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Poland: A Country Study

"Europe's Poster Child to Europe's Problem Child"

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Abstract

This article views economic and political events in Poland today in the context of the economic transition that began in 1989. The paper considers issues relating to attracting the creation of the *Balcerowicz Plan*, foreign direct investment, the current unstable political scene, and concerns for political corruption. It provides the most recent economic statistics relating to many of these issues.

Keywords: Poland, Balcerowicz plan, Foreign Direct Investment, Corruption

1. Introduction

In 2014, Bloomberg named Poland the "best country" in Eastern Europe and Central Asia with which to do business. (Bloomberg, 2014; Skolimowski, 2014). However, it might be important to recall Poland from an historical viewpoint in order to assess the tremendous progress that has been made. From the perspective of more than twenty-five years, it is now possible to state with certainty that despite a "propaganda of success" trumpeted by adherents to the former system of central planning (also called the *command-rationing method* or *CRM)*, had literally imploded by 1988-1989 because of a combination of four interrelated factors, have been termed as the "Grand Failures" of the system as it existed in Poland. These included:

1. Failure to create economic value or to improve the standard of living for the average Pole;
2. Failure to provide adequate individual and organizational incentives;
3. Failure to "measure up" to comparative economies, not only those capitalist economies in the West, but also several "fraternal" socialist economies in Central and Eastern Europe (most notably, Hungary, Czechoslovakia, and Slovenia—then a part of Yugoslavia); and
4. Failure to satisfy basic consumer needs, essentially creating an unofficial dollarization of the Polish economy through the existence of a large, open, semi-official, and surprisingly efficient black market, and the existence of official "dollar" stores and foreign currency shops. (Hunter & Ryan, 2006).

Since transitioning from communism in 1989, Poland's young, skilled, and low-cost workforce, coupled with political stability and business-friendly policies, has appealed to an array of foreign investors. The initial changes in the Polish economy were largely accomplished under the aegis of the *Balcerowicz Plan*—named for the Deputy Prime Minister and Minister of Finance in the first post-communist government led by Prime Minister Tadeusz Mazowiecki. (Sachs, 1993; Hunter & Ryan, 2009).

1.1 The Balcerowicz Plan

Early in the transformation process, Minister Balcerowicz decided on a strategy that would be based on two overriding considerations: *A market economy was preferred over a centrally planned economy and a private market economy was preferred over so-called "market socialism."* As result, the process of economic transformation in Poland has been quite *instructive* and has provided a more general model for other Central and Eastern European transition economies. The program adopted by Minister Balcerowicz was based on what have come to be known as the "*five pillars of economic transformation":* (1) *rapid transformation* of the *monocentric* system of state central planning into a private functioning market economy; (2) *liberalization* of economic functions, especially in relation to foreign trade and foreign direct investment; (3) *privatization* of state-owned enterprises (SOEs); (4) construction of an effective *social safety net*; and (5) *mobilization of international financial* *assistance* to support the process. (Hunter & Ryan, 2008; Hunter & Ryan, 2009).

The *Balcerowicz Plan* actually comprised ten individual laws enacted by the Sejm. The *Warsaw Voice* summarized its significant successes as follows: "They removed guarantees for the existence of all state-owned enterprises, banned the central bank from financing budget deficit(s) and issuing unlimited amounts of 'empty' money, lifted credit preferences for state-owned enterprises, introduced złoty convertibility on the internal market, and removed [the] state monopoly in foreign trade." (Warsaw Voice, 2007).

As noted by Johnson and Loveman in the *Harvard Business Review* (1995), the program was intended to:

"stabilize the macroeconomy and to create the conditions necessary for privatization, enterprise restructuring, and the development of an institutional system compatible with a market economy. Because of the speed and scope of the reforms, the impact on Polish markets and enterprises was immediate and profound. Remarkably, the main goals of the program, widely known as "shock therapy," were achieved within a few months."

