits and high taxes reduces the rewards from work. In Poland, for low-income and old age people, benefits are generous compared to wages. Unemployed workers receive a flat benefit for 6 to 18 months; low paid workers are eligible to benefits in the form of housing allowance and social assistance; and old-age workers have an incentive to leave on early-retirement or try to obtain a disability pension. On the other hand, taxes are high even for low-paid workers.

In these circumstances, the rewards from work can be limited. Returning to work, staying at work, or working more can be costly decisions. It is therefore not surprising that Poland has such a large pool of discouraged workers, in the form of hidden unemployment in the rural areas. It is also not surprising that workers are so attracted by early-pension schemes. It is also not surprising that the wage-bargaining process is so difficult and that the Tripartite Commission often fails to reach agreement, as workers try to obtain higher real wages to compensate for the level of taxes. Overall, this reduces labour supply (mainly through hidden unemployment and early-retirement) and labour demand (because labour costs are higher than they could be).

OECD countries have experienced new policies to make work more rewarding. The United States has been using an Earned-Income Tax Credit (EITC) scheme since 1975 to offset the adverse effects of taxes on working poor families, and to provide incentives to work by increasing the after-tax income. The United Kingdom is using a Working Family Tax Credit (WFTC) that guarantees a minimum income to families with at least one working adult. France has reduced payroll taxes for the low paid since 1996. The rebate reduces the cost of labour by 12.6 per cent at the minimum wage level. In addition, health insurance contributions are no longer based on payrolls but on overall income, including income derived from financial investments.

There are good economic and long-term labour market reasons to introduce a scheme that would make work pay more, especially more than living on benefits. The first priority step in this direction is to cut the abuse of disability benefits, early-pensions, and sickness allowances. The generosity of such benefits and their lax administration encourages to leave the labour market or to work in the official economy. This would help promote labour supply and encourage workers to shift from the underground to the official economy. If this is not enough, consideration could be given to a more generous flat income deduction from the personal income tax than currently for families with at least one working adult. It could also take the form of a tax credit for workers at the minimum wage.

* See also *OECD Economic Outlook 66* (1999), "V. Making work pay", pp. 151-158, Paris, December.

Poland introduced a pension reform in 1999 which substitutes labour taxes with contributions to individual pension accounts, which are a form of compulsory savings and therefore makes work pay better in the long-run. Under the reformed first and second pillars, at any time employees know the amount of their accumulated contributions and are therefore likely to perceive their contributions, not as compulsory taxes, but more as a form of contribution to long-term

savings. This should therefore encourage greater participation in the labour market, and notably encourage later rather than earlier retirement. If successful, the pension fund reform can have the effect of reducing the perceived tax wedge, make work pay more and encourage greater participation in the labour market. Assuming that pension contributions are saved incomes, and not taxes, for the average production worker the average tax rate falls from 42 per cent to 25 per cent and the marginal rate from 45 per cent to 28 per cent (Table 19).

To be successful, however, the pension reform needs to be credible. Workers have to be convinced that their contributions to pension funds will guarantee benefits. The initial difficulties with the pension reform show that this credibility does not come easily. As noted in Chapter III, measures need to be taken rapidly to correct the initial delays in registering contributors in the appropriate private funds, and to channel contributions to these funds.

The health insurance reform does not have the same positive impact. health premiums are not related to benefits; working more does not provide entitlement to a more generous health treatment. In addition, the unemployed are eligible for the health insurance; deciding to work or not to work has no influence on the eligibility to health benefits.

Taxation and international investments

The tax system is often seen as a factor taken into consideration by foreign direct investors. It is believed that, before making an investment decision, investors look at the corporate income tax, the property tax, and customs tariffs as well as the tax reliefs that may apply to all those taxes. International tax competition has put national authorities under pressure in recent years to offer greater tax incentives to attract international investments, and the recent trend in central Europe has been to offer more tax incentives. Based on recent available evidence and studies (Easson, 1998), however, it appears that the tax system is only one factor among others taken into consideration by international investors. A market-friendly economic environment, a well-educated work force and a stable legal system are more important determinants. Because of the risk of introducing unnecessary distortions in the tax system, OECD countries have generally taken steps since the early 1980's to phase down special tax incentives for international investors. Poland, on the other hand, still has a tax regime with features to attract international investors. As noted, tax exemptions are offered to investors in Special Economic Zones, including full exemption from corporate income tax for five to ten years and other advantages. Anecdotal evidence also suggests that large foreign direct investors to Poland (such as foreign car manufacturers) also benefited from special tax incentives.

Capital income and taxation

Capital income is subject to different tax rates: under the corporate income tax, income is taxed at 34 per cent. But under the personal income tax, dividends are taxed at 20 per cent, interest income is exempt, and capital gains on shares are taxed. The marginal effective tax wedge therefore varies depending on the type of financing sources for a given investment, as shown in Table 20. Firms are encouraged by the tax system to borrow because they can deduct interest payments from their taxable income. In contrast, the withholding tax on dividends depresses the price of shares and therefore discourages the floatation of new equity. This works against firms that do not have access to bank lending because their size, collateral and level of development are not sufficient. This also tends to penalise start-ups that need to raise equity to finance their development. In contrast, the tax system favours large and established firms. It is not surprising, therefore, that large, foreign owned firms, and firms with strong cash positions have high levels of leverage in Poland (Hussain and Nivorozhkin, 1999).

Table 20. **Effective marginal tax wedge by funding sources**

Top personal tax rates

	Retained earnings[1]	New equity[1]	Debt[1]	Weighted average[3]
Machinery[2]	1.73	5.64	–3.74	0.21
Buildings[2]	3.59	8.45	–3.24	1.68
Inventories[2]	7.27	12.31	0.00	5.23
Weighted average[3]	3.47	7.89	–2.78	1.72

Note: Calculations based on King-Fullerton methodology.
1. Calculated using the following weights: machinery 50 per cent; buildings 28 per cent; inventories 22 per cent.
2. Calculated using the following weights: retained earnings 55 per cent; new equity 10 per cent; debt 35 per cent.
3. The weighted average uses weights indicated in footnotes 1 and 2.

Source: Gordon, Kathryn and Harry Tchilinquirian (1998), ''Marginal effective tax rates on physical, human, and R&D capital'', OECD Economics Department, Working Paper No. 199.

Taxation and levels of government

Poland has inherited from the past a very centralised budget system, with the bulk of revenue going to the state and to social security administrations, and only 5 per cent of revenue going to local governments. Beginning in 1998, the authorities have allowed a greater degree of decentralisation, and steps have been taken to loosen central control over local budgets. Under the new system, local governments play a growing role for expenditure decisions. *Gminas* (communes) continue playing an important role in primary education, local roads,

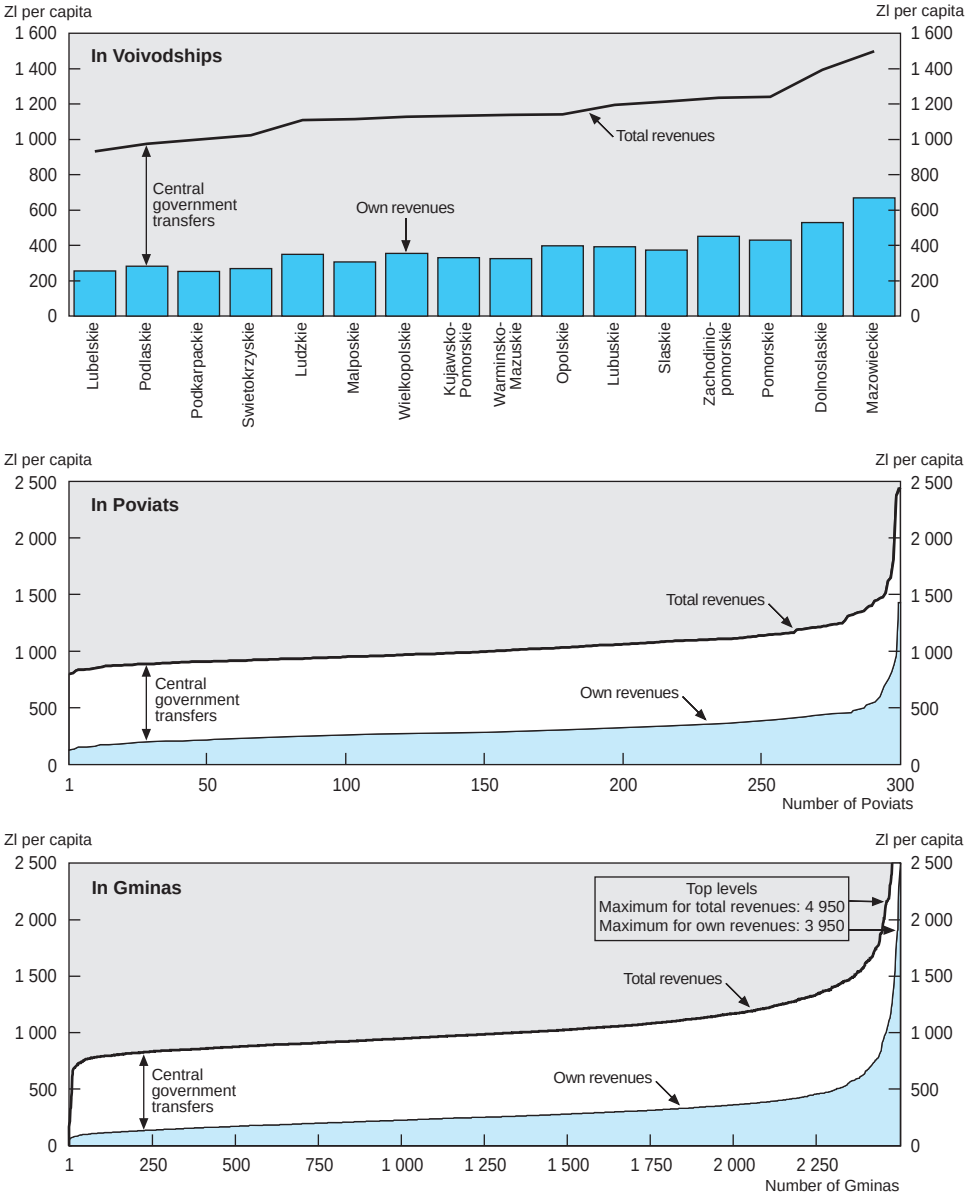
commercial services, and basic utilities. *Poviats* (counties) are called to play a role in secondary education and general health care. *Voivodships* (regions) are responsible for the regional economic development, co-ordinating the poviats and gminas they embrace. They also play a role in higher education and supervise the sickness funds.

Large financial transfers are made by the central government to local governments. In 1999, *gminas* are expected to get 45 per cent of their revenue from earmarked allowances and general grants distributed by the central government. *Poviats* are expected to rely even more on transfers from the central government, with 93 per cent of revenue coming under an earmarked allowance and a general grant from the central government. *Voivodships* should receive 76 per cent of their revenue from the central government, with most of the remainder coming from a pre-determined share of the CIT. Altogether, local governments appear to have little autonomous power in making tax policy decisions and to rely heavily on central government transfers. In 1998, central government transfers did not play a role in closing the income gap between regions. These transfers were merely based on the size of the population living in each region, without attempting to reduce income distribution (Figures 37 and 38). In addition, these extensive transfers, while helping local governments match their resources with the expenditure they are responsible for, ran against the principle of delegating more powers to localities in their policy decisions and in their development strategy. Steps to delegate tax policies to regions are therefore necessary.

Taxation and the property market

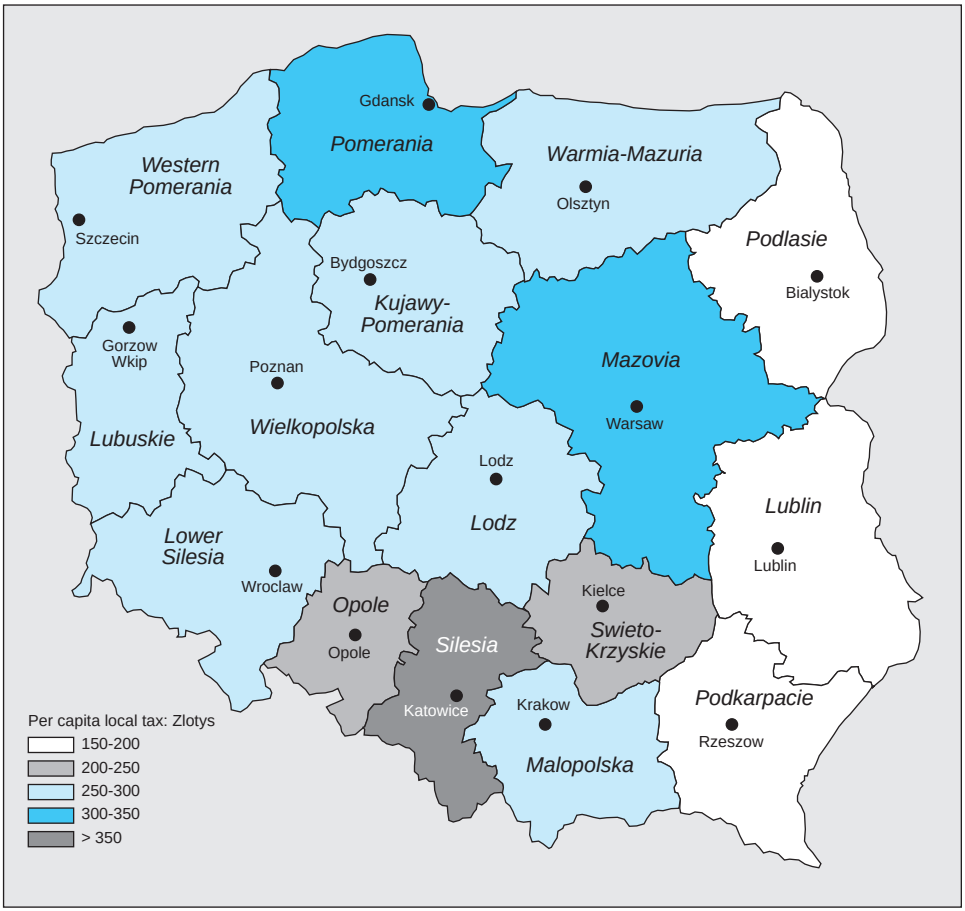
Several features of the Polish tax system have a potential impact on the property market. Under the personal income tax, individual taxpayers investing in rental flats can deduct a part of their investment from their taxable income and therefore considerably reduce their personal tax liability. Taxpayers involved in construction of single-family houses can take advantage of two tax credits, for the purchase of land up to 350 square meters, and for construction. Housing improvements and renovation are also creditable under the personal income tax. Based on the experience of other OECD countries, the elasticity of residential investment to tax deductions is likely to be high, because high-income taxpayers can take advantage of this exemption to reduce their tax liability and to reduce the cost of their investment. On the other hand, such an exemption may have a regressive impact because it benefits high-income taxpayers, without reducing the rental cost for low-income families. A different option to help low-paid families find affordable accommodation is to finance means-tested programmes that help purchase a first home. Public spending in mass transportation infrastructure and urbanisation of new areas may also be a more effective way to expand the availability of housing for low-income groups.

Figure 37. **Intergovernmental finances, 1998**
Own and total local government revenues per capita



Source: Central Statistical Office and Ministry of Finance.

Figure 38. **Local tax revenue per capita, 1998**
Regional distribution



Source: Central Statistical Office and Ministry of Finance.

A stamp duty is imposed on housing transactions. Buyers of properties in the secondary market must pay a stamp duty amounting to 5 per cent of the value of the transaction. Purchasers of new properties and of co-operative apartments pay a stamp duty amounting to 2 per cent of the property value. Agricultural buildings are not subject to stamp duty. This tax is high by international standards and is likely to have a negative impact on the property market. It also

reduces the mobility of the labour force inside the country. In addition, local governments impose property taxes based on the size of the living space in terms of square meters. The property tax is small and is unlikely to influence the property market.

