World Bank Group – Poland Partnership Program Snapshot

October 2014

RECENT ECONOMIC AND SECTORAL DEVELOPMENTS

Recent Economic Developments and Outlook

Growth

Economic growth slowed considerably in 2012 and 2013. Overall GDP growth declined from 4.5 percent in 2011 to 2 percent in 2012 and 1.6 percent in 2013, amid slowing domestic demand. Investment declined as fiscal consolidation and lower European Union (EU) co-funded investments curbed public investment, while private consumption was lackluster as a result of the Eurozone recession, falling corporate and consumer confidence, high unemployment, and subdued wage growth. Net exports, supported by the performance of the German economy—Poland's main trading partner—were the sole driver of growth from late 2012 to mid-2013.

The economic recovery gained momentum in the second half of 2013. Following first quarter real GDP growth of 0.5 percent year-over-year, growth steadily increased to reach 2.7 percent in the fourth quarter, supported by improving real wages, relatively generous pension indexation, low inflation, and relaxed credit conditions for mortgage and consumer loans. Investment began to pick up, driven by a high rate of capacity utilization in the manufacturing industry and the recovery of global demand (despite falling public investment), due to continued fiscal consolidation and lower EU funding.

Economic growth is projected to double to 3 percent in 2014, even though growth is expected to slow down somewhat toward the end of the year. Broadly based economic recovery was underway in the first half of the year, when Poland's GDP increased by 3.4 percent, driven by improved consumption and investment and a strong trade performance, as Poland benefited from a gradual pick-up in both global and Eurozone demand. The recovery of domestic demand was supported by a gradual increase in real wages and improved employment outcomes, as well as by a rebound in investor confidence and a new pipeline of 2014–20 EU Structural Funds. Recent releases of high-frequency data for July and August, however, point to a broad slowdown in economic activity in the second half of 2014. Growth in industrial production has moderated steadily over the past few months, dampened by reduced foreign demand, while construction and retail trade have been contracting in seasonally adjusted terms. Exports to Russia and Ukraine have fallen significantly and are no longer compensated by rising external demand from the EU (with growth in the Eurozone softening in the second quarter). Business confidence has weakened too, with the purchasing managers index (PMI) down to 49.0 in August from 55.4 in January. Overall growth is expected to increase to 3 percent in 2014 and strengthen further to some 3.5 percent by 2016.

Nonetheless, the downside risks to the macroeconomic outlook remain considerable. They include the impact of the ongoing geopolitical tensions between Russia and Ukraine, the economic impact of the sanctions on Russia's trade relations, the slow and fragile recovery in the Eurozone, and contagion from sovereign debt volatility in emerging markets, particularly as developed countries start to reduce their accommodative monetary policies, which may be transmitted through external trade and financial links. Poland remains partly vulnerable to external debt deleveraging, which may slow credit growth through parent bank funding of local subsidiaries. At the same time, weaker demand in the EU—which constitutes around 70 percent of foreign direct investment (FDI) flows and over half of exports—and globally could undermine the pick-up in exports, investment, and ultimately domestic demand. The pace of income convergence with the Eurozone should, however, remain sustained.

Shared Prosperity and Poverty

Poland's transition since the 1990s is widely seen as very successful. Since 1989, Poland has become the European growth champion, more than doubling its GDP per capita in that period. Its economy is modern, diversified, centered on industry and services (around 30 and 65 percent of GDP, respectively), and deeply integrated into the EU, especially within German supply chains. In 2009, Poland was the only EU country to avoid a recession (thanks to the size of its domestic economy, a floating exchange rate regime, limited imbalances at the onset of the crisis, and a fiscal stimulus in part financed through EU Structural Funds). In spite of the Eurozone turbulences, economic growth has remained solid by EU standards since 2010. In 2014 and 2015, GDP growth is projected to exceed 3 percent, and living standards are gradually converging to EU averages.

