PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

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Operation Name	Poland Growth and Resilience DPL2
Region	EUROPE AND CENTRAL ASIA
Country	Republic of Poland
Sector	General public administration sector (50%); General industry and trade sector (30%); Banking (20%)
Operation ID	P149781
Lending Instrument	Development Policy Lending
Borrower(s)	GOVERNMENT OF POLAND
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Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Country and Sector Background

Sound macroeconomic policies and sustained progress in implementing growth enhancing structural reforms have helped Poland sustain economic growth throughout the global downturn. During the two recent periods of weak Euro area growth, in 2008-10 and in 2013, Poland adopted counter-cyclical fiscal and monetary policies to help cushion the impact on the domestic economy. The general government deficit increased from 1.9 percent of GDP in 2007 to 4.9 percent in 2011 and then again from 3.7 percent in 2012 to 4 percent in 2013. Despite a decline in domestic demand, particularly investment, Poland was the only EU country that has grown continuously over the last six years. In 2014, economic growth strengthened in Poland and the authorities resumed their fiscal consolidation efforts in an effort to start rebuilding prudential fiscal buffers, reducing the fiscal deficit to around 3.2 percent of GDP.

To sustain the recovery the authorities prioritized reforms to strengthen public finances and financial sector oversight, supplemented by reforms aimed at bolstering the economy's long-term competitiveness. Challenges remain to achieve sustainable growth: future growth is less likely to rely on relatively cheap labor, with a large share of exports to Germany as part of their export-led supply chains. The new macroeconomic framework is therefore designed to help Poland cope with future shocks, while strengthening labor markets (in terms of both flexibility and raising participation rates), the business environment and promoting innovation. These reforms are critical to ensure that the economy remains competitive as it seeks to increase productivity and diversify into new product markets. Continuing to bolster financial sector resilience will also support a more sustainable recovery in credit and investment and further reduce risks from such factors as the divergent monetary policy in the EU and US or from regional geopolitical instability.

Having a job and the general growth in wages have been the main drivers of incomes of the bottom 40 percent, highlighting the importance of labor market reforms. Between 2005-2010 growth of incomes of the bottom 40 percent was primarily due to the growth in average earnings, which contributed roughly half of the overall income growth (Figure 2). The bottom 40 percent have much higher shares of unemployed, inactive, or residing in low work intensity households, or holding temporary contracts, or in elementary occupations.

Women face more barriers to employment. In 2014, female labor force participation was 61.1 percent against 74.6 percent for men (aged 15-64 years). This gap was particularly large during child-bearing years even though more women (43 percent) than men (29 percent) completed tertiary education. About 40 percent of inequality in access to full-time work is due to factors beyond an individual's control, such as parentage, with a quarter being due to gender. Access to affordable childcare as well as long-term care for the elderly, remains a key constraint to employment for women. The gender pay gap is estimated at about 10 percent at median earnings.

II. Operation Objectives

The main objective of the operation is to support Poland's macroeconomic growth and resilience, leading to more dynamic job creation and shared prosperity. The Government remains committed to the reform pillars outlined in the previous operation, namely to:

i. Enhance macroeconomic resilience, by reducing the general government fiscal deficit and debt levels toward the Medium-Term Objective (MTO) and bolstering macro-prudential oversight;
ii. Strengthen labor market flexibility and employment promotion; and
iii. Improve private sector competitiveness and innovation.

These reforms constitute the three pillars of the DPL and seek to address the main challenges facing the Polish economy. The main objective of the operation is to support macroeconomic growth and resilience, leading to more dynamic job creation and shared prosperity. Rebuilding fiscal space, financial depth and soundness, will enable Poland to increase investments (public and private) in infrastructure and human capital, as well as to respond to future shocks. Job growth requires both strong economic growth and structural reforms to reduce barriers and promote participation, especially given Poland's historically high structural unemployment and low participation rates. Lastly, continuing to improve the ability of firms to enter, exit and restructure, and support for innovation, will enable Poland to diversify and become more productive and flexible, which are seen as key challenges as Poland continues to converge with the rest of Europe. The World Bank supports Poland in these priority reform areas through policy lending, which embeds technical advice for reform design, as well as through a range of technical assistance and advisory support.

The proposed loan measures to be supported under each pillar are as follows:

Pillar 1: Enhancing fiscal resilience: A well-managed fiscal consolidation remains a top priority for the government, to provide sufficient counter-cyclical buffers while promoting expenditure efficiency. Structural reforms in the public finances – in particularly implementation of a new permanent fiscal (expenditure) rule for the central government and new debt rules for the local governments, as well as a prudent budget for 2015, will contribute to ongoing fiscal consolidation efforts. Improvements in the financial sector will also help to deepen liquidity and increase the range of financial instruments that will improve the resilience of the banking sector. These reforms will enhance Poland's fiscal resilience by putting public debt on a downward path.

Pillar 2: Strengthening labor market resilience and employment promotion: While restoring job growth requires strong economic growth, structural reforms are also critical for reducing structural barriers and promoting participation, especially given Poland's historically high structural unemployment rate. The Government has launched reforms aimed at supporting employment by increasing the flexibility of the Labor Code, deregulating access to many professions, and facilitating labor market (re-)entry for young mothers. The Government has also started implementation of a comprehensive reform of its Public Employment Services to support job seekers through better profiling and targeting.

