



Center for Social and Economic Research  
Foundation

Information about the project

**'Poland at the threshold of accession to the European Union:  
Outline of indispensable economic reforms'**

The significant economic slowdown in 2000-2002, compared to the high rate of growth achieved in the mid-1990s, gives us cause to conduct an in-depth analysis of the state of economic reforms in Poland. We need to examine the Polish economy's ability to face the challenge of foreign competition, in the context of EU accession in 2004 and deepening economic globalization. Such an analysis is evidently needed. Discussions of the factors underlying the slowdown have focused primarily on the short-term costs of disinflation, restoration of macroeconomic balance and on the effects of external business cycles. Much of this discussion has been decidedly populist and oversimplified. Poland's negotiations with the EU have been dominated by special interest groups and have been largely devoid of any deeper reflection on the need for changes in the institutional shape of the Polish economy and the optimal pace of structural and institutional adjustments to the operating principles of the European and global markets.

The current government's recently announced economic program includes only a portion of the reforms widely considered necessary, while others are completely neglected or given too little attention. Many of the proposed or already implemented solutions, intended to boost the economy, will result in the loosening of hard budget limits. This may lead to future consequences for public finances which are difficult to foresee, a further degradation of obligatory systemic solutions and a fall in the credibility of our country in the world.

As a result, towards the end of 2002, the CASE Foundation embarked on a project to diagnose the underlying problems and barriers affecting the Polish economy and to formulate a coherent program for further reforms. This work should be completed by the end of 2003. It encompasses both the areas covered in the EU's *acquis communautaire* (taking into consideration the transition periods and entry into the Economic and Monetary Union, the process of Poland's full integration into the EU will last many years, which makes it necessary to find the optimal path for achieving the ultimate goals) and the areas which mostly or wholly remain in the exclusive jurisdiction of national governments (e.g., labour market policy, retirement insurance systems, other aspects of social policy, fiscal policy, and

privatization). The main emphasis will be placed on structural and institutional matters, since it is in this area that progress will determine whether Poland is able to return to a path of high and sustainable growth.

The project is organized by the Center for Social and Economic Research (CASE), which in 1996-1999 carried out similar projects, "The Next Stage of Economic and Political Reforms in Poland" and "Sustainable Growth Through Consolidation of Reforms" (both financed by USAID). Many of the propositions put forward at the time, such as labour market liberalization, have not to this day been implemented. To some extent, then, this project is a continuation of our previous work. However, the current internal and external economic conditions are unfavourable, demanding complex and thoroughgoing reforms in many economic and social areas.

Leading specialists in specific fields work on this project. We also make use of the abundant material produced by international organizations such as the World Bank, the IMF, the OECD and EU institutions. CASE's international experience assures the high quality of the end product and its ability to make use of international best practice in its analysis, taking into consideration the increasing international competition in the area of regulatory, tax and legal regimes in free market conditions. To carry out this project, 11 teams were formed, working in three thematic groups.

List of topics covered in the project, and their coordinators:

#### **I. Systemic environment:**

- The strategy of accession to the Economic and Monetary Union and the competitiveness of the Polish economy (Jacek Rostowski)
- The legal conditions for a competitive system (Piotr Rymaszewski)
- Deregulation of the market for goods, services and real estate (Ewa Balcerowicz)
- The importance of foreign investment and improvement of the investment climate (Jacek Cukrowski)
- Improved competitiveness of the infrastructure sector (Tadeusz Syryjczyk)

#### **II. Public finances and structural reform:**

- Public finance reform (Małgorzata Markiewicz, Joanna Siwińska, Rafał Antczak)
- Fiscal reform (Jarosław Neneman)
- The costs of not moving forward on privatization (Barbara Błaszczyk)

#### **III. Human factors:**

- Deregulation and increased flexibility of the labour market (Michał Boni)
- Reform of the educational system and creating the basis for an information society (Mirosław Sawicki, Michał Górzyński, Richard Woodward)
- Reform of the health service and social security system (Stanisława Golinowska)

Subjects covered by the project:

## **I. Systemic environment**

### **I.1. The strategy of accession to the Economic and Monetary Union**

*Maintaining an independent national currency in the face of full freedom of capital movement means placing a relatively small economy such as Poland's at a significant risk. The expected rapid rise of the zloty resulting from Poland's EU accession will lead to upward pressure on the currency in the medium term, which will have a negative effect on the competitiveness of Polish products. A high current account deficit, which accompanies this phenomenon, suggests that a sudden lack of confidence in the zloty becomes more likely, and this may result in a sharp depreciation in the national currency, recession and inflation growth. New research suggests that maintaining a national currency does not act as a shock absorber for the countries of Central Europe, but rather in itself is a source of potential shocks to the economy. Poland's rapid entry into the Euro zone should therefore be the best solution, particularly in a situation in which we already fulfil many of the conditions to join the optimal currency area together with the countries in the EMU, to a greater extent than many of its existing members. However, many institutional aspects connected with accession need to be resolved, as do the problems of the crucial structural and fiscal reforms, which condition the increased immunity of the Polish economy to exogenous shocks.*

