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Poland

Growth, Employment and Living Standards in Pre-Accession Poland

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ACRONYMS AND ABBREVIATIONS

ALMPs	Active Labor Market Policies
BAEL	Labor Force Survey (<i>Badanie Aktywności Ekonomicznej Ludności</i>)
BGD	Household Budgets Survey (<i>Badanie Budżetów Gospodarstw Domowych</i>)
CAL	Local Activities Center (<i>Centra Aktywności Lokalnej</i>)
CASE	Center for Social and Economic Research (<i>Centrum Analiz Społeczno-Ekonomicznych</i>)
CEEC	Central and Eastern European Countries
CIT	Corporate Income Tax
COICOP	Classification of Individual Consumption by Purpose (<i>Klasyfikacja Spożycia Indywidualnego Według Celu</i>)
COP	Central Industrial Area (<i>Centralny Okręg Przemysłowy</i>)
CPI	Consumer Price Index
CSO	Civil Society Organization
ECA	Europe and Central Asia
EPL	Employment Protection Legislation
EU	European Union
FDI	Foreign Direct Investment
FDPA	Fundation for the Delopment of Polish Agriculture (<i>Fundacja na Rzecz Rozwoju Polskiego Rolnictwu</i>)
FTE	Full Time Employment Contract
GDP	Gross Domestic Product
GUS	Central Statistical Office (<i>Główny Urząd Statystyczny</i>)
HBS	Household Budget Survey
HDI	Human Development Index
IALS	International Adult Literacy Survey
IMF	International Monetary Fund
IPISS	Institute of Labor and Social Studies (<i>Instytut Pracy i Spraw Socjalnych</i>)
ISP	Institute of Public Affairs (<i>Instytut Spraw Publicznych</i>)
KRUS	Old Age and Disability Pensions System for Farmers (<i>Kasa Rolniczego Ubezpieczenia Społecznego</i>)
LFS	Labor Force Survey
LS	Living Standard
LSA	Living Standard Assessment

MARD	Ministry of Agriculture and Rural Development (<i>Ministerstwo Rolnictwa i Rozwoju Wsi</i>)
MGPIPS	Ministry of Economy, Labor and Social Policy (<i>Ministerstwo Gospodarki, Pracy i Polityki Społecznej</i>)
MONAR	Center for Drug Addicts' Therapy (<i>Centrum Terapii Narkomanów</i>)
MPC	Monetary Policy Council (<i>Rada Polityki Pieniężnej</i>)
NAS	National Account Statistics
NBP	National Bank of Poland (<i>Narodowy Bank Polski</i>)
NGO	Non-governmental Organization
OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Square
OMC	Open Method of Coordination
OPS	Social Aid Centers (<i>Ośrodki Pomocy Społecznej</i>)
PCK	Polish Red Cross (<i>Polski Czerwony Krzyż</i>)
PCPR	Powiat Center for Family Assistance (<i>Powiatowy Ośrodek Pomocy Rodzinie</i>)
PD	Poverty Deficit
PGR	State Farm (<i>Państwowe Gospodarstwo Rolne</i>)
PI	Price Index
PIS	Social Intervention Threshold (<i>Próg Interwencji Społecznej</i>)
PISA	Program for International Student Assessment
PIT	Personal Income Tax
PLFS	Polish Labor Force Survey
PPP	Purchasing Power Parity
REER	Real Effective Exchange Rate
SAPARD	Special Accession Programme for Agriculture and Rural Development
SGH	Main Trade School (<i>Szkoła Główna Handlowa</i>)
SME	Small and Medium Enterprises
UNDP	United Nations Development Program
VAT	Value Added Tax
WB	World Bank
ZUS	Social Security Office (<i>Zakład Ubezpieczeń Społecznych</i>)

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EXECUTIVE SUMMARY

1. Poland was an early comer to the transition process and a strong reformer. What came to be known as the “Polish model of transition” brought rapid changes to the economic system and, after an initial “big bang,” resulted in high growth rates and rapid employment growth. At the same time the potential social cost of the “shock therapy” adopted was mitigated by: (i) a generalized easy access to a generous social benefit package; and (ii) a relative drop in food prices that increased the relative purchasing power of the poor. The combination of these two factors kept the growth in the inequality of consumption to a minimum during the middle of the 1990s.¹ With high growth rates and only a slight increase in inequality, absolute poverty declined sharply over this period – from 18 percent in 1994 to 12.6 percent in 1998.

2. The loss of export markets in the East as a consequence of the Russian financial crisis triggered a new round of enterprise restructuring to curtail falling profitability. This time, the resulting improvements in productivity were brought about in large part by reducing employment. At the same time, expenditure on social transfers to become fiscally unsustainable and threatened to limit the country’s growth potential. Thus, as economic growth declined progressively to a meager 1 percent in 2001, inequality continued to slowly increase led by the increase in the dispersion of labor income which was associated with the sharp drop in employment.²

3. Low growth rates and growing inequalities combined to increase poverty after 1998 – from 12.6 percent in 1998 to above 15 percent by 2002. Moreover, poverty has increasingly become a “chronic” phenomenon associated with lack of skills, long-term unemployment and residence in small towns and/or particular regions. Thus, recent years have seen a growing pool of hard-core poverty emerging as a correlate of the increase in long-term unemployment and labor market mismatches. The risk of falling into this group is particularly high for women, individuals with low education and those living in rural areas. In addition, the transformation of the economy brought about a new territorial diversity that is connected to the decline in agricultural production and especially the collapse of collective (state) farms.