Pillar 3: Enhancing private sector resilience and promoting competitiveness: Based on previous reforms that have strengthened competitiveness, Poland remains well positioned to benefit from the gradual pick-up in the growth rates of its main trading partners. However, further measures are needed to reduce administrative burdens and to complete reforms in critical areas, such as the insolvency regime. The authorities continue to work on the legal frameworks for macro-prudential supervision and corporate restructuring. There are also initiatives to create one-stop shops for business start-ups and to reduce other barriers to doing business, including in obtaining construction permits. These reforms will enable the business sector to better take advantages of future growth opportunities.

III. Rationale for Bank Involvement

Strengthening public finances, sustaining economic growth, and facilitating job creation and innovation are key priorities. Across all these issues, the Government is concerned about addressing the short-term challenges, which are the legacy of the global financial crisis and the recent economic slowdown, as well as medium- to long-term structural rigidities. The short-term actions are aimed at rebuilding fiscal buffers and bolstering economic resilience, while medium and long-term structural reforms are targeted at lifting potential growth.

Weak economic activity in the Euro Area and fiscal consolidation during 2011-12 affected Poland's growth in 2012-13. This has enhanced the focus on measures to boost economic growth and improve competitiveness in a fiscally neutral way by: (i) bolstering resilience of the financial sector, (ii) supporting investment activity, and (iii) improving the business climate and innovation. Investment is supported by an off-budget medium-term investment program (Polish Investments Program) and a guarantee scheme for SMEs. The Government also recognizes the need to pursue further reforms to improve the business environment for Poland to stay internationally competitive in addition to enhancing the frameworks for insolvency to promote rehabilitation (rather than liquidation) of viable debtors.

The Government's short-term actions on labor markets are focused on enhancing labor market flexibility and providing support to the unemployed. Measures introduced to mitigate the impact of the global crisis on the labor market include greater flexibility to adjust working hours and a part-time work subsidy scheme. The Government also increased spending through the Labor Fund to support active labor market programs, such as training and wage subsidies (including apprenticeship schemes) for disadvantaged groups. Medium- and longer-term structural reforms are aimed at improving the effectiveness of public employment offices, providing better services for the unemployed through profiling and increased focus on the hard-to-place, and introducing new instruments to support job creation and re-integration, including for women re-entering the labor market after child-birth The Government has also taken steps to reduce labor market duality by introducing social security contributions on selected civil law employment contracts.

Supporting Innovation for "Smart Growth" is one of the pillars of Poland's National Reform Program. Building a competitive advantage in new industries requires significant improvements in the innovation capacity of Polish enterprises. Strengthening the links between universities, science and businesses R&D will help to achieve this goal. Poland has already made some important steps towards becoming more innovation-driven, in particular through securing, approximately EUR 8.61 billion for innovation support from European funds under the Smart Growth Operational Program (2014-2020).

The Executive Board of the IMF approved a successor two-year arrangement for Poland under the Flexible Credit Line (FCL) of US$23 billion in January 2015. The Polish authorities intend to treat the arrangement as precautionary and do not intend to draw on the FCL. The most recent review by the IMF Executive Board, in January 2015, concluded that "Poland's strong fundamentals and sound policies helped it to successfully withstand several bouts of market turbulence and paved the way for economic recovery. While Poland has benefited from its continued transformation into a more open and dynamic economy, its substantial trade and financial linkages with global markets, combined with still-large financing needs, also make it vulnerable to external shocks."

The DPL engagement in a high-income country like Poland must be based on a strong foundation of shared priorities and high quality, and often very specialized, analytical work. The value proposition for the Government is less about the Bank's financial resources, although these must be cost-effective and of a size proportionate to the economic environment, but more about the associated analytic support (including just-in-time TA, evaluations, policy notes etc.) and the programming processes provided by the Bank's operations that highlights a critical, and coherent, subset of government reforms. The current series also builds on previous series—for example, support for reforms to increase the statutory retirement age, harmonize pensions for men and women, and control of subnational deficits as part of the fiscal consolidation effort. Any operation with a member of the EU must also be consistent with the economic governance framework of the EU, which has adapted after the crisis and now includes moves towards the Banking Union. The program benefitted from the Government's well-developed and transparent consultation process around potentially contentious reforms.

IV. Tentative financing

Source:		($m.)
Borrower		0
International Bank for Reconstruction and Development		1,000
	Total	1,000

V. Institutional and Implementation Arrangements

The Bank continues to work closely with the Ministry of Finance, Prime Minister's Office and sector ministries to monitor and assess reform progress and impacts during the course of the program. Monitoring and evaluation will be supported by the various ministries as well as budgetary, legislative and economic data provided by the authorities and verified in official disclosures, directives and regulations. Baseline and updated data are provided by the respective specialized agencies and tracked according to the indicators and outcome measures shown in the monitoring and results framework of the policy matrix.