Tax administration and enforcement

The Ministry of Finance is responsible for enforcing compliance with tax legislation and for collecting tax revenue through its local tax offices. Tax administration employees number about 50 000, at a cost equivalent to about 1½ per cent of state budgetary revenue.[58] The Ministry of Finance and the social security administration use common tax identification numbers (TINs) to identify individual taxpayers. About 24 million taxpayers[59] are currently registered with TINs. Tax administration has been successful in collecting a relatively high share of revenue in GDP. The tax administration system resorts to a number of tools to fight against tax evasion. Personal income tax and social security contributions are directly withheld and paid by employers to the tax administration, thus reducing the scope to hide income. The Tax Identification Numbers help to simplify tax administration and cross-check the accuracy of income statements with other sources of information. With the expansion of international financial flows, Poland has taken steps to reinforce its co-operation with tax offices in other countries in order to share information and provide mutual assistance for the recovery of claims.

Notwithstanding these strengths, estimates of the size of the underground economy (15 to 20 per cent of GDP) suggest that a significant amount of income is removed from the tax base. The limited uses of computers and information technology resources confine tax administration agents in manual-record keeping tasks and reduce resources available for tax auditing and tax control. The tax administration has poor information on taxpayers' individual assets. The lack of central registration of liens also prevents the verification of the accuracy of taxpayers' liabilities.

Compliance with the tax system is undermined by the high administrative burden imposed on taxpayers. Individual taxpayers must select among 24 different types of forms for filing personal income tax declarations, depending on the type of income earned, the time span of declaration, the family status of the taxpayers, and the exemptions and tax credits claimed for. The VAT legislation requires 75 types of information to be filed monthly, and the corporate income tax even more (128 lines). While Poland has introduced simplified tax filing status for certain categories of taxpayers (tax card and lump-sum status), this has met with limited success because even these simplified regimes still remain too complex.

Taxation and the environment

Empirical evidence suggests that economic instruments, including taxation, can be a powerful means to achieve certain environmental goals. In environment protection, OECD countries are gradually moving toward greater and more consistent use of economic instruments as a complement or a substitute to other policy instruments such as regulation. Since the 1970s, Poland has utilised a system of environmental fees in combination with regulatory instruments (limits on emission of pollutants or discharge limits) (Peszko, 1999). Fees are based on actual, self-reported emission of pollutants. Under the principles of "the Polluter Pays", the system makes polluters pay fees for their actual pollution. This gives an incentive to reduce the level of emission in order to reduce the fees. In addition, firms must pay environmental non-compliance fines when their level of emission or discharge exceeds the level allowed in the facility permit. Fees and fines are charged on air pollutants, solid and hazardous wastes, discharges of wastewater, surface and ground water extraction, and land clearing. Under the pre-transition regime, fee rates were quite low and did not have a noticeable effect on pollution levels. Since 1990, the fee rates have been increased dramatically. Environmental fees are levied by the Environmental Protection Departments of the Regional (Voivodship) Offices. They are normally collected once a year, but may be required on a quarterly basis from large enterprises. All revenue from fines and fees are earmarked. They are distributed to the National Fund for the Environment, 49 Regional Funds, and approximately 2 500 Municipal Funds. The funds disburse resources for environmental investments and other environmental activities (education, research, monitoring equipment). These resources are disbursed through a variety of disbursement mechanisms (soft loans, grants, interest subsidies, equity investments).

In view of the challenge of meeting EU environmental standards in the future, the tax system could do more to promote environmentally-friendly practices. Although fees and fines are high, they are not high enough to stimulate investment in pollution-reducing equipment. By some estimates, the cost of such investments can be six times higher than the payment of fees.[60] The system of fees and fines has provided incentives for polluters to make low-cost investments in pollution-reducing techniques, but has not stimulated more drastic changes. Some taxes discourage progress towards stronger environmental protection – for instance, excise taxes on unleaded and leaded gasoline are similar. The government also continues to subsidise activities that have a perverse environmental impact (such as subsidies to the coal sector). Finally, compliance with the fees is limited, notably in the coal sector. It is, therefore, not surprising that Poland produces one of the highest levels of carbon dioxide in relative terms among OECD countries, thus contributing negatively to climate change.

The tax reform

Poland's current tax system is young but has many commendable features. The authorities have been able to transform the previous tax regime based on transfers from state-owned enterprises to a system adapted to a market economy. Nevertheless, as of 1999, the tax regime had been weakened by numerous alterations introduced in the previous few years and, if left unreformed, this could have resulted in fiscal revenue shortfalls and have a negative incidence on economic performance. It was, therefore, more than time to enact a decisive tax reform.

In 1999, the authorities formulated tax reform proposals which were partially enacted (Box 11). The tax reform was part of an overall economic strategy to boost the long-run growth potential of the economy. It was designed to lower the tax burden on the economy, provide greater incentive for productive activity, and reduce the distortions between different sources of income. As in other OECD countries having implemented tax reforms, the focus was put on lowering tax rates while broadening the tax base. The tax reform was launched by the "*White Book on Taxes*" drafted by the Ministry of Finance in 1998 and distributed among political, business, and academic circles to spur a public debate with a view to forging a consensus on the future tax reform.

Box 11. A summary of the tax reform enacted in 2000

Corporate Income Tax

- 34 per cent in 1999.
- 30 per cent in 2000.
- 28 per cent in 2001.
- 28 per cent in 2002.
- 24 per cent in 2003.
- 22 per cent from 2004.
- Elimination of investment allowances.
- Rates for capital depreciation reduced to 10.
- No new tax exemptions in special economic zones starting in January 2000.

Value added tax

– Municipal services:	7 per cent starting in 2000.
– Construction materials and services:	7 per cent in 2000 12 per cent in 2001. 17 per cent in 2002. 22 per cent subsequently.

Reform of the personal income tax

The government submitted to parliament proposals to reform the corporate income tax, the VAT, and the personal income tax laws. The first two draft proposals were passed into law but, due to a presidential veto, the personal income tax draft law was not enacted. The personal income tax reform aimed at broadening the taxable base while reducing the tax rates at the same time. Under the authorities' proposal, the tax rates would have been lowered from the schedule of 19, 30, and 40 per cent to 19, 29, and 35 per cent in 2000, 19, 28, and 35 per cent in 2001 and 18, 28 per cent in 2002 (the highest tax rate would have been eliminated). At the same time, most income deductions and tax credits would have been eliminated in order to broaden the tax base. Income deductions for donations to charities would have been limited to 10 per cent of income. Income deductions for the purchase of health services would have been eliminated. Investments made by the self-employed would no longer have been tax-deductible (except for investments already started in 1999). The deductions for investment in rental apartments and housing construction expenses would have been repealed. Instead, a means-tested programme would have been introduced to help less affluent people build their first home.

In addition, income derived from gambling would have been subject to a flat 10 per cent tax when exceeding three times the average salary. Small businesses employing disabled workers would no longer have been authorised to exempt their income from the personal income tax; instead a new programme targeted to the disabled and based on the level of disability would have been introduced. The depreciation system would have been simplified for small businesses. Dividends would have remained subject to a flat tax rate of 20 per cent in 2000, but the tax rate would have been reduced to 15 per cent in 2001. Interest income derived from fixed deposits, treasury bills, and municipal bonds would have been subject to a 5 per cent flat tax starting in 2003. Capital gains realised on the stock market would have been taxed, starting in 2003, at a minimum rate of 18 per cent and would have been aggregated to individual incomes. Although the government's proposal was stopped by a presidential veto, the authorities intend to submit it again for consideration by parliament in 2000.

Reform of the corporate income tax

The reform of corporate income taxation was passed into law and becomes effective in 2000. It aims at lowering the tax rate, and broadening the tax base at the same time. The income tax rate will be reduced from 34 per cent in 1999 in steps to 22 per cent in 2004. Simultaneously, investment incentives are eliminated in order to broaden the income tax base. Other aspects of the corporate income tax are reformed at the same time. The number of depreciation rates are reduced to 10; the initial value of fixed assets are re-indexed based on recent

inflation developments. Existing loopholes in the legislation are closed, with a clearer definition of taxable income being introduced. Steps are taken to avoid that income be filed in tax havens, or to avoid that international investors concentrate losses in Polish branches in order to reduce their tax liabilities.

Indirect taxes

The Polish government has proposed steps to harmonise the VAT and excise taxes with EU rules, in preparation for accession. These changes were accepted by parliament and become effective in 2000. Under the EU Sixth Council Directive, member countries must apply a common VAT scheme that spells out the basis for assessment, the tax rates to be applied, and the special arrangements that need to be put in place. The common regime establishes that a standard rate of at least 15 per cent must be applied to goods and services. Two reduced rates of at least 5 per cent are authorised for supplies of goods and services having a social or cultural purpose; the list of these goods and services is spelled out in Annex H of the Directive.[61] In addition, standard exemptions from VAT are allowed.[62] Finally, a recent Council Directive authorises member countries to apply the reduced VAT rate to a specific list of services with high labour content (such as housing maintenance and renovation).

Like other central and eastern European countries, Poland has taken steps in recent years to come closer to the common VAT rules.[63] The standard rate of 22 per cent is well above the minimum rate of 15 per cent (but close to the rate actually used by several EU members), and the reduced rate of 7 per cent is above the minimum required. Most importantly, municipal services (public transportation, garbage collection, water) already are, or soon will be, subject to the appropriate VAT rate. Similarly, energy-related products (electricity, coal, heating, and hot water) are already taxed at the standard rate of 22 per cent. A number of deviations from EU rules are expected by the authorities for social and political reasons, for which they may request transition periods (in particular articles for children, construction material, new residential construction, legal services, and newspapers).

Bringing the agricultural sector into the tax net is the most important EU accession requirement in the field of tax policy that Poland faces. This presents an economic, social, and political challenge for the authorities. Poland has two million farms, most of which are small. Although the sector accounts for only 4 per cent of GDP, it provides 27 per cent of employment. This clearly indicates that productivity is extremely low in the agricultural sector and that, concomitantly, rural area incomes are also low. Because of the dominant social and economic impact of agriculture, Poland exempts agricultural production and trade in agricultural products from VAT. In particular, unprocessed food items (eggs, milk, meat, fish) are exempt from VAT. Moreover, a large number of agricultural

inputs is zero-rated or taxed at the reduced rate, such as feed, seed, fertiliser, and machinery and equipment. Optional registration is available for farmers. However, *de facto*, the entire agricultural sector is zero-rated, except for a few purchases (electricity and building materials). All of these features are at odds with the Sixth Directive, which prescribes that agriculture should be included in the VAT base.

EU rules also require that excise taxes be maintained above certain minima. For most products, Poland has already taken measures to comply with EU rules, in particular for energy products and for alcohol. Legislative action is required, however, to put excise tax on cigarettes on an ad-valorem basis and raise the tobacco tax to the required level.

Assessment of the tax reform

The tax reform adopted by Poland is a courageous step which will decisively modernise the tax system, make it more equitable, and provide greater incentives. Regrettably, the personal income tax reform will not, for the time being, become effective. The authorities were right to aim at lowering personal income tax rates and broadening the tax base, as many OECD countries have done before with success. The proposed reform of the personal income tax would have eliminated the many debatable income deductions and tax credits, which benefit the most affluent taxpayers and therefore have a regressive impact on income distribution. The lowering of personal income tax rates would have been a step in the direction of increasing incentives. The reform of the personal income tax remains an importance piece of unfinished business. It should be resubmitted to parliament to ensure consistency with the reform of the corporate income tax. As they submit a new draft, the authorities could propose a larger flat income deduction or a larger flat tax credit, to make workers paid at or near the minimum salary tax exempt. This would contribute to making work pay more and would provide powerful incentives to participate in the labour market. The phasing out of the high income tax rate of 40 per cent would encourage those who are currently hiding income sources to comply with the tax system in the future.

The decision to comply with the EU Sixth Directive is also an initiative which will facilitate accession to the Union. Higher VAT taxes and excise taxes will generate the additional tax revenue needed to offset the losses stemming from the lower income tax rates. However, bringing the agricultural sector into the tax net carries particularly important political and social risks, with dubious benefits on the economy and on tax revenue. It is unlikely that Poland's two million small farms will be able to keep books of accounts and follow VAT rules in the near future. In any case, bringing the farms into the tax net would not generate new revenues because the VAT paid on farms inputs would be deducted from the VAT charged on foodstuffs. This would carry large administrative and compliance costs

both for farmers and the tax administration. At this stage, Poland should introduce a threshold (based for instance of the size of the farming land plot) below which farmers would not have to register for VAT, keep books, and pay taxes. Demographic trends and EU integration will eventually lead to a restructuring of the agricultural sector in Poland. Overtime, this threshold should therefore be reduced to a level that is consistent with EU rules. A similar approach could be followed for the integration of the small scale farming sector into personal income taxation.

Scope for further reform

Despite the tax policy measures recently proposed by the government, there are other important measures that need to be taken (Box 12). The *first* priority is to make the tax regime more friendly for job creation. The large tax wedge created by the combined effect of social security taxes and personal income taxes has likely had a detrimental impact on labour supply and labour demand. Fortunately, the recent pension fund reform helps to make perceive pension contributions as a form of savings rather than just another tax. This may have a positive impact on labour supply, encouraging more people to work and thus raising potential output. It will also encourage workers to shift out of the underground economy to the formal sector, but may not, however, reduce labour costs immediately due to existing wage rigidities, especially at the minimum wage level. An overall reduction in ZUS contribution rates is necessary to boost job creation. There are several ways to finance this overall reduction: disability pension benefits should be made less generous by tightening eligibility criteria; the ZUS tax base could be expanded to cover fringe benefits, payments in kind, contractual work, and other kinds of incomes. The self-employed should assess their social security contributions based on actual income, rather than artificially low presumed income. Spending on sickness leave could also be reduced, as there is scope for abuse in the presently generous system.

A *second* priority is to give more autonomy to local governments in formulating their tax policy. As shown by the experience in early 1999, large financial transfers from the central to local governments may have a destabilising impact on the central budget. Poland should instead allow local governments to build their own tax base with a range of tax instruments, rather than let them rely so heavily on transfers from the central government. In particular, local governments should assess the property tax on the value of properties rather than their size. Nonetheless, careful supervision of local budget operations is required to avoid slippage and possible fiscal crisis. Large borrowing by local governments with

Box 12. Further reform of the tax system: synopsis of recommendations for Poland

The following synopsis of recommendations draws on the experience of OECD countries and applies them to the specific economic and social circumstances of Poland.

Reduce the labour tax wedge to promote employment

Resubmit the personal income tax draft law to parliament.

High social security taxes, together with the personal income tax, create a large tax wedge and discourage employment. Lowering social security taxes could reduce the tax wedge. Tightening eligibility criteria for disability benefits, early pensions, and sickness allowances would reduce spending and enable lower social security contributions. Widening the tax base to include fringe benefits, contractual work, and wage payments in kind and closing existing loopholes would offset the tax cuts. The social security contribution of self-employed should be assessed on their actual income, not the existing low presumed income.

Eliminate distortions on capital income taxation

Poland has different effective tax rates on corporate income depending on the source of financing, the legal form of the investor, and the residence status of the lender. This distorts investment decisions and incites companies to make decisions based on fiscal opportunities rather than on economic factors. Effective tax rates on various capital incomes should be aligned.

Harmonise VAT with the European Union directives

In the context of its accession to the European Union, Poland will have to accept the obligations of the Sixth Directive on indirect taxation. Products currently exempt from VAT or subject to reduced tax rates should be brought in line with EU harmonisation requirements. This will most importantly affect the rate of tax on building materials, new apartments, articles for children, cultural services, books, magazines, and legal services. Excise taxes on tobacco need to be raised and calculated on an *ad-valorem* basis.

Introduce a threshold (based for instance on the farming land size) below which small farms would not have to register for VAT purposes or keep books of accounts. Overtime, reduce the threshold to the level authorised by the EU. A similar approach could be adopted for the application of the income tax to the farming sector.

Introduce environmental taxes

Introduce product charges on goods and services that damage the environment and contribute to climate change such as coal, electricity, packaging material.

Raise VAT to the standard rate for all goods and services damaging the environment.