This largely market-based, capitalist economy has seen tremendous growth over the past 25 years – much higher than anyone could have imagined. While the European Union's average growth rate has been .6% since 2007, Poland's economy has grown an impressive 24%. (United States Department of State, 2015). It was the only EU nation that managed to avoid a recession (and actually continued to grow) during the 2008-2009 financial crisis despite surrounding neighbors' tanking economies. As reported by *Eurostat*, "Poland recorded a Government Debt to GDP of 51.30 percent of the country's Gross Domestic Product in 2015. Government Debt to GDP in Poland averaged 46.24 percent from 1995 until 2015, reaching an all time high of 56 percent in 2013 and a record low of 36.50 percent in 2000." (Trading Economics, 2016b).

However, one of the largest economies in Europe is now faced with challenges posed within its own borders. Since the very conservative, religious, right-wing political party, PiS, came to power in the fall of 2015, Poland has slowly begun transitioning from Europe's *poster child* of post-communist nations to Europe's *problem child*. The political changes that the new government has undertaken during its short time in office have shaken the confidence of many foreign investors.

2. Poland at a Glance

According to data assembled by the World Bank, Poland's Gross Domestic Product (GDP) has grown from $64.7124 billion in 1990 to $544.9666 billion in 2014. The annual growth rate of GDP per capita between 1990 and 2012 averaged 4.3%. (UNICEF, 2013). In 1990, it was ranked 19 out of the 28 current members of the European Union (Figure 1) in terms of GDP. (Google Public Data, 2016a). Aside from the EU's three largest economies (Germany, United Kingdom, and France) whose GDPs measured far beyond other EU nations, Poland has the 5th highest GDP as of 2014 (Figure 2). It's fascinating to see how a country such as Poland, ranked among the lowest in 1990, has managed to surpass countries with larger, stronger economies. Taking into account all 58 European and Central Asian countries, as well as Malta, Poland has the *11th highest GDP as of 2013* (Figure 3). (Google Public Data, 2016b).

Looking at some of the World Bank's *World Development Indicators*, Poland's GNI per capita, PPP (current international dollars) rose from $5,610 in 1991 to $23,930 by 2014. (World Bank Data, 2016). As reported by the Central Statistical Office (GUS), Poland's unemployment rate decreased to 10 percent in March of 2016 from 10.3 percent in February. The number of registered unemployed stood at 1.601 million compared with 1.653 million in the previous month. The unemployment rate in Poland averaged 13.45 percent from 1990 until 2016, reaching an all time high of 20.70 percent in February of 2003 and a record low of 0.30 percent in January of 1990. (Google Public Data, 2015-2016; Trading Economics, 2016d). Between 2007 and 2011, only .1% of Poland's population was below the international poverty line ($1.25 per day). (UNICEF, 2016). In regards to education, UNICEF Statistics found that literacy rates for youth between the ages of 15 and 24 in the 2008-2012 time span were at 100% for both males and females. Enrollment rates for primary and secondary school for males and females were above 90% across the board. (UNICEF, 2016).

The *Corruption Perceptions Index* (2015) ranked Poland 30/168 and gave it a score of 62/100 (the closer the score is to 100 the *cleaner* it is). (Transparency International, 2016). The majority of corruption occurs in the public services and public procurement sectors. However, given the recent problems with the government, political corruption could pose an even greater threat to the private sector and foreign investors. As Business Anti-Corruption reports: "Poland's Criminal Code offenses include active and passive bribery of foreign officials, extortion and money laundering. However, the government does not prosecute these offenses effectively, and officials engage in corruption with impunity." (Business Anti-Corruption, 2016). The *Poland Country Profile* further notes that despite "facilitation payments and gifts being criminalized, these practices are widespread." (Business Anti-Corruption, 2016; generally, Hunter & Mest, 2015).

3. Attracting Foreign Direct Investment

For countries with depressed economies, little capital, and high unemployment rates, Foreign Direct Investment (FDI) can be a mutually beneficial way of stimulating the economy and job market, among many other sectors. (Hunter & Ryan, 2013). FDI enables the inflow of new technology, products, capital, and potential opportunities and collaboration with local businesses that would otherwise not be possible. Poland's track record in terms of attracting FDI has been quite impressive. Those who invested were especially drawn to the aerospace, automotive, biotechnology, business support services, domestic appliances, electronics, food processing, IT, renewable energy, and research and development sectors (PAIiIZ, 2016), although the manufacturing sector (30.2%) and financial intermediation (25.3%) continue to attract well over 50% of FDI into Poland. In terms of FDI inflows by country, the following is a list of the main investing countries in Poland:

- Germany (17.1%);
- Netherlands (16.1%);

- France (11.9%);
- Luxembourg (9.6%);
- Spain (6.5%);
- Italy (5.8%);
- USA (4.3%);
- Austria (4.0%); and
- Cyprus (3.8%). (OECD, 2014).