This fast growth has also translated into significant progress for the lowest-earning 40 percent of the population. During 2005–10, the share of the population with incomes below the US$5 per day threshold decreased from 14.8 percent to 5 percent (extreme poverty, defined as income per capita below US$1.25 per day, is below 0.35 percent of the population). At the same time, the lowest-earning 40 percent of the population saw their incomes grow relative to both the mean growth rate and other countries in the region. Yet, the at-risk-of-poverty rate remains high, particularly among the unemployed and the inactive, as well as among the youth, families with several children, and households in small towns and rural areas. There is also a relatively large cohort of the working poor; at 10.4 percent in 2012, the at-risk-of-poverty rate among employed people is the fifth highest in the EU. Furthermore, while all other groups have recorded some gains since 2008, the income per capita of the lowest decile has remained largely unchanged.

Despite this remarkable progress, Poland faces a number of challenges going forward. There remain significant disparities of income between Warsaw (by far the wealthiest part of the country), the western provinces (typically with strong entrepreneurship and better infrastructure), and the eastern provinces (relatively backward and poorer). Unemployment stands at about 10 percent (26 percent for youth), in spite of a relatively low labor force participation rate (at about 67 percent). There are persistent, although declining, gender gaps in labor force participation (59 percent for women vs. 73 percent for men) and earnings (10 percent at median earnings). The country is also rapidly aging; the share of the 65+ population is projected to increase from 13 percent in 2010 to 23 percent in 2030 (while the fertility rate stands at 1.4).

Inflation

Despite the solid pace of economic activity, inflation has decelerated sharply over the past year. After having been below the official target band of the National Bank of Poland (1.5–3.5 percent) since February 2013, the inflation rate in July 2014 turned negative. Consumer prices fell by 0.2 percent year-over-year, driven mainly by declines in food, beverage, and clothing prices. Core inflation at 0.4 percent year-over-year is also very weak. The low inflation readings appear to reflect a combination of low imported inflation, including from energy prices, and several domestic factors, such as weak demand in 2013, favorable weather conditions for crops in 2014, and one-offs, including reductions in electricity tariffs, which may still be weighing on prices).

Having completed the easing cycle of 225 basis points (bps) between November 2012 and July 2013, the Monetary Policy Council (MPC) has kept the policy interest rate at 2.50 percent since then. Going forward, monetary policy is at a challenging juncture. On one hand, with the economy slowing in the second half of 2014 and inflation clearly undershooting the central bank's target, there is an expectation of an interest rate cut this fall. On the other hand, geopolitical tensions and elevated risks of abrupt energy price surges, as well as the U.S. Federal Reserve's quantitative easing (QE) withdrawal, may lead the MPC to adopt a wait-and-see attitude and keep the policy interest rate at its current low level for now.

Going forward, inflation is expected to stay muted for the rest of 2014, before stabilizing around the target of 2.5 percent over the medium term, as the economic recovery gains strength.

Trade and Capital Flows

The current account deficit has narrowed and the external position is consistent with medium-term fundamentals. The current account deficit narrowed from 5 percent of GDP in 2011 to 1.4 percent of GDP in 2013 and further to 0.9 percent of GDP in the first half of 2014, driven by an improvement in the trade balance. The current account deficit was financed by net FDI and EU capital transfers. External debt stabilized at around 73 percent of GDP, over 15 percentage points higher than in the precrisis period, largely reflecting increased government indebtedness. The share of short-term debt in total external debt remains broadly stable at around 20 percent, with international reserves equivalent to five months of imports of goods and services.

Over the medium-term, the current account deficit is expected to stay below 3 percent of GDP. It is projected to continue to be financed mostly by FDI inflows and EU transfers. External debt is expected to gradually decline below 70 percent in 2015. The sustainability of the external debt position is generally robust, according to a range of standard stress scenarios. Private sector flows and continued favorable access to international capital markets suggest that external financing needs can be met, and the International Monetary Fund (IMF) arrangement provides an additional buffer against external shocks.[1]

Fiscal Performance

Weak domestic demand led to a significant drop in revenues in 2013, partly reversing the fiscal consolidation achieved during the previous two years. Poland's structural deficit declined from 5.3 percent of GDP in 2011 to 3.6 percent of GDP in 2012. In 2013, as a result of the slowdown, the general government deficit reached 4.3 percent of GDP, in spite of further consolidation measures. The EU extended the deadline for correction under the Excessive Deficit Procedure (EDP) by one additional year to 2015, while average debt costs fell and the average maturity of debt increased.