4. At the same time the social benefit system has come under increasing pressure to reduce expenditure and has grown increasingly inefficient in targeting the poor. In 2001, over 50 percent of the benefits paid – net of old-age pensions – did not reach who needed them most. Although the social insurance component of these benefits – e.g. unemployment benefits – is clearly not designed to target the poor, the extent of the spill-over raises concerns about the ability of the system to serve as an adequate safety net for the emerging hard-core poor and suggests the need for a radical reform.

5. By way of contrast, the European Union (EU) – which Poland is set to join in 2004 – has increased its focus on reducing social exclusion and welfare inequality via increasing employment opportunities, in the Lisbon Treaty. Thus the imminent EU accession presents Poland with the challenge of reversing the trends of the last decade and closing the gap between

¹ The Gini coefficients for household consumption increased only slightly from 0.25 in 1994 to 0.26 in 1998 and remained lower than in other Central European transition countries. The Gini coefficients for household income, however, were and remained the highest among the European OECD countries except Turkey (OECD, 2003).

² The Gini coefficient for household consumption grew from 0.26 to 0.28 over 1998- 2002 while that for household labor income rose from 0.32 to 0.35 and the employment rate declined from 66 percent in 1994 to 60 percent in 2001.

the “two Polands” that have emerged over the last decade. The experience of the mid-1990s shows clearly that a return to the high growth-high employment scenario is essential to achieve this objective. As economic growth is reaching again enviable rates, this report attempts to identify some measures that may help Poland back on a pro-poor growth path.

The Link Between Poverty and Growth

6. The report finds that in Poland poverty responds well to economic growth. Over the last decade the average estimated elasticity of poverty with respect to growth in average consumption from the Household Budget Survey (HBS) has been 3.57 with a peak of 4.11 in 1999.³ This value compares well with the estimates for other transition countries and with those typically found in other regions (Bruno, Ravallion, and Squire 1998; Ravallion and Chen, 1997).⁴

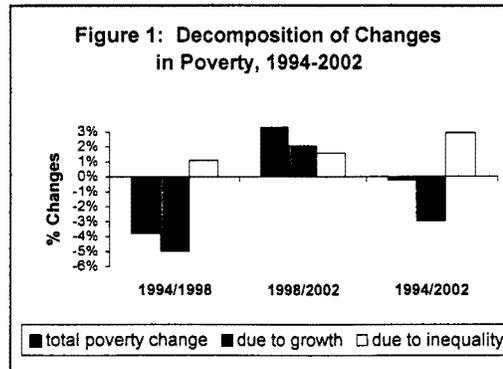
7. The relatively high degree of responsiveness of poverty to economic growth is rather surprising in the context of the dramatic economic transformation experienced over a short period, which is likely to have generated a number of winners and losers. But, as noted above, the potential increase in inequality was contained by a sharp increase in public expenditure on social transfers and a sizable relative drop in food prices. Indeed, as expected, inequality in the distribution of consumption grew over the decade – somewhat more rapidly than in other CEE countries. The relatively high growth rates of the pre-1998 period and the relatively small increase in inequality resulted in a reduction in poverty. By contrast, after 1998 mean consumption declined in all quintiles except the highest, and the reduction was particularly severe at the lower end of the distribution. The decline in average consumption and the increase in inequality combined to increase poverty by about 3 percentage points.

8. If this change is decomposed into a growth and an inequality component, it is evident that economic growth was the main driving force in poverty reduction in the first period (1994-98). During these years the economic growth effect (a reduction of 5 percentage points in the poverty headcount) far outweighed the negative effect of the increase in inequality (an increase of 1 percentage point), resulting in a cumulative decline in poverty of about 4 percentage points. By contrast, during the subsequent period, 1998-2002, slow – or negative - growth and rising inequality both contributed to the increase in poverty noted above.

9. Underlying the slowly rising inequality in consumption experienced over the last decade was the growing inequality in income in general and labor income in particular – the Gini coefficients for consumption increased from 0.25 in 1994 to 0.28 in 2002. Interestingly, this growing inequality is linked to wider differences across households in employment status and employment opportunities rather than to the more unequal distribution of wages that one would associate with labor market liberalization. The two main factors behind this growing inequality in labor income are geographical differences and skill differentials. In 2001 nearly 20 percent of the inequality was accounted for by differences between different skill groups, while 12 percent was due to differences across regions.

³ These estimates are in line with the value of 3.5 given in World Bank, 2002.

⁴ To give a few examples, the growth elasticity of poverty for Romania was estimated at 3 in 1996 and 1997 but has declined since then to below 2 (World Bank, 2003). An average elasticity of 3.7 was also estimated for Croatia. However, the limited information available suggests much lower responsiveness in other countries. Estimates of around 2 were derived for Russia (World Bank, 2002) and less than 1 for Armenia, Azerbaijan and the Kyrgyz Republic.



Source: Authors' calculations based on HBS.

What Is the Extent of Poverty?

10. Using our methodology, in 2001 over 14 percent of the total population – or more than 10 percent of households – lived in “moderate” poverty in Poland.⁵ This means that poverty affected over 5.5 million people. The extent of “deep” poverty was also considerable, reaching 8.6 percent or about 3.5 million people, and extreme poverty was also significant (headcount index H = 3.2 percent). At the same time, poverty depth was moderate. The poverty gap for moderate poverty has been estimated at around 0.5 percent of GDP (poverty gap index less than 20 percent), while the gap for deep poverty was 0.25 percent of GDP (gap index 18 percent).

11. Both moderate and deep poverty headcounts declined sharply between 1994 and 1998 and increased consistently after that date. The poverty decline in the middle of the decade was more pronounced than the poverty increase that came later. In 1994-98, according to our methodology, the moderate poverty headcount dropped from 18 percent to 12.6 percent.