Santander Trade (2016) reported that the "strong points" for investing in Poland include:

"A fast-growing economy, a location in central Europe, a multilingual and skilled workforce whose productivity is rising rapidly and cheap labor costs make Poland an internationally attractive country. Poland also enjoys a well-managed economy, which was able to withstand the crisis better than other European countries. Unlike other Central European countries, its population did not have to resort to loans in foreign countries, in particular Swiss loans, a fact which has protected the population from maximum debt." (Santandertrade.com, 2016).

Although there are negatives as well, including slow administrative procedures and continued uncertainty regarding Poland's eventual adoption of the Euro, one of the reasons Poland has experienced so much growth in the private sector through FDI is the tax incentive associated with FDI. In addition to certain tax exemptions and grants, the Corporate Income Tax (CIT) rate declined from 40% in 1991 to 19% in 2004 (see Figure 4). (Trading Economics, 2016c). During a time when transitioning nations were in need of foreign capital, Poland's lower CIT helped it stand out against neighboring competition and draw in massive amounts of FDI. According to the World DataBank, the annual net inflows of FDI increased drastically from $89 *million* in 1990 to $17.27 *billion* in 2014 (see Figure 5). (World Data Bank, 2016). As with other projects and investments, foreign investors had to curb their spending after the Eurozone crisis shook global markets. As a result, Poland's FDI inflow dropped from $18.485 billion to $7.358 billion in 2012 and again to $795 million in 2013. (World Data Bank, 2016). Nonetheless, Poland has done an excellent job of appealing to an increasing number of investors throughout the years. By 2014, net inflows of FDI accounted for 3.2% of Poland's GDP. (World Data Bank, 2016).

4. One Step Forward, Two Steps Back (Cue the PiS Government)

In October 2015, a new President and government stepped into the Presidential Palace. Opposite its predecessor, the center-right Civic Platform (Platforma Obywatelska, PO) party, the very conservative, right-wing Law and Justice (Prawo i Sprawiedliwość, PiS) party had many changes in mind for its time in office. Andrzej Duda, its candidate for President, ran on a platform campaigning for tax cuts, continued social welfare spending, continued privatization, constitutional reform, anti-corruption, closer ties with NATO, and increased military spending; limited support of further EU integration; and restrictions on euthanasia, abortion, and legal recognition of sex and violence in the media, as well as of homosexual couples. (Associated Press, 2015). After failing to win the majority of votes in the first round of elections, Andrzej Duda defeated then-President Bronislaw Komorowski 51.5% to 48.5% in the critical second-round of elections. (BBC.com, 2015; Foy, 2015).

Since the PiS party, led by Jaroslaw Kaczynski (brother of former President Lech Kaczynski who died in the 2010 plane crash in Smolensk, Russia), won the Polish parliamentary elections in October 2015, it has already managed to make several drastic policy changes. Their first order of business was selecting five judges and appointing them to Poland's Constitutional Tribunal, claiming the previous party's appointment of judges was illegal. On December 28, 2015, President Duda signed into law an amendment drafted by the PiS that would change the structural organization of the court and require them to pass rulings with two-thirds majority in place of the existing simple majority, and increase the minimum number of judges from 9 to 13 in order to validate a ruling. (RT International, 2015). This would make it much more difficult for the opposition to rule against the government and increases the government's influence over court rulings, essentially endangering democratic checks and balances, and the court's rule of law. On March 9, 2016, the constitutional court announced a verdict deeming the amendments unconstitutional. (BBC.com, 2016). The government, however, refused to publish the ruling because doing so would make it legally binding. Since the position was announced, the Venice Commission (a body of the Council of Europe), the European Commission, the majority of Members of the European Parliament, and several of Poland's allies have backed the court's ruling.