(continued on next page)

(continued)

Stop earmarking pollution fees and non-compliance fines and transfer these resources to the general budget of the central or local governments.

Improve and simplify tax administration

Calculate and publish a tax expenditure budget, that is, identify the cost of the loss of tax revenue due to exemptions, deductions, and credits allowed by the tax code. This would be intended to make policy-makers, legislators, and the public aware of the revenue shortfall directly linked to tax allowances.

Expand the use of information technology in tax administration.

Rewrite unclear parts of tax laws, especially of the corporate income tax law, in close co-operation with groups of taxpayers.

Begin the process of drafting a clear, simple, coherent, and comprehensive tax code covering all aspects, in co-operation with relevant parliamentary bodies and groups of taxpayers.

Bring the property market into the tax net

As foreseen in the EU Sixth Directive, new apartments and houses should be made subject to the standard VAT rate.

The property tax should be calculated on an *ad-valorem* basis, based on a new fiscal cadastre, and the revenue channelled to local governments

The stamp duty on the purchase of apartments and houses should be repealed.

municipal bonds or other debt instruments should remain subject to monitoring and, if necessary, pre-approval at the central level because local debt service defaults would have an impact on the debt rating of the entire country. A "golden rule" – limiting borrowing at no more than investment in infrastructure or buildings – could be introduced. Alternatively, a system of "internal stability pacts" could be introduced.

A *third* priority is that the tax system contributes to a development that would be less damaging for the environment and for the world climate. A number of changes in the tax system could be introduced in the short-term to contribute to an environmentally sustainable development. The government could consider introducing charges (such as excise taxes) on products that contribute to pollution and to climate change. At present, product charges are nearly non-existent in Poland.[64] A higher excise tax should also be introduced on leaded gasoline in order to differentiate its price from unleaded gasoline, following the experience of other OECD countries. In addition, some goods and services benefiting from the reduced VAT rate are damaging to the environment. For example, pesticides,

fertilisers, and chemical inputs to the feedstock are zero-rated under the VAT. Heat, electricity, coal, and gas are also subject to a standard VAT rate. Higher VAT rates and product charges would generate more environment-related revenues. The government could use these additional revenues to reduce the labour tax wedge. Finally, the authorities should stop earmarking the environmental fees and non-compliance fines. In general, earmarking tax resources reduces flexibility in the budget execution, leads to misallocation of fiscal revenue, may result in poor governance of public institutions and, in extreme cases, encourages bribery and corruption. Environmental fees and fines in Poland should be transferred to the general budgets of the central and local governments.

A *fourth* priority is to strengthen tax administration further, to boost revenue and prepare for European Union accession. Further simplification of tax declaration obligations and greater transparency in the tax interpretation would help maintain voluntary tax discipline in the future. This could be achieved by eliminating the need for most individual taxpayers whose taxes are withheld to file a tax return. Personal income tax liabilities are already directly withheld from wage payments. Similarly, income derived from financial sources could be subject to a withholding tax. This should cover a broad range of taxpayers once the government has eliminated most income deductions and tax credits.

A *fifth* priority is to reform property market taxation. At present, the construction sector and the property market largely escape the tax net. New residential construction is subject to 0 per cent VAT rate, rents are not taxed, construction materials are taxed at the reduced rate, and property taxes are low. The sector even benefits from indirect subsidies in the form of deductions from the personal income tax and tax credits. To bring residential construction into the tax net, Poland should start by applying the standard VAT rate to new apartments and new houses. Applying the standard rate is required by the Sixth Directive, is likely to generate additional revenues, and would not have a regressive impact because affluent individuals usually make new residential construction. Social housing could be taxed at the reduced rate, as permitted under Annex H of the Directive. In addition, as envisaged by the government, a means-tested program could help low-income families purchase a first principal residence. The property tax should be based on the *value* of properties, rather than their size. *Ad-valorem* taxation of properties requires creation of a fiscal cadastre, registration of the value of housing transactions, and assessment of the change in the value of properties. This will take some time to put in place but, eventually, will help local governments build their own taxable base. In contrast, the 5 per cent stamp duty on the purchase of residences in the secondary market should be repealed in order to foster the real estate market and encourage mobility.

Notes

1. Statistical work is still being undertaken on the magnitude of the initial output contraction. On the basis of official figures, in 1998 real GDP exceeded its 1989 level by 21 per cent. Recent work by Recess, a research institute associated to the central statistical office, suggests however that the initial contraction may have been less severe than initially estimated.
2. See De Broek and Koen, 1999.
3. See "Poland, quarterly statistics", Central Statistical Office, Warsaw, June 1999.
4. Unclassified transactions appear only in the balance of payments measured on a cash basis. These transactions are split and assigned to appropriate categories of the balance of payments on a transaction basis with the help of additional information.
5. EBRD statistics exclude intra-company loans and reinvested earnings, and therefore are not directly comparable with OECD or Polish statistics.
6. Measured by the Polish Agency for Foreign Investment (which uses a broader definition), the cumulated flow of FDI since 1990 reached $30.7 billion in 1998, the equivalent of about $800 per capita.
7. Membership of the Council can be terminated only in the event of: 1) resignation; 2) permanent illness; 3) a conviction for a criminal offence under a final and conclusive court verdict; and 4) resumption of activities in a political party or trade union.
8. The result of votes by the Monetary Policy Council, with the actual votes of each member, are published by the NBP after a delay of 2-3 months.
9. National Bank of Poland (1998*a*), "*Medium-Term Strategy of Monetary Policy (1999-2003)*", Warsaw, September.
10. In 1998, the inflation target of 9.5 per cent by year-end was undershot. For 1999, the MPC established an inflation target range of 8 to 8.5 per cent by year-end, rather than a single figure. In March 1999, however, in view of the faster-than-expected disinflation, the target range was lowered to 6.6 to 7.8 per cent by end-1999. For 2000, the MPC has announced a target range of 5.4 to 6.8 per cent by year-end.
11. New Zealand, Canada, the United Kingdom, Finland, Sweden, and Australia also use direct inflation targeting.
12. By the end of 1998, the money market bill was the only market instrument used by the NBP. Repurchase operations were eliminated as the central bank was seeking to withdraw the liquidity generated by its exchange market interventions.
13. Nominal GDP increased by 16 per cent in the fourth quarter of 1998 year-on-year.
14. One consequence of these sterilisation efforts was a build-up of large required reserves by commercial banks. In 1998, required reserves reached the exceptionally high level of 20 per cent on zloty demand deposits, 11 per cent on zloty time

deposits, and 5 per cent on foreign currency deposits, which imposed a financial burden on the banking sector and entailed high bank lending rates. To alleviate this burden, the NBP agreed with commercial banks in mid-1999 on an arrangement to reduce the required reserve ratios without injecting liquidity into the banking system. The NBP agreed to lower the required reserve ratios to 5 per cent on all types of deposits in September 1999 and, in return, commercial banks agreed to invest the funds released in new NBP securities. The new securities are non-marketable bonds, earning an interest rate equal to the inflation rate, and with maturities of 6, 7, 8, 9 and 10 years. The total amount issued has a face value of Zl 13 billion. Because the issuance of these securities could affect the future financial performance of the NBP, a parallel agreement was reached with the Ministry of Finance under which all government non-marketable liabilities to the central bank were converted into marketable Treasury securities. Securities obtained by the NBP are to be used for open market operations. The decision reduces the level of required reserves closer to European standards, and also brings greater clarity in the previously obscure system of required reserves.

15. "The Strategy of Public Finance and Economic Development – Poland 2000-2010", Council of Ministers and Ministry of Finance, June 1999.

16. The rate of VAT was raised from 2 per cent to 4 per cent on medications, ready-made drugs, diagnostic tests, pharmaceutical and medical items in 1999. In addition, excise taxes were raised on gasoline and cigarettes close to the minimum levels required in the Sixth EU Directive on indirect taxation. Non-residents were also authorised to obtain a VAT refund when they leave the country on the goods purchased during the stay in Poland.

17. Issues related to taxes on labour and social transfers are further discussed in Chapter V.

18. For 1999, the average annual nominal wage increases in the national economy has been set at 10.6 per cent with an inflation projection of 8.5 per cent.

19. Vacancies in each office, number of appointments to the civil service planned for a given year, deadlines for qualifying proceedings, and vacancies of high-rank positions will be published in the "Civil Service Bulletin" and announced in the press.

20. Based on 19 March 1999 issue of Puls Biznesu No. 55, p. 6.

21. The Labour Offices System currently comprises 495 units, of which 16 are regional labour offices, 33 branches of regional offices, 322 district labour offices, and 124 branches of district offices.

22. For example, in higher economic education, applied computer courses are first taught at the upper level classes (Zajicek, Steen and Domanski, 1998).

23. The reform provides also for setting up education management of kindergartens, elementary schools and gymnasiums as the own tasks of the communes (gminas), while the remaining schools and education institutions would remain within the competencies of districts (poivats) and regions (voivodship).

24. The Ministry of Education estimates that the number of full-time teachers should be reduced to 90 000 by 2005.

25. The eight sectors cover activities such as drilling for oil and gas and the extraction of mineral deposits; storage of substances and waste in underground reservoirs and excavations; production and sale of explosives, arms, ammunition and military and police equipment; manufacture and sale of liquid fuels and energy; construction and

operation of toll motorways and air transport and air services; railways services, and radio and television broadcasting.

26. The new pension system covers workers born after Dec. 31, 1948. Other workers stayed in the old system.

27. Chlon, Agnieszka, Marek Góra, and Michal Rutkowki: "Shaping Pension Reform in Poland: Security through Diversity", World Bank Social Protection Discussion Paper No. 9923, August 1999, Washington DC.

28. In the old system, early retirement was offered to workers for sectors such as mining, railways, education, aviation, navigation, journalism and the arts, and employees working in harmful conditions. In the new system, early pension will be limited to people working in environments considered as unhealthy by an *ad-hoc* medical Committee.

29. IMF (1999), "Poland – Selected Issues", Washington DC, February (available on www.imf.org).

30. The banking system is heavily concentrated, with 11 banks holding more than Zl 1 billion in net assets.

31. Since 1990, the privatisation of both manufacturers and wholesalers is proceeding gradually. Among the 57 enterprises in the industry, 39 are private, and the remaining state-owned, accounting for more than 50 per cent of the Polish market in 1998. By contrast, pharmacies have been rapidly privatised. Between 1990 and 1997, the ratio of pharmacies in the private sector rose from 44 per cent to 93 per cent.

32. The non-paying sector of the population includes farmers not paying personal income tax and unemployed not receiving benefits. See footnote of Figure 24 for more details.

33. Other responsibilities include providing education and post-graduate training of medical staff, financing of major health care investment, and setting standards for medical service quality.

34. The branch fund obligations are the same as those of regional health funds.

35. The Board of the Branch Health Fund consists of representatives of the Transportation Ministry (6), Defence Ministry (6), Interior Ministry (6), Office of the State Protection (1) and Justice Ministry (2).

36. It includes diagnostic procedures, care for pregnant women, basic dentistry services, medicines and medical products, orthopaedic aids, health resort treatment for a primary disease or number of diseases and transportation by medical vehicles.

37. There is a charge for changing family doctor within six months of choosing them.

38. Recent regulations on medical professions introduced supply-side measures to restrict the number of specialists resident in medical school training. A specialisation course raising requirements for family doctors has been introduced with a fast track option for those who have already worked extensively in primary care sector.

39. The age correction is established for persons over 60 years old, and the revenue correction is based on average premium rather than individual's premium.

40. Three Schools of Public Health (Warsaw, Krakow and Lodz) and some other university schools (Warsaw, Katowice and Wroclaw) offer courses leading to qualifications in health care management.

41. This problem is commonly found in other Eastern European countries and is not unknown in some OECD countries.

42. Depreciation allowance was introduced in 1999.

43. The public finance law for 1999 requires, however, that hospitals monitor their spending carefully.

44. The largest numbers of specialists are those in internal medicine and paediatrics (accounting for 21 per cent and 16 per cent respectively of the total).

45. Consultations per primary care physician at around 2 per capita per year reflect the under-use of family physicians.

46. By the end of 1998, the overall debt of the health sector was estimated by the MH at around Zl 8-10 billion. As part of the reform process, the state is obliged to eliminate the debts of public health care establishments before concluding agreements with the health funds. Therefore, the Ministry of Finance has announced the debt conversion into treasury bonds and has signed agreement with banks, including Bank Handlowy and BIG Bank Gdanski group, for buying up part of the debt. About Zl 6 billion has been underwritten by the Treasury. The other part will be repaid in cash to suppliers.

47. The level of health expenditure in Poland is higher if unofficial out-of-pocket payments are included. One estimate put a figure of 3 to 3.5 per cent of GDP in 1997, according to a bulletin published by the Government Information Center (Polityka) in January 1999. Such payments are, however, fairly widespread in low-income OECD countries such as Turkey and Mexico and other Eastern European countries, and so are underground activities which make measured GDP smaller than otherwise. For these reasons, the ratio of health expenditure to GDP may not be as inaccurate a comparative measure as one might think.

48. A new Drug Committee was formed in 1997 and has reportedly taken a more dynamic approach over registration procedures than did the previous body.

49. Additional reimbursement categories exist for specific illnesses (such as infectious diseases, special mental illnesses, tumours and cardiovascular disease) or particular groups (war and disabled veteran patients, and voluntary blood donors).

50. Higher administration costs may be necessary and acceptable elements in the reform that Poland is pursuing to increase micro-efficiency in the financing and delivery of medical services. It may, for example, be costly to generate price and effectiveness data on medical treatments but these costs may well pay their way if integrated into better managerial and medical practice (see OECD, 1995). The administrative costs of the insurance system are estimated to be around 2 per cent of total contributions according to a report presented by Vice-Minister of Health Anna Knysok.

51. The computerisation of the health funds has been delayed due to the cancellation of the public tender for the delivery of computer system in December 1998 by the MH. As a consequence, the budget allocation earmarked for the creation of the nationwide system has been transferred to individual funds which are expected to buy the equipment on their own. Risks that these systems will be incompatible are not negligible, as hardware will be bought independently.

52. As noted in Chapter III, Poland has a large problem of hidden unemployment, only one-quarter of the population aged 15-24 has a job, and most workers retire before the statutory retirement age.

53. See OECD, *Survey of Poland* (1998).

54. By comparison, the underground economy is estimated to range from 5 per cent of GDP (Scandinavian countries, Austria, the Netherlands) to 20 per cent (Italy and

Greece) in the European Union, and to be about 40-50 per cent of GDP in Russia and Ukraine.

55. Poland maintained a general import surcharge of 6 per cent to generate additional revenue. This was gradually phased out and eventually cancelled in 1997 in line with Poland's commitment under the GATS agreement to liberalise its foreign trade.

56. The labour marginal tax wedge is the increase in payments of income taxes and social security contributions associated with an increase in gross labour earnings (gross wages plus employers' contribution to social security and private pension plans).

57. The average and marginal tax rates would be even higher if indirect taxes were included.

58. By comparison, the cost of tax administration is equivalent to 1.6 per cent of tax revenue in France, 1.1 per cent in United Kingdom, and 0.5 per cent in the United States.

59. Farmers do not pay taxes and are, therefore, not registered as taxpayers. Poland intends to bring farmers into the tax net in 2000.

60. According to Peszko (1999), the fees on SO_2 and NO_x were approximately \$94 per ton at the beginning of 1997. However, the estimated marginal cost of investments to achieve a 30 per cent reduction (equivalent to new standards) in SO_2 is approximately \$600 per ton for large combustion sources.

61. Annex H items consists of basic foodstuffs, other food products; luxury food items; water; pharmaceutical products; medical equipment; accessories for the handicapped; public passenger transportation; books; newspapers; periodicals; authors, composers, and artists; radio and TV broadcasts; cultural events; sporting events and facilities; social housing, hotels, boarding houses, and camping sites; agricultural inputs (except machinery and buildings); funerals; garbage collection; and waste treatment.

62. Standard exemptions consist of postal services; medical care; dental care; charitable work; education; non-commercial activities of non-profit making organisations; cultural services; radio and TV broadcasting; insurance and reinsurance; letting of immovable property; financial services; lotteries and gambling; supply of land.

