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Report No. 97725-PL

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A PROPOSED LOAN

IN THE AMOUNT OF EURO 912.7 MILLION

(APPROXIMATELY US$1 BILLION EQUIVALENT)

TO THE

REPUBLIC OF POLAND

FOR THE

SECOND RESILIENCE AND GROWTH DEVELOPMENT POLICY LOAN

June 26, 2015

Macroeconomic and Fiscal Management Global Practice
Europe and Central Asia Region

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REPUBLIC OF POLAND

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of May 31, 2015)

1 EUR=4.12495PLN 1 USD=3.7645

ABBREVIATIONS, ACRONYMS & TERMS

AROP	At-risk-of-poverty (Eurostat)
CPI	Consumer Price Index
CPS	Country Partnership Strategy
CRD	Capital Requirements Directive IV
DPL	Development Policy Loan
EC	European Commission
ECA	Europe and Central Asia Region
ECB	European Central Bank
EDP	Excessive Deficit Procedure
EDevP	Enterprise Development Program
ESA	European System of Accounts
ESF	European Social Fund
EU	European Union
FCL	Flexible Credit Line
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
Gmina	Municipality/commune administrative unit (2,478)
GNI	Gross National Income
GUS	National Statistical Office
IBRD	International Bank for Reconstruction and Development
IFIs	International Financial Institutions
IMF	International Monetary Fund
KNF	Financial Supervision Authority
LFS	Labor Force Survey
LM	Labor Market
M&E	Monitoring and Evaluation
MOF	Ministry of Finance
MTO	Medium Term Objective
NCBR	National Center for R&D
NBP	National Bank of Poland
OECD	Organization for Economic Cooperation and Development
OPF	Open Pension Fund
PER	Public Expenditure Review
PFA	Public Finance Act
PFM	Public Finance Management
PIT	Personal Income Tax
Powiat	County administrative unit (379)
PLN	Polish Zloty
RER	Regular Economic Report
R&D	Research and Development
SGP	Stability and Growth Pact
SGOP	Smart Growth Operational Program
SME	Small and Medium Enterprises
TA	Technical Assistance
VAT	Value-Added Tax
Voivodeships	Province administrative unit (16)
ZUS	Social Insurance Institution

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REPUBLIC OF POLAND
SECOND RESILIENCE AND GROWTH DEVELOPMENT POLICY LOAN (DPL2)
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LOAN AND PROGRAM SUMMARY

REPUBLIC OF POLAND

SECOND RESILIENCE AND GROWTH DEVELOPMENT POLICY LOAN

<table>
<tr><td>Borrower</td><td>REPUBLIC OF POLAND</td></tr>
<tr><td>Implementation Agency</td><td>MINISTRY OF FINANCE</td></tr>
<tr><td>Financing Data</td><td>Amount: EUR 912.7 million
Terms: Flexible Loan in Euro, at six-month Euribor for EUR plus Variable Spread, with 30 years of total maturity, including 9.5 years of grace, and level repayment of principal.
Front end fee: 0.25% of loan amount to be financed from own resources</td></tr>
<tr><td>Operation Type</td><td>Programmatic (2nd of 2), single-tranche</td></tr>
<tr><td>Main Policy Areas</td><td>Public finance, labor markets, financial sector, growth and private sector development</td></tr>
<tr><td>Program Development Objective(s)</td><td>This is the second in a series of two development policy loans (DPL) structured around three pillars:
(i) Enhancing macroeconomic resilience, by reducing the general government fiscal deficit and debt levels toward the Medium Term Objective (MTO) and bolstering macro-prudential oversight;
(ii) Strengthening labor market flexibility and employment promotion; and
(iii) Improving private sector competitiveness and innovation.
The proposed DPL series is central to the Bank's engagement in the areas of public finance, labor markets and private sector development, as described in the Country Partnership Strategy, presented to the Board on July 15, 2013.</td></tr>
<tr><td>Result Indicators</td><td>(i) By the end of 2015, the public debt-to-GDP ratio (ESA definition) is lower than 52 percent of GDP, the general government deficit is 3.2 percent of GDP or lower, and the start of the covered bond market continues to deepen financial markets.
(ii) By the end of 2015, the number of registered long-term unemployed is reduced by at least 30,000 persons, of which two-thirds are women, i.e. from 1,107 thousands in 2013 to fewer than 1,077 thousands.
(iii) The Doing Business Report 2016 shows an improvement in the time taken to start a business (25 days or fewer), to issue construction permits (140 days or fewer), and a new 'simplified' procedure for corporate restructuring is introduced and total spending on R&D rises from 0.9 percent of GDP in 2012 to 1 percent in 2014.</td></tr>
<tr><td>Overall risk rating</td><td>Moderate</td></tr>
<tr><td>Operation ID Number</td><td>P149781</td></tr>
</table>

IBRD PROGRAM DOCUMENT FOR A PROPOSED SECOND RESILIENCE AND GROWTH DEVELOPMENT POLICY LOAN TO THE REPUBLIC OF POLAND

I. INTRODUCTION AND COUNTRY CONTEXT

1. **This proposed second loan in a programmatic series of two development policy loans (DPL2) is structured around three pillars.** These are: (i) enhancing macroeconomic resilience, by reducing the general government fiscal deficit and debt levels toward the Medium Term Objective[1] (MTO) and bolstering macro-prudential oversight; (ii) strengthening labor market flexibility and employment promotion; and (iii) improving private sector competitiveness and innovation. The main objective of the operation is to support macroeconomic growth and resilience, leading to more dynamic job creation and shared prosperity. The proposed DPL series is at the core of the Bank's engagement in Poland, as described in the Country Partnership Strategy presented to the Board on July 15, 2013. The proposed amount for the loan (DPL2) is EUR 912.7 million (approximately US$1 billion equivalent).

2. **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 is 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.

3. **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.

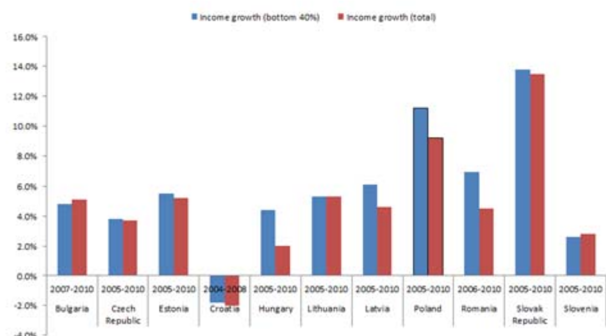
4. **Following Prime Minister Tusk's appointment as President of the European Council, Ewa Kopacz became Prime Minister in September 2014, a year before Parliamentary elections.** The coalition Government, composed of the Civic Platform (PO) and the Polish Peasants' Party (PSL), has a small majority in Parliament, but was elected with a strong mandate

[1] The country-specific medium-term objective (MTO) corresponds to the structural budgetary position that EU Member States should achieve, and maintain, over the cycle, in order to ensure sustainable public finances and provide room to safeguard respect of Treaty reference values for deficit and debt at times of negative output gaps. The MTO for Poland is a structural deficit of one percent of GDP.

for reform, particularly in the areas of public finance, financial markets, labor markets, business climate and innovation. Through this DPL series the Bank continues to support the implementation of the Government's reform program, which is backed by complementary analytic and advisory services that help foster greater global knowledge exchange.

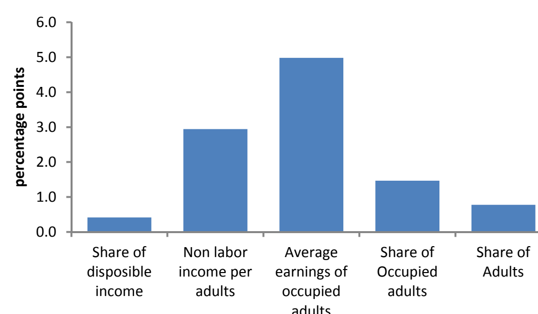
5. **Economic growth has raised living standards for most of the population, including the bottom 40 percent.** Between 2005-2010 the share of the population with incomes below the US$5/day threshold decreased from 14.8 percent to 5 percent[2] while the incomes of the bottom 40 percent of the population grew, both relative to the mean and relative to other countries in the region (Figure 1). However, according to Eurostat, the at-risk-of-poverty (AROP) rate remains high, particularly among the unemployed and inactive, as well as among youth, families with several children, and households in small towns and rural areas. There is also a large cohort of working poor: at 10.4 percent in 2012 the AROP rate among employed people is the fifth highest in the EU. While all other groups have recorded some gains since 2008, the income per capita of the lowest decile remained largely unchanged.

Figure 1: Shared prosperity indicators in EU New Member States



Source: Staff estimates based on EU-SILC data.

Figure 2: Shapley decomposition of the growth of incomes of the bottom 40 percent (2005-2010)



Source: Staff estimates

6. **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.

7. **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 (World Bank 2013). 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.

[2] Eurostat's at-risk-of-poverty (AROP) rate has similarly decreased from 16 percent in 2005 to 6.1 percent in 2010 (see http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=ilc_li22&lang=en)

II. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

8. **An increase in investment and private consumption helped strengthen economic growth in 2014 and early 2015.** GDP growth doubled to 3.4 percent in 2014, from 1.7 percent in 2013 and 1.8 percent in 2012. Domestic demand became the main driver of growth as investment activity rebounded strongly in 2014 amid favorable financing conditions and improving business confidence, while private consumption benefitted from significant improvements in employment and real wages. Growth momentum continued into the first quarter of 2015, with GDP accelerating to 3.5 percent from a year earlier amid strong growth of industrial production, retail sales, and improved export performance.

9. **Strengthening growth and more flexible labor markets have helped reduce unemployment rates.** The harmonized unemployed rate dropped to 7.7 percent in March 2015 from over 9 percent a year ago. This is the lowest rate since 2008, with the number of unemployed falling by almost 400,000 people since December 2013. Job creation has been concentrated in manufacturing, utilizing flexible term contracts, while the number of open-ended contracts declined slightly. Despite the positive impact on aggregate employment, the shift toward flexible term contracts has aggravated concerns over labor market duality where workers with open-ended (usually full-time) contracts enjoy preferences, protection and training that increasingly contrast with those on fixed-term contracts. Real wages have increased markedly over the past few years supporting household incomes and private consumption.

10. **Strong exports to the EU, combined with EU structural funds and moderate import growth have helped to reduce external imbalances.** The current account deficit narrowed to 1.4 percent of GDP in 2014 from over 5 percent of GDP in 2010-11. The improvement stemmed from strong export growth, especially to traditional trade partners from the EU - Germany, Czech Republic and Italy. The current account deficit was largely financed from EU structural funds and direct investment inflows, although the later remain subdued, compared to pre-2008 levels, reflecting the prolonged period of low investment across Europe. External debt stabilized at around 65 percent of GDP, with the share of short-term debt in total external debt at around 20 percent. International reserves amount to the equivalent of 5.2 months of imports of goods and services.

11. **Inflation remains well below the central bank's 1.5-3.5 percent target range, affected by strong declines in food and energy prices.** While price levels were 1.1 percent lower in April 2015 from a year earlier, the pace of price declines has slowed since February when Poland recorded the trough with prices down 1.6 percent year on year. Overall, inflation in Poland has been negative since July 2014, reflecting a combination of factors - predominantly low imported inflation from Euro Area trading partners, as well as declining global food and energy prices. Twelve-month core inflation stood at 0.4 percent in April, while 12-month inflation expectations for the next 12 months hover around 0.7 percent. The central bank's Monetary Policy Council (MPC) resumed its easing cycle in late 2014 and early 2015 by lowering the main policy rate by 100 basis points. This brought the main policy rate to an historical low of 1.5 percent.