Next on the agenda was restructuring media laws as a means to suppress critics from speaking out against the new government. On January 7, 2016, not even 2 weeks after trying to amend the laws of the constitutional court, the PiS drafted and President Duda subsequently signed legislation authorizing the government to appoint heads of TV and media, and civil service directors. (Day, 2016). A clear disruption to freedom of press and media, the European Commission, Council of Europe, Reporters Without Borders, and protestors among many others, were outraged. Poland's new government is on a slippery slope towards communism and implementing such laws becomes a tool for propaganda. It endured further scrutiny from the EU as threats came in to potentially remove Poland's voting rights concerning EU policy. (BBC.com, 2016a; 2016b).

Soon after, it was time for the nationalist party to stir the pot with its neighbors. After rebuke from Germany and countless other countries on the ideology of the new government, a Polish right-leaning magazine released a publication depicting Angela Merkel as Hitler alongside other EU leaders in military uniforms. (Politico.eu.com, 2016). But that wasn't the end for PiS. In order to cut taxes for citizens and still be able to fund social spending, the government introduced new taxes and levies on the banking and retail industries- both of which are foreign-dominated businesses. Banks were already subject to a .44% levy on their adjusted assets – a plan estimated to bring in about 1 billion Euros in 2016. Through the new anticipated tax plan targeted at larger retailers, taxes for supermarkets (also predominantly foreign-owned) will be determined by a progressive scale and are estimated to bring in approximately 450 million Euros per year. (Foy, 2016). Retailers with 1.5 million Zloty in monthly revenues will be in the tax-free bracket, those generating between 1.5 million and 300 million Zloty will be subject to a .7% tax, and those generating over 300 million Zloty per month will be subject to a 1.3% tax. (Martewicz & Krasuski, 2016). Though this tax plan may not be significant enough to influence current investors to pull their funds out of Poland, it certainly raises several red flags for *potential* investors and questions the course of future business policies.

5. Some Tentative Conclusions: The future of FDI in Poland

At the height of the constitutional crisis in January 2016, Standard & Poor downgraded Poland's rating on the S&P 500 from an A- with a positive outlook to a BBB+ with a negative outlook. (Business Recorder, 2016). Though the adjustment isn't immense, it speaks volumes as to the direction in which the new political party is driving the country. The Polish Zloty dropped 2.4%, the biggest decline among emerging-market currencies, in April and hit its lowest mark in two months to 4.4275 per Euro. (Krasuski, 2016). Despite much rebuke from neighbors, outcry from its citizens, and even public revile from three past Polish Presidents (Cienski, 2016), PiS refuses to back down. Anti-government demonstrations have increased so much that a recent protest was the largest since 1989 when Poland eluded Communism. (Reuters, 2016). Poles are concerned the PiS government has been undermining democratic institutions, curbing democratic checks and balances, violating EU principles, and creating tension between the EU and its allies.

What are the policy implications of the recent political turmoil in Poland? Critics fear the unpredictable government could potentially drive out foreign investors and the economy will tank. Casillas (2016) reports that other issues loom as potential negatives in Poland's future besides those relating to political uncertainty: fiscal policy (especially relating to Poland's external debt), and the economy of the European Union as a whole. These issues will demand attention as well.

However, the actions of the PiS government and President thus far haven't been impulsive. In fact, they have been in line with what they've campaigned and promised. President Duda has repeatedly stated he aimed to "lower the retirement age, increase the tax-free income threshold, introduce a payment of 500 zlotys for every child in poor families, raise taxation of large international companies, and "repolonize" the banks" – and that's exactly what he has been working towards. (Stanley, 2015). Interestingly enough, we know what to expect. Therefore, the political events occupying Poland now aren't worrying foreign investors just yet. Though the taxes imposed were aimed at foreign-owned companies, the profits to be made still outweigh the costs.

Perhaps Hungary could offer some insight. Prime Minister Viktor Orban has led Hungary down the same authoritarian path upon which Poland may be embarking. Mr. Orban increased taxes explicitly on foreign-dominated sectors, announced that his goal for Hungary is an "illiberal democracy," and blatantly defies the core values of NATO and the European Union even though Hungary is a member of both institutions. (Marton, 2014). It's interesting that even though the EU accounts for 95% of Hungary's public investments (Marton, 2014), it doesn't stop Orban from making such radical statements. Even more interesting is that with the authoritarian rule, the Hungarian Ministry predicted an 8% to 24% increase in FDI inflow in 2014 (Landry, 2014) and GDP actually increased since Orban came to power in 2010. (Trading Economics, 2016a). In recent reports, the European Commission reported economic growth in Poland and Hungary will be faster than previously expected due to increasing domestic demand. (Sobczyk & Feher, 2016).