63. OECD, 1998, 'Value-Added Taxes in Central and Eastern European Countries – A Comparative Survey and Evaluation", OECD Centre for Co-operation with Non-members.

64. Only one excise tax on plastic packaging has been introduced with an environmental objective in July 1995. There is also a deposit refund system on bottles.

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Annex I

The Polish tax system as of January 2000

Value-added tax (VAT)

The VAT was introduced on 5 July 1993 to replace the turnover tax. The VAT applies to taxpayers that sell, import and export taxable goods and services in Poland. Taxpayers with annual turnover below Zl 80 000 are not obligated to register for VAT.

Nature of the tax: The VAT is a standard invoice style, consumption and destination-based tax. For imported goods, the tax base includes excise duties and customs fees. Imported goods are subject to the same level of VAT rates as similar domestically produced products.

Deductions and allowances: Unprocessed agricultural products, financial, insurance, educational, health, art and cultural, postal services, and apartment rental are exempt from VAT. Taxpayers paying income tax in tax card form are also exempt from VAT. The law provides for other exemptions, including the sale of unprocessed foodstuffs, financial services, educational, health care and social assistance services. VAT does not apply to some sales in duty-free zones. The Polish authorities took recently necessary action to enable VAT refunds to taxable persons not established within the country (such as foreign tourists).

Tax rates: The standard rate of the tax, applicable to most goods and services, is 22 per cent. Reduced rates are applied to some products: 7 per cent, 4 per cent and 0 per cent. The 7 per cent rate is applied to most processed foodstuffs, most construction raw materials, certain construction works (in particular those related to housing), long-distance passenger transport (by rail and coach), and medicines and pharmaceuticals. The zero per cent rate mainly applies to exports, books and magazines, and basic agricultural inputs (fertilisers, crop protection chemicals, feed, agricultural machines and equipment).

Excise tax

The excise tax was introduced in 1993. It applies to the importation and production of excisable goods.

Nature of the tax: Excise duty is charged on consumer products referred to as "excisable products", including alcoholic beverages, tobacco, fuel, passenger cars, luxury electronic equipment, gambling, salt, plastic packaging, furs, cosmetics, luxury yachts, sailboats. Taxes are not levied on exports. Excise duties do not apply to some sales in duty-free zones.

Tax rates: Tax rates on important excisable commodities sold in Poland are as follows as of 1 December 1999:

Spirits:
Quality vodkas and alcoholic drinks up to 18 per cent;
Zl 5 677/hl at 100 per cent spirit.
Wine:
Fruit wine Zl 89/hl;
Wine type alcohol drinks ZI 220/hl;
Grape wines Zl 110/hl.
Beer:
Per per cent extract of beer base Zl 5.45.
Tobacco products:
Cigarettes:
Foreign brands Zl 97.40/1 000;
Domestic brands with filter > 70 mm Zl 83.40/1 000
Domestic brands with filter < 70 nun Zl 65.60;
Domestic brands without filter Zl 63.70/1 000;
Cigars Zl 97.40/1 000
Other tobacco products 60 per cent.

Fuel for engines:
Leaded gasoline 94 Zl 1 219/1 000 l;
Unleaded gasoline Zl 1 127/1 000 l;
Diesel fuels Zl 806/1 000 l.
Passenger cars:
Engine capacity > 2 000 cm^3 10 per cent,
Others 2 per cent.
Electronic equipment (luxury amounts), 10 per cent. Gambling 15 per cent.
Salt:
Without iodine, 15 per cent;
With iodine, 7 per cent.
Plastic containers Zl 12/1 000.
Furs, 20 per cent.
Chewing gum, 20 per cent.

Corporate income tax

Corporate income tax (CIT) was introduced in 1989. The CIT is based on the "classical" system. Under this system, corporate income is fully taxed and distributed profits (dividends) are taxed once again by way of withholding. To reduce the impact of double-taxation, dividends are taxed at only 20 per cent. The taxable base consists of the annual worldwide income after deduction of business expenses. All legal persons incorporated in Poland are subject to corporate income tax. All legal persons incorporated abroad are subject to tax on Polish-source income. Income derived from agricultural activity and forestry is tax-exempt. Deductible business expenses include depreciation, expenditure on research and development, interest on liabilities, provisions for bad debts, donations, exchange rate losses, and mandatory social insurance contributions. The CIT rate is 30 per cent in 2000.

Deductions and allowances: Depreciation is treated as a tax allowable cost and can be calculated by means of the straight-line or declining method. For certain assets and in regions with structural unemployment, an extra allowance may be applied. In 1999, there were 63 different depreciation schedules. Annual depreciation rates varied from 1.5 per cent to 30 per cent. The depreciation rates were: buildings 1.5-10 per cent; general machinery 10 per cent; ships, rail, aircraft 14-20 per cent; office equipment 14 per cent; road building machinery 8-20 per cent; road vehicles other than cars 18-20 per cent; and computers 30 per cent.

Various tax incentives apply to enterprises located in special economic zones (SEZs). Economic entities running their business in SEZs are eligible for tax allowances, preferential treatment and other benefits. Income of entities eligible for tax exemption can be totally exempt from CIT through a period equal to half of the period for which the zone has been established. After that time, up to 50 per cent of their income can be exempt from

taxation. In the existing zones, total exemption from tax can be granted to entities whose investments exceed a certain threshold, characteristic of each zone, or investors, which create a certain number of jobs. Entities which do not enjoy income tax exemptions can be granted preferences in the form of the right to treat investment expenses related directly to their business in the zone as costs of the generated income, as well as the right to apply increased rates of depreciation. Moreover, entities operating in the zone under a permit are exempt from local fees and charges, *e.g.* real estate tax. As from 1 January 2000 no new exemptions will be granted to companies operating in SEZs.

Tax incentives are offered to encourage investment in certain sectors of activity (such as scientific research, new businesses, and fisheries) and in export-oriented firms. When some conditions are met, the taxpayer may deduct the cost of investment up to 30 per cent of profit the first year, and up to 15 per cent of profit the second year

Personal income tax

The personal income tax (PIT) was introduced in 1992. The PIT applies to the world-wide income of resident individuals. Polish citizens are taxable on their income from foreign sources, unless bilateral taxation treaty applies. Foreign citizens are taxable on the income derived from Polish sources.

Nature of the tax: Taxable income includes income from employment, cash and fringe benefits, remuneration and benefits in kind, bonuses, retirement and disability pensions, income from non-agricultural businesses, income from leasing and renting for purposes other than agriculture, and income from financial investments. Several income sources are exempt from personal taxes, including income generated from agricultural activity (with some exceptions) and from forestry, inheritances, interest income, income derived from investment funds, capital gains, and disability and veteran pensions. However, income generated from the sale of stakes in companies, shares acquired outside public trading and shares acquired outside the stock exchange, as well as interest on deposits in bank accounts connected with performed economic activity, is taxable jointly with other income. Interest on dividends are subject to a 20 per cent final withholding tax.

Deductions and allowances: The current tax legislation, contains a comprehensive system of income deductions. These are social security contributions and other obligatory contributions, housing related expenses, pensions and other permanent burdens, spending on educational, equipment, expenditures for paid education of children, and medical expenses. Charitable contributions are deductible only if made for the benefit of legal entities. A flat income deduction (“cost of income generation”) established by law at ZI 982.08 in 2000 is allowed. Married couples can reduce their tax liability by filing a joint tax return. Certain housing expenses and obligatory contributions to health funds are deductible from the PIT.

Tax rates: Taxable income net of income deductions is subject to a progressive schedule with there marginal tax rates. In 2000:

- 19 per cent for income of Zl 0 to Zl 32 736 (Zl 436.20 tax credit applies);
- 30 per cent (Income of Zl 32 736 – 65 472);
- 40 per cent (Income above Zl 65 472).

Presumptive taxes based on turnover apply to certain small-scale entrepreneurs with turnover below Zl 400 000. These are taxed at three rates: 8.5 per cent of revenue from services; 5.5 per cent from manufacturing, construction and cargo transport; and 3.0 per cent on revenue from trade and catering. For most employed workers, the PIT is directly

withheld by the employer from the monthly pay. Self-employed individuals pay the PIT on an annual basis.

Social security contributions

Contributions to the Social Insurance Office (ZUS). Contributions to ZUS are paid by the employer (17.9 per cent of gross wage) and the employee (18.71 per cent of gross wage). They are split between different accounts: old-age pension (19.52 per cent), disability pension (13 per cent), sickness insurance (2.45 per cent) and work injury insurance (1.62 per cent). An annual ceiling established at 30 times the monthly average salary is applied for employers' and employees contributions. Once the ceiling is reached in a given year, contributions are no longer due. Self-employed individuals must pay both the employer and employee contributions.

Contributions to labour fund and GESF. Obligatory premiums are paid to the Labour Fund. The contribution rate is 2.45 per cent of the payroll expenditures. The premium for Guaranteed Employee Services Fund for 1999 is 0.08 per cent of net wage.

Insurance premium to health funds

In January 1999, as part of the health insurance reform, a new mandatory health insurance premium was introduced to provide financial resources to the new Health Funds. The mandatory premium is calculated as 7.5 per cent of income. Employers or other providers of income must withhold insurance premiums and pay them directly to ZUS on a monthly basis. ZUS then channels these premiums to relevant Health Funds. Most income sources are subject to the health insurance premium, including salaries, self-employed income, farmers' income, pensions, and other social benefits. Income from financial sources (interest, dividends, and capital gains) is not subject to the health insurance premium. The health insurance premium is entirely deductible from personal income tax liability. Therefore, individual taxpayers can reduce their PIT liability by the amount of the health insurance premium.

Tax on inheritances and donations

Individuals who receive inheritances or gifts are liable to tax for the portion they receive.

Nature of the tax: The tax base consists of the market value of all property received by the beneficiary, after deducting debts and other liabilities. The tax rate is established in accordance with the taxpayer group to which the beneficiary belongs, and the value of the property received. Classification to a tax group takes place in accordance with the personal relationship of the acquirer to the person from whom the property has been acquired.

Deductions and allowances: The following are exempt from the tax:

- acquisition by inheritance of money or other valuables by a person classified to the first tax group, up to the amount defined in the Act, designated to be spent for housing purposes;
- acquisition by donation of rights to a savings account by a spouse, descendants, ascendants, siblings, and a person remaining in joint marital cohabitation with the owner of the savings account in a housing fund, on the condition that

the funds accumulated in this account are designated to be spend for housing purposes;
- acquisition by inheritance, by persons classified to the first and second tax group, of objects of home furnishings, bed linen, clothing, linen and work tools appropriated for household use;
- acquisition by a spouse or descendants, by inheritance or donation, of a manufacturing, construction, trade or service establishment or its part;
- acquisition by a person carrying on economic activity, by donation, of machinery, equipment and tools received from abroad;
- acquisition by inheritance of the right to a living accommodation or residential house up to the equivalent of 110 m^2 (based on market prices), if it serves to satisfy own housing needs.

Agricultural tax

The tax obligation on this account was imposed by the Act of 15 November 1984 on the agricultural tax. This is essentially a property tax, assessed on the area of farm land and taking into account the type of land, the classes of farm land and the place where the land is located.

Deductions and allowances: The following land is not taxable:

- land under lakes and running water, land on which water reservoirs are located which are used for water supply for the population and land under flood dams;
- land recognised as wasteland;
- land entered in the register of monuments, on the condition that it is developed and maintained in accordance with the provisions on protection of monuments;
- land occupied for carrying on economic activity other than farming;
- land constituting infields of members of agricultural production co-operatives who have reached the retirement age or are invalids of the first or second group;
- land excluded for non-agricultural purposes on the basis of final administrative decisions.

Forest tax

Nature of the tax: The tax base for the forest tax is the number of conversion hectares, established on the basis of the area of the main tree species in the tree stand and classification of the tree stand for the main tree species – resulting from the plan of arranging the forest, as of 1 January of the tax year.

The tax base: The forest tax on one conversion hectare is the cash equivalent of 0.200 m^3 of coniferous sawmill timber, calculated according to the price of sale of this timber acquired by forest superintendence.

Real estate tax

The real estate tax is an annual local tax paid by individual and business taxpayers. The taxable base is determined according to the floor area of the building. Tax rates are determined by Gimina councils, subject to certain ceilings.

Deductions and allowances: The property tax provides for various exemptions set out in the law, including property used for public purposes, property in special economic zones, and other real estate exempted on the basis of separate legislation. The following have been statutorily exempted from the real estate tax:

- real estate or their parts occupied for the needs of local governments;
- real estate being the property of foreign states or international organisations (on reciprocity basis), or turned over for perpetual usufruct to them, appropriated for the seats of diplomatic representations, consular offices and other missions enjoying privileges and immunities under statutory acts, international agreements or customs;
- public roads;
- public rail transportation, airports, sea and river ports;
- power plants, transmission and distribution electric power lines and lines of the distribution network of gas, heat, fuels and water, sewage systems, buildings or their parts directly connected with the process of water intake and purification;
- land under flowing water and navigation channels, with the exception of lakes and land occupied for water reservoirs or water power stations;
- utility buildings or their parts connected with forest activity, occupied for running special sections of agricultural production, and in farms, in the understanding of the provisions on the agricultural tax, utility buildings or their parts connected with agricultural activity;
- real estates or their parts occupied for the needs of conducting statutory activity by children and youth associations, in the field of education, upbringing, science and technology, physical culture and sports, with the exception of those used for carrying on economic activity, and land occupied on a sustained basis for camping sites and recreational areas for children and youth;
- buildings and land individually entered in the register of monuments, under the condition that they are maintained and preserved in accordance with the provisions on protection of monuments, with the exception of parts occupied for carrying on economic activity;
- buildings and land under the management of registered museums;
- real estates or their parts exempted from the real estate tax on the basis of separate regulations;
- land, structures and buildings located within a Special Economic Zone.

Annex II

International comparison of tax systems

Table A1. **Personal income tax**

Rates in percentage, 1998

	Highest and Lowest marginal PIT rates	Number of PIT tax Schedules	Zero-rated band	Tax credit	Unit of taxation 1995[1]	Average effective household tax rate 1991-96[2]
United States	15-39.6	5	Yes	No	Joint	14.4
Japan	10-50	5	Yes	No	Ind	10.8
Germany	..	..	Yes	No	Joint	15.8
France	10.5-54	6	Yes	No	Joint	9.8
Italy	18.1-45.5	7	No	Yes	Ind	15.9
United Kingdom	20-40	3	Yes	No	Ind	12.9
Canada	17.51-31.3	4	No	Yes	Ind	21.3
Australia	20-47	4	Yes	No	Ind	20.4
Austria	10-50	5	No	Yes	Ind	14.4
Belgium	25.75-56.65	7	Yes	No	Ind	19.3
Czech Republic	15-40	5	Yes	No	Ind	9.3
Denmark	8-29	3	Yes	No	Ind	39.8
Finland	6-38	6	Yes	No	Ind	29.5
Greece[3]	5-40	4	Yes	No	Ind	4.4
Hungary	20-42	6	No	Yes	Ind	12.1
Iceland	29.31-34.41	2	No	Yes	Ind	..
Ireland	26-48	2	Yes	No	Opt	17.7
Korea	10-40	4	No	No	Ind	5.6
Luxembourg	6-32	10	Yes	No	Joint	..
Mexico[4]	3-35	8	No	Yes	Ind	6.7
Netherlands	8.85-60	3	Yes	No	Ind	18.1
New Zealand	15-33	2/3	No	..[5]	Ind	25.4
Norway	18.8-32.5	3	Yes	No	Opt	19.2
Poland	**19-40**	**3**	**No**	**Yes**	**Opt**	**11.9**
Portugal	15-40	4	No	Yes	Joint	9.5
Spain	17-47.6	8	Yes	No	Opt	13.3
Sweden	25	1	Yes	No	Ind	30.9
Switzerland[6]	0.77-13.2	10	Yes	No	Joint	21.1
Turkey	25-55	7	Yes	No	Ind	..