The fiscal deficit is projected to decline to around 3.4 percent of GDP in 2014 and 3 percent in 2015, in line with Poland's obligations under the EDP. The Government plans to gradually reduce the structural fiscal deficit toward its Medium Term Objective (MTO) of a structural deficit of 1 percent of GDP. In 2014, the authorities continued to contain expenditure, while increased activity led to a recovery in revenues and the Open Pension Funds reform brought about additional fiscal savings. The 2015 budget will maintain a focus on fiscal consolidation so as to allow Poland to exit the EDP in 2016, despite some fiscal loosening on social expenditures related to the one-off change in the pension indexation formula and the introduction of the earned tax income credit (especially for large families).

Public debt is expected to decline in 2014. Fiscal consolidation, together with strengthened fiscal institutions and the one-off transfer of assets from the second pillar pension system, will bring public debt close to 50 percent of GDP. Public debt sustainability analysis suggests that the debt path is highly sensitive to a growth shock, but it is not expected to put the level of public debt above the constitutional threshold of 60 percent of GDP.

Financial Sector

The banking sector has remained well capitalized, liquid, and profitable, with stable credit growth. Capital adequacy is strong (at around 15 percent in September 2014, 90 percent of which is Core Tier 1 capital) and liquidity is high. In 2014, the profit of the banking sector is likely to reach record highs, exceeding PLN16 billion (US$5 billion). The deleveraging of the Eurozone banks has stabilized and the fall in foreign funding was offset by rising domestic deposits. Private sector credit grew by 8 percent by June 2014 over the previous year, including a welcome pick-up in credit to the corporate sector.

Selected Sectoral Policies for Economic Growth

Poland's challenge is two-fold. In the short term, Poland ought to further mitigate the impact of a difficult external environment and support a rapid recovery of economic activity. Beyond this horizon, Poland needs to avoid a decline in its long-term growth potential as a result of both the aging of society and the diminishing returns of its current "catching up" growth model. This will require action on a multiplicity of fronts, including but not limited to: mitigating the effects of the aging process, enhancing the business environment, increasing innovativeness, and further strengthening public finances.

[1] Poland has a Flexible Credit Line (FCL) Arrangement with the IMF. The FCL is a precautionary tool that provides a cushion against external risks and bolsters market confidence in the country's economic fundamentals. The arrangement has been in place since 2009 and has been subject to three renewals. The current two-year FCL arrangement was approved by the IMF Executive Board in January 2013 in the amount of US$33.7 billion.

Business Environment

Substantial efforts are underway to improve the country's business environment. Poland was the "top performer" in *Doing Business* (DB) 2013 and has made the largest progress in DB reforms among the EU and Organisation for Economic Co-operation and Development (OECD) countries since 2005. Yet, it is still ranked only 45th, with particular weaknesses in starting a business, dealing with construction permits, getting electricity, and paying taxes. These are priority areas for government action in the coming years. The World Bank has provided technical advice to strengthen the insolvency law, revamp the bank resolution framework, and improve contract enforcement. The World Bank has also provided support to enhance financial reporting through advisory services financed by the Swiss Agency for Development and Cooperation (SDC).

Innovation

Poland's current growth model may be gradually approaching its limit. Over the past two decades, Poland's growth has been driven by simple "post-transition" reserves in terms of productivity growth and capital accumulation. Yet, as income per capita increases, Poland will need to further move up the value chain and achieve productivity gains through innovation and additional structural reforms. Poland remains one of the least innovative economies in the OECD according to the rankings and still needs to make efforts to best equip its workers for the needs of a modern economy. Addressing this will require a combination of steps to foster more effective "ecosystems" for innovation (and in particular, links between research, entrepreneurs, and financiers) to strengthen public support for innovation, enhance the quality and relevance of general, vocational, and higher education, and further develop skills and entrepreneurship.