Who Are the Poor in Poland?

12. Over the last decade, poverty has been decreasing with age.⁶ It has also been increasingly associated with the following factors:

- Living in the north, northwest and southeast and/or in small towns;
- Unemployment;
- Lack of education;
- Having a large number of children or dependents in the family.

13. It is particularly important to note that, using the World Bank standard definition of aggregate consumption, the differences between rural and urban areas and the higher poverty risk of farmers found in previous studies is considerably reduced. The higher risk of poverty in rural areas appears to be the result of extremely high poverty among former PGR (state farm) workers rather than private farmers. Moreover, in the case of private farmers the poverty risk decreases sharply with land size. This suggests that the problem is not low agricultural productivity, but is rather (i) limited access to land for private farmers and (ii) lack of employment for former PGR workers.

⁵ The poverty line for “moderate poverty” is PPP \$6.33 a day; the line for “deep poverty” is PPP \$5.50 a day and that for “extreme poverty” is the internationally used \$4.30 a day.

⁶ However, some evidence is emerging of a recent increase in poverty among the elderly

14. A comparison of the correlates of poverty over the last decade suggests that the profile of poverty has remained relatively stable over time, with changes in poverty incidence being determined by fluctuations in the unemployment rate. However, in 2000-01 the position of farmers improved slightly relative to other groups, and the relative importance of education in moving people out of poverty has increased over time.

15. Finally, the analysis of two panel sub-samples of the HBS suggests that the 1990s saw an increase in the incidence of chronic, long-term poverty and a slowing down of the movement out of poverty. This trend suggests the emergence of a growing hard-core group of chronically poor households that are becoming increasingly excluded from the process of economic transformation and are unlikely to benefit from future economic growth. The road to chronic poverty and social exclusion is marked by the same milestones as the road to “transient” poverty and closely follows the increase in long-term unemployment experienced in Poland. Geographical location and poor educational attainments are not only the main factors that lead individuals into poverty. They are also the main barriers to their moving out of poverty, because they adversely affect employment prospects. This suggests the existence of a growing gap between the Poland of long-term unemployment and chronic poverty and the rest of Poland, in which people are unlikely to experience poverty during their lifetime.

The Strong Link between Income Poverty and Other Dimensions of Poverty

16. There is a very close relationship between income poverty (as measured by household consumption) and other dimensions of poverty, such as access to, and quality of, such social services as education and health, with rural areas and the poorest regions receiving significantly fewer resources than the rest of the country (World Bank, 2002).

17. While there is little evidence of a systematic relation between poverty and ethnicity and/or gender, the evidence suggests a strong link between poverty and risky behavior, especially in rural areas. One type of behavior that is of particular importance is alcohol abuse, which affects around 3 to 4 million people, making it the most troublesome social problem after unemployment (Sierosławski, 1998). Strong regional inequalities also exist in access to informal safety nets, with the poor inhabitants of villages that were formerly established to house collective farm workers being largely excluded from both local and broader social networks. In these areas, neighbors can provide little help as they tend to be equally poor. In addition, most former collective farm workers are not local to the regions in which they live and have no access to the informal safety net that in Poland is provided by the immediate family.

18. It is also worth noting that the conclusion regarding no direct link between poverty and gender is based on the comparison of poverty incidence in female-headed and other households. This is clearly a very limiting definition of gender inequality, and a clear disadvantage emerges for women when other dimensions are considered. Particularly striking is the extent of gender inequalities in the labor market, with women being substantially more likely than men to be among the long-term unemployed and to receive substantially lower wages for the same job descriptions despite their comparable productivity endowments.

Poverty and Labor Market Outcomes

19. The poverty diagnostics presented above clearly show the important role played by employment status in determining the probability of falling into poverty. At the aggregate level this is also shown by the close correlation between the trends in poverty incidence and the employment rate. In addition, this report highlights the importance of growing inequalities in

labor income--i.e., the amount of household income derived from labor--in explaining the growth of inequality over the last decade.

20. Wage inequality remained roughly steady from 1992 to 1998 and has increased only slightly since. This small increase in wage inequality at a time of increasing labor market deregulation may appear surprising, especially in light of the growth of private employment from little over a quarter of total employment in 1994 to almost 60 percent by 2002. However, it could be explained by a number of factors. Important among these factors are: (i) the relatively high level of minimum wages; and (ii) the related substantial and progressive drop in employment opportunities for low-skilled employees, which has resulted in the wage distribution being truncated downwards. In addition, a substantial increase in the supply of highly educated labor – in response to the initial increase in returns to education – has contained the increase in wages at the top end of the distribution.

What Is Behind the Recent Polish Jobless Growth?

21. If growing earnings inequality is not the cause of the rising inequality in household labor income, then the explanation must be the polarization of employment away from worse-off households and in favor of better-off ones. The factors behind the decline in employment are complex. On the one hand it is linked to the intensive industrial restructuring of the early 1990s – and the associated reallocation of labor leading to skill and geographical mismatches – and the elimination of labor hoarding and the sharp increase in productivity of the mid-1990s.