1. Ind = Independent taxation of husband and wife; Joint = Joint taxation of husband and wife; Opt = Option different systems.
2. Taxes on income, profits, capital gains of individuals (including social security contributions) divided by wages and salaries plus property and entrepreneurial income of the self-employed.
3. For 1997.
4. In the case of Mexico, the tax on individual income is applicable to wage earners only; self-employed are taxed under the corporate income tax regime. Data for self-employment income and household property income are estimated from the 1994 household survey.
4. A rebate in the form of a tax credit is granted for those with low incomes. The rebate converts the statutory two step scale into a three step scale with positive rates.
5. Include all (private) medical insurance premiums in household taxation.

Source: The OECD Tax Data Base.

Table A2. **VAT**

Rates in per cent, 1996

	VAT standard rate	VAT in per cent of total tax revenue	VAT revenue in per cent of GDP	Productivity[1]	Effective VAT[2]	Example of zero-rated goods
United States	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Japan	5.0	5.3	1.5	50.5	2.6	None
Germany	15.0	17.6	6.7	44.7	11.6	None
France	20.6	17.2	7.9	38.2	14.3	None
Italy	19.0	13.0	5.6	29.6	9.6	Books, newspapers
United Kingdom	17.5	19.4	7.0	39.9	10.6	Food, books, children's clothing
Canada	7.0	7.0	2.6	36.6	4.4	Medicine, exports, agriculture
Australia	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Austria	20.0	19.1	8.4	42.1	16.2	None
Belgium	21.0	15.2	7.0	33.4	12.5	Car for handicapped, newspapers
Czech Republic	22.0	19.5	7.2	32.7	..	n.a.
Denmark	25.0	19.5	10.2	40.8	22.1	Newspapers
Finland	22.0	17.1	8.2	37.4	17.0	Newspapers, vessels, international transport
Greece	18.0	22.7	9.2	51.2	10.9	None
Hungary	25.0	18.6	7.5	30.0	..	n.a.
Iceland	24.5	29.1	9.4	38.4	17.1	International transport, food
Ireland	21.0	20.9	7.0	33.5	15.5	Books, medicine, seeds
Korea	10.0	18.5	4.3	43.1	..	n.a.
Luxembourg	15.0	15.0	6.7	44.7	..	None
Mexico	15.0	17.7	2.9	19.2	4.4	Medicine, food, exports
Netherlands	17.5	16.1	7.0	39.8	13.0	None
New Zealand	12.5	23.6	8.5	67.7	15.3	Exports, fine metal
Norway	23.0	21.0	8.6	37.5	21.2	Books, newspapers
Poland (1998)	**22.0**	**20.8**	**7.8**	**35.4**	**11.7**	**Books, magazines, agricultural inputs**
Portugal	17.0	22.8	8.0	46.9	13.5	None
Spain	16.0	16.3	5.5	34.4	9.4	None
Sweden	25.0	13.5	7.0	28.1	14.1	Commercial aircrafts, medicine
Switzerland	6.5	9.5	3.3	50.6	5.5	None
Turkey	15.0	23.8	6.0	40.3	9.2	None

1. VAT productivity is VAT revenue in per cent of GDP divided by standard VAT rate.
2. Effective VAT rate is VAT revenue divided by base (consumption).

Source: OECD, Revenue Statistics of OECD Member Countries.

Table A3. **Central government corporate taxes**

Per cent

	Type of corporate tax system[1]	CIT statutory tax rate 1991	CIT statutory tax rate 1998	CIT revenue in per cent of GDP 1996
United States	Classical	34	35	2.7
Japan	Classical	38	34	4.7
Germany	Split rate with full imputation	50-36	42-56	1.4
France	Full imputation	34-42	33-36.7	1.7
Italy	Full or partial imputation	36	37	4.0
United Kingdom	Partial imputation	34	31	3.8
Canada	Partial imputation	28	28	3.3
Australia	Full imputation	39	36	4.7
Austria	Classical	30	34	2.1
Belgium	Classical	39	39	3.1
Czech Republic	Partial deduction of dividends paid	..	39	4.2
Denmark	Partial credit	38	34	2.4
Finland	Full imputation	23	28	3.2
Greece	..	46	35-40[2]	2.6
Hungary	Classical		18	1.9
Iceland	Partial deduction of dividends paid	45	30	0.9
Ireland	Partial imputation	43	32	3.2
Korea	Partial credit			2.7
Luxembourg	Classical	33	30	7.2
Mexico	Full imputation	..	34	2.3
Netherlands	Classical	35	35	4.1
New Zealand	Full imputation	33	33	3.5
Norway	Full imputation	27	28	4.3
Poland	**Classical**	**..**	**34**[3]	**2.8**[4]
Portugal	Partial credit	36	34	3.3
Spain	Partial deduction of dividends paid	35	35	2.0
Sweden	Classical	30	28	2.9
Switzerland	Classical	4-10	7.8[5]	1.9
Turkey	Partial credit	49	25	1.5

1. A classical system does not give shareholders credit for corporate taxes paid on dividend distributions. A full imputation system gives the shareholder a full tax credit for corporate taxes paid on dividend distribution (*i.e.* it eliminates double taxation of dividends). Partial credit systems retain some double taxation of dividends. Split rate systems impose different corporate tax rates on retained earnings than on distributed earnings (which may also be given full or partial imputation).
2. 1997.
3. CIT rate of 34 per cent in Poland is for 1999.
4. 1998.
5. The figure for 1998 is a net rate. The federal tax is deductible from its own base.

Source: The OECD Tax Data Base.

Table A4. **Social security contributions**

Per cent

	1997	1997	1994	1996	1996
	Employee's social security contributions/ labour cost[1]	Employer's social security contributions/ labour cost[1]	Use of income ceiling[1]	Social security contributions and payroll taxes/total tax revenue	Social security contributions and payroll taxes/GDP
United States	7	7	Yes	24.7	7.0
Japan	7	7	No	36.5	10.4
Germany	17	17	Yes	40.6	15.5
France	13	29	Yes	45.4	20.8
Italy	7	32	No	34.3	14.8
United Kingdom	8	9	Yes	17.3	6.2
Canada	5	6	No	16.3	6.0
Australia	2	0	No	6.7	2.1
Austria	14	24	Yes	41.1	18.1
Belgium	10	26	No	32.3	14.9
Czech Republic	9	26		42.0	17.0
Denmark	10	0		3.6	1.9
Finland	6	20	No	25.8	12.4
Greece	12	22	No[2]	31.4	12.8
Hungary	8	32		33.9	13.7
Iceland	0	4	No	8.6	2.8
Ireland	5	11	Yes	14.6	4.9
Korea	4	7		9.4	2.2
Luxembourg	11	12		26.6	11.9
Mexico	2	24	No	16.9	2.7
Netherlands	30	7	Yes	39.6	17.1
New Zealand	0	0	No	1.0	0.3
Norway	7	11	No	23.3	9.6
Poland[3]	**0**	**33**[4]	**No**	**31.8**	**13.4**
Portugal	9	19	No	25.7	9.0
Spain	5	24	No	35.9	12.1
Sweden	4	25	No	32.4	16.8
Switzerland	10	10	No	37.4	13.0
Turkey	9	13	Yes	15.8	4.0

1. Single individual at the income level of the average production worker.
2. 1993.
3. In early 1999, social security taxes were split between employers and employees.
4. Including labour fund contribution.

Source: OECD, The Tax/Benefit Position of Employees and Revenue Statistics of OECD Member Countries.

Table A5. **Taxation of interest income, dividends, capital gains and private pensions**

	Taxation of interest income from bank deposits 1998[1]	Taxation of interest income from Government bonds 1998[1]	Taxation of dividends 1998[1]	Taxation of capital gains (top rate of taxation)	Contributions to private pension funds	Pension fund annuities
United States	As ordinary income	As ordinary income[2]	As ordinary income	Taxed generally at 20 per cent	Deductible	Taxed
Japan	20 per cent WT	20 per cent WT	Depends on amount of dividend	For listed companies: 20 per cent plus 6 per cent local tax	Deductible	Taxed
Germany	31.5 per cent TC	31.5 per cent TC	As ordinary income or with 48.47 per cent tax credit	Generally exempt	Depends on type of pension	Taxed
France	15 per cent WT[3]	15 per cent WT[3]	As ordinary income or with 33.33 per cent tax credit	Flat rate of 26 per cent	Deductible	Taxed
Italy	27 per cent WT	12.5 per cent WT	12.5 per cent WT or as ordinary income with 10 per cent tax credit	Rate of 12.5 per cent on non-substantial holdings	Deductible	Taxed
United Kingdom	As ordinary income 20 per cent TC	As ordinary income 20 per cent TC	As ordinary income with 20 per cent tax credit	As ordinary income	Deductible with limits	Varies
Canada	As ordinary income	As ordinary income	Dividends are grossed-up by 25 per cent and treated as ordinary income with 13.34 per cent tax credit	Treated as ordinary income	Deductible	Taxed
Czech Republic	15 per cent WT	15 per cent WT	25 per cent WT	Exempt (securities held for more than 6 months)	Taxed	Taxed
Hungary	Exempt	Exempt	20-25 per cent WT	Generally taxed at 20 per cent	Deductible	Exempt
Poland	**Exempt**	**Exempt**	**20 per cent WT**	**Exempt**	**Varies**	**Varies**

Note: WT: Final withholding tax; TC: Withholding tax with a tax credit.
1. For resident individuals.
2. Except for tax exempt bonds.
3. Other taxes also apply.
Source: OECD tax database.

Annex III

Poland's accession to the European Union

Under the Copenhagen agreement, the European Commission makes regular reports to the European Council reviewing the progress made by each candidate country towards accession, in particular the rate at which it is adopting the Union *acquis*. The reports mainly draw on information provided by member countries in the context of their national programmes for the adoption of the *acquis*, on information provided in the context of analytical examinations (so-called "screening"), and on data provided during negotiations.

The report from the Commission on progress towards accession released on 13 October 1999 generally praised Poland for the progress made in harmonising its policies and legislation in many areas with the EU rules. Some progress was noted in particular in the areas of economic reform, justice and home affairs, and regional development. The report, however, noted that more needs to be done in areas such as agriculture, environmental protection, internal market, and anti-corruption measures. The present annex briefly summarises the assessment made in these areas.

- **Agriculture.** Alongside with environmental protection, agriculture is the biggest impediments on the way to the EU. The agricultural sector employs 27 per cent of workers but produces only 4.5 per cent of value-added, which implies low average incomes in rural areas. The Progress Report from the Commission acknowledges that people living in rural areas have not benefited greatly from economic growth. Strong protests followed the collapse of exports to Russia and the decline in market prices at the end of 1998. The government responded by increasing farming price support and by stepping up protectionist measures. However, price support and protectionism draw both attention and resources away from the real issues and as a result worsen rather than enhance the future of the sector. According to the Commission, the authorities need to develop a long-term strategy which would treat in a coherent manner market and price policy, rural development, the social impact of restructuring, land issues, and the agro-industrial industry. Such a strategy would need to be costed, budgeted, and programmed over time to become an effective instrument.
- **Environmental protection.** The progress report considers that, in the environmental field, Poland has a moderate level of alignment with the EU rules. Some limited legislative progress has been achieved, but the overall rate of progress is slow. Strong emphasis appears to be placed on drafting an Act on Environment Protection, but more specific legislation has been significantly delayed. In addition, where legislation has been adopted, the general level of compliance is low. Insufficient effort has been made in particular to transpose EU regulations in the areas of nature protection, air quality, noise, chemicals, ozone depleting substances, nuclear safety, radiation protection, waste sectors. Monitoring structures also need to be improved, notably for air quality. The

Commission acknowledges that the investments required to adopt EU directives are considerable and will need to be carried out over time.

- **Internal market.** The internal market is perhaps the most important aspect of EU policies. This involves dismantled internal borders, common certification and standardisation standards, public procurement harmonised rules, free capital movements, respect of intellectual and industrial property and common competition rules. Progress has been made on certain policies. A new act on public procurement should enter into force in 2000, although further amendments to the law are needed. Draft legislation on standardisation and certification is before parliament. There has been progress in the area of antitrust law, and further legislative alignment is under consideration by the government to align Polish competition law with EU requirements. To date, however, little progress has been made in the areas of intellectual and industrial property, data protection, conformity assessment, and public aid. Public aid legislation is pending adoption but further progress is needed regarding the alignment of rules of state monopolies in certain sectors. The system of public aid monitoring is being developed in co-operation with the EU, however more needs to be done to provide adequate means for state aid monitoring authority, complete preparation of state aid inventory and adopt and implement a legal framework. Considerable efforts are needed to fulfil the requirements regarding the transparency of public aid.
- **Anti-corruption measures.** The report from the Commission notes that Poland needs to intensify the fight against corruption through the adoption of a national policy and the establishment of adequate institutional and enforcement measures. Poland's own reports on corruption by the Ministry of the Interior and the Court of Auditors underline the gravity of the problem in key economic sectors such as customs, public procurement, real estate, industrial waste disposal, healthcare and insurance. The widespread use of bureaucratic controls in the Polish economy through the issuance of permits, licenses and certificates tends to support a regulatory climate in which corruption prospers and in which political transparency is impaired. It is important to adopt an effective anti-corruption policy and to provide adequate institutional resources and powers to tackle the issue and its potentially negative impact on economic development.*

EU funding. It is expected that as from the next year the EU's assistance to Poland will significantly increase. Up to now the annual EU funding averages around euro 200 million, whereas the plan is now to increase this value up to some euro 900 million. The total EU funding from the PHARE II programme will reach as much as euro 400 million in 1999, and will be kept at this level in the following years. It is also planned that during the period of 2000 to 2006 Poland will be eligible to receive about euro 340 million per year from the Instrument for Structural Policies for pre-Accession fund (ISPA) for environmental protection and transport infrastructure, and about euro 168 million per year in the same time period from the SAPARD pre-accession fund (Special Accession Programme for Agriculture and Rural Development). The EU's Structural Funds system requires however Poland to provide matching amounts of financial assistance. The draft 2000 Polish budget envisages Zl 500 million on PHARE co-financing projects.

* The Polish government's position is that the extent of corruption is not significantly different from that found in some other European countries.

Annex IV

Intergovernmental transfers

Poland has a budgetary system that entails large transfers from the central government to local governments, social security administrations, and extra-budgetary funds. By OECD standards, these transfers are large, reflecting the fact that most tax revenues are collected by the central government, in particular income taxes and indirect taxes. In 1998, one-third of central government revenue was spent on transfers to other levels of governments, the equivalent of close to 8 per cent of GDP. The main transfers are made to local governments, particularly communes (*gminas*), and to social security funds, particularly the social insurance fund (ZUS) and the farmers insurance fund (KRUS).

Transfers to local governments

In July 1998, under the Law on the Three-level Territorial Division of the State, Poland introduced an important reform of its public administration. The reform establishes three levels of territorial division in the country and decentralises policy functions to the level of government where these policies can be best implemented. By applying the principle of subsidiarity,[1] Poland followed the trend of bringing policy functions closer to the people. The three administrative divisions consist of 2 489 gminas (communes), 373 poviats (counties or districts), and 16 voivodships (regions). The law establishes the main responsibilities of each level of local governments, along with its revenue.

2 489 Gminas	373 Poviats [1]	16 Voivodships
Resources	**Resources**	**Resources**
Property tax	Share in PIT (1%)	Share of PIT (1.5%)
Agricultural tax	Special purpose subsidies	Share of CIT (0.5%)
Forest tax	General subsidies	Leasing revenues
User fees	Education subsidies	Special purpose subsidies
Shares of PIT (27.6%) and CIT (5.0%)	Road maintenance subsidies	General purpose subsidies
Special purpose subsidies		Education subsidies
Education subsidy		Road subsidies
General purpose subsidy		Compensation grants
Main expenditure	**Main expenditure**	**Main expenditure**
Elementary schools	Secondary schools	Regional economic development
Primary health care	General hospitals	Higher education
Land zoning	Fire stations	Environmental issues
Water management	Tax offices	
	Environment protection agencies	

1. Includes 65 urban poviats which assume both gminas and poviats functions.
Source: Ministry of Finance.

Local governments receive the bulk of their revenue in the form of grants and transfers (hereafter "subsidies") from the central government. There are several categories of subsidies.