12. **The banking sector remains well capitalized, liquid, and profitable, with credit growth to the private sector gradually strengthening.** Capital adequacy is strong (at 14.7 percent in 2014, under CRDIV with Tier 1 capital at 13.5 percent), and liquidity is high. The

banking sector profits in 2014 reached a record level of PLN 16.7 billion. The deleveraging of the Euro area banks present in Poland continued in an orderly fashion with falling foreign funding offset by rising domestic deposits. The *stress tests*, carried out by the KNF, NBP and EBA, confirmed the financial sectors resilience to external shocks, including an appreciation of the Swiss franc (CHF). A 30 percent increase in the CHF would reduce the CAT1 ratio to around 13.3 percent from 13.5 percent at the end of 2014[3]. The share of NPLs in banks' credit portfolio stood at 7 percent in 2014 with notable differences across among borrowers – e.g. NPLs to medium and small enterprises were close to 13 percent, with mortgage related NPLs at 3 percent. Private sector credit growth recovered slowly in 2014 and early 2015 driven by increased lending to households and corporates, with 12-month increases of about 7 percent in March 2015.

13. **Fiscal consolidation has continued.** The fiscal deficit narrowed to 3.2 percent of GDP in 2014 from 4 percent in 2013, due to stronger-than-expected revenue collection as domestic demand pushed up VAT receipts. In addition, changes to second pillar pensions have reduced the government's social contributions. Expenditures are also expected to have turned out lower than in 2013, in particular due to limited public investment growth resulting from the transition to the next EU (budget) perspective, the continued freeze in public sector wage levels and lower interest payments. Given Poland's fiscal balance in 2014 and taking into account the cost of systemic pension reform of 0.4 percent of GDP, the European Commission recommended that the European Council abrogates the excessive deficit procedure (EDP) for Poland in 2015, i.e. one year ahead of schedule. The public debt stock declined to 50.1 percent of GDP in 2014 from 55.7 percent in 2013, as the reform of the second pillar pension reduced the debt stock by some 7.6 percent of GDP (as government bonds were returned to the government balance sheet).

2.2. MACROECONOMIC OUTLOOK

14. **Resilient domestic demand amid improving external environment will stabilize economic growth at about 3.6 percent in 2015 and 2016**. Domestic demand is expected to remain the main driver of growth backed by strong consumption and investment growth. Private consumption growth is projected to reach 3.3 percent on the back of strong employment growth, leading to a reduction in unemployment. In addition, the scaling up of some social expenditure—notably an increase in the child tax credit for families and in the pensions indexation—will further support the growth of real household incomes. Investment will also benefit from the roll-out of new projects financed by EU structural funds and the ongoing recovery of credit growth to enterprises. The recent upgrades of the Euro Area outlook, as well as low oil prices should be conducive to economic growth going forward. Geopolitical tensions related to the conflict in eastern Ukraine, as well as the still fragile recovery in the Euro Area, raise uncertainty, which could dampen consumer confidence and private sector investment.

15. **Accelerating domestic demand is expected to push inflation back toward the central bank's target.** The Monetary Policy Council ended the easing cycle in March 2015 and no further changes in the monetary stance are expected until early 2016. Inflation is expected to reach the NBP's target bound in the first half of 2017, as activity strengthens and the impact of lower oil import prices wane.

[3] Poland has a high stock of CHF loans (EUR30 billion or 8 percent of GDP), all of them mortgage loans. However, CHF borrowers tend to be wealthier, CHF mortgages benefit from low variable interest rates, and since 2005-08, when 90 percent of CHF loans were granted, average nominal wages have increased by over 40 percent.

Table 1: Economic and Fiscal Developments and Prospects 2010-2017

	2010	2011	2012	2013	2014	2015 (f)	2016 (f)	2017 (f)
Real economy	Annual percentage change, unless otherwise indicated							
GDP (billion zloty)	1,437.4	1,553.6	1,615.9	1,662.7	1,728.7	1,792.2	1,878.4	1,980.0
Real GDP	3.7	4.8	1.8	1.7	3.4	3.6	3.6	3.7
Per Capita GDP (In US$ Atlas Method)	*12,640*	*12,850*	*13,180*	*13,440*	*13,730*	*14,010*	*14,230*	*14,520*
Growth								
Private Consumption	2.7	3.0	1.0	1.2	3.1	3.3	3.9	4.0
Public Consumption	3.3	-2.3	0.2	2.1	4.7	2.7	1.4	1.4
Gross Fixed Investment	-0.4	9.3	-1.5	1.1	9.2	7.8	5.9	5.4
Net exports (contribution to growth)	-0.5	0.9	2.2	1.3	-1.4	-0.6	-0.4	-0.3
Exports of goods and services	12.9	7.9	4.3	4.8	5.7	5.3	5.8	5.8
Imports of goods and services	14.0	5.5	-0.6	1.8	9.1	6.7	6.6	6.3
Unemployment rate (Eurostat definition)	9.7	9.7	10.1	10.3	9.0	8.2	7.6	7.0
CPI (average)	2.6	4.3	3.7	0.9	0.0	-0.2	1.2	1.7
Fiscal Accounts	Percent of GDP, unless otherwise indicated							
Expenditures	45.9	43.9	42.9	42.2	41.8	41.6	41.1	40.2
Revenues	38.2	39.0	39.2	38.2	38.6	38.8	38.5	37.9
General Government Balance	-7.7	-4.9	-3.7	-4.0	-3.2	-2.8	-2.6	-2.3
Primary Balance	-5.2	-2.4	-1.0	-1.5	-1.2	-0.9	-1.1	-0.8
General Government Debt (ESA2010)	53.6	54.8	54.4	55.7	50.1	50.7	50.5	50.3
General Government Debt (national methodology)	52.0	52.5	52.0	53.1	47.9	--	--	--
Selected Monetary Accounts	Annual percentage change, unless otherwise indicated, end of period							
Broad Money	8.4	11.5	4.2	6.7	8.8	--	--	--
Credit to non-government	8.4	13.4	1.5	4.2	7.0	--	--	--
Interest (key policy interest rate)	3.5	4.5	4.3	2.5	2.0	--	--	--
Balance of Payments	Percent of GDP, unless otherwise indicated							
Current Account Balance	-5.6	-5.1	-3.6	-1.3	-1.4	-1.2	-1.5	-1.7
Exports of goods and services	40.2	42.9	44.8	46.1	46.9	45.7	46.8	47.9
Imports of goods and services	42.2	44.9	45.0	44.0	45.1	45.7	47.5	49.0
Direct Investment, net	1.8	2.6	1.2	0.6	1.6	1.6	1.4	1.4
Gross Reserves (in billions US$, eop)	93.5	97.9	108.9	106.2	100.4	--	--	--
External Debt (in USD terms)	66.8	61.7	73.9	72.8	64.2	67.3	67.9	66.8
Exchange Rate to USD (average)	3.02	2.96	3.26	3.16	3.16	--	--	--
Exchange Rate to EUR (average)	3.99	4.12	4.19	4.20	4.19	--	--	--
Memo items								
GDP nominal (in billions of US$)	476.6	524.3	496.1	526.0	547.9	--	--	--

Source: World Bank staff calculations based on Central Statistical Office, National Bank of Poland, Ministry of Finance, Eurostat, and IMF. *Note:* Main difference between national and ESA definitions of public debt is that the former excludes the National Road Fund.

16. **On the external side, the current account deficit is expected to remain below 2 percent of GDP over the medium term as exports and imports pick-up modestly, in line with the gradual recovery.** The current account deficit is projected to be financed mostly by FDI inflows and EU transfers. External debt is expected to have peaked at around 74 percent of GDP in 2012, before falling below 65 percent in 2014 and stabilizing at slightly higher levels over the medium term.

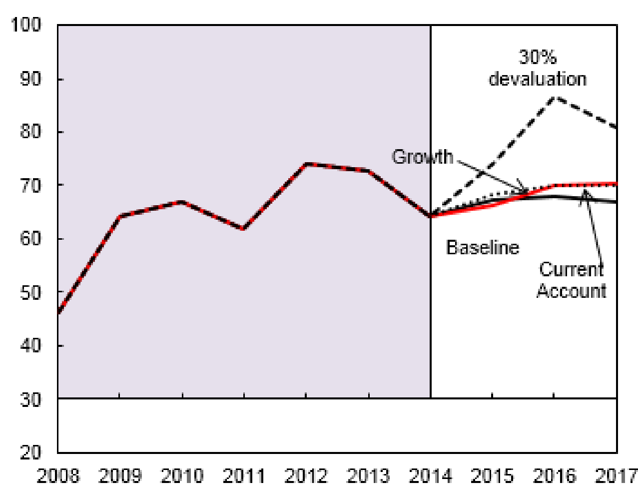
Table 2: Balance of Payments: Financing Requirements and Sources 2012-2017

	2012	2013	2014	2015 (f)	2016 (f)	2017(f)
Financing requirements (USD, mln)	144,503	134,741	135,834	127,849	128,660	130,824
Current account deficit	17,631	6,856	7,578	6,125	8,567	10,235
Short term debt amortizations	71,864	70,462	75,452	68,511	60,309	58,589
Medium and Long term debt amortization	55,008	57,423	52,804	53,214	59,784	62,000
Financing Sources (USD, mln)	144,503	134,741	135,834	127,849	128,660	130,824
Direct investment and portfolio equity investments (net)	12,809	17,469	11,596	9,068	14,520	13,934
Capital grants	8,808	12,400	14,800	13,500	13,900	14,000
Short term debt disbursements	70,462	75,452	68,511	60,309	58,589	52,080
Medium and Long term debt disbursements	66,009	57,423	52,804	53,214	59,784	62,000
Other capital flows incl. errors and omissions	-24,634	-25,308	-6,095	-10,548	-6,895	-1,267
Change in reserves	11,049	-2,695	-5,781	2,307	-11,238	-9,923

Source: World Bank staff calculations based on Central Statistical Office, National Bank of Poland, Ministry of Finance, IMF

Figure 2. External debt sustainability

External Debt Sustainability Analysis



External Debt Composition in 2014

	USD, bln	Share of total debt	% of GDP
Central Bank	5.8	1.6	1.1
General government	145.7	41.4	26.6
Financial Sector Instititions	61.0	17.3	11.1
Other sectors	139.5	39.6	25.5
of which intercompany lending	83.7	23.8	15.3
Total external debt	**352.0**	**100.0**	**64.2**
long-term	230.5	65.5	42.1
short-term	37.8	10.7	6.9
intercompany lending	83.7	23.8	15.3

Source: World Bank based on National Bank of Poland, Eurostat, IMF. *Note:* Shaded area reflects historical values. Depreciation shock assumes a 30 percent devaluation in the first year. Real GDP growth is at baseline minus one-half standard deviation in the first year. Current account is at baseline minus one-half standard deviation.