Large resources will be made available to support private sector–led innovation under the new EU financial perspective. Both the national and subnational governments are developing "innovation and smart specialization strategies" to provide a framework for using these resources effectively. Over the last period, the World Bank Group has carried out a review of public support to the innovation system and helped develop innovation strategies at both the national and subnational levels. The World Bank Group continues to provide support to the Polish authorities to further increase the efficiency and effectiveness of the innovation system and research and development (R&D) programs in Poland, including through a trailblazing project involving a firm needs assessment as part of the entrepreneurial discovery process.

Poland is also stepping up its participation in the digital economy, in particular by expanding broadband access up to isolated areas (possibly with the involvement of the private sector) and gradually moving toward e-government services. This is facilitated by the provision of large resources under the EU financial perspective. Yet, despite recent progress, access to the Internet is below the EU average and is of low speed. Hence, further improvement in building a modern information and communications technology (ICT) sector is indispensable to increasing competitiveness, economic growth, and job creation in Poland.

Effective Public Finance

The Government has taken significant steps to improve the public financial management system. In late 2009, the Parliament enacted the new *Public Finance Act*, which significantly strengthened the transparency and efficiency of the budgetary process in Poland. The new legislation introduced, among other measures, a medium-term fiscal framework and performance-based budgeting, enhanced debt safety procedures, strengthened control and internal budget audit, and increased budget transparency through the consolidation of some budgetary units and the establishment of a separate budget for EU funds. To accompany the ongoing fiscal consolidation effort, the Government carried out further reforms aimed at strengthening fiscal rules and institutions and improving the quality of expenditure and public sector effectiveness, including in social sectors. The Bank has been actively engaged in this area through successive Development Policy Loan (DPL) series and technical assistance in the areas of spending reviews, management of a public sector wage bill, and local government fiscal management, in close cooperation with the European Commission (EC) and the IMF.

Selected Sectoral Policies for Equity and Inclusion

Action in this area is critical to ensure that the lowest-earning 40 percent of the population can enjoy the full benefits of economic growth, including in terms of accessing economic opportunities as well as benefiting from efficient social services. This is a multitiered agenda, where specific support is needed for each of the various groups that altogether constitute the lowest-earning 40 percent of the population, in particular, the unemployed (inclusive and effective labor market), those living in lagging regions (balanced regional development), and the older/less healthy people (strengthened health care and health prevention in an aging society).

Labor Market

The labor market, which deteriorated in 2012–13 on the back of weaker economic growth, started to recover in 2014. The harmonized unemployment rate according to the Labor Force Survey (LFS) dropped to 9 percent in July 2014 from close to 11 percent at the peak of the economic slowdown.

Beyond the short term, however, increased participation in the labor market is critical for Poland's sustained economic growth as well as for social inclusion and poverty reduction. The Government is making efforts to improve the functioning of the labor market, including by reviewing unemployment services and activation policies (with support from the European Social Fund). The ongoing deregulation of professions (supported, among others, by the Bank DPL) is also likely to provide increased employment opportunities and better matching in the labor markets. In addition, the significant gap in employment conditions between those whose work is regulated by civil contracts (about 1.4 million workers) and those covered by labor contracts continues to draw concern and has been listed as a country-specific recommendation (CSR) by the EC. The Government has proposed an increase in the social security contributions for some of the civil contracts, and the Bank has provided input into the Government's thinking in these areas.

Regional Development

The process of national convergence within the EU has been accompanied by increased internal divergence among and within regions. Several of Poland's 16 regions have made significant progress in terms of growth and living conditions, but five of them (those located in the eastern part of the country) have experienced a relative loss. These regions remain among the 20 poorest regions of the EU27. In addition, disparities within each region have been on the rise (typically with large cities faring relatively well and rural areas and small towns falling behind) and now rank among the highest in the OECD. Poverty and the risks of economic marginalization have a significant territorial component, due to accessibility constraints, the mixed quality of public services, and initial resource endowments. The challenge is to help people living in the poorest parts of the country escape a vicious cycle of impoverishment and low investment and private sector activity.