The Ministry of Justice will evaluate ex-post the effect of labor market deregulation on the legal sector. In cooperation with the Chancellery of the Prime Minister, the World Bank is providing technical assistance to the Ministry of Justice to develop a monitoring and evaluation strategy, with an initial focus on legal professions. This will help indicate the social as well as economic impact of these reforms and suggest possible further deregulation. The Bank is also continuing to work closely with other sector ministries supported through this operation, for example on labor market duality issues and to assist with the development of a new construction code.

VI. Risks and Risk Mitigation

The overall risk of the operation is considered to be moderate:

Political risks could arise from public discontent with reforms, which in turn could undermine support with elections in 2015. Ensuring support within the coalition Government and more broadly will be key for the successful implementation of the envisioned reform agenda, particularly given the Presidential (May) and Parliamentary (October) elections in 2015. For example, the deregulation of labor markets risks protests from affected professions, despite popular support, and could reduce the Government's ability to implement and sustain fiscal and structural reforms.

The Government has developed widespread support for the reforms, which mitigates this risk. Despite having a small parliamentary majority, the ruling coalition has been effective in securing sufficient political support to maintain the reform agenda. The Government's strong commitment to strengthening public finances was demonstrated through approval of the 2014 and 2015 budgets. The administration also has a well-developed process of internal, stakeholder and public consultations for legislation that enables both discussion and the amendment of draft laws. This helps to mitigate the stakeholder risks, which are still rated moderate given the impact of the reforms on large numbers of people.

Macroeconomic risks stem largely from potential shocks to the global economic outlook and regional instability, and remain titled on the downside. A global, Euro area or regional shock could undermine the gradual improvement in economic growth in Poland, and jeopardize fiscal outcomes, particularly as global interest rates diverge (e.g. between the US and EU), or stemming from regional energy supply disruptions or uncertainty over the economic situation in Greece. Moreover, financial sector vulnerabilities remain, reflecting uncertainties from sovereign stress in the rest of Europe or emerging markets. Poland remains vulnerable to external debt deleveraging through parent bank funding of local subsidiaries and tighter access to capital.

Mitigating factors against downside macroeconomic risks include the improving outlook in key trading partners, a track record of sound macroeconomic management and growing energy security. Although Germany remains Poland's most important trading partner, the expansion of exports into non-EU markets is spreading the economic risks. Poland's energy security has also improved with the development of alternative supply routes and greater storage capacity. Flexible monetary policy, especially a flexible exchange rate, continues to cushion the impact of external shocks and divergent monetary policy between major global trading partners. A new round of EU structural funds should also boost investment in 2014-20. The solid track record of macroeconomic management will help market confidence and access to international financial markets, based on medium-term fiscal and structural reforms. Adequately capitalized, liquid, and profitable banks as well as effective and strong financial supervision are key mitigating factors against financial risks. The authorities could also draw on the FCL with the IMF to smooth a shock.

VII. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

The overall poverty, social and gender impacts of policy measures supported by this operation are expected to be positive. Several policy measures will improve the living conditions of the poor, provide greater opportunities for women to participate in the labor market, and contribute to the income growth of the bottom 40 percent. This will occur directly through expanded coverage and greater progressivity of the child tax credit, the reduction of restrictive labor practices, and through reforms to services for job seekers. It will also occur indirectly through improved stability and solvency of public finances, which increases the scope to smooth economic downturns, and measures to enhance the business environment for sustained growth.

The child tax credit, labor market reforms and deregulation of professions are expected to have a positive impact on shared prosperity and particularly women in Poland. Each of these reforms should have a positive impact for people on low incomes, and particularly women, by improving incentives and opportunities to enter the labor market. This is reflected in the results indicators for labor market reforms, which has been disaggregated to reflect that two-thirds of the reduction in long-term unemployed would be women.

Measures to improve the business environment are expected to contribute indirectly to reducing poverty and increasing the incomes of the bottom 40 percent. The easing of regulations for registering new businesses registrations should benefit low income consumers and expand opportunities for employment and entrepreneurship. Similarly, easing the process for issuing construction permits is expected to increase employment in that sector, an important source of jobs for those with relatively low skills. Addressing major constraints to business and innovation, as well as reducing the obstacles to starting a business or adopting new innovative technologies and practices are expected to boost job creation, in particular for small and medium enterprises that are key to the economic opportunities of the bottom 40 percent. Enabling companies and individuals to restructure their debts or move more swiftly through insolvency is also expected to contribute to inclusive growth. Altogether, these reforms aim to enhance Poland's long-term growth and employment prospects.

Environment Aspects

The specific policies supported by the DPL series are unlikely to have significant effects on the environment, forests, water resources, habitats or other natural resources. The risk of unanticipated adverse effects to the environment and natural resources is small. Credible scenarios for direct or indirect negative impacts appear unlikely. Poland has adequate controls and environmental legislation and regulations are closely aligned with EU environmental directives. Poland has adopted EU guidelines on the integration of environmental assessments into the planning and programming of projects and the EU's Environmental Liabilities Directive setting out liability for damage to property and natural resources.

VIII. Contact point

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