### **I.2. The legal conditions for systemic competitiveness**

*Poland's rapid development in the early '90s was due, to a large extent, to the freeing of economic processes from the extreme centralization and paralyzing state control. However, legislative activity from the mid '90s on had the effect of gradually but systematically reducing the free market spontaneity of economic processes. A return to the path of rapid growth demands the optimization of the regulations governing economic processes and introducing mechanisms for creating an "economically efficient" legal system. An effective economic infrastructure (based on regulations of a systemic nature) will result in the lowering of transaction costs and will increase the country's systemic competitiveness. Building the optimal legal infrastructure demands methodical and systematic analysis of the systemic solutions adopted by economically successful countries. Linking results of such an analysis with a functional approach to improving existing laws and creating new laws may lead to creating world-class competitiveness in terms of conditions for economic development. In the case of Poland, building a competitive system also demands a significant improvement of the quality of the legislative process and radical improvement in the functioning of the judicial system. This part of the project will focus on the legal elements of systemic solutions that we consider to be crucial for the country's competitiveness. These include the security of economic transactions (property and contractual rights), anti-trust laws and government regulations in this area and corporate law. Apart from the above-mentioned legal elements, the character of the processes of making and executing the laws will be analyzed.*

### **I.3. Deregulation of the market for goods, services, and real estate**

*It is increasingly difficult to run a business in Poland. This is one of the important reasons for the slowdown of economic growth. At the root of the macroeconomic situation are always microeconomic foundations; these have weakened significantly in the last few years and there is no sign of improvement in the near future. The analysis will highlight those areas and those reasons of growing state control in the Polish economy, and will contain concrete proposals for cancelling red tape in the economic system. An important aspect in this analysis will be the inadequate role of market forces in land and property transactions. Proposals for reform will be based on comparisons which are closer to a free market than Poland, with whom we shall have to compete, within an enlarged UE and in a global economy.*

### **I.4. The importance of foreign investment and improvement of the investment climate**

*The overall size of investments depends on the basic conditions of economic growth. Yet the influence of investments on economic growth is not automatic. Its effects are the result of many other factors – technological progress and the possibility of innovation, development of human capital, and the organizational and institutional conditions. The overall level of investments is seen as a starting point for many economic strategies, and stimulating the investment processes (savings and foreign direct investment) is one of the central problems of economic policy. In the context of the significant slowdown in Polish and global economic growth that has taken place in recent years, the issue of the FDI finds itself at the focus of economists' and politicians' attention. In this part of the project, we will be analyzing the influence of FDI on Poland's economic development, considering the conditions essential to attracting foreign investors, and the factors involved in improving the investment climate.*

### **I.5. Improved competitiveness of the infrastructure sector**

*Infrastructure – telecoms, energy, transportation, and related services, create the essential conditions for economic growth. Access, quality and cost depend on the competitiveness of the services and the correct division of duties between the state and the private sector. The progress of vital transformation in the infrastructure services is highly differentiated. An assessment of the current ownership structure, extent of privatization, the legal and institutional status and the influence of these factors on access, prices and quality will form the basis of our conclusions. Recommendations will focus on directions for legal change, the role of the state and local authorities, institutional changes and regulatory policy.*

## **II. Public finances and structural reform**

### **II.1. A program to repair public finances**

*Public finances are in a bad shape. It is essential to define the basic reasons for the current state of affairs, which include a chronic budget deficit, the fixed-cost nature of budget expenditure and high labour costs. Earlier attempts at partial reforms of the public finance, focused primarily on reducing the deficit, have ended up in a complete failure. Currently, the scope and depth of the public finance reform, as well as its timing, stem from external, as well*

*as internal factors. The latter point to the necessity of a complete reorientation of fiscal policy to one that will promote long-term economic growth and macroeconomic stability. External conditions, in the form of the Maastricht criteria and the demands of the Growth and Stability Pact, confirm the necessity of urgent, thoroughgoing reforms. The analysis of the causes of the current state of public finances and proposals of vital reforms will be presented in the context of integration and absorption of EU funds.*

## **II.2. Fiscal reform**

*The universal criticism of the Polish tax system creates the need to find new solutions, so that taxes would not be a hindrance to businesses and individuals. Above all, the repressive nature of the tax authorities needs to be reduced. The problem is not just of excessive fiscalism, but also of the extremely poor relationship between the taxpayer and the tax authorities. The growing tax burden is accompanied by a complicated system of tax exemptions and relief, which on the one hand reduces tax revenues, and on the other complicates the system, increasing uncertainty and the costs of raising tax revenue. At the very least, the current system needs arrangement, especially from the legal and institutional point of view. In the longer term, in parallel with the rationalization of expenditure, the tax and quasi-tax burden needs to be reduced, and with it, the ever-increasing „tax wedge” which stimulates the growth of the underground economy. This might be achieved by the lowering of social security contributions, widening the tax base and reducing the progressive nature of the income tax, eventually reducing the number of income tax thresholds (flat taxation), widening and unifying the VAT base and introducing a tax based on the value of real estate.*