Significant EU resources will be available in the next 2014–20 programming period directly at the subnational level to finance investments, where local governments have a solid track record for disbursing such funds. The challenge is two-fold: to maximize results (beyond disbursements), especially with regard to reducing the inequality of opportunities across and within regions, which stand in the way of creating shared prosperity; and to ensure the sustainability of these investments (in particular by strengthening local public finance to free up resources for cofinancing, operations, and maintenance). An additional objective for Poland is to develop public-private partnerships, especially to raise the number of hybrid projects. Over the past years, the Bank has worked in close cooperation with the EC, providing a range of knowledge services and developing solid relationships with several key counterparts at both the national and subnational levels.

Aging and Health

In an aging society, the Government has engaged in several successive reforms of the

pension system. The system, adopted in 1999, rested on a defined-contributions scheme based on a multipillar system: (i) a mandatory pay-as-you-go scheme based on notional defined contribution (NDC) accounts and run by the State Social Insurance Institution (ZUS) ("first pillar"); (ii) a mandatory fully funded defined contribution scheme run by Open Pension Funds (OFEs) ("second pillar"); and (iii) a voluntary private pension scheme ("third pillar"). In 2012, the pension age was raised to 67 (from 60 for women and 65 for men) and the mandatory length of service for "uniformed services" (military, border security, etc.) was increased from 15 to 25 years. In late 2013, the Government adopted a reform of the Polish pension system, including: (i) the transfer of Government bonds held by OFEs to the ZUS and the banning of any further investment by OFEs in Government bonds; (ii) the introduction of a clause making contributions to the second pillar voluntary, with the default option being nonparticipation; and (iii) the transfer of OFE funds to ZUS over a ten-year period ahead of a contributor's retirement. The changes have resulted in a significant downsizing of the second pillar in terms of both assets and participants.

The low level of replacement ratios and the subsequent impact on pension adequacy remain the central issue faced by the Polish pension system. The "dependency ratio" is projected to dramatically increase in the decades to come for demographic reasons. As a result, pensions could drop to as low as 30 percent of pre-retirement incomes, presenting the risk that a large share of the older population would fall into poverty (especially in the absence of strong family support networks). Measures are needed to ensure the adequacy and sustainability of pension benefits, such as: (i) aligning special pension systems to the general system (in terms of duration of contributions, retirement age, and levels of benefits); (ii) reviewing the disability systems (to cover only the disabled); (iii) considering a further increase in the retirement age as may be needed based on actuarial data; (iv) developing instruments to encourage voluntary long-term individual savings; and (v) ensuring that minimum pensions remain at or above subsistence level. The Bank has been engaged in analytical support of the Government's policy agenda related to aging through a regional aging project and the "Saving for Growth and Prosperous Aging" Country Economic Memorandum (CEM).

A growing elderly population is also associated with increased health care service utilization as well as with increased risks of old-age exclusion. Poland's objective in the health sector is to develop an effective care system that can deliver quality services and cope with demographic changes in a fiscally constrained environment. Achieving this will in particular require strengthening the spatial planning for health service delivery to account for the health needs of an aging population, streamlining hospital infrastructure, and developing less hospital-centric care practices. This will also include developing measures to limit the growth of long-term care needs by prevention and rehabilitation and by expanding the capacity of independent living. Significant reforms have already been implemented, in particular the transfer of responsibility for hospital management (and financial losses) to subnational governments, which heightens the pressures for consolidation and restructuring.

Selected Sectoral Policies for Climate Action

Poland's economy is among the least emissions efficient in the EU. The consumption of energy equal to one ton of oil equivalent generates 3.4 metric tons of CO_2 compared to an EU average of 2.5. This largely reflects the dependence on coal, especially in the power sector; very high rates of emission growth in the transport sector; and an energy-efficiency performance that remains below EU averages. Action is needed in a number of areas related to climate-informed policy making, climate change adaptation, and climate change mitigation.