22. On the other hand, an important cause of the slow-down increase in job creation experienced since the late 1990s is the relatively high – and increasing – cost of doing business in Poland, which results from a combination of high taxation, high labor costs relative to productivity and the high cost of entry that are associated with administrative barriers, corruption, etc.. Compared to other transitional and OECD countries, Poland has one of the highest payroll taxes (48 percent) (Riboud et al. 2002).⁷ In addition, between 2000 and 2003 – at a time of declining employment – labor costs in Poland have increased by 21.7 percent, 11.5 percent faster than the EU(15) average but slower than that in the other Central European Accession countries, except for Lithuania.⁸

23. Partial deregulation in the goods market may be an additional possible explanation. The radical economic transformation of the early 1990s has resulted in massive restructuring and some privatization of former state firms but the process of deregulation and privatization has progressively lost momentum over the last decade and much remains to be done. Recent literature suggests that the positive effects of product market deregulation may not be felt in the labor market when deregulation affects only part of the economy – for example, because the rest of the system remains heavily regulated. In this case, employment in existing restructured firms will fall but the drop may not be compensated by adequate job creation in incumbent firms, with adverse effects on unemployment. This mechanism can partially explain Poland's sluggish employment performance and deserves to be studied in detail.

24. Finally, an important potential factor is the apparent increase in structural unemployment experienced over the last decade as a result of massive changes in the demand for and supply of skills which are by no means uniform across Poland's regions. Voivodships vary substantially in

⁷ Carey and Tchilinguirian (2000) estimated the average effective tax rate for labor in the period 1991-95 as 42.06 percent.

⁸ The 2003 figure refers to the third quarter, which is the most recent period for which information is available.

terms of unemployment and skill/education mix and the two variables are strongly correlated. Differences in educational attainment account for at least half of the regional variation in Polish unemployment rates.

25. The differences in the unemployment rate explain only a part of the regional relationship between unemployment and skills levels. In addition, lower skilled workers tend to experience longer periods of unemployment. Thus, part of the skill-unemployment regional correlation may have to do with regional differences in factors that affect the individual's chances of finding work once he or she becomes unemployed. On the supply side, such factors include: (i) those that affect reservation wages, such as a high replacement ratio; and (ii) those that inhibit geographical mobility, such as housing market constraints and length of entitlement to unemployment benefits. On the demand side, an important element is regional differences in average labor productivity that are not adequately reflected in differences in labor costs, owing to factors such as the nationwide minimum wage.

What Is the Role of Social Benefits in Poverty Reduction?

26. As mentioned above, during the “big bang” years the social transfer system came to be used as a way of maintaining social cohesion rather than as a way of supporting the income levels of those most in need. Today the system and its underlying objective remain largely unchanged. The average amount received in social transfers per capita has increased over time and so has the percentage of the population relying on transfers to keep them from falling into poverty. Without social transfers, the poverty rate would be over twice the estimated rate.

27. However, the current system is extremely costly and inefficient. Excluding old-age pensions from the calculation, this report estimates that, despite recent efforts to increase the efficiency of the system, the following problems remain:

- 26 percent of benefits paid are in excess of the amount necessary to bring household consumption to the poverty line level
- 30 percent (an equivalent of 2 percent of GDP) of total expenditure is estimated to go directly to non-poor households
- the average size of social transfers per capita in the poorest decile is the second lowest after the top decile.

Policy Recommendations

28. Based on the findings of the analysis, this report puts forward a number of recommendations designed to bring Poland back onto the pro-poor growth path of the early 1990s and closer to the Lisbon targets for employment and social inclusion. These recommendations are summarized in Box 1.

Box 1: Main Policy Recommendations

1. Improve employment opportunities for the population by:
 - Increasing labor demand by:
 - Introducing regional differentiations in the minimum wage;
 - Reducing non-wage labor costs;
 - Reducing administrative barriers to “doing business” and improving governance;
 - Speeding up the process of privatization and liberalization of goods, labor and other markets.
 - Increasing labor supply by:
 - Reducing the high reservation wages of unskilled rural workers;
 - Reforming social transfer systems so as to reduce the existing “unemployment trap”;
 - Increasing the skills level of the labor force, especially in disadvantaged regions.
 - Reducing labor market mismatch by:
 - Improving job search assistance;
 - Encouraging mobility via a policy mix that includes:
 - Equalizing the length of entitlements to unemployment benefits across the country;
 - Reducing housing market rigidities;
 - Improving access to transport; and
 - Providing mobility grants.
 - Encouraging entrepreneurship by providing selective training and improving access to credit for groups with the highest unemployment levels – i.e., women, people living in rural areas.
2. Improve the targeting of income support benefits so as to provide an effective safety net for those who cannot benefit fully from economic growth and increased employment opportunities.
3. Target social transfers towards income-support by shifting the emphasis away from disability pensions and pre-retirement benefits to income-related family benefits and considering the possibility of having these benefits conditional on: (i) children attending secondary or tertiary education; and/or (ii) household heads working a minimum number of hours – i.e., 16 hours a week.
4. Increase the capacity for poverty monitoring by: (i) providing public access to HBS individual record; (ii) improving the HBS questionnaire to allow more accurate aggregate consumption figures to be calculate; and (iii) expand the panel component of the survey.

1. INTRODUCTION

1.1 Poland is the largest of the countries set to enter the EU in May 2004. It is also a country with profound regional inequalities closely linked to historical divisions and the reshaping of its borders in 1945. It accounts for over 50 percent of the cumulative population of the ten acceding countries⁹ and also for about 50 percent of their cumulative GDP.

1.2 Poland was an early comer in the process of economic transformation that swept through Central and Eastern Europe in the 1990s and a strong reformer. A “shock-therapy” program implemented during the early 1990s enabled the country to quickly transform its economy into one of the most dynamic and robust in Central and Eastern Europe. However, there was concern that the economic upheaval associated with these reforms could result in a substantial increase in inequality in living standards and a considerable increase in poverty. In fact, early studies did not find evidence of rising inequality – at least in the initial years of transition - and concluded that the wide use of social transfers played a crucial role in alleviating inter-group conflicts as well as mitigating the potential increase in inequalities (IMF, 2000; OECD, 1997, World Bank, 1999). Indeed some claimed that it was the substantial redistributive role played by the benefits system that enhanced Poland’s growth during early transition by fostering socio-political stability at a time of dramatic economic reforms (IMF, 2000). Others, however, warned that the high level of social transfers would, in the long term, limit the country’s growth potential and, indirectly, increase poverty.