## **II.3. The costs of not moving forward on privatization**

*The privatization process in Poland has dramatically slowed down. We will not devote much space to this topic in the project. We will instead try to analyze what the costs of slowing down the process are. These costs appear in various areas; one is the necessity of state aid for enterprises still in the state sector, which are unable to remain solvent. We will analyze all forms of state aid and calculate the total cost to the state treasury over the past five years. We will compare the relative value of this aid to the scale of public aid in the EU. The second area of interest is the cost incurred on the economy by the lower effectiveness of state enterprises compared to the private sector. A comparative assessment of the financial situation of enterprises in both sectors and an analysis of the key economic and financial indicators will allow us to draw conclusions. Finally, there is the privatization potential of the country (in terms of what's left to privatize, and in the sense of potential revenues to the state treasury), measured against other Central and Eastern European and EU countries. Unfulfilled potential is an evident loss to the economy.*

## **III. Human factors**

### **III.1. Deregulation and increased flexibility of the labour market**

*The challenges facing labour market policy are enormous. We will consider which instruments to use to reduce unemployment and to stimulate growth of the number of people who are economically active. Other than the speed of economic growth, tax incentives, and the improvements in the functioning of the employment services, one of the key factors in*

*improving the labour market is increasing its elasticity. This means greater elasticity of labour regulations and a greater degree of freedom for organizations – not only public – which assist in the flow of labour resources. The question of deregulation is one debated in Poland, across the EU and globally. Our intention is to review the ongoing discussion and to analyze the possibility of introducing new solutions to our labour market. The modern economy, globalization, competitiveness, the huge and rapid influence of new technology on forms of work and employment, make us look for possible reforms of legal regulations to come up with recommendations of new forms of work and employment and ways to implement them, so as to promote economic development, and with it the development of human capital and society.*

### **III.2. Reform of the educational system and creating the basis for an information society**

*Work in this area of research will concern the two most important aspects of supporting the creation of an economy (and society) based on knowledge (knowledge economy), closely connected with one another, though with differing characters. One is the thoroughgoing reform of the education system, which would create equal access to knowledge, and would ensure high standards of teaching and quality of educational content in keeping with the demands of the technological revolution. An important condition for improving the effectiveness and quality of education is proposing adequate methods and tools to measure them. An analysis and diagnosis of the current institutional shape of education in Poland, compared to other developed countries is also essential, as is a comparison of education levels in our country with other OECD countries. This would allow us to recommend directions for educational reform which would make better use of our human capital, thus creating opportunities for permanent economic development. The second important aspect in building a knowledge-based economy is the totality of actions supporting the growth of the broadly understood concept of innovative potential in the economy. The ability to increase innovation in the Polish economy to a higher level is becoming one of the more basic problems of the current phase of our country's development. Without a significant breakthrough in this field, we will not be able to increase the competitiveness of the Polish economy, thus assuring for it a higher place in the value-added division of labour in the globalizing economy. The level of innovation in our economy will be compared to that in other developed countries; reasons for our country's weakness in this field will be analyzed. The main institutional factors (other than the educational system), which influence the current state of affairs, will be set out. Foreign experiences in breaking through the key barriers in this field will also be analyzed. We will make recommendations for economic policy, especially in the area of support for R&D activities in new production and communication technologies, in light of the new opportunities arising from Poland's EU accession.*

### **III.3. Reform of the health service and social security system**

*Social policy over the past 12 years depended on transformation simultaneously influenced by several factors, such as budget limitations, social reforms, decentralization of social policy institutions and a move away from universal to selective social benefits. The changes that have taken place so far were undertaken independently of one another; their effects are not yet fully known; they do not add up to all the changes which need to be introduced for policies to become socially effective and economically rational. There is therefore an urgent need to conduct an audit of social policy reforms. Because the biggest*

*problems appear in the functioning of the health care system, it will be subject to rigorous analysis aimed at firming up proposals for change. Health service reform and the ongoing implementation of current changes still do not tackle the basic questions facing the functioning of the health care system. This also affects the definition of the principles and scope of the private health care sector, and the principles and scope of private participation by patients in financing the health services. These should not take the form of “blind” expenditure cuts in the social sphere; rather on the rational allocation and effective management of social funds and the effective functioning of social services offices.*

## **Additional information**

Funds for the project “Poland at the threshold of accession to the European Union: Outline of indispensable economic reforms” will come predominantly from domestic commercial sources. In this way, we wish to ensure the independence of assessments and opinions and avoid political pressure. More than anyone, it is the free enterprise sector that depends on Poland having good systemic solutions, which allow for growth. The authors of this project will strive to ensure that the project will receive additional finance from national, foreign and international institutions supporting scientific research and socio-economic reform to help publicize widely the results of the research.

**Commercial Union Polska Group** – leader on the open pension funds and personal life insurance markets, has supported CASE in the realization of this project. “We regard this project as very important – for decision makers in government institutions, parliament, local authorities, as indeed for owners and managers of enterprises. *Commercial Union, as a company regarding itself as an ‘forward outpost’ of the EU in our country, a company seeing itself as a socially-responsible business, expects that in the final report there will be as many detailed recommendations for action – along with the results of taking or ignoring these recommendations – supported by figures*”, said Jarosław Myjak, president of CU Polska Group.

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