Climate Change Policy

The EU climate change and energy package, or the "20-20-20" targets, requires comprehensive action by EU members to achieve, by 2020, a 20 percent reduction of greenhouse gas (GHG) emissions below 1990 levels; 20 percent of EU energy consumption coming from renewable resources; and a 20 percent improvement in energy efficiency. The 20-20-20 package requires Poland's energy-intensive sectors to contribute to the EU-wide target while allowing the emissions from the country's other sectors to increase by 14 percent compared to 2005. This implies a change in production structures and energy consumption patterns. A World Bank study showed that the transition is expected to generate economic costs in output and employment until 2020 that are higher than those of the average EU country, but that the shift toward low emissions through better fuel efficiency, energy efficiency, and other measures would eventually boost Poland's economic growth in the long term.

In early 2014, the EC proposed a more ambitious climate policy framework, setting a target for the EU to reduce GHG emissions by 40 percent below 1990 emission levels by 2030. The 2030 target reflects the Intergovernmental Panel on Climate Change's (IPCC) suggestion for developed countries to reduce GHG emissions by 80–95 percent below 1990 levels by 2050.

The Polish Government is keenly interested in developing a better understanding of the implications of climate change policy decisions on the overall economy, especially with regard to the impact on growth prospects and relevant macroeconomic aggregates, so as to be able to analyze policy options and trade-offs. In recent years, the World Bank Group carried out analytical work and provided technical assistance. The Bank has supported the Polish Government by providing technical expertise and by building institutional capacity to develop a comprehensive modeling toolbox for energy and climate change policy analysis.

Adaptation: Protection against Floods

Climate change is expected to heighten flood risks, to which large parts of the country are already exposed, especially in the basins of the two main rivers (the Odra and the Vistula). Effective protection requires a combination of infrastructure investments (e.g., dikes, reservoirs, etc.) and adequate arrangements for coordination among the various entities in charge of administering the river basins. The Government has developed a comprehensive program to enhance flood protection along the Upper Odra River (which was affected by a devastating flood in 1997) and is now preparing similar plans for the Lower Odra River and the Upper Vistula River. Over the last period, the Bank has supported these efforts by providing financing and technical leadership and by mobilizing other financiers (the EC and the Council of Europe Development Bank [CEB]) to implement the Odra River program.

Mitigation: Resource-Efficient Infrastructure

In close cooperation with the EC, Poland is making efforts to gradually strengthen its low carbon infrastructure systems, including for transport (railways) and energy (energy efficiency, alternatives to coal). This is especially important in the context of a growing economy with increasing trade with EU partners and expanding North-South and East-West transit. Yet, this has proven a challenging endeavor, and in several key sectors the authorities have had difficulties in absorbing the corresponding EU funds. Over the last period, the World Bank initiated a dialogue to support reforms of the railways sector. The Bank also provided a DPL in support of energy efficiency in 2011 as well as targeted advisory services, including on nongrant financing instruments for energy-efficiency investments.

POLITICAL DEVELOPMENTS

Poland has become a major actor within the EU. With a population of about 38.2 million and a GNI per capita of US$13,080 (2013, Atlas method), Poland has the largest economy in Central Europe. Since joining the EU in 2004, the country has made remarkable progress in catching up with the core of the EU in terms of economic development and living standards (GDP per capita in purchasing power standards [PPS] has risen from 51 percent to 68 percent of the EU average). The country's ambition to become one of the key participants in European debates is also becoming manifest through the nomination of senior Polish government representatives to top EU positions, including Prime Minister Donald Tusk's nomination for the President of the European Council and deputy Prime Minister Elżbieta Bieńkowska's nomination for the EU Commissioner responsible for the internal market, industry, entrepreneurship, and small and medium-sized enterprises (SMEs).

European nominations of Poland's key politicians for EU posts triggered a government reshuffle in early fall 2014, with parliamentary and presidential elections scheduled for late 2015. While the coalition formed in late 2007 by the Civic Platform (PO) and the Polish Peasants Party (PSL) is expected to remain in power until the end of its second term in late 2015, Prime Minister Tusk will likely be replaced by Ewa Kopacz, the hitherto Marshal of Sejm and the PO deputy chairman. Further changes in the Cabinet composition are expected by end-September. The Cabinet reshuffle takes place against the backdrop of the preelection period, with regional and municipal elections scheduled for November 2014 and parliamentary and presidential elections for late 2015.

