FREE NETWORK POLICY BRIEF SERIES

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March 2018

Poland's Road to "High Income Country" Status: Lessons Learnt – Not Only for Other Countries

In this brief we summarize and discuss results presented in a recent World Bank Report focused on Poland's path from middle to high-income country status. In the period until 2015, Poland's economic development distinguished itself by its stability and consistency of the implemented reform package, and its inclusive nature. Poland became classified as a high-income country after only 15 years from gaining a middle-income status. At the same time, income inequality remained stable and absolute poverty levels fell significantly. The World Bank Report offers lessons from and insights for Poland, which are discussed from the perspective of the policies implemented by the governments in the last two years.

Poland's status in the World Bank nomenclature has recently been "upgraded" from being middle to high-income country. While this categorization is only a nominal change, it reflects the country's economic development over the recent decades and is an important recognition of the success of a wide range of reforms implemented across a broad number of areas. Notably, Poland moved from the middle to high-income status in a period of less than 15 years.

In a book recently published by the World Bank, it is argued that the Polish experiences from the reform process can serve as valuable lessons for countries that are in the process of, or have just embarked upon major socio-economic reforms, as well as for those, who have fallen into the so-called middle-income trap and are looking for solutions to their stagnant economies. At the same time, in comparison to other established high-income countries, there are a number of insights that Poland's policy makers ought to bear in mind in order to stay on course of the reform process and continued stable growth.

Looking at policies of the recent governments, however, one gets a strong impression that some important insights have been ignored. As rapid population aging looms over the horizon, the lack of necessary adjustments combined with the risks to stability of the political and economic environment might in the medium run have significant implications for Poland's further development.

The big picture

The key feature of the Polish socio-economic policy approach, over the period covered by the World Bank analysis (i.e. up to 2015), was a unique consistency of a broad direction taken by subsequent administrations. This allowed the reform process to develop without major breaks or U-turns, which ensured the overall stability of the socio-economic environment and provided stable investment prospects. The World Bank highlights the key role of institutions, including rule of law, property rights, and democratic accountability of different levels of government. Basic market institutions, including the respect for rules on price and product regulations, corporate governance and market regulations, as well as foreign trade and investment, have played a crucial role. This framework allowed for continued improvement in the efficiency of resource allocation – including the allocation between sectors of the economy, as well as between and within enterprises.

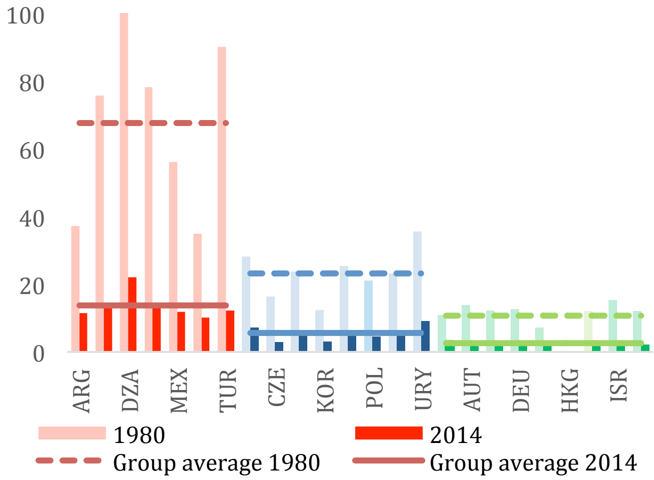
Crucially, Poland prepared well and took full advantage of the integration with the European Union. The EU accession was first used as a common anchor for stability of the reform process, and after 2004, the European funds became an additional engine of growth. At the macro level, stability of the fiscal framework with limited deficits and public debt were combined with appropriate regulation and supervision of the financial sector, an independent central bank, and close links to global markets.

Shared prosperity

While the above points provided the basis for Poland's economic development, the Report highlights another unique feature of Poland's success, namely the degree to which the fruits of the process have been equally shared among different groups of society. The overall income inequality has remained relatively stable, with the Gini coefficient actually falling slightly between 2005 and 2014, from 0.351 to 0.343. Relative income poverty levels remained stable over this period (at about 20%), and the levels of absolute poverty fell significantly. For example, the proportion of the population living on less than $10 per day fell from 51.3% in 2005, to 29.6% in 2014. Growing incomes were primarily driven by increases in labor earnings, but employment growth – in particular among older age groups – also made a contribution. The government's labor market policy also played a role with a rapid increase in the level of the national minimum wage (NMW), which grew by 65% in real terms between 2005 and 2015, i.e. almost twice as fast as the average wage. While there is evidence that the rapid growth in the NMW had negative effects on employment – in particular among temporary, young, and female workers, these have been relatively modest. Additionally, the tax and benefit policy has contributed to reduced inequality. It has been estimated that nearly half of the reduction in the Gini coefficient, over the period 2005–2014, resulted from reforms of the tax and benefit system (Myck and Najsztub, 2017).