Though the political chaos in Hungary and Poland is the cause of much domestic apprehension, investors aren't as distressed. In fact, research conducted on the correlation between multiple parties in authoritarian governments and investors conclude that they "generate better investor protections" and "such protections facilitate stock market development, domestic investment, and ultimately economic growth." (Jensen et al., 2013). This explains the advanced economic performance in Hungary, and even insinuates the same could be true for the future of FDI in Poland. If PiS and Duda continue down this path, they may actually reduce investment risk for foreign companies and actually attract more investments. Though their actions have been unconstitutional and undemocratic, they don't necessarily pose a threat for investors. As it stands, PiS could actually reduce the risk for investors and attract further FDI.

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Appendixs

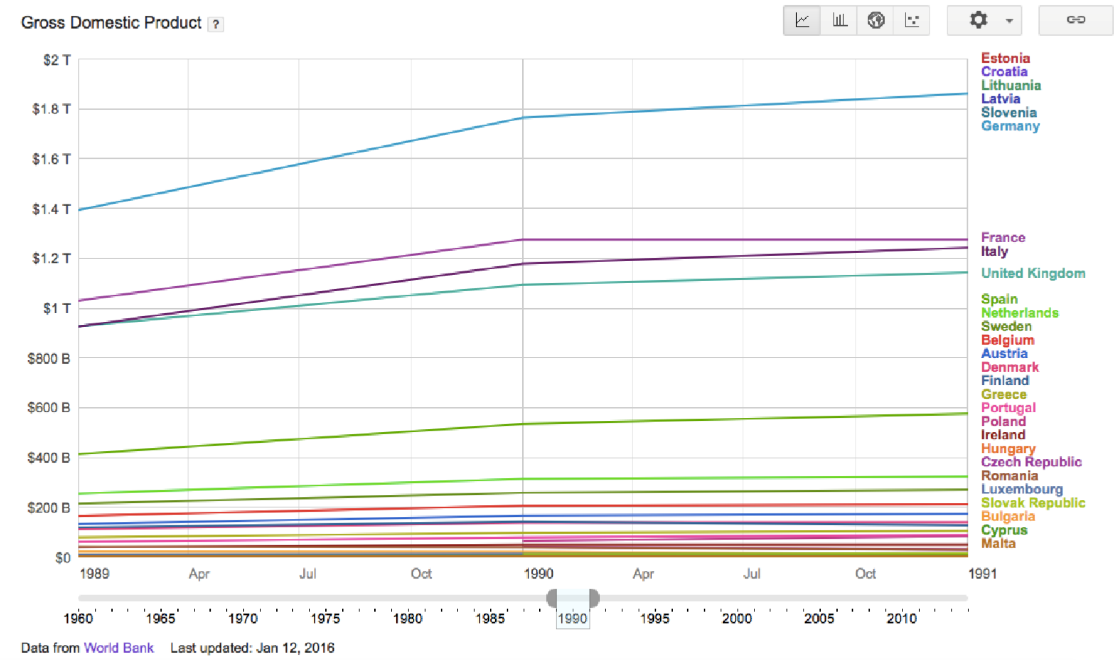


Figure 1.