- **Special purpose subsidies** are to be spent only on pre-defined outlays. The list of spending categories for which these subsidies can be requested include social assistance, investment plans (such as sewage systems), and environmental projects. Central government co-financing cannot exceed 50 per cent of the cost of any particular project, except in some Gminas where it can reach 75 per cent, including territories previously used by the Soviet Army. Special purpose subsidies can also be received to finance mandatory administrative functions required by the law.
- The **education subsidy** is the largest subsidy. It finances the education system responsibilities of Gminas, Poivats, and Voivodships. The education subsidy allocates a fixed 12.8 per cent of planned central government revenue according to strict formulas. In 1999, out of Zl 16 billion paid under this subsidy, Gminas should receive Zl 9 billion. The education subsidy must be transferred up to the 25th day prior to the month when payments have to be made. In case of late payments, the law foresees that the central government must pay a penalty.
- The **general purpose** subsidy is intended to close the income gap between various Gminas. It is financed by a fixed 1 per cent of projected central government revenue combined with payments made by the richest Gminas to the poorest ones. The Ministry of Finance distributes the subsidy according to a rigid formula that allows for no discretion. The formula is based on the measured tax revenue per capita for each Gmina during the first six month of a given fiscal year. If the Gmina's tax revenue is less than 85 per cent of the national average, a subsidy is granted; 1500 Gminas (out of 2200) are in such a case. The subsidy can cover 90 per cent of the difference between the Gmina's revenue and the national average. In contrast , Gminas that are above the national average have to make a payment to the central government; 80 of them are in such a case.
- **Compensation grants** are given to Gminas to compensate them for the loss of revenue due to the cancellation of a tax or the loss of the tax base. For instance, Gminas are fully compensated for the loss of the transportation tax.

Transfers to social security administrations

The central government provides subsidies to cover the needs to social security funds and to finance specific programmes. FUS receives a subsidy to finance the reform of the pension system, in particular offset the losses due to the transfer of pension contributions to private pension funds under the second pillar.

Fund	Main functions	Subsidy foreseen in 2000 (1999) in Zl billion
Social Insurance Fund (FUS)	Payment of pensions and sickness benefits	14.4-(9.6)
Farmer's Social Insurance Fund (KRUS)	Payment of pensions to retired farmers	14.0-(13.4)
Alimony Fund	Payment of alimony benefits	0.84-(0.68)
Labour Fund	Unemployment benefits; labour market polices	0.74-(0.79)
State Fund for War Veterans	War veteran pensions	0.1-(0.1)

Note

1. Subsidiarity, in the Polish context, is considered as "the division of public finances and administrative functions in such a way that the responsibility for every function is assigned to the lowest level of government capable of performing that function". From: "Effectiveness, Openness, Subsidiarity – A new State for new Challenges", Chancellery of the Prime Minister of the Republic of Poland, September 1998.

Annex V

Main tracks of privatisation

Privatisation is a complex technical process, involving large-scale redistribution of ownership among various actors – such as the state, regional and local governments, managers, employees, creditors, and investors. Privatisation can be further complicated by claims presented by owners destituted from their ownership rights during the pre-transition period or during the second world war. Privatisation is also often directly related to the restructuring of companies, the deregulation of sectors, and de-monopolisation. The success of privatisation offers is intertwined with the fluctuations in world equity markets, and the shift of sentiment in emerging markets of 1997-98 made the process an ever more challenging one.

To ensure a proper co-ordination of these difficult tasks, the management and privatisation of state enterprises were put under the umbrella of a single government agency, the Ministry of the State Treasury. The Law of 30 August 1996 on commercialisation and privatisation of state owned enterprises replace the legal framework established by the 1990 law. The Law establishes that the state can withdraw entirely from any sector (except for the Polish Post) but does not set a time framework for the privatisation of particular enterprises or sectors. In practice, privatisation takes place when the authorities consider that a particular state enterprise is ready for sale under financially adequate terms. Sectors considered as "sensitive" both socially and politically – such as the coal, steel, railway, and defence sectors – are set aside and dealt with under specific restructuring and privatisation strategies.

The 1996 Law establishes several privatisation tracks that the government can follow at the same time (Table A6).

"Indirect privatisation" (also called "capital privatisation") is the path normally followed for large enterprises. Under this path, large firms are first commercialised (corporatised), if necessary restructured, and then sold. This is seen by the government as the best way to create value for the state, the enterprises' employees and the economy as a whole. Following the first stage of commercialisation, shares are sold either through floatation in initial public offerings, trade sale based on public invitation to negotiations, or presentation of sealed bids. The government favours public invitations because, as opposed to initial public offerings, through this option it can select "strategic investors" deemed able to provide a long-term growth strategy to the privatised company. Criteria for the selection of strategic investors include, apart from the negotiated price and payment conditions, commitments to make further investments, protect the environment and improve social conditions. This is seen by the authorities as the best way to secure the proper level of competitiveness to privatised companies, and as best to protect employee's interests. In addition to selling a stake to a strategic investor, up to 15 per cent can be reserved for free distribution to eligible employees, at least 10 per cent shall be set

Table A6. **The many tracks of ownership transfer**

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Number of enterprises (end-period stock)									
Commercialisation[1]									
Started	58	308	480	636	845	1 075	1 229	1 269	1 366
Completed through:									
Capital privatisation[2]	6	27	51	96	132	159	183	227	244
Public offerings[3]	5	11	12	15	22	27	28	37	42
Trade sales	1	16	39	81	110	132	152	165	169
Written tenders (sealed bids)	0	0	0	0	0	0	3	25	33
NIF-programme (mass privatisation)[4]	0	0	0	0	0	321	512	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	1 698
of which: Through leasing	24	339	557	672	736	788	869	968	1 121
Completed	0	182	475	707	945	1 054	1 244	1 423	1 573
Liquidations (under the law on state-owned enterprises)									
Started	18	540	857	1 082	1 245	1 358	1 405	1 420	1 584
Completed	0	19	86	186	303	396	564	675	752
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	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	7 069
Leasing and sale of liquidated assets	..	46	172	287	323	406	973	359	447
Capital privatisation	..	125	309	439	847	1 714	1 945	3 254	5 102
Privatisation of banks	0	0	4	54	425	521	831	2 925	1 518

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 the Treasury.

aside for social security reform, and another 5 per cent for restitution purposes (see below). The sale of very large and valuable enterprises, such as the telecommunication company and LOT airline, is subject to specific plans approved by the Council of Ministers. These plans typically include the selection of a privatisation advisor, injection of equity if necessary, the sale of a first stake to a strategic investor and the sale of further blocs of shares possibly via public offerings. The entire process may take several years for very large and complex companies.

"Direct" privatisation is used for smaller companies. It consists in disposing of all assets of a state enterprise by direct sale, contribution to a company, or leveraged lease buy-out. In two-thirds of the cases, direct privatisation involves leasing to the employees. If the company's size exceeds a certain threshold (500 workers, euro 6 million in sales or euro 2 million in capital), however, its direct privatisation requires the approval of the Council of Ministers, which is not always granted. The authorities consider that leasing is appropriate only for companies in stable financial conditions. For other enterprises, and notably for those that require long-term modernisation, a contribution of enterprise's assets to a company is considered as more advisable.

Mass privatisation involved the issuance of share certificates* to the population in 1996. mass privatisation has involved 512 state enterprises in Poland. The initial stage of the mass privatisation program was a success, and more than 96 per cent of the 27 million eligible adult individuals received certificates. Share certificates have been transformed into electronic book entries starting in June 1996, and into shares in national investment funds (NIFs) since May 1997. By end-1998 (the deadline for the conversion), 98.7 per cent of the certificates were converted into electronic forms and automatically into NIF shares. Fifteen NIFs were established and 512 state enterprises were assigned to them. Each fund was provided a leading role in 33/34 entreprises (33 per cent stake) and a small number of shares (1.9 per cent) in the other firms. Some NIFs adopted a conservative investment attitude, withdrawing from corporate governance activities, and simply investing in a diversified portfolio of shares. Other funds have been more active and played an active shareholder role, inciting companies to restructure, assisting them in rearranging their financing, and helping their direct sale to a strategic investor, their initial public offering, or their introduction on the Warsaw Stock Exchange. The performance of NIFs was disappointing in 1998, and on average the funds lost half of their market value. NIFs listed companies in which they had a large stake on the stock exchange, only to find that the price fell immediately after listing. Employees who received for free 15 per cent of the shares frequently sold their shares, NIFs holding minority stakes did the same. The State Treasury holds 15 per cent of shares in each fund. Simultaneously, it directly holds up to 25 per cent of shares in the 468 companies included in the NIF programme. In principle, the State Treasury adopts a passive shareholder attitude in the funds, except when national interests are at stake. In practice, however, the state has played an active role on some issues. NIFs also were hampered by a controversy with the Ministry of Finance on the taxation of their capital gains. The resolution of the tax disputes should help NIFs achieve a better performance in the future.

Debt-equity conversion is another privatisation path undertaken under the aegis of the 1993 Law on financial restructuring. Under this path, creditors can convert financial claims on a state company into direct equity. However, straight debt-equity conversions have been rare and the law on privatisation stipulates that this form of ownership transfer is to be discontinued in 1999.

Management contracts are another route of ownership transfer. Such management contracts are signed with individuals or firms contracted to manage selected state treasury companies. The purpose of the management contracts is to restructure state companies, increase their value, and prepare them for the eventual privatisation.

Privatisation in agriculture is undertaken by a special agency (State Treasury Agriculture Property Agency) which took over assets of all former state-owned farms and leased

* Officially called "Universal Share Certificates" (USC).

them out. **Military properties** are handled by the Military Property Agency and the Military Housing Agency which act under the supervision of the Ministry of Defence.

Restitution to private owners expropriated during the pre-transition period is a new way of ownership transfer. A draft law is being prepared to restitute properties to these previous owners or compensate them. This is a complex undertaking as such property may have already been privatised, land may have been used to build public infrastructure or set aside in environmental reserves. Estimating the value of claims from previous owners is also fraught with great difficulties. The draft law envisages to restitute properties confiscated during the period 1944-62 whenever possible, or to grant compensation in the form of restitution vouchers. It is planned to cut the value of all claims irrespective of the form of compensation by 50 per cent. Under the draft plan, restitution vouchers could be used to purchase substitute property specially earmarked for this purpose.

Annex VI

List of selected Internet resources on Poland

State administration	
President of the Republic of Poland	http://www.prezydent.pl/
Chancellery of the Prime Minister	http://www.kprm.gov.pl/
Senat (Upper House of the Parliament)	http://www.senat.gov.pl/
Ministry of Finance	http://www.mofnet.gov.pl/
State Treasury Ministry	http://www.mst.gov.pl/
Ministry of Foreign Affairs	http://www.msz.gov.pl/
Ministry of Post and Telecommunications	http://www.ml.gov.pl/
Ministry of National Defence	http://www.wp.mil.pl/
Ministry of Environmental Protection, Natural Resources and Forestry	http://www.mos.gov.pl/
Ministry of Agriculture and Food Economy	http://www.minrol.gov.pl/
Other central institutions	
Agency For Agricultural Markets	http://www.arr.gov.pl/
State Committee for Scientific Research	http://www.kbn.gov.pl/
National Bank of Poland	http://www.nbp.pl/
National Atomic Energy Agency	http://www.paa.gov.pl/
Polish Agency For Foreign Investment	http://www.paiz.gov.pl/
Office for Competition and Consumer Protection	http://www.uokik.gov.pl/
Office of Public Procurement	http://www.uzp.gov.pl/
Privatisation Agency	http://www.mst.gov.pl/ap/index.htm
Central Statistical Office	http://www.stat.gov.pl/
Polish Academy of Science	http://www.ippt.gov.pl/
Media	
The Polish Market	http://www.polishmarket.com/
The Warsaw Voice	http://www.warsawvoice.com.pl/
The Warsaw Business Journal	http://www.wbj.pl/
Research Institutes	
CASE	http://www.case.com.pl/
The Gdansk Institute for Market Economics	http://www.ibngr.edu.pl/
Education	
Jagiellonian University	http://www.uj.edu.pl/
Warsaw University	http://www.uw.edu.pl/
Gdansk University	http://www.univ.gda.pl/
Wroclaw University	http://skierka.adm.uni.wroc.pl/

Nicholas Copernicus University	http://www.uni.torun.pl/
International organisations	
OECD	http://www.oecd.org/
IMF	http://www.imf.org
WTO	http://www.wto.org/
The World Bank Group	http://www.worldbank.org/
Other	
Warsaw Stock Exchange	http://www.gpw.com.pl/
The Official Website of Poland	http://poland.pl/
The InsidePoland	http://www.insidepoland.pl/
The PolishWorld	http://www.polishworld.com/
Pension reform	http://www.reform@emerytalna.mpips.gov.pl

Source: Internet.

Annex VII

Chronology of main economic events and policy measures

1998

May

European Commission presented evaluation of the Polish Economy.

June

The government adopted a restructuring programme for the hard coal mining sector.

July

The Polish government adopted a new privatisation programme with targets for 2001.

September

The government approved "The strategy for development of the telecommunications and postal services market in 1998-2001".

October

The government adopted the draft 1999 Budget Law.

November

Poland praised for its economic performance in EU special report on membership prospects.

Poland started official discussions on EU membership.

Shares of Telekomunikacja Polska SA are floated on the stock exchange.

The international rating agency Fitch IBCA raised Poland's rating from "BBB" to "BBB+".

The European Commission stated that Poland has successfully avoided the consequences of the crises in Asia and Russia.

December

A set of position papers was provided to the European Commission covering customs union, statistics, consumer and health protection, foreign relations and legal issues of enterprises' activities.

1999

January

Position papers covering: competition policy, free flow of goods and economic and monetary union were delivered to the European Commission.

Poland officially invited to join NATO.

The government launched a public administration reform, a new health care system, and introduced a new pension system for workers less than 50 years old.

February

President Aleksander Kwaśniewski authorised to ratify the North Atlantic Treaty.

The Parliament adopted the final version of the 1999 Budget Law.

March

Poland started talks with World Bank on the restructuring of the Polish coal mining industry.

On 12 March 1999 Poland officially became NATO member.

April

New ministers were appointed for health care, telecommunications, agriculture and culture.

A medium-term strategy for the public finance entitled "Public finance and economic development strategy: Poland 2000-2010" was released by the Finance Ministry.

An outline of the tax reform was presented.

May

New Head of the Central Customs Office has been appointed.

During accession talks between Poland and the European Union in Brussels, the initial round of membership discussions was successfully concluded on telecommunications, public health and consumer protection, and industrial policy.

June

The Treasury Ministry sold majority stakes in two major Polish banks. A stake of 52 per cent in Pekao SA was sold to a consortium of Uni-Credito Italiano and Allianz. A stake of 80 per cent in Bank Zachodni was sold to Allied Irish Bank.

The NBP decided to stop trading at fixing, which started to be used for reference purposes only.

Standard & Poor's raised its long-term credit ratings on Poland from "BBB–" to "BBB".

The government approved the modified tax reform proposal. The draft tax regulations have subsequently been sent to the Parliament.

The Council of Ministers approved the Finance Ministry prepared strategy for 2000-2010, aimed to accelerate growth and create new jobs.

Pope John Paul II visited Poland.

July

Bank Handlowy and BRE Bank decided to merge thus forming the country's third largest bank in terms of assets (after Pekao and PKO BP).

September

The government accepted the draft law on property restitution.

The Finance Minister revoked the licences of two Polish insurance companies holding a combined 3 per cent share of the Polish property insurance market

The government cancelled its planned Eurobond floatation amounting to euro 400 million.

An education reform was introduced.

October

The Monetary Policy Council has adopted the "Monetary policy guidelines for 2000".

New environmental protection minister has been appointed.

The European Commission released a report on Poland's progress towards EU accession. The Commission praised Poland for economic performance and criticised for delay in adopting EU legislation.