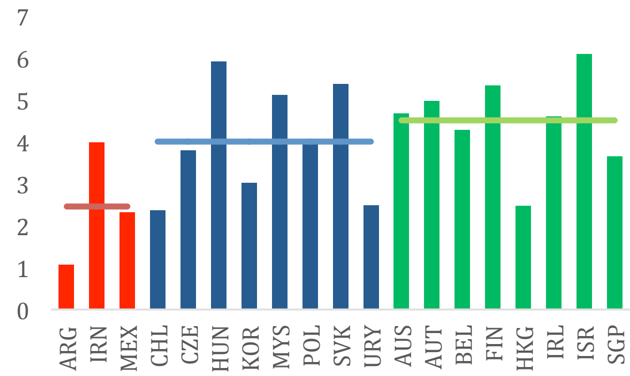
It is clear that human capital was one of the cornerstones of Poland's success in recent years. Developments on the labor market, such as a rapid productivity growth, were facilitated by a well-educated labor force, which could respond and adjust to the changing conditions and requirements. In this regard, Poland's advantage in comparison to many other low and middle-income countries has been the relatively high level of spending on public education and healthcare, not only since the start of the economic transformation in the 1990s, but also before that. Indicators, such as the infant mortality rate, were low in Poland already in the 1980s, and have since further improved (see Figure 1). For a long time, public spending on education has been at levels comparable to those in established high-income countries (see Figure 2). Additionally, a series of reforms to the education system since 1990, have resulted in improvements in the quality and coverage of education. This, in turn, has lead to a rapid improvement of scores in language, mathematics, and science in the PISA study (Programme for International Student Assessment), in which Polish students recently outperformed those from many other OECD countries (OECD 2014). Importantly, the improvements in the education results have been found across the socio-economic spectrum, which further stresses the inclusive character of the changes that have taken place.

Figure 1. Infant mortality rate (per 1,000 live births), 1980 and 2014



Notes: Countries grouped in the following manner: red – middle-income countries; blue – new high-income countries; green – established high-income countries. Horizontal lines represent group averages. *Source*: World Bank (2017), Figure 5.16, based on World Development Indicators.

Figure 2. Government expenditure on education, percent of GDP, 1990



Source: World Bank (2017), Figure 5.11, see notes to Figure 1.

Insights for Poland

"As economies enter the high-income group, weakness in economic institutions such as the rule of law, property rights, and the quality of governance become increasingly important to sustain convergence."

World Bank (2017)

While the Polish reform experience, over the period examined in the World Bank Report, offers important lessons for other countries aspiring to the high-income status, the authors point out that

Poland's continued development needs to rely on further improvements in a number of key areas. The following policy areas have been highlighted in the Report:

- Working on more inclusive political and economic institutions and enhancing the rule of law with the focus on the judiciary;
- Adjustments to fiscal policy in particular to deal with the consequences of population aging;
- Increasing the domestic level of savings to facilitate large investment needs;
- Supporting innovation through more intense competition and high quality research education;
- Improving social assistance programs and access to high quality health and education for low income groups;
- Increasing the progressivity of the tax system to support inclusive growth;
- Adjusting migration policies to bring in skills and innovative ideas and compensate for the country's aging workforce.

"Sustaining Poland's record of high, stable growth will require adjustments to fiscal policy (…). Government will need to create the fiscal space to deal with the increasing pressures coming from aging, the inevitable decline of EC structural funds for investment, and a more uncertain global context."

World Bank (2017)

Lessons, insights and recent policies

While several of the Law and Justice majority governments' policies since 2015 have been well in line with the World Bank recommendations, there have also been a number of questionable policy areas. One major concern seems to relate to the broad background of reforms of the judiciary, which have drawn significant criticism of the European Commission and other international institutions. Implications of such major changes for economic growth are uncertain but potentially very damaging.

Another long-term concern arises from the new pension age reform. From the socio-economic perspective, rapid ageing of the population is one of the main challenges facing the country. Between 2015 and 2030, the number of people aged 65+ will grow from 6.1 million to 8.6 million, i.e. by over 40%. This will put significant strains on the country's public finances due to increasing public-pension expenditures and growing costs of health and long-term care. These pressures will only be exacerbated by the current government's decision to lower the statutory retirement age to 60 for women and 65 for men, from the target uniform age of 67 legislated in the reform of 2012. Given the contributions-defined nature of the Polish pension system, this will result in significantly lower levels of pensions, especially among women, and a substantial drain on public finances resulting from lower levels of contributions and taxes.

The generous family benefits of the Family 500+ Program – implemented in 2016 and which cost about 1.3% of the GDP – have also been criticized on a number of grounds. They have undoubtedly changed the financial conditions of numerous families and limited the extent of child poverty. At the same time, they contribute to maintaining low levels of female labor-force participation and there is so far little indication that they have significantly changed Poland's very low fertility rate. It seems that while the program may have positive long-term consequences resulting from reduced poverty, it is unlikely to shift the demographic dynamics.

Uncertainty also surrounds the consequences of a haphazard major education reform, which is another trademark policy of the Law and Justice party. The reform re-introduced the 8+4 system in place of the post-1999 three-level educational arrangement (6+3+3). The new system takes the number of years of general education back from 9 to 8 years, and instead extends by one year the length of secondary schooling. While the potential effects of such a change are difficult to foresee, the 8+4 system may be in particular disadvantageous to children from rural areas, who are most likely to continue their education in their rural primary schools for the two extra years.

A number of steps taken by the government since late 2015, and in particular those related to the redistributive policies implemented in the last two years, seem to be consistent with the World Bank insights. On the other hand, the approach towards the reforms of the judiciary, the general approach to the rule of law, and the reforms of education and pension regulations, quite clearly appear to ignore not only the insights, but also the lessons resulting from Poland's own experience of the recent decades. Given the challenge of rapid aging in the Polish population, there seems to be much gained from taking them seriously if the current and future administrations want to ensure Poland's continued inclusive growth and to secure its status as an established high-income country.

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This policy brief draws heavily on the World Bank (2017) Report: *"Lessons from Poland, Insights for Poland: A sustainable and inclusive transition to high-income status"* (co-authored by Michal Myck) and the accompanying Working Paper by Myck and Najsztub (2016). Views and opinions expressed in this brief are the sole responsibility of the author and are not endorsed by the World Bank or CenEA.

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