1.3 As Poland becomes a member of the EU, it faces increasing pressure to reduce fiscal imbalances while also working towards reducing social exclusion and welfare inequalities via increasing employment opportunities, as set out by the Lisbon strategy which is detailed in Box 1.1. Combining these two objective may prove to be a serious challenge for Polish policy makers. This report is designed to help address this challenge.

A. THE OBJECTIVES AND SCOPE OF THE REPORT

1.4 This report builds on the wealth of existing literature on living standards and inequality in Poland and is intended to continue the ongoing debate. The focus is on lack of access to economic opportunities as the most important dimension of poverty in Poland and one that is strongly associated with social exclusion, vulnerability and other dimensions of poverty. The findings of the report are based on a variety of data sources. In addition to publicly available data from aggregate and sectoral sources, it relies heavily upon several primary sources of micro-economic data such as surveys of households and individuals. In particular the Household Budget Surveys (HBS) and the Labor Force Survey are extensively used.

⁹ The Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Slovak Republic, Slovenia, and Poland.

Box 1.1: The Lisbon Strategy

*In March 2000, the European Council in Lisbon set out a ten-year strategy to make the EU “the world's most dynamic and competitive economy”. The leading principle of the Lisbon Strategy is that a stronger economy will drive job creation alongside social and environmental policies that ensure sustainable development and social inclusion.**

Objectives in the area of social inclusion:

- Annual increase in per capita investment in human resources
- Halving the number of 18 to 24 year olds with lower-secondary level education
- Reducing proportion of the population – now 18% or 60 million people - at risk of poverty (without social transfers this rate would have been 26%)
- Stimulating the take-up of lifelong learning
- Strengthening equal opportunities for the disabled
- Promoting gender equality, a good working environment and involvement of social partners in managing change
- Promoting corporate social responsibility
- Adapting pension and healthcare / long-term care systems to an ageing population with the twin objectives of ensuring quality and financial sustainability

Objectives in the area of employment:

- Raising the employment rate from 61% to 70% by 2010
- Reducing by 2010 the average level of unemployment in the EU to the levels already achieved by the best performing countries (around 4%)
- Increasing the number of women in employment from 51% to over 60%
- Increasing the employment rate for older workers (55-64) in 2010 to 50%
- Raising by 2010 the retirement age by five years
- Raising the availability of childcare by 2010 for 90% of children (3 years +) and 33% of children under 3
- Removing barriers to mobility between and within Member States (e.g. recognition of qualifications, pension portability, better provision of information, etc.)
- Improving quality at work, in particular the working environment and health and safety

Progress towards Lisbon goals in the areas of employment and social cohesion (Europe15 averages)

	Lisbon (2000)	Barcelona (2002)	EU 2010 Target
Employment			
a. Overall (% active population)	63.2	63.9	70
b. Women	52.8	54.7	60
c. Older workers (55-64)	37.2	38.3	50
Social Cohesion			
a. Risk of poverty (after social transfers)	18	18	

Communication from the Commission to the Spring European Council in Barcelona. The Lisbon Strategy-Making Change Happen. *Brussels, 15.1.2002. COM(2002)14.*

* (http://europa.eu.int/comm/lisbon_strategy/intro_en.html)

1.5 The report's main objectives are to: (i) describe what happened to Polish living standards after the "shock therapy" of the early 1990s and in the less prosperous last five years; (ii) highlight the main factors behind the recent increase in poverty and inequality; (iii) identify the main risk factors associated with social exclusion and "transient" and "permanent" poverty in pre-accession Poland; (iv) address the growth of a hard-core of chronic poverty; and (v) point to policy measures that may help Poland to move closer to the Lisbon targets for employment and social inclusion.

B. THE STRUCTURE OF THE REPORT

1.6 This report consists of two volumes. Volume 1 presents the main findings and their policy implications. It begins with a general overview of the macroeconomic climate and its changes over the transition period. It then moves on to address the links between economic growth and poverty reduction in the high growth years (when poverty declined considerably) and in the following slow-down in growth (during which poverty increased). A description of the poverty profile and its changes over the last decade follows and leads to an analysis of the strong link between skills levels, employment opportunities and social inclusion as a way of avoiding poverty. Particular attention is paid to the growing divide between the chronically poor and the rest of the population. The role of social transfers as an important safety net for the most vulnerable (but also a potential barrier to effective long-term poverty reduction) is then discussed, along with the role currently played by civil society and informal networks as non-governmental safety nets. Finally some options are presented on policies that may help to bring Warsaw closer to Lisbon – i.e., to the EU targets for employment, social inclusion and reduction in inequalities.

1.7 A collection of 14 background papers provide more detailed analysis of the issues discussed in this report. The chapters are organized into four parts which are designed to bring together chapters with similar focus. The main findings of the chapters are summarized in a matrix presented as an Appendix to this report. Given their number and the volume of information, the background papers will be made available only upon request.

2. THE ECONOMIC BACKGROUND

2.1 The first post- communist government elected in early 1989 inherited: (i) an economy that lagged behind that of Western Europe despite intense industrialization programs and many modernization-oriented ventures; (ii) the challenge of high inflation rates, unsustainable fiscal deficits; and (iii) an educational system dominated by basic vocational education designed to satisfy the demand for semi-skilled manual labor resulting from the industrialization process.