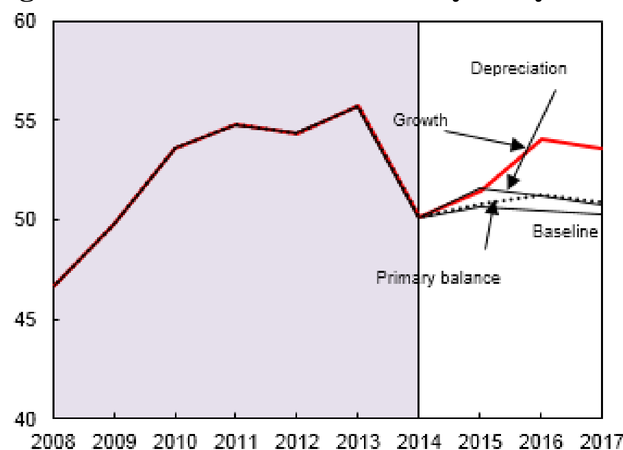
17. **The sustainability of the external debt position is generally robust within a range of standard stress scenarios.** These include lower GDP growth, higher current account deficits and remains manageable under an adverse exchange rate shock. About a quarter of external debt is inter-company liabilities which, to some extent mitigates rollover risk. However, non-resident holdings of government debt constitute about 27 percent of total external debt which increases vulnerability to changes in investor sentiment. Private sector flows and continued favorable access to international capital markets suggest that external financing needs can be met. The IMF flexible credit line arrangement provides an additional buffer against external shocks.

18. **The public debt to GDP ratio is expected to remain around 50 percent of GDP over the forecast horizon.** Changes to the pension system, associated with a transfer of pension fund assets and liabilities to the government, and the change in ESA methodology resulted in the reduction of the debt to GDP ratio from 55.7 percent in 2013 to an estimated 50.1 percent of GDP

in 2014. Continued fiscal consolidation and a favorable differential between projected GDP and the real interest rate will help keep public debt levels around 50 percent of GDP over the horizon period. This would ensure that public debt remains below the Maastricht ceiling of 60 percent of GDP and key national debt thresholds (calculated according to the national methodology). Public debt sustainability analysis suggests that Poland's public debt is moderately high, but sustainable. Its structure and risk profile in terms of interest, rollover, and foreign currency risks is robust, and contingent liabilities are not deemed material. Average maturity is around 5 years, and the share of short-term debt in total government debt is negligible. The main risk to the debt outlook stems from a negative growth shock.

19. **Continued fiscal consolidation is needed for Poland to reach its medium-term objective of 1 percent structural deficit.** The consolidated general government deficit is set to decline to 2.8 percent of GDP in 2015 and to 2.6 percent in 2016. The main adjustment in 2015 comes from limiting aggregate expenditure in line with the recently introduced expenditure rule (Box 1). The government has taken discretionary measures by continuing the freeze of public sector wages, the abolition of early retirement schemes, increases in the retirement age, and the streamlining of administration costs. On the revenue side, the higher VAT rate will be maintained in 2015 at 23 percent (a 1 percentage point rise on the pre-adjustment rate).

Figure 2. Public debt sustainability analysis



Source: World Bank staff based on MoF, Eurostat, and IMF
Note: The shaded area reflects historical values. Depreciation shock assumes 15 percent depreciation in the first year. Real GDP growth is at baseline minus one-half standard deviation in the first year. Primary balance is at baseline minus one-half standard deviation

Box 1. Poland's Stabilizing Expenditure Rule

The new stabilizing expenditure rule is designed to put the fiscal deficit on a sustainable downward path toward the MTO, while allowing greater scope for counter-cyclical policies when required. The Public Finance Act sets out two thresholds for public debt—55 percent of GDP and 60 percent—with breaches to thresholds automatically triggering successively more restrictive deficit cuts. However, severe deficit cuts would have undermined Poland's ability to take counter cyclical measures during the recent downturn and a 50 percent threshold was suspended in 2013 to enable the functioning of automatic fiscal stabilizers. To address these problems the Government enacted a new fiscal rule based on limiting public expenditure growth to the average of GDP growth in eight consecutive years—growth in six previous years, forecasted growth in the current year and the following year's projected growth—combined with an adjustment mechanism that would tighten rules if public finances breached the targets specified in the Stability and Growth Pact and/or in the Public Finance Act. It is also worth adding that discretionary changes in revenue will not affect sustainability of public finance, since any decrease (increase) in taxes or contributions will automatically lower (raise) permissible level of expenditure.

The fiscal rule also includes escape clauses which automatically suspend the adjustment mechanism in case of severe economic shock to allow for anti-cyclical fiscal responses. The two public debt thresholds currently in place remain unchanged. However, two new lower ones have been added to the spending rule, at 43 percent of GDP and 48 percent, to compensate for the changes to the pension system described above, that will still trigger downward corrections in spending, though this will be a milder sanction than the previous requirement to balance the budget or ban new borrowing. The rule applies to central and local governments in 2015.

20. **Growth and fiscal consolidation measures have created fiscal space for increasing spending on selected social programs, with neutral impact on fiscal deficit.** Programs include the extension of maternity leave, more generous pension indexation and the expansion of child tax credits. On the revenue side, the main adjustment comes from reducing transfers to the second pillar pension funds, freezing PIT thresholds, and abolishing various tax reliefs, as well as measures to increase tax compliance and the effectiveness of tax administration. The child-tax credit changes will reduce PIT revenues, but the loss will be fully compensated by the other revenue raising measures. Fiscal neutrality of those measures will be ensured through the operation of the stabilizing expenditure rule, which stipulates that decrease (increase) in taxes or contributions will automatically lower (raise) permissible level of expenditure while new expenditure should be compensated by decrease of other expenditure as to be consistent with the limit.

Table 3: Fiscal Developments and Prospects 2010-2017
(percent of GDP unless otherwise indicated, ESA'2010, General Government)

	2010	2011	2012	2013	2014	2015 (f)	2016 (f)	2017 (f)
Overall Balance	-7.7	-4.9	-3.7	-4.0	-3.2	-2.8	-2.6	-2.3
Primary balance	-5.2	-2.4	-1.0	-1.5	-1.2	-0.9	-1.1	-0.8
Total Revenues (and grants)	38.2	39	39.2	38.2	38.6	38.8	38.5	37.9
Current revenue	36.9	37.3	37.9	37.2	37.4	37.5	37.2	36.6
Tax revenues	20.4	20.6	20.0	19.5	19.7	19.9	19.4	19.7
Direct taxes on income	6.7	6.8	7.0	6.8	7.0	7.1	7.1	7.2
Taxes on production and imports	13.7	13.8	13.0	12.7	12.7	12.8	12.3	12.5
Social security contributions	11.8	12.2	13.0	13.2	13.2	13.4	13.4	13.2
Sales	0.9	0.9	1.2	1	0.7	0.7	0.6	0.6
Other current revenue	3.8	3.6	3.7	3.5	3.8	3.5	3.8	3.1
Capital revenue	1.3	1.7	1.3	1	1.2	1.3	1.3	1.3
Expenditures	45.9	43.9	42.9	42.2	41.8	41.6	41.1	40.2
Current expenditures	39.6	37.3	37.5	37.6	36.8	36.6	36.1	35.3
Wages and compensation	11.0	10.6	10.4	10.3	10.2	10	10.4	10.3
Goods and services	6.5	5.8	5.9	5.9	6.0	6.0	5.9	5.8
Interest payments	2.5	2.5	2.7	2.5	2.0	1.9	1.5	1.5
Social benefits	14.6	13.9	14.0	14.3	14.2	14.2	14.1	14.1
Other current transfers payable	2.0	2.1	2.2	2.2	2.0	2.0	2.0	2.0
Subsidies	0.9	0.8	0.7	0.7	0.6	0.6	0.6	0.6
Other current expenditure	2.1	1.6	1.6	1.7	1.8	1.9	1.6	1.0
Capital expenditures	6.3	6.6	5.4	4.6	5.0	5.0	5.0	4.9
Capital investments	5.7	6.0	4.8	4.1	4.4	4.5	4.6	4.5
Capital transfers	0.6	0.6	0.6	0.5	0.6	0.5	0.4	0.4

Source: World Bank staff based on Ministry of Finance, IMF.

21. **The macroeconomic policy framework is considered adequate for this operation.** Macroeconomic policies implemented during and after the global financial crisis, including monetary easing and allowing automatic fiscal stabilizers to operate, partially mitigated the negative effects of the external shock in 2012-13, while keeping external imbalances in check and maintaining an adequately capitalized financial system. In 2014, the Government continued to rebuild fiscal buffers through the fiscal consolidation effort, which allowed Poland to exit the EDP a year ahead of schedule. Monetary easing in 2014-15 also helped to support economic stability. These policies, combined with the structural measures supported by this DPL, support a gradual recovery of external and domestic demand while ensuring that the economy is resilient to future shocks.

22. **The risks to the macroeconomic outlook are titled to the downside.** Downside risks include further instability in the Euro area and protracted low growth among Poland's main trading partners, an upsurge in financial market volatility as the US Fed and ECB implement divergent monetary policies, from regional uncertainty over the outlook for Greece, and geopolitical tensions related to Russia and Ukraine. Poland also remains vulnerable to external debt deleveraging

through parent bank funding of local subsidiaries, which may slow credit growth. On the upside, lower oil prices should support an increase in consumption as Poland is a large net importer. Better growth performance of the Euro Area, triggered by the ECB QE (with a depreciating Euro and lower interest rates), and the launch of the so called Juncker plan to promote investment, may also increase Poland's growth prospects.

2.3. RELATIONS WITH THE IMF

23. **The Executive Board of the IMF approved a successor two-year arrangement for Poland under the Flexible Credit Line (FCL) with a reduced access amount of US$23 billion (from US$33.8 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 FCL has allowed for a more flexible policy response to the global crisis while preserving favorable access to international capital markets. An IMF-World Bank FSAP mission took place in February-March 2013.

III. GOVERNMENT REFORM PROGRAM

24. **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. Multi-pronged policy action has been launched to achieve these goals.

25. **Public finance: The immediate reform agenda relates to Poland's commitments under the EU economic governance framework.** The Budget for 2015 assumes continued fiscal consolidation with a view to eventually reducing fiscal deficit to the MTO (having exited the EDP in 2015). Implementation of the fiscal expenditure rule, supported by the DPL program, is key to achieving such reductions in the fiscal deficit.

26. **Economic Growth: Weak economic activity in the Euro Area and fiscal consolidation during 2011-12 affected Poland's growth in 2012-13.** In his speech of October 2012, the Prime Minister announced a series of measures to boost economic growth and improve competitiveness in a fiscally neutral way. These measures are centered on three sets of issues: (i) bolstering resilience of the financial sector, (ii) supporting investment activity, and (iii) improving the business climate and innovation. Reforms of the financial sector include improved macro-prudential oversight and a sound bank resolution framework; better supervision over cooperative banks, investment and hedge funds; and implementation of the EU's Capital Requirements Directive of July 2013. 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. The so called “Fourth Deregulation Package”, which follows liberalization reforms from 2008, 2009 and 2011, and the planned changes to the Construction Law, are aimed at addressing constraints to business activity in the areas of starting a business, dealing with construction permits, and closing a business. The authorities are also working on enhancing the frameworks for insolvency to promote rehabilitation (rather than liquidation) of viable debtors.

27. **Jobs: Government's short-term actions on labor markets are focused on enhancing labor market flexibility and providing support to the unemployed.** Temporary measures introduced in 2010/11 to mitigate the impact of the global crisis on the labor market, including greater flexibility to adjust working hours and a part-time work subsidy scheme, became permanent features of the Labor Code in 2013. 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. In parallel, a large scale profession deregulation reform is taking place to facilitate access to over 200 professions, many of which are attractive for youth. The Government has also taken steps to reduce labor market duality by introducing social security contributions on selected civil law employment contracts. These measures will be implemented in 2016.

28. **Innovation: Supporting Innovation for "Smart Growth" is one of the pillars of Poland's National Reform Program submitted to the European Council in 2015.** 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, (i) secured, approximately EUR 8.61 billion for innovation support from European funds under the Smart Growth Operational Program; (ii) the Parliament amended the Act on Financing Science to allow for more efficient financing of strategic research infrastructure, and funds for the promotion of science and the streamlining of financing for science, and (iii) pursued projects in line with development of smart specializations, including the entrepreneurial discovery process (supported by the World Bank).