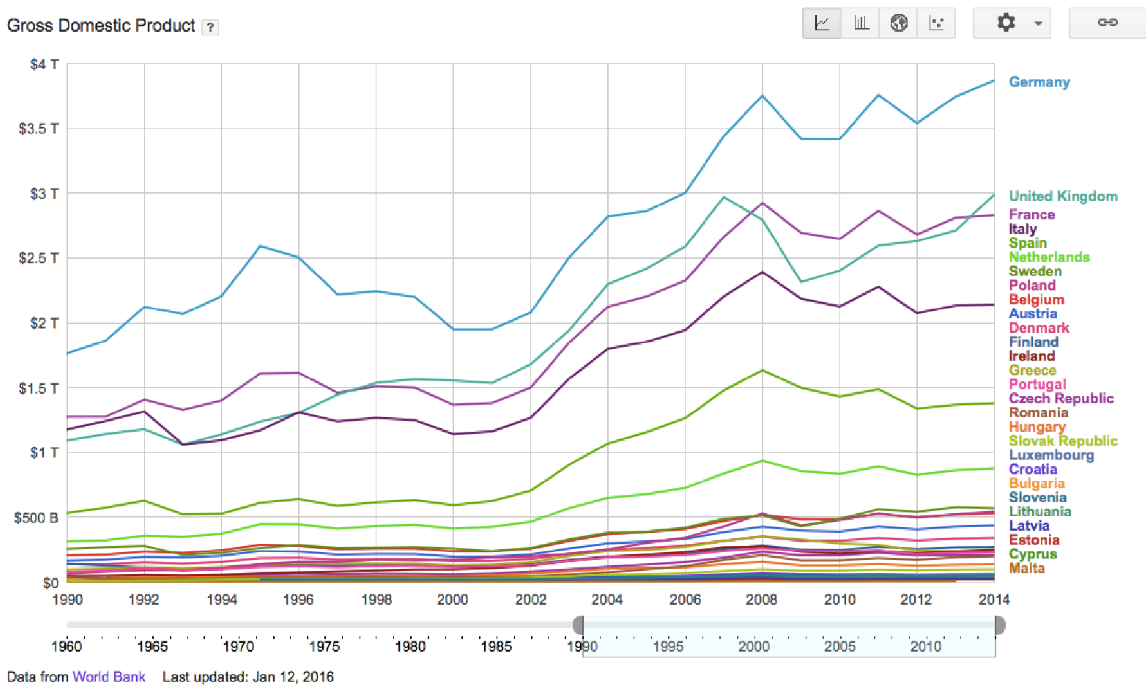
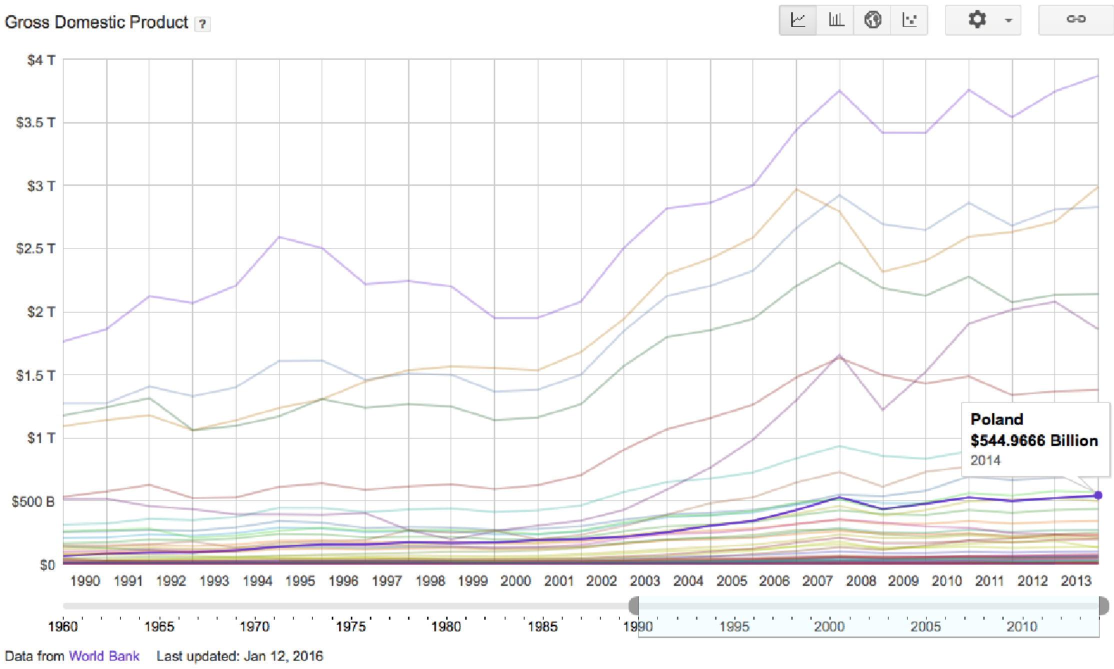


Figure 2.