2.2 The fifteen years that followed saw a major transformation of the economy and massive improvements in many macroeconomic indicators but much remains to be done. The milestones of the economic transition of Poland can be grouped into three distinct periods: (i) the years of the “big bang” 1989-93; (ii) the high growth rate years 1994-98; (iii) the years of economic slow-down, 1999-2002.¹⁰

A. THE “BIG BANG”

2.3 With the adoption of the “Balcerowicz Plan” in January 1990, the new Mazowiecki government chose a path of deep structural reforms designed to quickly turn Poland into a free market economy where the private sector would flourish and government intervention would be limited. In 1990 the government implemented a comprehensive reform program – the Government Program for the Reconstruction of the Economic System. The program soon became known as the “Polish model of transition” and was characterized by the so-called “shock therapy” approach to economic reform. Polish policymakers took huge risks by making the zloty convertible, fixing the exchange rate, and lowering import barriers.

2.4 With privatization lagging behind, many predicted a crisis based on the notion that enterprises would not be able to cope with market conditions, which would lead to politically unacceptable mass bankruptcy and social upheaval. This did not happen. On the contrary, Poland turned out to be unique among the large early reforming European transition countries in having an unbroken record of growth once expansion resumed after the initial output collapse. By 1993, inflation had been significantly reduced and the budget deficit had been brought down. Stabilization had achieved its objectives of lowering the fiscal deficit and inflation and setting the stage for economic growth.

2.5 However these results had been achieved at the expense of a significant contraction of the economy, a sharp reduction in employment and a significant fall in real wages brought about by price/exchange rate liberalization. The drop in employment was particularly severe in rural areas where collective farms collapsed and employment in mining and industry dropped dramatically. The key to maintaining socio-political stability and support for reform in this context was the use of an extensive social safety net program designed to contain the adverse impact of stabilization on the poor.

¹⁰ The macroeconomic developments of the past decade are described in more detail in chapter 2 of Background Papers.

B. THE HIGH GROWTH YEARS

2.6 Between 1994 and 1998 the Polish economy grew at an annual average rate of above 6 percent. Many factors can account for this growth record, including consistent economic policies despite frequent changes of government. At its core, this meant maintaining a combination of hard budget constraints for enterprises, a competitive real exchange rate, and a post-privatization governance structure that allowed business to flourish. Indeed, the primary engine of growth was the private small and medium enterprise manufacturing sector. There were significant inflows of foreign direct investment and employment continued to increase until 1997.

2.7 In the meantime the relative prices of food declined substantially. In addition, as a way of maintaining socio-economic stability, the government retained the overly generous social transfer network of the pre-transition era; a system that guaranteed easy access to social safety net programs to redundant workers and those most affected by the transformation process.

2.8 The combined effect of these trends was a continuous reduction in poverty from 18 percent in 1994 to 14.8 percent in 1998 using our methodology.¹¹ At the same time, inequality in consumption and income increased only slightly with the Gini coefficients for consumption increasing from 0.25 in 1994 to 0.26 in 1998. However, by the middle of the 1990s the large volume of social transfers that continued to be paid and the slowdown in economic transformation generated increasing concerns about the long-term sustainability of the “Polish model of transition”.

C. THE ECONOMIC SLOWDOWN

2.9 The loss of export markets in the East as a consequence of the Russian financial crisis triggered a new round of enterprise restructuring to curtail falling profitability. This time, the resulting improvements in productivity were brought about in large part by reducing employment. This reduction, together with the increased numbers of newcomers to the labor market owing to the baby boom of the early 1980s, led to significant increases in unemployment. As of April 2003, over 3.2 million people were unemployed (18.4 percent of the labor force).

2.10 These developments coincided with a shift in monetary policy in 1999 following the creation of an independent Monetary Policy Council (MPC). Inflation targeting became the main anchor of monetary policy. When inflation rebounded into double digits during 1999 and 2000, the MPC progressively tightened monetary policy by raising its rediscount rate to a peak of 21.5 percent in August 2000. As a result, and in combination with possible over-investment during the high growth years of 1994/1998, domestic demand, and in particular investment, declined significantly starting in the second half of 2000 and employment continued to fall.

2.11 A strong rebound in export growth during 2000 initially contributed to maintaining GDP growth for that year at an acceptable level of 4 percent, as shown in Table 2.1. However, owing to the global slowdown in 2001, Poland could not sustain export growth sufficiently to keep overall economic expansion at a high level. Growth rate has averaged only 1 percent in 2001 and 1.4 percent in 2002 and employment plummeted (See Table 2.1). This was reflected in a decline in average consumption overall and a shift in the consumption distribution away from the poor. The latter mainly reflected increased inequality in labor income, driven at first by raising skill premium and then by a reduction of employment opportunities for the unskilled.

¹¹ The comparable figures using GUS methodology are 20 percent in 1994 and 15.2 percent in 2001.

Table 2.1: Main Macroeconomic Indicators

	1997	1998	1999	2000	2001	2002	2003
GDP growth, % y/y	6.8	4.8	4.1	4.0	1.0	1.3	3.7
Private consumption growth, % y/y			5.2	2.7	2.0	3.3	3.0
Gross fixed investment growth, % y/y	21.7	14.2	6.8	2.7	-9.8	-7.2	1.0
Unemployment rate, e.o.p., %	10.3	10.4	13.1	15.1	17.4	18.1	17.7
Poverty headcount, % of population	14.7	13.1	14.3	14.8	15.6	16.6	..
General govt. expenditures, % of GDP	43.5	41.9	42.7	41.1	43.9	44.5	46.9
General govt. budget balance, % of GDP	-2.8	-2.4	-3.1	-3.0	-5.1	-6.0	-6.3
Consumer price inflation, % y/y	13.2	8.6	7.3	10.1	5.5	1.9	0.9
NBP refinancing rate, %	28.0	21.0	21.5	24.0	16.5	9.75	6.0
Current account deficit, % of GDP	-2.9	-4.2	-7.2	-6.1	-3.9	-3.5	-3.0
External debt, % of GDP	35.5	36.0	42.4	40.3	38.1	40.7	..