IV.THE PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

29. **This is the second in a series of two lending operations aimed at supporting priority areas under the Polish National Development Strategy (NDP) 2020**. In late autumn 2014, the Government outlined the reform agenda up to the parliamentary elections, which will take place in October 2015. 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 MTO and bolstering macro-prudential oversight;
ii. Strengthen labor market flexibility and employment promotion; and
iii. Improve private sector competitiveness and innovation.

30. **These reforms, and the three pillars of the DPL, seek to address the main challenges currently 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.

31. **Lessons learnt from the previous DPL series suggest that the best results are achieved when the Bank focuses its support on areas with a strong analytical foundation that are of strategic relevance to the Government.** 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.

4.2. PRIOR ACTIONS, RESULTS, AND ANALYTICAL UNDERPINNINGS

32. **Adjustments to the scope and timing of the Government's reform agenda led to modifications of some Prior Actions, which have left the strength of the program unchanged.** The modifications to the program presented to the IBRD Board of Executive Directors in July 2014, which outlined nine indicative triggers for DPL2, are summarized in Table 4.

- Under Pillar A, to strengthen macroeconomic resilience, the substitution of two prior actions and the dropping of a third reflect changes in the Government reform program and were designed to ensure the program remained of equivalent strength with regard to achieving the program objective: regarding activities that support financial sector resilience, progress on the Bank Guarantee Fund (BGF) law was delayed, due to Constitutional issues around bank insolvency, while technical discussions to develop the macro-prudential framework are ongoing. These actions were substituted by important new legislation to promote covered bonds and mortgage banks—an important source of financing that helps to reduce the maturity mismatch for banks and promotes new lending instruments in other EU countries—and amendments to the banking law that incorporates EC directives on capital requirements that should bolster banks resilience to any future

financial stress. The introduction of a General Anti-Avoidance Rule (which will now be considered as part of a more comprehensive tax policy reform that is planned) was also substituted by new provisions to limit the ability of Polish owned companies to shift profits out of Poland, thus both measures reduce the scope for tax avoidance.

- Under Pillar B, which promotes job creation, a significant prior action was added to reflect the expansion of the child tax credit to bolster incomes and reduce the effective tax wedge for around 1.5 million families with children and predominantly those on low incomes. While the second tranche of the professions deregulation was approved in 2014, the final tranche required minor amendments to ensure consistency with other policies, mainly relating to gun control, and as highlighted in the Letter of Development Policy the Government remains committed to the full implementation of the draft law, which is expected later in the year.

- Under Pillar C, to promote private sector resilience and competitiveness, the actions were strengthened to reflect the enactment of priority amendments to the existing Construction Law, notably for SMEs, as opposed to the adoption of a policy paper for a totally new construction code that will be developed in due course.

Table 4: Indicative Triggers from DPL1 and Prior Actions for DPL2

Indicative Triggers in the DPL1 program document	DPL2 Prior Actions	Notes on modifications
Pillar A--- ENHANCING MACROECONOMIC RESILIENCE		
Trigger # 1: Enact Budget Law for 2015 in line with the new permanent fiscal rule, limiting growth of public expenditures to trend GDP growth to foster compliance with obligations deriving from the Treaty on the Functioning of the European Union in the area of budgetary policy	Prior Action #1: Unchanged.	**Unchanged**:
Trigger # 2: Enact Tax Ordinance Act to introduce a General Anti-Avoidance Rule	Prior Action #2: Strengthen tax compliance of Controlled Foreign Companies, through the enactment of amendments to the laws on personal and corporate income tax.	**Substituted:** In order to ensure that General Anti-Avoidance Rule provisions are consistent with other legislation this action has been incorporated into the future development of a new and more comprehensive Tax Code—the planning process has been initiated by Government. The replacement action limits the ability of Polish owned companies to shift profits out of Poland, thereby strengthening the tax base. Both the original and replacement actions prevent tax avoidance and have broadly equivalent impact on the program objective.
Trigger # 3: Enact the Law to Improve the Provision of Services by Local Government Units to introduce shared services centers at the local level	Dropped.	**Met:** The Law was approved on May 20, 2015. However, this action was dropped from DPL2, as the benefits are likely to materialize over time as implementation is likely to be gradual and at this stage indeterminate.
Trigger # 4: Enact Law on Macro-Prudential Oversight and	Prior Action #3: The Council of Ministers has approved: (a)	**Substituted:** Legal and design issues have delayed enactment of the original two laws.

establishment of the Systemic Risk Board and enact Law on the Bank Guarantee Fund to establish a framework for orderly liquidation of banks	the Draft amendments to the Law on Covered Bonds and Mortgage Banks ; and (b) the Draft amendments to the Banking Law, which amendments will enable the Borrower to implement the European Union Capital Requirements Directive No. 2013/36/EU.	The two laws in the new Prior Action strengthen financial sector resilience consistent with the original objective of the Pillar: The Law on Covered Bonds and Mortgage Banks provides a vehicle for mobilizing both foreign and domestic long-term savings, and reducing maturity mismatches in mortgage financing. The banking law amendments implement the EU Capital Requirements Directive (CRD-IV) that will help to ensure strong prudential solvency requirements for banks.
Pillar B--- LABOR MARKET RESILIENCE AND EMPLOYMENT PROMOTION		
Trigger # 5: Enact amendments to the Law on Promotion of Employment and Labor Market Institutions to strengthen job-seeker services and promote flexible employment	Prior Action #4: Unchanged.	**Unchanged**.
Trigger # 6 Deregulate around 190 professions by implementing the Second and the third Professions' Deregulation tranche	Prior Action #5: Deregulate around 195 professions by: (a) deregulating access to ninety one (91) professions (second professions deregulation tranche) through the enactment of the Law on the Easing of Access to Certain Regulated Professions, and (b) submitting to Parliament a draft Law Amending Laws on Access Conditions to Certain Professions for the purpose of approving the third profession deregulation tranche which will cover one hundred and four (104) professions	**Reformulated:** Approval of the third tranche was delayed by minor amendments to ensure consistency with other policies. As highlighted in the Letter of Development Policy, the Government remains committed to the full implementation of this action and expects parliament to approve the third tranche by August 2015.
	Prior Action #6: Increase support for families with more than one child and reduce the effective tax wedge for such families on low incomes, through the enactment of amendments to the Law on Personal Income Taxation.	**New measure**. This reform to the child tax credit encourages labor force participation by increasing incentives for second earners from poorer families (usually women) to join the labor force.
Pillar C--- ENHANCING PRIVATE SECTOR RESILIENCE AND PROMOTING COMPETITIVENESS		
Trigger # 7: Commence implementation of the new Smart Growth Operational Program (SGOP) to guide EU co-financed programs with more focused, streamlined and business centered programs for innovation, with a revised M&E framework	Prior Action #7: Through the NCBR issue three inaugural calls for proposals for R&D (research and development) and innovation projects and programs in accordance with the Smart Growth Operational Program (SGOP) to guide European Union co-financed programs with more focused,	**Reformulated**: to simplify the wording, with no impact on substance.

	streamlined and business centered programs.	
Trigger # 8: Enact the insolvency law for corporate sector (General Restructuring Law)	Prior Action #8: Enact the Law on General Restructuring, which introduces an insolvency and restructuring legal framework for the corporate sector.	**Unchanged**.
Trigger # 9: Creation of "one-stop-shops" for quick business registration and approval by the Council of Ministers of the assumptions to the Construction Code to provide a comprehensive framework for construction activity in Poland.	Prior Action #9: Creation of "one-stop-shops" for quick business registration through the enactment of the amendments to the law on National Court Register and enactment of amendments to the Construction Law to ease issuance of construction permits.	**Strengthened**: to reflect the enactment of priority amendments to the existing Construction Law, as opposed to the adoption of a policy paper for a new construction code.

Pillar 1: Enhancing macroeconomic resilience

DPL2 Prior Action #1: *Enact Budget Law for 2015 in accordance with the stabilizing expenditure rule set forth in the Public Finance Act, limiting growth of public expenditures to trend Gross Domestic Product (GDP) growth to foster compliance with the provisions set forth in the Treaty on the Functioning of the European Union in the area of budgetary policy.*

33. **The fiscal rule is expected to facilitate Poland's transition toward the MTO by further limiting Poland's structural deficit**. The stabilizing expenditure rule (see Box 1 above), was introduced in 2013 through the amendment to the Public Finance Act and became binding for the 2015 budget. It is designed to help preserve long-term fiscal sustainability, while allowing scope for countercyclical fiscal policy. Most of government budget expenditures are consistent with the permanent fiscal rule in 2015 (with Poland having exited the EDP in 2015), with the deficit expected to fall below 3.2 percent of GDP. The budget therefore reflects the government's commitment to continue the fiscal consolidation in line with the move toward the MTO.

DPL2 Prior Action #2: *Strengthen tax compliance of Controlled Foreign Companies, through the enactment of amendments to the laws on personal and corporate income tax.*

34. **In a package of measures designed to improve tax compliance and administration, Poland has enacted a law aimed at introducing taxation rules for controlled-foreign companies (CFCs).** The objective is to tax CFCs of Polish tax payers so as to prevent them from shifting profits to other jurisdictions with lower tax rates. Under the new rules, income earned by foreign subsidiaries or permanent establishments of Polish entities may be subject to 19 percent income tax in Poland regardless of whether it is distributed to Poland.

35. **In her *exposé* of October 2014, Prime Minister announced the Government's intention to develop a new Tax Ordinance**. A special body, composed of representatives from academia, the business sphere, the judiciary, tax advisors and other practitioners, is supposed to prepare the assumptions to the new ordinance in the first half of 2015. The Government's plan to

introduce a general anti-avoidance rule (GAAR) to the new Tax Ordinance will now be developed as part of the proposed new Tax Code, given the constitutional issues raised by the consultation draft regarding the interpretation of "tax avoidance".

DPL2 Prior Action #3: *Approval by the Council of Ministers of (a) the Draft amendments to the Law on Covered Bonds and Mortgage Banks; and (b) the Draft amendments to the Banking Law, which amendments will enable the Borrower to implement the European Union Capital Requirements Directive No. 2013/36/EU.*

36. **DPL2 continues to support legal initiatives to strengthen financial sector resilience.** Although Poland's banking sector is robust[4], following the global financial crisis the authorities have continued to take steps to strengthen financial sector resilience, including efforts to deepen capital markets and strengthen macroprudential frameworks. The DPL supports the following:

- **Amending the Law on Covered Bonds and Mortgage Banks is required to address key weaknesses of the previous legislation that have inhibited the development of the sector**, namely: (i) providing a framework for mortgage bank bankruptcy proceedings; and (ii) providing a waiver against the withholding tax for foreign investors. Several commercial banks are actively preparing business operations for specialized mortgage banks as subsidiaries, to issue covered bonds (CBs) in 2015 or 2016. Mortgage banks will originate the new PLN loans and later refinance transferred pools from their mother banks. The banks have already invested significant resources in this business model and the supervisor (KNF) is actively supporting this through its regulatory process. With this change, banks could reduce their maturity mismatches and reinvest long-term resources (between 5 and 10 years) into a new generation of fixed-rate mortgages (currently all mortgages are variable-rate). By itself, this would be a welcome development, as market rates are likely to rise and the existing portfolio of adjustable rate mortgages carries higher credit risk. These new CBs could also be attractive to foreign investors, which would help provide a liquid market, while euro bond markets are also currently attractive, given the surplus of available resources and the ECB purchase program. Development of the Polish covered bonds market will also provide vehicle for mobilizing both foreign and domestic long-term savings, which will reduce maturity mismatches in mortgage financing, thereby strengthening macroeconomic resilience.