Poland and Development Cooperation

Poland is aspiring to play an increasingly stronger role in the international arena, in line with its demographic weight, economic performance, and political capacity. The Government is aware of the potential importance of development cooperation in Poland's foreign policy in helping to raise the country's profile and influence in selected areas and to contribute to the stability and development of its neighbors and partners. Poland is also playing an increasingly strong role in a broad range of international forums (it hosted the Conference of the Parties, COP, on climate change in Warsaw in November 2013). From an economic angle, the authorities are keen to support the internationalization of Polish firms and to develop links with the Polish diaspora and with Poles living abroad to help promote Poland's interests in the world.

Poland has significant experience to share with other countries on economic transition and sectoral reforms. Yet, resources for development cooperation remain very limited, and there are substantial aid effectiveness issues. The aid budget of US$474 million in 2013 included a mandatory contribution to the EU budget and other multilateral organizations (of about US$355 million in 2013) and a relatively small bilateral program (about US$119 million in 2013) focused on micro-projects implemented by Polish nongovernmental organizations (NGOs) (in the Eastern Partnership countries and in selected International Development Association [IDA] countries). Poland's contribution to the IDA17 amounted to US$10 million.

THE WORLD BANK GROUP PROGRAM IN POLAND

The World Bank Group's engagement in Poland aims to support shared prosperity. The International Bank for Reconstruction and Development (IBRD) program is well aligned with the Government's strategy and with EU priorities (the "smart, sustainable, and inclusive growth" EU 2020 agenda), and follows a "niche" strategy. The International Finance Corporation (IFC) has not had any significant operation in Poland for several years, but is now considering a modest re-engagement. The Multilateral Investment Guarantee Agency (MIGA) has no significant activity at present.

The current four-year Country Partnership Strategy (CPS), presented to the Board of Executive Directors on August 6, 2013, sets out the country context, country development program, and envisaged World Bank Group program for Poland for the period 2014–17. Poland had indicated its interest in continuing to benefit from the World Bank's financial and technical support (and its intent not to seek graduation in the near future). The CPS' two-fold aim is: (i) to foster sustainable income growth for the bottom 40 percent of the population (within the context of Poland's economic convergence with the EU), and (ii) to support Poland's emerging role as a global development partner. The program rests on four strategic engagement areas: (i) economic competitiveness (business environment, innovation, public finance); (ii) equity and inclusion (labor market, regional development, health, aging); (iii) climate action (climate policy, flood protection, resource-efficient infrastructure); and (iv) Poland as a global development partner. The strategy foresees two series of two DPLs each, and a number of investment lending (IL) programs over the period (including in health, flood protection, and social inclusion).

The previous lending program was anchored around successive programmatic DPL series in support of the Government's reforms in public finance, the labor market, and the social sectors, as well as in private sector development.

The new series is focused on resilience and growth, with the first operation of €700 million approved by the Board on July 1, 2014 and the second scheduled for the Board by end-FY15. The investment portfolio consists of one project under implementation (on flood prevention along the Odra River) and a follow-up operation in the pipeline (on flood prevention along the Odra and the Vistula Rivers) planned for the Board in early FY16.

Analytical and Advisory Assistance (AAA) Program. The World Bank program is largely based on "knowledge products"—analyses and advisory services, in part reimbursed by the Government. The authorities value their partnership with the World Bank as a way to access global knowledge in specific technical "niches" (e.g., on a bank resolution framework, innovation and competitiveness, climate change modeling, infrastructure financing, etc.). This serves several purposes, including to inform policy debates and to facilitate the design or implementation of technical reforms. Examples of such work include: (1) support on *Doing Business*, which is provided across several ministries (on insolvency, contract enforcement, access to electricity, etc.), including Subnational *Doing Business* conducted in 18 Polish cities; (2) dialogue on innovation and smart specialization, with a series of engagements with the Ministry of Infrastructure and Development, the National Center for Innovation and Development, the Ministry of Economy, and some regional authorities; (3) support to the development of a macroeconomic model to assess the economy-wide impact of climate change–related policy decisions; (4) analytical work on aging (healthy, active, and prosperous aging), and on savings and growth (in a context of aging); (5) support to the Ministry of Finance on issues such as forecasting for subnational governments and macroeconomic analysis as part of preparation for an eventual adoption of the euro and improving the process for spending reviews; (6) development of financial instruments in the energy efficiency and waste management sectors; and (7) financial reporting (funded by the Government of Switzerland).