Source: GUS, e.o.p – end of period, 2003 – forecast or latest available.

2.12 As economic growth declined, inequality continues to increase, led by the increase in the dispersion of labor income associated with the sharp drop in employment. Low growth and rising inequality combined to produce the continuous increase in poverty experienced since 1999. Using GUS definition of consumption, poverty incidence increased from 14.3 percent in 1999 to 16.6 percent in 2002. At the same time the Gini coefficient for aggregate consumption increased by a full percentage point from 0.26 to 0.27. The factors underlying the increase in inequality resulted in poverty becoming increasingly a ‘chronic’ phenomenon associated with lack of skills, long-term unemployment and residence in small towns, especially in disadvantaged regions. The transformation of the economy has emphasized old territorial divisions and created new ones, reflecting the decline of agricultural production and especially the collapse of collective (state) farms. To some extent the problems of poverty and low growth spread from the eastern part of the country to the northern and northwestern regions.

2.13 At the same time public expenditure on social benefits begun to place a growing burden on public finance, leading to a widening fiscal deficit since the turn of the century. By 2001, a substantial share of net government borrowing was financing government recurrent expenditures. This trend continued in 2002 and the budget for 2003 shows little sign of improvement (See Table 2.1).

2.14 Given Poland’s already relatively high level of taxation, the emphasis for fiscal stability is on reducing public spending. In 2001, 44.4 percent of this expenditure went to “social security and welfare.” Thus the focus is on reducing the extensive use of safety nets. The challenge is to achieve this objective while avoiding the potential deterioration of the living standards of those who have been left behind by the process of economic transformation and are not likely to benefit immediately from a restoration of economic growth. Thus, what is required is a considerable improvement of the targeting of social transfers so that limited resources can be channeled to the most vulnerable.

D. EU ACCESSION AND THE CHALLENGE FOR THE FUTURE

2.15 Poland is set to join the EU in May 2004. This provides a great opportunity for moving back onto the pattern of high employment growth that prevailed at the beginning of the 1990s. However, the challenges are considerable as Poland will need to move considerably closer to other EU countries with respect to a number of indicators, as highlighted in Box 1.1.

2.16 Table 2.1 above shows the prospects for growth in 2003 to be good. Growth for 2003 was estimated at 3.7 and in 2004 is projected to be at around 4.3 percent, indicating a budding recovery and reflecting continuing strong export performance, especially in exports to the EU, and a clear resurgence in industrial production. Investment appears to have grown for the first time since 2000 and over the last few years, the growth of the current account deficit appears to have declined and consumer price inflation is a record low. Assuming the growth of inequality will remaining at the average level experienced over the last five years, this should reduce poverty by 6.4 percent, lowering it by 1.5 percentage points to 15.1 percent in 2004. However, government expenditure as a percentage of GDP is predicted to continue to rise together with the budget deficit. This is a major concern.

2.17 A return to long-term robust growth requires a stable macroeconomic environment with a balanced fiscal-monetary policy mix. To prevent the re-emergence of economic imbalances, fiscal consolidation and the reduction of overall deficits are needed to complement the recent monetary easing. A parallel reduction in the size of the government budget would provide greater space for private sector development. Together with an additional and necessary reallocation of government expenditures from consumption to investment, these policies would significantly strengthen Poland's growth prospects.

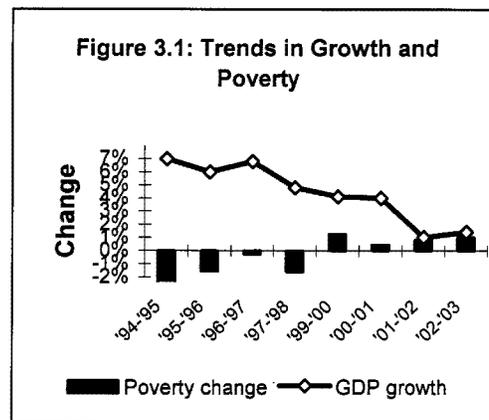
2.18 However, the experience of the last decade has shown that for growth to be poverty-reducing it needs to be reflected in comparable growth in employment. In the Polish case the challenge is in reducing the high cost of labor relative to productivity, especially for unskilled workers. These costs are kept artificially high by a nationally set binding minimum wage and by a high tax wedge. The experience of the last five years has shown that, given the downward rigidity of labor costs, any slow-down in growth results in massive shedding of low skilled jobs.

2.19 This is not a new phenomenon. Something very similar happened in other EU countries in the late 1970s and early 1980s. Spain and Portugal are particularly obvious examples. On the positive side, the experience of these countries has suggested that, while in the short-run labor shedding has massive adverse effects on employment and poverty, it does lay the foundation for subsequent higher incomes through the large increase in productivity it generates. To date Spain and Portugal are the two EU countries with the highest continuous growth in recent years. The key to their success has been putting in place the right mix of economic reforms, not simply in the labor market but across the economy as a whole, and especially in the product market and in the previously highly monopolized infrastructure sector.

2.20 On the eve of EU accession the challenge for Poland is to follow in the footsteps of these more established members and continue the radical reform program begun – but not completed – in the early 1990s.