- **Amendments to the Banking Law will help Poland implement the EU Capital Requirements Directive *(CRD IV)*, which aids the supervision of the banking sector**[5]. The CRD IV package transposes new global standards on bank capital (the Basel III agreement) into law. New rules tackle some of the vulnerabilities shown by banking institutions during the crisis, namely the insufficient level of capital, both in quantity and in quality, resulting in the need for unprecedented support from national authorities. CRDIV sets stronger prudential requirements for banks, requiring them to keep sufficient capital reserves and liquidity. This new framework will make EU banks more solid and strengthen their capacity to manage risks linked to their activities, and absorb losses they may incur in doing business.

[4]A number of banks were restructured during the crisis in the 1990s, using emergency regulations. While Poland's banks are now well regulated and capitalized, there is a large number of relatively small distressed credit unions.

[5] The banking sector is currently well capitalized, liquid, and profitable with the total capital ratio under CRDIV around 15 percent.

Expected Results:

37. **The overarching aim of fiscal rules and policies is to reduce and subsequently stabilize the deficit and public debt**. The general government deficit is projected to improve from 4.5 percent in 2013 to 2.8 percent of GDP in 2015 (the cyclically adjusted fiscal deficit would be around 1.5 percent of GDP in 2015). Public debt would be lower than the current level of 55.6 percent of GDP by 2015 and is expected to be on a downward trend. While it is difficult to measure the immediate results of improvements in financial resilience, given that the expected economic pickup should reduce demand for such services in the short term, reforms should improve the flexibility and confidence in the economy's ability to manage future shocks while bolstering credit for investment and growth. An initial step should see the issuance of mortgage-backed securities.

Pillar 2: Labor market resilience and employment promotion

DPL2 Prior Action #4: *Strengthen job-seeker services and promote flexible employment through the enactment of the law amending the Law on Promotion of Employment and Labor Market Institutions.*

38. **In addition to greater labor market flexibility, the DPL series supports policies to improve services for job-seekers**. The key elements of the Law on Promotion of Employment and Labor Market Institutions are: (i) strengthening the role of provincial governments in occupational career services; (ii) tailoring services provided by Public Employment Services (PES) to the specific needs of the unemployed through enhanced profiling, case management, combining vocational counseling with job search assistance, outsourcing the 'hard-to-place unemployed', and improving the sharing of information on job vacancies; (iii) developing new instruments to support job creation and re-employment (including for women re-entering the labor markets), such as telecommuting grants, hiring subsidies, loans for new jobs or start-ups, and regional training programs; and (iv) stronger support for youth and older (50+) employment, such as temporary suspension of social security contributions, partial wage subsidies. The Law will also create a National Training Fund to support firms with the provision of training, and as such to promote skills development.

39. **The Law on Promotion of Employment and Labor Market Institutions was signed by the President in May 2014 and is being implemented**. Most of the provisions regarding profiling of the unemployed and the new instruments for labor offices entered into force on July 1, 2014, while the rest of the Law became binding on January 1, 2015. The implementation of the Law is proceeding smoothly with all implementing regulations issued and some early results already visible, in particular in the increased number of new job offers at local labor offices, enhanced collaboration with the private sector, and significant take up of the Youth Guarantee Scheme. The implementation of the Law is informed by the ongoing dialogue between the Ministry of Labor and the World Bank team. A joint workshop will be held in the coming months to design an evaluation strategy of the implementation progress and to discuss international good practices to further strengthen cooperation between Public Employment Services and employers at the local level.

DPL2 Prior Action #5: *Deregulate around 195 professions by: (a) deregulating access to ninety one (91) professions (second professions deregulation tranche) through the enactment of the Law on the Easing of Access to Certain Regulated Professions, and (b) submitting to Parliament a draft Law Amending Laws on Access Conditions to Certain Professions for the purpose of approving the third profession deregulation tranche which will cover one hundred and four (104) professions.*

40. **Easing the access to professions is a priority to lower the cost of services and to enhance employment opportunities, especially for youth**. A survey in November 2011 concluded that Poland had the highest number of regulated professions and activities among EU Member States with around 300 professions, accounting for almost 0.5 million workers[6]. Many restrictions were considered unnecessary, leading to higher prices, inefficient job-worker matching, lower quality, and reduced employment levels. Reducing the restrictions—i.e. lowering educational requirements, shortening certificate periods and experience, or lifting some prior checks—would help improve access to these professions, particularly by the young and less-advantaged groups. This in turn can shorten the duration of unemployment and improve worker-job matching. Due to the broad scope the deregulation was divided into three tranches, with the first 51 professions being deregulated in 2013 following the approval of the Law in June 2013. This included taxi drivers, driving instructors, attorneys-at-law, legal counselors, notaries, real estate agents, and tour guides[7].

41. **DPL2 continues to support the process of deregulating professions**. DPL1 supported the initial tranche of professions' deregulation. The second (91 professions) and third (104 professions) tranches of professions are under the Ministry of Finance and Ministry of Transport, Construction and Maritime Economy, and cover professions such as engineers, architects, tax advisors, insurance agents, railway professionals, actuaries, and customs agents etc. The second professions' deregulation tranche was adopted by the Parliament in May 2014. The third tranche, which embraces professions mostly in the mining sector, is currently being discussed at the Parliamentary Deregulation Commission. The draft bill was submitted to the Parliament in early April 2015, and is expected to be adopted in July 2015.

42. **The Ministry of Justice will evaluate ex-post the effect of 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 for the deregulation, with an initial focus on legal professions. This will help to indicate the social as well as economic impact of these reforms and suggest possible further deregulation. Preliminary results from existing data on the effects of deregulation on employment and prices were produced in June 2015, and are to be reviewed by the Government[8].

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[6] A database was compiled by the Ministry of Science and Higher Education (MSHE) with experts from the Ministry of Justice, in accordance with EU Directive 2005/36/EC. The full list can be found on the MSHE and Ministry of Justice websites along with the EU evaluation on national regulations on access to professions (2013).

[7] While there have been some protests from existing professions, for example by taxi drivers, the Public Opinion Research Center (CBOS) found a majority of respondents were supportive of the change, even among professionals performing regulated tasks (survey in June 2012).

[8] For a study into the impact of deregulation of legal, accounting, architectural and engineering activities in the EU over the period 2008-2011 see: Canton et al, *The Economic Impact of Professional Services Liberalisation*, EC Economic Papers 533 | September 2014. It is found that less strict regulation improves their allocative efficiency and reduces the observed larger-than-average profitability, through intensified business dynamics.

DPL2 Prior Action #6: *Amend the child tax credit to increase support for families with more than one child and reduced the effective tax wedge for such families on low incomes, through the enactment of amendments to the Law on Personal Income Taxation.*

43. **The government is committed to supporting low income families with children back into work**. Starting from 2015, changes in the child tax credit in PIT will increase support for families with multiple children through raising by 20 percent the value of the tax credit for the third and subsequent children. This should also enable practically all entitled persons to deduct the maximum level of relief through the introduction of an '*unused relief refund'* (where the refund must not exceed the total amount of deductible social security and health insurance contributions paid by the tax payer/parents). The change will also compensate for differences in the effective charging of revenues generated under term employment contracts and the so-called junk contracts.

44. **The new child tax credit formula is effectively introducing a refundable tax credit to the Polish tax system.** It helps low earners increase their income and therefore, it may incentivize parents to seek employment or become more active in the labor market. These features combined should have a positive impact on the labor market, especially more vulnerable workers, through the reduction of the tax wedge for families with children and large families with relatively lower incomes—this will improve incentives for job seekers, particularly for low income workers, who may be returning to the labor market or are long-term unemployed. The tax revenue decrease resulting from the extension of the child tax credit is estimated at PLN1.1 billion, equivalent to 0.06 percent of GDP in 2015.

Expected Results

45. **While job growth requires strong economic growth, structural reforms are also critical for reducing obstacles to job creation and promoting access to employment, especially given Poland's historically high structural unemployment rate**. The ultimate goal of the reforms supported by this DPL series is a reduction in the number of long-term unemployment in total registered unemployment by 30,000, of which two-thirds are women, from 1,107 thousands (average) in 2013, to less than 1,077 thousands in December 2015.

Pillar 3: Enhancing private sector resilience, promoting competitiveness and innovation

DPL2 Prior Action #7: *Through the NCBR issue three inaugural open calls for proposals for R&D (research and development) and innovation projects and programs in accordance with the Smart Growth Operational Program (SGOP) to guide European Union co-financed programs with more focused, streamlined and business centered programs.*

46. **Poland aims to prioritize innovation and increase R&D to sustain economic growth.** Poland belongs to the four least innovative economies in the EU and the economy spent only 0.9 percent of GDP on R&D in 2012, well below the EU-28 average of two percent or EU2020 target of three percent. In order to boost productivity and innovation going forward Poland has set itself a target for R&D spending to reach 1.7 percent of GDP per annum by 2020.

47. **DPL2 will continue supporting the development of new national programs to promote innovation**. In February 2015, the European Commission adopted the 2014-2020 Smart Growth Operational Program (SGOP) of Poland, which provides €8.6 billion from the European Regional

Development Fund (ERDF), plus an additional €1.5 billion from national budgetary co-financing to support innovation programs in 2014-2020. The SGOP also aims to directly leverage an additional €4.4 billion from the private sector, and is designed to be a catalyst (by creating a more conducive framework) for a sustained improvement in R&D and other investments in innovation. It aims to help improve innovation outcomes by streamlining innovation support programs, reducing them to around 20 for the 2014-2020 period, relative to 29 in the 2007-2013 EU budget perspective. It will strengthen institutional capacity, and put the private sector at the center of the innovation support system. Financial instruments such as guarantees and equity investments will play a key role in achieving those objectives, with almost €900 million dedicated to more efficient forms of public financing, with a special focus on enhancing the capacity of companies, mainly of small- and medium-sized enterprises (SMEs), to develop new ideas into competitive advantages. The new SGOP largely incorporates the recommendations of the World Bank review of the previous program (2014) and 'Innovation support review' (2012).

48. **Implementation of SGOP commenced in April 2015** with the announcement by the National Center for R&D (NCBR) of three inaugural open calls for applications for enterprise R&D projects. The first call, announced on April 4, sought applications under a program for "Enterprise R&D projects", (and the sub-program for Industrial research and developmental works conducted by enterprises). In line with World Bank advice, the new program is designed to be "fast track", with decisions processed within 60-90 days from submission, a change from the average of 200+ days during the 2007-2013 EU perspective.

49. **Prior Action #8:** *Enact the Law on General Restructuring, which introduces an insolvency and restructuring legal framework for the corporate sector.*

50. **The DPL supports the development of a new insolvency framework, with a focus on restructuring**. Efficient exit systems are as significant as entry systems for economic growth and entrepreneurship, as they serve to free both entrepreneurs and capital for more productive uses. While the reform of the Polish bankruptcy regime has been ongoing for some years, the number of legal proceedings for bankruptcy has been low, the process time-consuming and costs excessive with outcomes heavily biased toward liquidation. Bankruptcy cases are also often considered by lower level courts, where capacity is low. Consequently the system neither adequately protects creditors' rights nor offers a viable rescue mechanism for viable debtors. The new law should enable companies to enter the process at an earlier stage and with more specialized legal services, including trained practitioners, time limits for decisions, better trustee remuneration, greater participation for creditors, the introduction of tax deductions for forgiven debt, with special out-of-court restructuring available for some SMEs, and more public awareness campaigns.