POLAND: ODRA RIVER FLOOD PROTECTION PROJECT (ORFPP) - *Project 086768*

Key Dates:

Approved: March 21, 2007

Effective: July 9, 2007

Closing: December 31, 2017

Financing in million Euro:

Financier	*Financing*	*Disbursed ***	*Undisbursed*
Government of Poland	30.0	57.5%	12.7
World Bank	140.1	50.29%	69.64
Council of Europe Dev Bank	204.9	57,10%	87.9
European Union	130.0	42.85%	74.3
Total Project Cost	**505.0***	**51.57***	**244.54***

***As per PAD (2004 figures). Updated cost about €750 million**

**** Per June 30, 2014 Project report for the second quarter of 2014 and World Bank records as of September 11, 2014.**

The Odra River Flood Protection Project (ORFPP) will better ensure the protection of the population in southeastern Poland (Lower and Upper Silesia) and in particular, the economically crucial city of Wroclaw, from loss of life and damage to property caused by severe flooding. These areas are heavily affected by recurrent devastating floods, most recently in 1997. As the final total cost is likely to be close to US$1 billion, this project is among the Bank's largest engagements in the Europe and Central Asia (ECA) region. The project is co-financed by the Council of Europe Development Bank (CEB) and European Union (EU) Cohesion grants. The project has three main components:

- **Rehabilitation and modernization of dikes and river embankments in and around Wroclaw,** as well as the widening of bridges and weirs, and the dredging and improvement of the floodwater by-passing capacity;
- **Construction of a flood retention dry polder (reservoir) near Raciborz** upstream of Wroclaw; and
- **Improvement of flood forecasting and flood management capabilities.**

The project is being implemented in three phases. First, the implementation structure was established and staff trained; the implementation involves several ministries (notably the Ministries of Home Affairs, the Environment, and Regional Development) and four project implementation units (PIUs) inside the four regional Implementing Agencies. Teams of experts (technical assistance, contract engineers) were recruited to assist these agencies. This first phase was completed at end-2009. In the second phase, land was acquired and all permits obtained, in particular for the construction of the 24 kilometer-long dikes for the dry polder in Racibórz—critical protection for downstream Wroclaw. An area of 1,260 hectares was acquired for the dry polder dikes; the total polder area is 26 square kilometers. Furthermore, 202 households are being resettled. Forty-seven households have opted to move into the new town Nove Nieboczowy; the first 25 houses are under construction with the (relocated) church and community center completed and other village infrastructure (e.g., wastewater, electricity) in process. In these areas, culturally significant archeological fragments have also been found, including the *Silesian Venus*. The third phase, now in full operation, concerns all the construction flood works. This phase will last from early 2013 through 2017. Most works are progressing reasonably well, though technical and managerial challenges remain. Environmentally significant areas, such as Natura 2000 sites, receive protection or are compensated.

The Bank's finance will have leveraged about 5–6 times the non-Bank funds, mostly EU Cohesion Funds. It will also have built administrative and policy capacity within the Government to carry out complex large infrastructure works of a national strategic nature, involving numerous national and local agencies. This rich engagement (both on the technical and policy aspects) has resulted in interest from the Government for a follow-on project on the neighboring Vistula River (which suffered from flooding in 2010, unlike in the project areas).

Expected Results:

(i) Improved protection for about 2.5 million people in the Wroclaw area, as well as other urban centers and towns upstream of Wroclaw, against severe flood episodes, such as the 1997 flood.

(ii) Improved flood forecasting, to allow for better prevention of flood damage and the minimization of damages.

Key Partners: The main partners are the Ministries of Home Affairs and of the Environment; Water Management Boards; the Institute of Meteorology and Water Management (IMGW), and Voievod and local governments. In addition, financial partners are the European Commission (EC), and the Council of Europe Development Bank (CEB).