The government adopted a draft law to combat money laundering, which provides for establishment of a supervisory office that would gather, process and analyse financial data in order to counteract illegal transactions.

A new head of the Social Insurance Office (ZUS) was appointed.

The government adopted the 2000 draft Budget Law.

November

Parliament adopted the tax reform proposed by the government.

STATISTICAL ANNEX AND STRUCTURAL INDICATORS

OECD 2000

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

Average percentage change

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Consumer prices (CPI)	60.2	251.1	585.8	70.3	43.0	35.3	32.2	27.8	19.9	14.9	11.8
Food	49.4	320.1	574.7	46.1	36.9	33.6	33.0	27.0	18.6	12.6	7.7
Alcoholic beverages	68.2	247.9	388.7	87.6	36.5	23.6	29.2	28.6	25.4	13.7	12.7
Non-food-stuffs	65.3	226.7	591.2	75.8	36.5	36.8	31.4	27.3	20.7	14.0	11.5
Services	63.5	170.9	780.7	131.5	67.6	38.1	32.5	29.3	20.1	19.3	17.5
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	24.1
Central heating and hot water supply	90.9	54.4	1 203.5	222.8	222.5	68.4	65.9	31.3	17.1	22.0	23.6
Electricity and gas	79.1	85.2	1 297.0	217.0	94.6	34.2	34.7	26.7	17.1	15.5	14.5
Health	61.6	196.5	410.3	169.4	77.7	40.3	36.9	23.5	17.5	13.1	10.0
Public urban transport	96.0	292.7	720.7	120.9	59.8	48.4	34.0	27.3	27.4	21.6	17.1
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	7.3
Mining	68.3	104.3	850.3	77.8	31.2	48.0	40.5	22.9	11.8	16.4	8.5
Manufacturing	59.3	222.3	610.3	39.6	26.8	29.3	24.2	25.9	10.7	8.7	6.5
Electricity, gas and water supply	..	..	..	40.5	86.7	40.1	23.6	27.1	15.1	11.3	10.0

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

Source: Central Statistical Office.

Table B. **Monetary survey**

End-year million zloty

	1996[1]	1996	1997	1998
Total money stock	**134 796**	**136 662**	**176 392**	**220 780**
Zloty money supply[2]	111 518	113 270	145 571	187 137
Notes and coins in circulation (excl. vault in cash)	23 563	23 564	27 256	30 225
Vault cash[2]	*3 681*	*3 681*	3 819	3 768
Zloty deposits of non-financial sector	87 955	89 706	118 315	156 912
Personal	57 396	57 418	80 896	109 584
Corporate	30 559	32 288	37 419	47 328
Foreign currency deposits of non-financial sector	23 278	23 393	30 821	33 642
Personal	20 469	20 465	25 258	24 471
Corporate	2 809	2 927	5 563	9 171
Counterpart of total money stock				
Net foreign assets	**61 501**	**61 524**	**85 990**	**96 285**
Net domestic assets	**73 295**	**75 138**	**90 402**	**124 495**
Lending to non-financial sector	**80 037**	**81 085**	**108 291**	**138 482**
Personal loans	11 672	11 777	18 395	23 904
Corporate loans	68 365	69 308	89 896	114 578
Net general government debt	**46 832**	**48 241**	**55 259**	**61 229**
excl. Treasury bonds denominated in US dollars	33 105	34 317	36 490	42 275
Balance of other item (net)	**–53 574**	**–54 187**	**–73 148**	**–75 217**

1. Previous definition. See *Economic Survey of Poland* (1988), Table C.
2. Zloty money supply excludes vault in cash in 1996.

Source: National Bank of Poland.

Table C. **Monetary policy instruments in 1998 and 1999**

Item	1998												1999										
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	I	II	III	IV	V	VI	VII	VIII	IX	X	XI
Refinancing rate																							
Basic	28.0	28.0	28.0	28.0	27.0	27.0	25.0	25.0	25.0	23.0	23.0	21.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0	18.0	21.5
For central investment Projects	27.0	27.0	27.0	27.0	26.0	26.0	24.0	24.0	24.0	22.0	22.0	20.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	20.5
Rediscount rate	24.5	24.5	24.5	24.5	23.5	23.5	21.5	21.5	21.5	20.0	20.0	18.3	15.5	15.5	15.5	15.5	15.5	15.5	15.5	15.5	15.5	15.5	19.0
Lombard rate	27.0	27.0	27.0	27.0	26.0	26.0	24.0	24.0	24.0	22.0	22.0	20.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	17.0	20.5
Reserve requirement																							
Zloty deposits																							
Demand	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	5.0	5.0	5.0
Time	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0	5.0	5.0	5.0
Foreign currency deposits																							
Demand	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Time	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Crawling peg (monthly)	1.0	0.8	0.8	0.8	0.8	0.8	0.65	0.65	0.5	0.5	0.5	0.5	0.5	0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Reference rate (rate on 28-day open market operations)	23.5	24.0	24.0	23.0	21.5	21.5	19.0	19.0	18.0	17.0	17.0	15.5	13.0	13.0	13.0	13.0	13.0	13.0	13.0	13.0	14.0	14.0	16.5

Note: Interest rates (including reference rate) are presented per annum.
Dates of entering into force of new provisions:
1998: February 25, April 23, May 21, July 17, September 10, October 29, December 10.
1999: January 21, March 25, September 23, November 18.
Source: National Bank of Poland.

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

In Zl million, end-period

Specification	1991	1992	1993	1994	1995	1996	1997	1998
State-owned enterprises	**10 379**	**11 770**	**14 252**	**16 751**	**20 327**	**24 025**	**28 612**	**31 186**
Short-term	6 203	5 989	6 534	6 971	8 852	9 720	10 301	10 818
Housing	759	24	13	9	6	0	24	108
Other long-term	3 418	5 050	6 408	8 364	10 142	13 616	17 759	19 770
Interest unpaid	0	707	1 297	1 406	1 328	690	528	490
Private firms	**8 249**	**11 907**	**16 679**	**21 464**	**30 262**	**44 200**	**59 343**	**78 319**
Short-term	4 565	4 905	6 317	7 988	11 951	18 606	25 481	35 906
One to five years	1 440	1 878	2 787	3 941	6 316	10 177	14 696	19 308
Housing	1 976	3 304	4 010	4 734	5 547	5 764	5 770	5 662
Other long-term	268	1 024	1 450	1 951	2 867	6 078	9 542	13 978
Other (including interest unpaid)	0	796	2 115	2 850	3 580	3 575	3 855	3 465
Households	**714**	**1 187**	**2 239**	**3 324**	**5 602**	**11 753**	**18 368**	**23 878**
Short-term	335	633	1 058	1 442	2 217	3 496	4 532	6 375
One to five years	255	339	770	1 311	2 646	6 612	10 461	12 472
Housing	115	197	346	470	562	1 020	1 815	2 986
Other long-term	9	10	17	37	88	380	1 333	1 746
Interest unpaid	0	9	47	64	89	245	228	299

Source: National Bank of Poland.

Table E. **Local government budgets**

Zl million

	1993	1994	1995	1996	1997	1998	1999 Law
Local government revenue	9 649	14 808	19 993	30 956	39 497	46 120	65 386
Local tax revenue	4 907	6 569	8 969	13 118	16 476	18 484	18 242
Corporate income tax (CIT)	349	366	469	564	703	777	949
Personal income tax (PIT)	2 099	3 054	4 148	7 017	8 866	10 666	9 378
Other taxes	2 459	3 148	4 353	5 537	6 907	7 040	7 915
Transfers from central government	2 674	5 339	7 150	12 156	15 076	18 305	36 097
Other revenue	2 068	2 901	3 874	5 682	7 945	9 331	11 047
Local government expenditure	9 583	14 904	19 828	31 499	40 504	47 495	66 535
Current expenditure,	6 982	11 382	15 056	24 328	30 704	36 457	55 998
Social expenditure[1]	845	1 222	1 914	412	2 959	3 988	3 300
Current expenditure of budgetary units	3 719	6 669	8 600	17 120	19 379	22 609	42 016
Other current expenditure	2 418	3 491	4 541	6 796	8 366	9 861	10 682
Capital expenditure	2 435	3 364	4 658	7 056	9 681	10 937	10 537
Other expenditure	166	158	115	115	119	100	0
Balance of local governments	65	–96	165	–543	–1 007	–1 375	–1 150
Memorandum items:							
Tax revenue by level of government	..	..	..	..	..	..	18 242
Gminas[2]	..	..	..	..	..	..	17 346
Poviats[2]	..	..	..	..	..	..	324
Voivodships[2]	..	..	..	..	..	..	572
Share in national taxes (per cent)[3]	11.7	11.3	11.5	13.5	14.3	14.0	12.9

1. Social expenditure (excluding transfers within public sector).
2. Since 1999, gminas, poviats and voivodships.
3. Share of local taxes in national taxes (CIT, PIT, other).

Source: Ministry of Finance.

Table F. **Finances of the selected Social Insurance Funds**

Zl million, cash basis

	1994	1995	1996	1997	1998
Social Insurance Fund (FUS)					
Revenues	34 049	41 983	52 198	62 636	71 960
of which: Transfers from the state budget[1]	8 297	6 000	6 031	7 000	8 793
Expenditures	33 919	41 191	51 218	63 835	72 779
of which: Pensions	27 701	35 547	44 082	54 244	62 385
Social Insurance Fund for Farmers (KRUS)					
Revenues	5 026	6 498	8 095	10 069	11 316
of which: Transfers from the state budget	4 722	6 102	7 550	9 444	10 652
Expenditures	5 014	6 483	8 018	10 170	11 311
of which: Pensions	4 642	6 173	7 656	9 466	10 442
Labour Fund					
Revenues	4 478	6 270	7 540	7 011	5 120
of which: Transfers from the state budget	2 800	4 024	4 621	3 402	881
Expenditures	4 346	6 207	7 418	6 585	4 816
of which: Unemployment benefits	3 672	5 275	6 381	4 572	3 220
Total					
Revenues	43 552	54 751	67 833	79 716	88 396
of which: Transfers from the state budget	15 819	16 125	18 202	19 846	20 326
Expenditures	43 279	53 881	66 654	80 590	88 906
of which: Pensions	32 343	41 720	51 738	63 710	72 827

1. The rules governing this subsidy changed on March 1, 1995.
Source: Ministry of Finance.

Table G. **Selected extra-budgetary funds and agencies**

According to supervisory institution
Zl million

	1997		1998	
	Revenue	Expenditure	Revenue	Expenditure
Ministry of the Treasury	**2 472**	**1 867**	**3 119**	**2 313**
Agency for Military Property	11	–	31	30
Privatisation Agency	2	1	3	4
Agency for Industrial Development	364	290	753	598
Polish Agency for Regional Development	54	71	44	42
Agency of the Treasury's Agricultural Property	1 024	854	1 019	850
Polish Agency for Foreign Investment	28	26	13	14
Polish Press Agency	31	32	33	37
Military Housing Agency	958	592	1 222	737
Ministry of Agriculture	**13 555**	**13 674**	**14 098**	**14 777**
Agency for Restructuring and Modernisation of agriculture	1 555	2 006	1 322	1 705
Administrative Fund	333	351	372	376
Pension and Disability-Pension Fund	10 069	10 056	11 353	11 311
Prevention and Rehabilitation Fund	23	24	24	24
Farm Land Protection Fund	19	19	41	39
Agency for Agricultural Market	1 555	1 218	988	1 322
Ministry of Labour and Social Policy	**72 217**	**72 308**	**80 451**	**79 884**
Alimony Fund	956	560	1 219	708
Guarantee Fund for Employee Benefits	235	12	270	17
Labour Fund	7 011	6 585	5 119	4 816
Social Insurance Fund	62 636	63 835	71 960	72 778
State Rehabilitation Fund	1 379	1 317	1 882	1 564
Ministry of Economy	**377**	**227**	**355**	**300**
Agency for Material Reserves	348	208	322	280
Technical and Technological Agency	10	2	10	3
State Agency for Restructuring of Hard Coal Mining	20	16	22	16
Ministry of Transportation and Maritime Economy				
Agency for Construction and Exploitation of highways	201	179	196	179
Ministry of Health and Social Assistance				
Sanitary Reserves Agency	6	7	6	9
Head of Combatant Office				
State Combatant Fund	117	89	115	120
Ministry of Culture and Art				
Creativity Promotion Fund	1	1	1	1
Ministry of Environmental Protection Natural Resources and Forestry				
National Fund for Environmental Protection and Water Economy	1 081	393	1 216	297
Ministry of Internal Affairs and Administration				
Central Fund for Geodetic and Cartographic Economy	13	14	13	17

Source: Ministry of Finance.

Table H. **Direction of trade**

Customs basis, US$ million

	1992	1993	1994	1995	1996	1997	1998
Imports							
Total	**15 913**	**18 834**	**21 569**	**29 050**	**37 137**	**42 308**	**47 054**
Developed countries	11 516	14 371	16 212	21 595	27 326	31 107	35 270
of which:							
EU	8 446	10 785	12 403	18 781	23 738	26 998	31 027
EFTA	2 065	2 103	2 443	901	939	1 045	1 051
Other	1 005	1 483	1 366	1 913	2 649	3 064	3 192
Central and Eastern Europe	2 589	2 531	3 063	4 476	5 776	6 325	6 252
of which:							
CEFTA	647	677	919	1 625	2 161	2 652	2 974
Others	1 942	1 854	2 144	2 851	3 615	3 673	3 278
Developing countries	1 808	1 932	2 294	2 979	4 035	4 876	5 532
Exports							
Total	**13 187**	**14 143**	**17 240**	**22 895**	**24 440**	**25 751**	**28 229**
Developed countries	9 475	10 630	12 992	17 189	17 535	17 792	20 758
of which:							
EU	7 632	8 951	10 805	16 036	16 196	16 526	19 270
EFTA	1 363	1 108	1 410	359	535	395	468
Other	480	571	777	794	804	871	1 020
Central and Eastern Europe	2 026	1 869	2 499	3 954	5 010	6 249	5 971
of which:							
CEFTA	669	682	823	1 245	1 481	1 738	2 026
Others	1 357	1 187	1 676	2 709	3 529	4 512	3 945
Developing countries	1 686	1 644	1 749	1 752	1 895	1 710	1 500

Source: Central Statistical Office.

Table I. **Foreign trade by commodity group**

Customs basis, US$ million

	SITC group	1992	1993	1994	1995	1996	1997	1998
Imports		15 913	18 834	21 569	29 050	37 137	42 308	47 054
Food and live animals	0	1 531	1 838	1 876	2 339	3 143	2 894	2 968
Beverages and tobacco	1	162	146	186	217	250	299	302
Crude materials, inedible, except fuels	2	861	866	1 111	1 562	1 737	1 762	1 655
Mineral fuels, lubricants and related materials	3	2 674	2 346	2 253	2 651	3 389	3 710	2 964
Animal and vegetable oils, fats and waxes	4	106	117	159	189	216	239	282
Chemicals and related products	5	2 145	2 507	3 168	4 340	5 120	5 839	6 405
Manufactured goods classified by material	6	1 882	3 482	4 354	6 266	7 455	8 283	9 711
Machinery and transport equipment	7	4 743	5 568	6 226	8 688	12 272	15 228	18 273
Miscellaneous manufactured articles	8	1 642	1 912	2 133	2 701	3 435	3 950	4 411
Commodities and transactions, not classified elsewhere	9	167	52	103	97	120	104	83
Exports		13 187	14 143	17 240	22 895	24 440	25 751	28 229
Food and live animals	0	1 686	1 410	1 735	2 100	2 461	3 026	2 840
Beverages and tobacco	1	75	136	240	164	131	103	96
Crude materials, inedible, except fuels	2	1 128	788	810	1 029	825	820	804
Mineral fuels, lubricants and related materials	3	1 413	1 374	1 566	1 870	1 675	1 719	1 546
Animal and vegetable oils, fats and waxes	4	20	18	20	35	38	42	38
Chemicals and related products	5	1 134	964	1 163	1 774	1 887	2 027	1 899
Manufactured goods classified by material	6	3 585	3 745	4 742	6 314	6 316	6 830	7 116
Machinery and transport equipment	7	2 523	2 966	3 411	4 828	5 719	5 560	8 022
Miscellaneous manufactured articles	8	1 547	2 739	3 542	4 772	5 379	5 611	5 861
Commodities and transactions, not classified elsewhere	9	76	3	11	9	9	13	7

Source: Central Statistical Office.