51. **DPL2 will support the enactment of the new general restructuring law[9].** This should both reduce the compliance costs (and speed) for exits and restructuring while additional measures will be required to reduce the stigma associated insolvency and restructuring. The law is expected to be enacted by June 1, 2015 and enter into force on January 1, 2016. Whether the new law will lead Polish companies to restructure rather than liquidate can only be assessed in a few years,

[9] The Restructuring Law has three components: (i) an amendment to the Bankruptcy and Reorganization Law, which after entry of the new statute, will apply only to liquidation proceedings, (ii) a new statute regarding restructuring and (iii) various regulations implementing the changes.

although one of the initial steps will be the introduction of unified forms for the 'simplified' procedure that would permit the approval of a plan after creditors' votes[10].

DPL2 Prior Action #9: *Creation of "one-stop-shops" for quick business registration through the enactment of the amendments to the law on National Court Register and enactment of amendments to the Construction Law to ease issuance of construction permits.*

52. **The DPL2 will continue supporting reforms aimed at promoting job creation through easing the processes for starting a business or construction projects**. These reforms are focused in particular on small and medium enterprises (SMEs) and construction of single family residential housing and small sized commercial or industrial buildings. As economic growth rates gradually start to improve, the potential for new SME businesses and housing and small building construction is likely to grow. On December 1, 2015, the new law on the "one-stop-shop" business registration came into force. All applications for company registrations are now fully handled by the Court Registry, which automatically assigns a tax and a statistical code to a new company based on online information sharing with the tax office, Social Security and the statistical office. It is expected that the new law will considerably shorten the time needed for new business registration from the current 30 days, according to the Doing Business 2015 survey, to less than 20 days in Doing Business 2016.

53. **The amendments to the construction law tackle some of the most urgent issues.** It will simplify the administrative procedures preceding the start of construction work, introduce a time limit for the local authority to file comments on planned investment requiring a building permit, and remove permits for minor works. The act is currently awaiting the president's signature and will come into force three months from being published, i.e. around mid-year. The Government has also commenced work on the development of a single comprehensive town planning and construction code, which will eventually replace the numerous acts regulating preparations for construction.

Expected Results

54. **This DPL aims to support priority reforms to enhance the business environment and promote innovation** The reforms should remove impediments to doing business, with a reduction in the time it takes to start a business, from the current 30 days to 20 days or fewer by 2015, and for dealing with construction permits, from the current 161 days to under 140 days in 2015. The ongoing reforms to improve the framework for R&D should also help increase R&D spending (to at least one percent of GDP in 2014).

ANALYTICAL UNDERPINNINGS

55. **Extensive analytical work and policy dialogue underpin the policy areas supported by the DPL series**. Table 7 summarizes the main analytical and TA activities and their linkages to prior actions. In all areas the Bank has carried out expert discussions and prepared policy notes with recommendations to enhance the design and implementation of reforms.

[10] This is where the debtor lists its claims and liabilities, obtains creditors consent for a restructuring plan and cooperates with a supervisor of the plan. It is therefore a shortened procedure that limits the role of the court.

Table 7: Prior actions and Analytical Underpinnings

Selected prior actions	Analytical underpinnings
ENHANCING MACROECONOMIC RESILIENCE	
In accordance with the stabilizing expenditure rule set forth in the Public Finance Act, limit growth of public expenditures to trend Gross Domestic Product (GDP) growth to foster compliance with the provisions set forth in the Treaty on the Functioning of the European Union in the area of budgetary policy, through enactment of Budget Law for 2015. Strengthen tax compliance of Controlled Foreign Companies, through the enactment of amendments to the laws on personal and corporate income tax.	*(i) Public expenditure review (PER 2010)*: on needed fiscal consolidation and on strengthening fiscal framework through expenditure ceilings; (ii) *Fiscal Rules Policy Note* and advice on the sub-national rule and the permanent expenditure rule (2012); (iii) *EU New Member States Regular Economic Reports (RERs 2011-)*: on deficit control, debt stabilization and gradual debt reduction; (iv) a savings and investment CEM (ongoing); and (v) Public Pay Review (TA) (FY13). *Public expenditure review (PER 2010)*: on needed fiscal consolidation and on strengthening fiscal framework and TA on tax expenditures (2010). TA support for the design of a new fiscal equalization formulae (2014-15) and on medium-term fiscal financial forecasting (ongoing). Tax incidence review (as part of ongoing support to government *Spending Review* of support to low income families).
Council of Ministers approval of: (a) Draft amendments to the Law on Covered Bonds and Mortgage Banks; and (b) Draft amendments to the Banking Law, which amendments will enable the Borrower to implement the European Union Capital Requirements Directive No. 2013/36/EU.	Policy Note: The Polish Bank Insolvency Regime: issues and Assumptions for the Design of an upgraded Bank resolution framework (TA, 2012); ROSC - Financial Sector Assessment Program (2013). Review mission 2015.
LABOR MARKET RESILIENCE AND EMPLOYMENT PROMOTION	
Strengthen job-seeker services and promoted flexible employment through the enactment of the law amending the Law on Promotion of Employment and Labor Market Institutions.	"Europe 2020. Fueling Growth and Competitiveness in Poland through Employment, Skills, and Innovation" (ESW, 2011); Employment Entrepreneurship and Human Capital Development, PL2-PL3 (FY9-10); and Human Capital Development Strategy (HCDS) TA, including workshop on Lifelong Learning (FY12). "Towards greater social inclusion in Poland—a qualitative assessment in three regions" (ESW, 2013). Support to Ministry of Justice in developing methodology for impact evaluation of professions deregulation (ongoing). Dialogue with the Ministry of Labor on the productive employment and labor market duality agenda (ongoing). "Back to Work: Growing with Jobs in Europe and Central Asia" (2013). TA support to government *Spending Review* of support to low income families (ongoing), TA on Labor Market Duality
Deregulate around 195 professions by: (a) deregulating access to ninety one (91) professions (second professions deregulation tranche) through the enactment of the Law on the Easing of Access to Certain Regulated Professions, and (b) submitting to Parliament a draft Law Amending Laws on Access Conditions to Certain Professions for the purpose of approving the third profession deregulation tranche which will cover one hundred and four (104) professions.	
Increase support for families with more than one child and reduced the effective tax wedge for such families on low incomes, through the enactment of amendments to the Law on Personal Income Taxation.	
ENHANCING PRIVATE SECTOR RESILIENCE AND PROMOTING COMPETITIVENESS	
Through the NCBR, issue three inaugural open calls for proposals for R&D (research and development) and innovation projects and programs in accordance with the Smart Growth Operational Program (SGOP) to guide European Union co-financed programs with more focused, streamlined and business centered programs.	ESW: (2011)"Europe 2020: Fueling Growth and Competitiveness in Poland through Employment, Skills, and Innovation"; (2012) *"Poland Enterprise Innovation Support Review"*; (2013-14) Review of the national *Smart Growth Operational Program* for the Ministry of Infrastructure and Development (MID). TA: (2013) assessment of quality, coherence, and fulfillment of ex ante conditionalities for national and regional Research and Innovation Strategies (RIS3), (2014) External evaluation of selected innovation programs with NCBR.
Enact the Law on General Restructuring, which introduced an insolvency and restructuring legal framework for the corporate sector.	Policy Note: "Towards a stronger contract enforcement and insolvency in Poland" (TA, RAS), completed in FY 2013.
Establish "one-stop-shops" for quick business registration through the enactment of the amendments to the law on National Court Register: and ease the issuance of construction permits through the enactment of the amendments to the Law on Construction.	Improving the business regulatory environment in five Doing Business areas where Poland lags the most (TA) (RAS). "Review of Public Enterprise Innovation Support Systems" (TA) (EFO). Technical review of the amendments to the construction code (2015).

4.3. LINK TO COUNTRY PARTNERSHIP STRATEGY AND OTHER OPERATIONS

56. **The DPL series is central to the Bank's engagement in Poland, as highlighted in the 2014-17 Country Partnership Strategy (CPS).** The CPS, discussed by the Board on July 15, 2013 has the following four *strategic areas of engagement* to reduce poverty and boost shared prosperity: (i) *economic competitiveness*, with a focus on business environment (CPS Goal 1, DPL Pillar 3), innovation, and public finance effectiveness (CPS Goal 3, DPL Pillar 1); (ii) *equity and inclusion*, with a focus on inclusive labor markets (CPS Goal 4, DPL Pillar 2), balanced regional development (CPS Goal 5, DPL Pillar 1) and strengthened healthcare and health prevention in an

aging society; (iii) *climate action*, with informed climate change policy making, adaptation and flood protection, and resource efficient infrastructure; and (iv) *Poland as a global development partner,* focusing on Poland's contribution to development cooperation and global public goods. Actions supported by the DPL series are also aligned with the CPS's focus on lending that: (i) support reforms in the implementation phase (as a follow up to advisory services in the design phase); (ii) highlights economic reforms where Poland is a leader; and/or (iii) enhances institutional capacity, including through the development of new legislation.

4.4. CONSULTATIONS AND COLLABORATION WITH PARTNERS

57. **All legislative measures and reforms are subject to a thorough consultation process with social partners, civil society and groups likely to be impacted**. Public consultations are compulsory by law for all new policy initiatives. According to the regulatory guidelines for this process, stakeholders need to be involved throughout the policy-making and legislative preparation processes. Various methods were used for these consultations, including public hearings and meetings, citizens' panels, surveys, electronic consultation (e.g., government websites) and media. In particular, on the measures related to labor market changes, the authorities held consultations with a wide range of social partners, civil society, trades unions, the EU and affected groups. In addition, changes to the banking resolution framework have been discussed with various internal stakeholders and external partners in the World Bank, EU, ECB and IMF. Regular updates to the process are posted on government websites. Amendments to the insolvency and restructuring law have been widely debated and consulted with trade unions, employer organizations, as well as with NGOs and think tanks. Inputs of this consultation were reflected in the amendments.

COLLABORATION WITH IFIs AND OTHER DEVELOPMENT PARTNERS

58. **The Bank has collaborated closely with the IMF and the European Commission (EC) on this program.** The measures under the proposed DPL program have been discussed with both to ensure that they reinforce and complement their support to Poland.

V. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY, SOCIAL AND GENDER IMPACT

59. **The overall poverty, social and gender impacts of policy measures supported by this DPL 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.

60. **Enhancing macroeconomic resilience, through the gradual reduction of fiscal deficits and strengthening the macro prudential framework, are integral for shared prosperity.** Aligned with the permanent fiscal rule adopted in 2013, the Budget Law for 2015 continues the fiscal consolidation that is expected to lead to Poland's exit from the EU's EDP in 2015. This should enhance the government's ability to undertake countercyclical fiscal policy, reducing

macroeconomic volatility and providing support to the bottom of the income distribution[11]. Similarly, strengthening the macro prudential framework should enhance Poland's ability to mitigate macroeconomic shocks by addressing systemic risks. A stable macroeconomic environment should also promote investment, growth and shared prosperity.

61. **The changes to the child tax credit are expected to have a strong positive impact in reducing poverty and lifting the incomes of the bottom 40 percent of the income distribution.** The incidence of the credit is made more progressive by increasing the amount of the credit received by households with low incomes. Under the current system the tax credit is applied to the personal income tax owed after a household has deducted social insurance contributions, deductible expenses, tax-free allowances and a portion of mandatory health insurance contributions (NFZ) from their gross income. In 2013 an estimated one in three families with children had insufficient income to take full advantage of the credit because their PIT liability is less than the value of the child tax credit for which they would be eligible[12].