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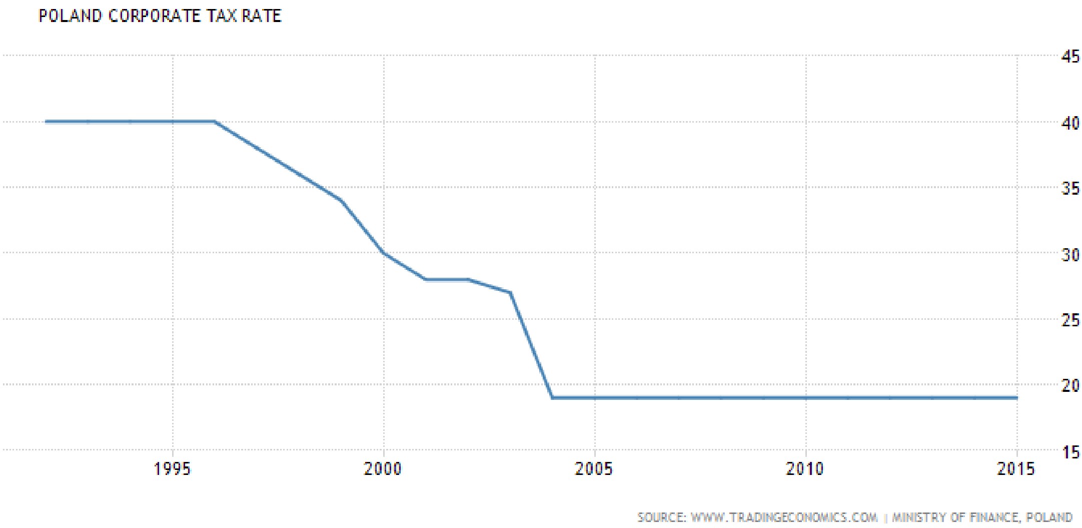

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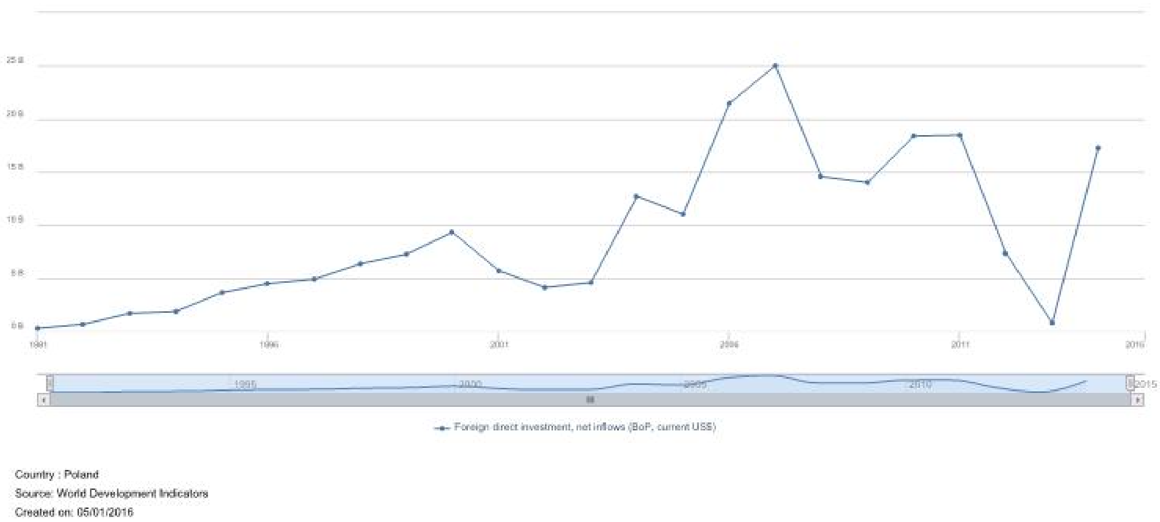
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Foreign direct investment, net inflows (BoP, current US$)
Country : Poland
Source: World Development Indicators
Created on: 05/01/2016

Figure 5.