Table J. **Balance of payments on a cash basis**

US$ million

	1994	1995	1996	1997	1998
A. Current account	**677**	**5 310**	**–1 371**	**–4 312**	**–6 858**
Trade balance	–895	–1 912	–8 179	–11 320	–13 720
Exports of goods	17 024	22 878	24 453	27 229	30 122
Imports of goods	17 919	24 790	32 632	38 549	43 842
Services: net	59	146	–213	305	–509
Income: net	–2 835	–613	–356	–458	–567
Current transfers: net	634	544	1 002	1 150	1 942
General government	112	220	73	102	408
Others sectors	522	324	929	1 048	1 534
Unclassified transactions on current account	3 714	7 145	6 375	6 011	5 996
B. Capital and financial account	**–1 236**	**3 785**	**4 521**	**5 414**	**10 800**
Capital account	9 214	285	90	90	73
Financial account	–10 450	3 500	4 431	5 324	10 727
Direct investment: net	542	1 134	2 741	3 041	4 966
Polish direct investment abroad		2	–27	–36	–163
Foreign direct investment in Poland	542	1 132	2 768	3 077	5 129
Portfolio investment: net	–624	1 171	241	2 098	1 330
Polish portfolio investment abroad	–624	1	282	815	–180
Foreign portfolio investment in Poland	0	1 170	–41	1 283	1 510
Other investment: net	–10 368	1 195	1 449	185	4 431
Polish assets	–2 359	287	6 532	–872	2 247
Long-term credits extended	–21	71	–22	–82	–82
Short-term credits extended	–21	–22	–5	–60	–16
Other assets	–2 317	238	6 559	–730	2 345
Polish liabilities	–8 009	908	–5 083	1 057	2 184
Long-term credits received	–8 695	–82	–5 941	416	1 669
Short-term credits received	–31	88	85	592	–46
Other liabilities	717	902	773	49	561
C. Net errors and omissions	**772**	**720**	**486**	**2 488**	**1 766**
Overall balance	**213**	**9 815**	**3 636**	**3 590**	**5 708**
D. Financing of overall balance	**–213**	**–9 815**	**–3 636**	**–3 590**	**–5 708**
Reserve assets (Gross official reserves)	–1 513	–8 432	–3 641	–3 591	–5 698
Credits from IMF	610	–1 400	–	–	–
Exceptional financing	690	17	5	1	–10

Source: National Bank of Poland.

Table K. **Balance of payments on a transaction basis, 1994-98**

$ million

		1994[1]	1995	1996	1997	1998
A.	**Current account**	**954**	**854**	**–3 264**	**–5 744**	**–6 901**
	Trade balance	–575	–1 646	–7 287	–9 822	–12 836
	Merchandise exports, fob	18 355	25 041	27 557	30 731	32 467
	Merchandise imports, fob	18 930	26 687	34 844	40 553	45 303
	Services, net	2 840	3 537	3 404	3 172	4 216
	Credit	6 699	10 675	9 833	8 986	10 920
	Debit	3 859	7 138	6 429	5 814	6 704
	Income, net	–2 563	–1 995	–1 075	–1 129	–1 178
	Credit	546	1 089	1 527	1 467	2 226
	Debit	3 109	3 084	2 602	2 596	3 404
	Current transfers, net	1 252	958	1 694	2 035	2 897
	General government	128	244	82	120	458
	Other sectors	1 124	714	1 612	1 915	2 459
	Current transfers – debit	922	1 501	1 131	665	623
	General government					20
	Other sectors	922	1 501	1 131	665	603
	Current transfers – credit	2 174	2 459	2 825	2 700	3 520
	General government	128	244	82	120	458
	Other sectors	2 046	2 215	2 743	2 580	3 062
B.	**Capital and financial account**	**664**	**8 149**	**6 584**	**8 026**	**13 118**
	Capital account	9 215	285	94	66	63
	Financial account	–8 551	7 864	6 490	7 960	13 055
	Direct investment	1 846	3 617	4 445	4 863	6 049
	Polish direct investment abroad	–29	–42	–53	–45	–316
	Foreign direct investment in Poland	1 875	3 659	4 498	4 908	6 365
	Portfolio investment	–624	1 177	301	2 098	1 697
	Polish portfolio investment abroad	–624	1	282	815	–130
	Foreign portfolio investment in Poland	0	1 176	19	1 283	1 827
	Other investment, net	–9 773	3 070	1 744	999	5 309
	Other investment – assets	–1 841	3 356	6 191	–754	2 107
	Trade credit	126	–119	–224	170	–94
	Other credits extended, long-term	–21	75	–21	–111	–82
	Other credits extended, short-term	0	–134	–6	–77	–1
	Currency and deposits	–1 853	3 793	685	–768	2 229
	Other foreign assets	–93	–259	5 757	32	55
	Other investment – liabilities	–7 932	–286	–4 447	1 753	3 202
	Trade credit	–174	223	703	–159	–51
	Credits from IMF	610	–1 400	0	0	0
	Other credits received, long-term	–8 324	397	–5 420	1 437	2 632
	Other credits received, short-term	–71	–8	–12	320	19
	Currency and deposits	193	508	276	155	602
	Other foreign liabilities	–166	–6	6	0	0
C.	**Errors and omissions**	**–105**	**–571**	**321**	**1 309**	**–519**
	Total (items A through C)	**1 513**	**8 432**	**3 641**	**3 591**	**5 698**
D.	**Foreign assets (gross official reserves)**	**–1 513**	**–8 432**	**–3 641**	**–3 591**	**–5 698**

1. Until October 1994 interest and principal in arrears were calculated on the credits obtained from the creditors of the London Club. As a result of the agreement signed with the London Club, these arrears were reduced and reorganised, so that at the end of 1994 Polish foreign debt was not included in arrears

Source: National Bank of Poland.

Table L. **Stock of FDI at end-1998 by country of origin**

	$ million	Share (%)	Investment plans ($ million)	Share (%)	Number of companies	Share (%)
OECD countries	**24 254**	**88.9**	**11 508**	**86.3**	**683**	**95.7**
North America	**5 147**	**18.9**	**3 712**	**27.9**	**133**	**18.7**
United States	4 911	18.0	3 654	27.4	112	15.7
Canada	236	0.9	57	0.4	21	2.9
European Union	**16 160**	**59.2**	**6 288**	**47.2**	**500**	**70.0**
Germany	5 117	18.8	2 231	16.7	163	22.8
Italy	2 038	7.5	1 224	9.2	64	9.0
France	2 399	8.8	1 294	9.7	60	8.4
Netherlands	1 879	7.0	411	3.1	42	5.9
United Kingdom	1 930	7.1	367	2.8	28	3.9
Austria	758	2.8	155	1.2	31	4.3
Sweden	692	2.6	337	2.5	37	5.2
Denmark	558	2.0	43	0.3	28	3.9
Ireland	226	0.9	n.a.	n.a.	3	0.4
Finland	191	0.7	59	0.4	16	2.2
Belgium	157	0.6	100	0.8	19	2.7
Spain	62	0.2	n.a.	n.a.	3	0.4
Greece	4	0.0	4	0.0	2	0.3
Portugal	147	0.5	63	0.5	3	0.4
Luxembourg	2	0.0	n.a.	n.a.	1	0.1
Other OECD countries	**2 947**	**10.9**	**1 508**	**11.3**	**50**	**7.0**
South Korea	1 412	5.2	496	3.7	4	0.6
Switzerland	666	2.4	236	1.8	13	1.8
Australia	98	0.4	90	0.7	4	0.6
Norway	456	1.7	439	3.3	12	1.7
Japan	198	0.7	188	1.4	11	1.5
Turkey	48	0.2	58	0.4	2	0.3
Czech Republic	68	0.2	n.a.	n.a.	4	0.6
Non-OECD countries	**1 213**	**4.4**	**1 004**	**7.5**	**13**	**1.8**
Croatia	138	0.5	70	0.5	1	0.1
South Africa	25	0.1	40	0.3	1	0.1
China	25	0.1	25	0.2	1	0.1
Russia	958	3.5	616	4.6	1	0.1
Hong Kong	20	0.1	20	0.2	1	0.1
Liechtenstein	30	0.1	12	0.1	3	0.4
Slovenia	6	0.0	1	0.0	1	0.1
Taiwan	6	0.0	200	1.5	1	0.1
Israel	5	0.0	20	0.2	3	0.4
Multinational enterprises	**1 813**	**6.6**	**815**	**6.1**	**18**	**2.5**
Total investment exceeding $1 million	**27 280**	**100.0**	**13 327**	**100.0**	**714**	**100.0**
Estimated investment not exceeding $1 million	**3 372**					
Total stock of FDI	**30 651**					

Source: Polish Agency for Foreign Investment.

Table M. **Stock of FDI by sector of destination**

	End 1998 ($ million)	Investment plans ($ million)
Production activities including:	15 912	6 971
Food products, beverages, tobacco	4 461	1 471
Means of transportation	3 628	2 083
Other non-metallic raw materials, *of which:*	2 577	1 250
Timber	392	124
Textiles	226	40
Paper, printing and book-binding	1 354	325
Chemicals, chemical products	1 272	470
Electrical and optical equipment	1 016	373
Other technical equipment	585	343
Rubber and plastic products	423	228
Metals and metal product	354	253
Other	242	175
Financial services	4 803	1 140
Trade and repairs	2 943	2 194
Construction	1 685	1 134
Transportation and communications	719	159
Hotels and restaurants	430	207
Service and municipal activities	398	386
Electricity, gas and water supply	242	1 000
Real property services	112	124
Agriculture	24	8
Mining and quarrying	12	4
Total	27 280	13 327
Estimated investment not exceeding USD 1 million	3 372	
Total stock of FDI	30 651	

Source: Polish Agency for Foreign Investment.

Table N. **The top 50 of Major Foreign Investors in Poland**

$ million, 1998

No.	Investor	Equity and loans	Plans	Origin	Activites
1	Fiat	1 357	709	Italy	Automotive, banking, insurance
2	Daewoo	1 348	471	Korea	Automotive, electronics, construction, insurance
3	RAO Gazprom	958	616	Russia	Construction
4	Bayerische Hypo- und Vereinsbank AG	724	n.a.	Germany	Banking
5	EBRD	653	216	International	Banking, capital investment
6	Metro AG	598	650	Germany	Retail and wholesale trade
7	Polish-American Enterprise Fund	505	n.a.	USA	Capital investment
8	IPC	440	35	USA	Pulp and paper
9	ING Group	420	n.a.	Netherlands	Banking, insurance
10	Commerzbank AG	389	7	Germany	Banking
11	Philip Morris	372	80	USA	Tobacco processing
12	Reemtsma Cigarettenfabriken GmbH	368	202	Germany	Tobacco processing
13	Adam Opel AG	360	260	Germany	Automotive
14	Coca-Cola Beverages Plc	360	n.a.	Great Britain	Food processing
15	Harbin BV	326	n.a.	Netherlands	Brewing
16	ABB Ltd.	310	217	International	Machinery, electronics
17	Nestle	309	43	Switzerland	Food processing
18	Saint-Gobain	296	150	France	Glass, building materials
19	Pilkington	295	50	Great Britain	Glass
20	International Finance Corporation	284	n.a.	International	Capital investment
21	PepsiCo	283	380	USA	Food processing
22	Thomson Multi Media	264	94	France	Electronics
23	BP Amoco Plc	250	n.a.	Great Britain	Distribution of petroleum products, retail trade
24	Citibank	235	290	USA	Banking
25	Kronospan AG	234	40	Switzerland	Furniture production
26	France Telecom	232	n.a.	France	Telecommunications
27	Glaxo Wellcome	230	n.a.	Great Britain	Pharmaceuticals
28	Lafarge	209	141	France	Cement production
29	Epstein	200	n.a.	USA	Construction, property development, food processing
30	Statoil	200	400	Norway	Distribution of petroleum products, retail trade

Table N. **The top 50 of Major Foreign Investors in Poland** *(cont.)*

$ million, 1998

No.	Investor	Equity and loans	Plans	Origin	Activites
31	Procter & Gamble	190	59	USA	Consumer products
32	Aral	181	n.a.	Germany	Distribution of petroleum products, retail trade
33	Heineken	181	n.a.	Netherlands	Brewing
34	British Oxygen Corporation (BOC Group)	180	n.a.	Great Britain	Technical gas production
35	Framondi NV	175	n.a.	Austria	Pulp and paper
36	Heildelberger Zement - CBR Baltic BV	175	20	International	Cement production
37	Allied Irish Bank Plc	165	n.a.	Ireland	Banking
38	Mars Incorporated	163	30	USA	Food processing
39	IKEA	150	120	Sweden	Furniture production, retail trade
40	Shell	150	50	Great Britain	Distribution of petroleum products, retail trade, technical gas production
41	Creditanstalt Bankverein	145	50	Austria	Banking
42	Casino	140	n.a.	France	Retail trade
43	Unilever	140	n.a.	International	Chemicals, food processing
44	Lucent Technologies Network Systems Netherlands BV	139	10	Netherlands	Electronics
45	Pliva d.d.	138	70	Croatia	Pharmaceuticals
46	Auchan	137	n.a.	France	Retail trade
47	Michelin	136	151	France	Rubber and plastics, automotive
48	Dyckerhoff	135	194	Germany	Cement production
49	Enron International	132	n.a.	USA	Heat and power supply
50	Cadbury's Schweppes	127	n.a.	Great Britain	Food processing

Source: Polish Agency for Foreign Investment.

Table O. **Education levels in comparison**

Percentage of the population by level of education, 1996

	At least upper secondary education					At least university-level education				
	Age 25-64	Age 25-34	Age 35-44	Age 45-54	Age 54-64	Age 25-64	Age 25-34	Age 35-44	Age 45-54	Age 54-64
Poland[1]	**74**	**88**	**82**	**68**	**47**	**10**	**10**	**10**	**12**	**8**
Australia	57	62	60	54	46	15	16	18	14	8
Austria	71	82	75	67	53	6	7	7	5	4
Belgium	53	70	58	47	31	11	14	11	10	6
Canada	76	85	81	73	56	17	20	18	17	11
Czech Republic	84	92	87	84	71	10	11	12	10	8
Denmark	66	74	70	65	50	15	16	17	16	11
Finland	67	83	76	60	40	12	13	13	12	7
France	60	74	64	56	38	10	12	10	10	5
Germany	81	86	85	81	71	13	13	16	14	9
Greece	44	66	52	36	22	12	16	14	11	6
Hungary	63	80	75	62	28	13	14	15	15	9
Ireland	50	66	54	38	30	11	14	11	9	6
Italy	38	52	46	31	17	8	8	11	8	5
Korea	61	88	63	41	25	19	30	18	11	7
Luxembourg	29	32	33	28	20	11	11	14	12	6
Netherlands	63	72	66	57	47	23	25	25	21	16
New Zealand	60	65	64	56	49	11	14	13	10	6
Norway	82	91	87	78	62	16	19	17	14	8
Portugal	20	32	24	15	9	7	11	9	6	4
Spain	30	50	34	20	11	13	19	15	10	6
Sweden	74	87	80	70	53	13	11	15	16	10
Switzerland	80	87	82	78	71	10	11	10	9	6
Turkey[2]	17	23	19	14	7	6	7	7	7	3
United Kingdom	76	87	81	71	60	13	15	15	12	8
United States	86	87	88	86	77	26	26	26	28	20
Unweighted average	**60**	**72**	**65**	**55**	**42**	**13**	**15**	**14**	**12**	**8**

1. Year of reference 1995.
2. Year of reference 1997.

Source: OECD (1998), *Education at a Glance.*

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.
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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

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