62. **The child tax credit reform expands low income households' access to the child tax credit by effectively introducing a refundable tax credit.** Under the new design the child tax credit may be applied against social insurance and health insurance contributions paid during the tax year, even if the household has no PIT liability. The reform also increases the amount of the credit for third and subsequent children by 20 percent. This increase in benefits applies to all households with three or more children that pay PIT or social or insurance contributions, including high income households. However the overall incidence of the 20 percent increase is progressive because households with three or more children tend to be poorer, and because the increased credit is a larger proportion of low income households' incomes.

63. **The child tax credit redesign is also expected to contribute to poverty reduction and shared prosperity through labor markets.** The proposed changes will help increase income of families with children and may have a positive impact on the labor market activity of parents, as they increase their effective returns from employment and make employment more attractive financially. For low income families in particular, the child tax credit reform provides an incentive for second earners (usually women) to enter the labor market because the tax credit may be applied to their social and health insurance contributions. The combination of increased labor market activity and increased returns should have a positive impact on the labor market, especially of more vulnerable workers, through the reduction of the tax wedge for families with children and large families with lower incomes.

64. **Labor market reforms supported by the DPL are expected to promote inclusive growth.** Attachment to the labor market has been a key driver of the growth of incomes for the bottom 40 percent since 2005. The prior actions are designed to reduce the regulatory restrictions to entering a range of professions, provide better services to the unemployed through profiling, and promotion of early childcare facilities to support the return of parents to the labor market, and can additionally reduce early achievement gaps to boost shared prosperity. The reforms are expected to increase labor market participation and reduce the length of unemployment spells. Among the planned improvements in the Public Employment Services are greater focus on re-

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[11] See Global Economic Prospects, January 2015, *Having Fiscal Space and Using It*, World Bank.
[12] The analysis of the child tax credit draws in part from Myck et al. (2014), "Child Tax Credit Reform," CenEA Commentary 19/09/2014.

employment (including the return to work of women with young children) and instruments to support flexible work arrangements, such as telecommuting grants.

65. **The deregulation of professions is expected to benefit those at the bottom of the income distribution.** The government estimates that deregulation would allow for the creation of 50,000 to 100,000 additional jobs. Simulations carried out for the first tranche of professions deregulation indicate that a large share of the new jobs will be filled by currently unemployed persons who are at the lower end of the income distribution. The analysis also shows that the negative impacts of professions' deregulation (the loss of economic rents gained by those in the regulated professions) will fall mostly on those in the top four income deciles. The relaxation of educational and certification requirements should improve access among the young and less advantaged groups to more remunerative employment. Reducing the barriers to regulated professions can also encourage women's employment as either a primary or secondary earner in the household, for example, where lengthy qualification periods may be a deterrent.

66. **The child tax credit, labor market reforms and deregulation of professions are expected to have a positive impact on women in Poland.** As highlighted above, 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.

67. **The array of 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. Recent research shows that rules-based bank insolvency resolution policy has a positive effect on firm growth[13]. Altogether, these reforms aim to enhance Poland's long-term growth and employment prospects.

5.2. ENVIRONMENTAL ASPECTS

68. **The specific policies supported by the DPL series are not likely 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

[13] Korte, J. (2013). "Catharsis – the real effects of bank insolvency and resolution." Deutsche Bank Discussion Paper No. 21.

planning and programming of projects and the EU's Environmental Liabilities Directive setting out liability for damage to property and natural resources.

5.3. FIDUCIARY ASPECTS

69. **The overall fiduciary risk from Poland's public financial management system (PFM), the use of budget resources and its foreign exchange environment as controlled by the NBP is moderate.** Following significant improvements during EU accreditation, the PFM system enhanced budget transparency and predictability. Poland has introduced a performance-oriented four year rolling budget plan with a binding annual cash-based budget, cash management consolidation, and strengthened internal audit, and management control over public spending and debt via fiscal rules. Public procurement is based on EU Directives with the most recent update in 2014. New law is under preparation to transpose latest EU procurement Directives dated February 26, 2014 into national legislation. Further efforts are expected to streamline the flow of funds processes, harmonize public sector accounting, reporting standards and practices supported by integrated IT system—in response to the Eurostat initiative to improve the quality and comparability of fiscal reporting across the EU which includes the introduction and adoption of harmonized European Public Sector Accounting Standards (EPSAS) which are likely to be substantially based on existing International Public Sector Accounting Standards (IPSAS).

70. **The MoF discloses publicly the state budget act along with monthly and quarterly execution reports based on a national cash methodology covering main revenue and expenditure aggregates within 1-2 months after the end of a period.** It also publishes quarterly aggregate reports on budget execution by LGs. Annual cash-based reports on central state budget execution are published after being audited by the Supreme Audit Office (NIK) within 6 months after the end of the year. Accrual based ESA 2010-compliant reports for the general government are available on a quarterly basis on the website of the MoF, the Central Statistical Office, and Eurostat within 3-4 months of the end of the quarter.

71. **In the area of external audit, Poland has a well-functioning public financial accountability and assurance mechanism for the legislature and the public.** Poland is advanced in the availability of the audit reports to the public, and independence of the NIK. At the LG level, 16 Regional Accounting Chambers supervise and control financial, fiscal and procurement activities of self-governing entities. The PFA also requires that annual financial statements prepared by large LGs be audited by independent statutory auditors. A Public Finance Sector Audit Department of the Ministry of Finance coordinates management control and internal audit in public finance sector units, which follow International Standards.

72. **The NBP accounting and reporting policies are defined by the Monetary Policy Council, and are in line with the guidelines of the European Central Bank.** In managing the foreign exchange reserves, while striving to maximize returns, the NBP manages credit and liquidity risks. An independent auditor selected by the Monetary Policy Council regularly audits the NBP's annual financial statements. The most recently available audit opinions are unqualified.

5.4. IMPLEMENTATION MONITORING AND EVALUATION

73. **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 (Annex 1).

74. **Grievance Redress**. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns.

75. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond.

76. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

5.5. DISBURSEMENT AND AUDITING

77. **Loan proceeds will be disbursed in one single tranche to the foreign currency national budget account at the NBP, which forms part of the country's foreign currency reserves, and of the country's budget management system.** Disbursements will not be linked to specific purchases, thus no procurement requirements will be necessary. The Bank will not require an audit of the deposit account but will require the Government to provide confirmation to the Bank on the amounts deposited in the foreign currency account within 30 days of receipt.

VI. SUMMARY OF RISKS AND MITIGATION

78. **The overall risk of the operation is considered to be moderate.** While there is no single risk category rated higher than moderate, the political and macroeconomic risks are discussed below because of their particular relevance for the success of the program.

79. **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.

80. **The Government has developed widespread support for the reforms, which mitigates this risk.** Despite having a small parliamentary majority, and a significant cabinet reshuffle in 2014, 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.

81. **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. Further, the nominal stock of NPLs continued growing over the last year, particularly within forex-denominated mortgage loans and construction.

82. **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.

83. **As highlighted in the PSIA section, the poverty and shared prosperity impacts of policy measures supported under this DPL series are expected to be either positive or negligible**. At the same time, there are few risks arising from the program on Poland's environment, forests, water resources, habitats or other natural resources. Fiduciary risks are moderate due to the advanced PFM system and management of foreign exchange by the Central Bank.

Table 8: Systemic Operations Risk Rating Tool

Risk categories	**Rating (H, S, M L)**
1. Political and governance	Moderate
2. Macroeconomic	Moderate
3. Sector Strategies and policies	Low
4. Technical design of program	Moderate
5. Institutional capacity for implementation and sustainability	Low
6. Fiduciary	Low
7. Environment and social	Low
8. Stakeholders	Moderate
9. Other	Low
Overall	**Moderate**

ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions		Results
Prior Actions under DPL 1	**Draft Prior Actions for DPL 2**	
Pillar A--- ENHANCING MACROECONOMIC RESILIENCE		
Prior action #1: The Borrower has enacted: (a) an amendment dated November 8, 2013 to the Public Finance Act to introduce a permanent fiscal rule limiting growth of public expenditures to trend GDP growth to foster compliance with its obligations deriving from the Treaty on the Functioning of the EU in the area of budgetary policy; and (b) the Budget Law for 2014 in line with the new permanent fiscal rule as set forth in the Public Finance Act.	Prior action #1: The Borrower has, in accordance with the stabilizing expenditure rule set forth in the Public Finance Act, limited growth of public expenditures to trend Gross Domestic Product (GDP) growth to foster compliance with the provisions set forth in the Treaty on the Functioning of the European Union in the area of budgetary policy, through enactment of Budget Law for 2015.	Result Indicator A1-- baseline Fiscal deficit in 2013:4.0 percent of GDP Public debt in 2013: 55.7 percent of GDP No mortgage banks issuing covered bonds Result Indicator A1— target Fiscal deficit in 2015: 3.2 percent of GDP Public debt in 2015: lower than 52 percent of GDP Mortgage bank bonds issued (end-2016)
Prior action #2: The Borrower has enacted the amendments dated November 8, 2013 to the Law on Value Added Taxes (VAT) to defer the reduction in VAT rates in the period of 2014-16 to support fiscal consolidation.	Prior action #2: The Borrower has strengthened tax compliance of Controlled Foreign Companies, through the enactment of amendments to the laws on personal and corporate income tax.	
Prior action #3: The Borrower has enacted an amendment dated November 8, 2013 to the Public Finance Act implementing a fiscal rule for local governments to ensure debt sustainability at the local level and effective absorption of European Union funds.	Prior action #3: The Borrower, through the Council of Ministers has approved: (a) the Draft amendments to the Law on Covered Bonds and Mortgage Banks; and (b) the Draft amendments to the Banking Law, which amendments will enable the Borrower to implement the European Union Capital Requirements Directive No. 2013/36/EU.	

Draft Prior actions and Triggers		Results
Prior Actions under DPL 1	**Draft Prior Actions for DPL 2**	
Pillar B--- LABOR MARKET RESILIENCE AND EMPLOYMENT PROMOTION		
Prior action #4: The Borrower has enacted amendments dated July 12, 2013 to the Labor Code to increase the flexibility of the labor market by extending the calculation period for employees' working time.	Prior action #4: The Borrower has strengthened job-seeker services and promoted flexible employment through the enactment of the law amending the Law on Promotion of Employment and Labor Market Institutions.	Result Indicator B1-- baseline The number of registered long-term unemployed is at 1,107 thousands (average) in 2013. Result Indicator B1 -- target The number of registered long-term unemployed is reduced by at least 30,000, of which two thirds would be women, i.e. from 1,107 thousands in 2013 to less than 1,077 thousands in December 2015.
Prior action #5: The Borrower has: (a) implemented the first professions deregulation tranche through enactment of the Law Amending Laws on Access to Certain Professions thereby deregulating access to fifty one (51) professions; and (b) approved, through a Decision of its Council of Ministers, the draft Law on the Easing of Access to Certain Regulated Professions and the draft Law Amending Laws on Access Conditions to Certain Professions for the second and third professions deregulation tranches.	Prior action #5: The Borrower has (a) deregulated access to ninety one (91) professions (second professions deregulation tranche) through the enactment of the Law on the Easing of Access to Certain Regulated Professions, and (b) submitted to the Borrower's Parliament a draft Law Amending Laws on Access Conditions to Certain Professions for the purpose of approving the third profession deregulation tranche which will cover one hundred and four (104) professions.	
Prior action #6 The Borrower has enacted amendments dated May 10, 2013 to the Law on Early Childcare to facilitate parents re-joining labor force.	Prior Action #6: The Borrower has increased support for families with more than one child and reduced the effective tax wedge for such families on low incomes, through the enactment of amendments to the Law on Personal Income Taxation.	
Pillar C--- ENHANCING PRIVATE SECTOR RESILIENCE AND PROMOTING COMPETITIVENESS		
Prior action #7: The Borrower, by way of resolution of its Council of Ministers, has approved Poland's Enterprise Development Program (EDevP) to create clearer institutional arrangements and increase support for early stage innovation and technological startups to enhance innovation through focused support programs in this area.	Prior Action # 7: The Borrower, through the NCBR, has issued three inaugural open calls for proposals for R&D (research and development) and innovation projects and programs in accordance with the Smart Growth Operational Program (SGOP) to guide European Union co-financed programs with more focused, streamlined and business centered programs.	
Prior action #8: The Borrower, through a Decision of its Council of Ministers dated February 11, 2014, has approved a concept ("assumptions") of a new General Restructuring Law dealing with insolvency and restructuring in the corporate sector.	Prior Action # 8: The Borrower has enacted the Law on General Restructuring, which introduced an insolvency and restructuring legal framework for the corporate sector.	

Prior action #9: The Borrower, through the Ministry of Economy, has submitted to the Council of Ministers Standing Committee, a draft Law on Facilitating Access to Business Activity (alternatively referred to as "Fourth Deregulation Law') and through a Decision of the Council of Ministers dated January 8, 2014, has approved draft amendments to the Law on the National Court Register aimed at improving business environment through streamlined procedures, including port clearance, business startups and enterprise transactions.	Prior Action # 9: The Borrower has: (a) established "one-stop-shops" for quick business registration through the enactment of the amendments to the law on National Court Register: and (b) eased the issuance of construction permits through the enactment of the amendments to the Law on Construction.	Result Indicator C1-- baseline Starting a business – 32 days (DB 2013) Construction permits – 161 days (DB 2013) No 'simplified' restructuring procedures Total R&D spending – 0.9 percent of GDP in 2012 Result Indicator C1-- target Starting a business – 25 days (DB 2016) Construction permits – 140 days (DB 2016) Forms available for procedure permitting approval of a restructuring plan after creditors' votes (2016) Total R&D spending – 1 percent of GDP in 2014

ANNEX 2: LETTER OF DEVELOPMENT POLICY

Warsaw, June 17, 2015

REPUBLIC OF POLAND
MINISTER OF FINANCE
Mateusz Szczurek

DZ1.913.76.2015

Mr. Jim Yong Kim
President
World Bank

1818 H Street NW
Washington D.C. 20433
United States of America

Dear Mr. President,

Allow me first to express my gratitude for the World Bank's continued support over the past few years to the reform process in Poland. Budgetary support operations, technical assistance projects and knowledge activities continue to play a significant role in supporting the economic and social reforms undertaken by the Polish Government amidst what remains a turbulent and uncertain external environment.

With that in mind, I am writing to request your approval for the second in the series of the programmatic Resilience and Growth Development Policy Loan (DPL2) in the amount of EUR 912.7 million. The loan is aimed at strengthening macroeconomic resilience and promoting economic growth. The loan, prepared in close collaboration with the World Bank, builds on the Government's strategic priorities of reinvigorating economic growth, consolidating public finances, promoting jobs and innovation in Poland.

Macroeconomic Framework

In the past few years, and in spite of the uncertain external environment, Poland's economic fundamentals have remained strong, underpinned by sound macroeconomic policies. Poland has enjoyed one of the highest economic growth rates among EU countries. This strong performance can be credited to the considerable diversification of Poland's economy, the reduction in external imbalances prior to the crisis and prudent macroeconomic policies. Counter-cyclical policies have also helped to lessen the impact of the economic slowdown.

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The fiscal deficit narrowed to 3.2 percent of GDP in 2014, from 4 percent in 2013. Revenue collection was stronger than expected, as domestic demand pushed up VAT receipts, while expenditures continued to be closely controlled, for example through the maintenance of the ongoing wage bill freeze. Recognizing the success of the government's efforts and taking into account the cost of systemic pension reform, of 0.4 percent of GDP, the European Commission has recommended that the European Council abrogate the excessive deficit procedure (EDP) in 2015, one year ahead of schedule.

Strong macroeconomic fundamentals and sound policies have helped Poland withstand several bouts of global market turbulence and paved the way for economic recovery. Nonetheless, while benefiting from the continued transformation into a more open and dynamic economy, substantial trade and financial linkages with global markets, combined with still-large financing needs and geopolitical tensions in the region, expose the economy to external shocks and necessitate the need to further strengthen macroeconomic resilience and support growth.

Government Program

The Government remains committed to strengthening public finances, boosting private sector led economic growth, and innovation to facilitate job creation and shared prosperity. Across all these issues, the Government is concerned to address the short-term challenges, which are the legacy of the global financial crisis and current economic uncertainties, as well as medium- to long-term structural rigidities. Short-term actions are aimed at rebuilding fiscal buffers and bolstering macroeconomic resilience, while medium and long-term structural reforms are targeted at lifting productivity and potential growth. These measures are designed to help to ensure that prosperity continues to be shared across society.

In order to **strengthen public finances**, the Budget for 2015 assumes continued consolidation with a view to eventually reducing the deficit to the Medium Term Objective of a structural deficit of one percent of GDP. Implementation of the fiscal expenditure rule, supported by the DPL program, is key to achieving such reductions in the fiscal deficit. Growth and fiscal consolidation have also created fiscal space for spending on well targeted social programs that protect poor and vulnerable groups. Programs include the extension of maternity leave, more generous pension indexation and the expansion of child tax credits. On the revenue side, the main adjustment comes from reducing transfers to the second pillar pension funds, freezing PIT thresholds, and abolishing various tax reliefs, as well as measures to increase tax compliance and the effectiveness of tax administration.

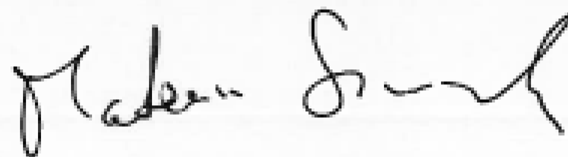
The Government remains committed to enhancing **labor market flexibility and facilitating job creation.** While Poland has witnessed significant recent improvements in labor markets, with the unemployment rate falling to levels not seen since 2007, continuing to increase professional activity and employment remain amongst the main challenges. The Government has introduced measures to enhance the flexibility to adjust working hours, introduced a part-time work subsidy scheme and increased support to active labor market programs for disadvantaged groups — such as training and wage subsidies, and apprenticeship schemes. Measures have also been put in place to improve the effectiveness of public employment offices to

provide better services for the unemployed, through profiling and increased focus on the hard-to-place. The Government is also promoting the expansion of childcare facilities for the re-integration of women into the labor market after child-birth. In parallel, the deregulation of professions will enhance access to over 200 professions, many of which provide greater opportunities for youth and women. The Government remains committed to the third tranche of the professions deregulation, and expects the legislation to be fully enacted by parliament in August and signed by the President by September 2015. Steps to reduce labor market duality include the introduction of social security contributions on selected civil law employment contracts, while the expansion of the child tax credit will reduce the tax wedge for low income families.

Boosting **private sector growth and innovation** continues to be one of the main pillars of the Government's reform agenda. Innovation and knowledge-based development represent an opportunity for ensuring dynamic growth of the Polish economy, especially in light of the diminishing impact of traditional sources of economic growth. In order to increase the innovativeness of enterprises, measures in numerous fields are necessary—removing barriers for conducting business activity, improving the quality of education to provide competent personnel, expanding access to finance, promoting knowledge transfer, developing business environment institutions, and stimulating cooperation between science and business. With the support of the World Bank, the Government has made significant progress in creating one-stop shops for easing business startups, has streamlined the process for obtaining construction permits for SMEs and is improving the insolvency law to promote the restructuring of viable enterprises and expedite the resolution of others. The Government also remains committed to promoting R&D, with advice from the World Bank and support from European funds under the Smart Growth Operational Program that will support the innovative activities of enterprises.

In light of the above, I strongly believe that the World Bank can continue to provide valuable support to the Polish Government's reform program. The Bank's financial assistance and expertise will serve as a crucial impetus towards the fulfillment of the program's objectives.

With kind regards,



ANNEX 3: FUND RELATIONS

IMF Executive Board Approves New Two-Year US$23 Billion Flexible Credit Line Arrangement for the Republic of Poland

Press Release No. 15/05
January 14, 2015

The Executive Board of the International Monetary Fund (IMF) today approved a successor two-year arrangement for the Republic of Poland under the Flexible Credit Line (FCL) with reduced access in an amount equivalent to SDR 15.5 billion (about US$23 billion, or 918 percent of quota). The Polish authorities intend to treat the arrangement as precautionary and do not intend to draw on the FCL.

The Republic of Poland's first FCL arrangement was approved on May 6, 2009 (see Press Release No. 09/153). Successor arrangements were approved on July 2, 2010 (see Press Release No. 10/276); January 21, 2011 (see Press Release No. 11/15); and January 18, 2013 (see Press Release No. 13/17).

Following the Executive Board discussion of the Republic of Poland, Mr. Min Zhu, Deputy Managing Director and Acting Chair, made the following statement:

"Poland has very strong economic fundamentals and policy frameworks. The fiscal position is sound and public debt is sustainable. Its credible inflation targeting regime is an effective tool for macroeconomic management. The flexible exchange rate has played a stabilizing role, acting as a shock-absorber during periods of volatility in global financial markets. The banking system is liquid, well capitalized, and profitable, bolstered by an effective financial supervision.

"The authorities have continued to rebuild policy space and further strengthen policy frameworks. Gradual fiscal consolidation has continued and a permanent expenditure rule, implemented in 2013, is expected to help safeguard long-term fiscal soundness. International reserves have increased and are broadly adequate against standard benchmarks. In the banking system, reliance on cross-border parent bank funding has declined and foreign currency mortgage origination was halted with the tightening of prudential rules.

"External risks have abated somewhat but remain elevated. A protracted period of slower growth in the euro area could have large effects on Poland via trade and confidence channels. An abrupt surge in volatility in global financial markets, or a severe deterioration in external financing conditions could affect Poland's economy given its relatively high external financing needs. Persistent geopolitical tensions in the region add to downside risks.

"Against this background, a successor two-year FCL arrangement with lower access, which the authorities intend to continue to treat as precautionary, reinforces Poland's buffers against external risks, helps sustain market confidence, and supports the authorities' sound economic strategy. In addition, the lower access sends a clear signal of the authorities' intention to exit from the FCL arrangement once external risks recede."

Background:

The FCL was established on March 24, 2009 and further enhanced on August 30, 2010 (see Press Release No. 10/321). The FCL is available to countries with very strong fundamentals, policies, and track records of policy implementation and is particularly useful for crisis prevention purposes. FCL arrangements are approved for countries meeting pre-set qualification criteria (see Press Release No. 09/85). The FCL is a renewable credit line, which could be approved for either one or two years. Two-year arrangements involve a review of eligibility after the first year. If the country draws on the credit line, the repayment period is between three and five years. There is no cap on access to Fund resources under the FCL, and access is determined on a case-by-case basis. Qualified countries have the full amount available up-front, with no ongoing conditions. There is flexibility to either draw on the credit line at the time it is approved, or treat it as precautionary.

The Republic of Poland is a member of the IMF since 1986 and has a quota of SDR 1,688.40 million (about US$2,485.51 million).