3. THE GROWTH-POVERTY LINK

3.1 There seems to be wide consensus that poverty in Poland declined in the high growth period 1994-98 but then increased sharply (see Figure 3.1) even though the growth rate remained positive, albeit much lower. The key to understanding this result may lie in statistics as well as in the changes in inequality experienced during this period.

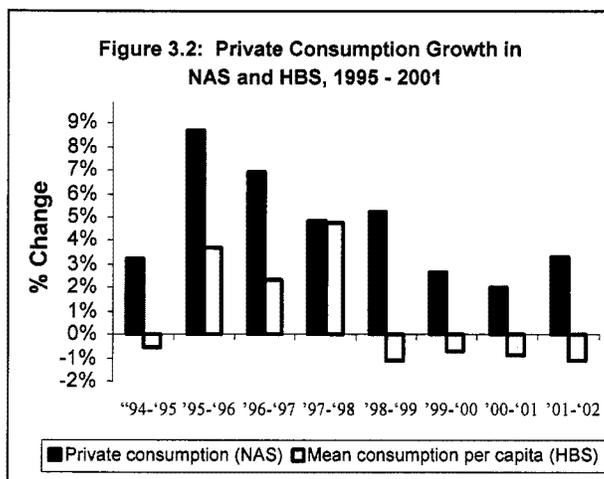


Source: Authors' calculation based on HBS.

A. A STATISTICAL ARTIFACT?

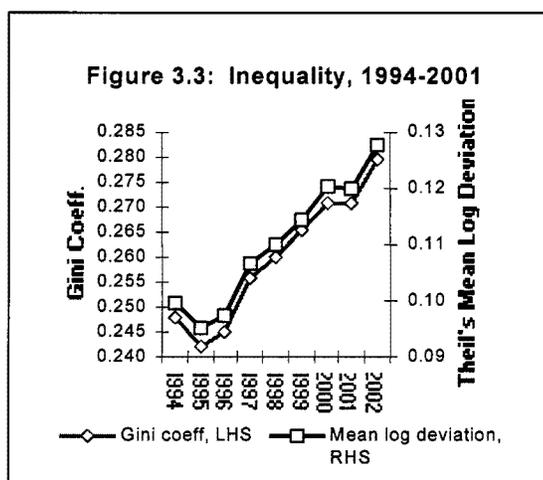
3.2 First we should note that household consumption - as captured by the Household Budget Surveys (HBS) - seem to have performed much worse than the National Accounts Statistics (NAS) would suggest. This difference persists even when the figures for changes in aggregate private consumption are considered rather than GDP growth. This is not a phenomenon unique to Poland and may be explained by the unusually high investment accumulation experienced in Poland over the 1990s and by the relatively high export rate.¹² Reconciling these two series is beyond the scope of this report but it is important to note that the HBS shows declining values of average per capita consumption for the period 1999 - 2002 while the NAS data show moderate positive growth (Figure 3.2). Hence the estimates of poverty, which are based on the HBS, showed increases in poverty in these years despite the positive consumption growth rates shown by the national accounts data.

¹² Richard (2003)



B. BUT INCREASED INEQUALITY IS ALSO A FACTOR

3.3 However, this is far from the whole story. Average consumption per capita based on HBS data increased immediately prior to 1998 and started to decline only after that year. Also during 1994/98 poverty declined but at a much lower rate than the rate of growth. This is not altogether surprising. As mentioned in the introduction, one would expect that the dramatic economic transformation of the “big bang” years would have generated winners and losers affecting the living standards of many.



3.4 Indeed, as expected, the inequality in the distribution of consumption also grew over the decade, as shown in Figure 3.3, with Gini coefficients increasing from 0.25 in 1994 to 0.29 in 2002 but remained in line with that in other CEE countries (see Table 3.1). Until 1998 average consumption increased in all percentiles leading to a reduction in poverty, despite the increase in inequality. This is evident from Figure 3.4 which shows the growth incidence curve for the period 1994-98 consistently above zero, indicating an increase in the consumption level of the

whole population. The resulting reduction in poverty was achieved despite the fact that the increase in consumption was higher at the top end of the distribution than at the bottom end. Thus over the period 94-98 there was weak pro-poor growth in the sense that the consumption growth rate of the poor was positive, although lower than for the top deciles.

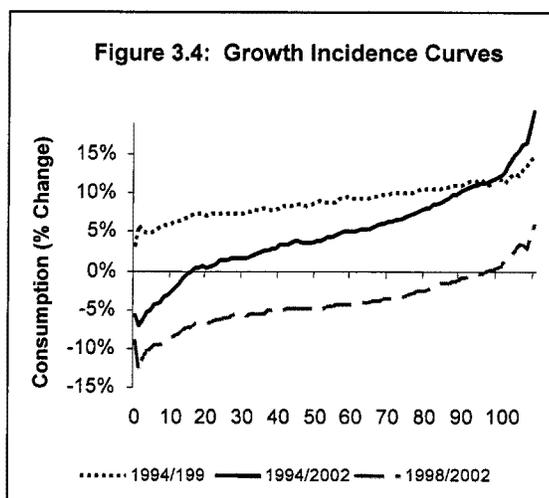
Table 3.1: International Comparisons of Consumption-Based and Income-Based Measures of Inequality for Accession Countries

Country	Consumption-based Measure Gini Coefficient	Income-based Measure Gini Coefficient
Poland*	0.29	0.32
Hungary	0.28	0.25
Latvia	0.34	0.32
Slovenia	0.28	0.25
Bulgaria	0.27	0.41
Romania**	0.29	n/a

Source: World Bank (2002) unless otherwise stated

* Authors' calculations from 2002 HBS.

** World Bank (2003).



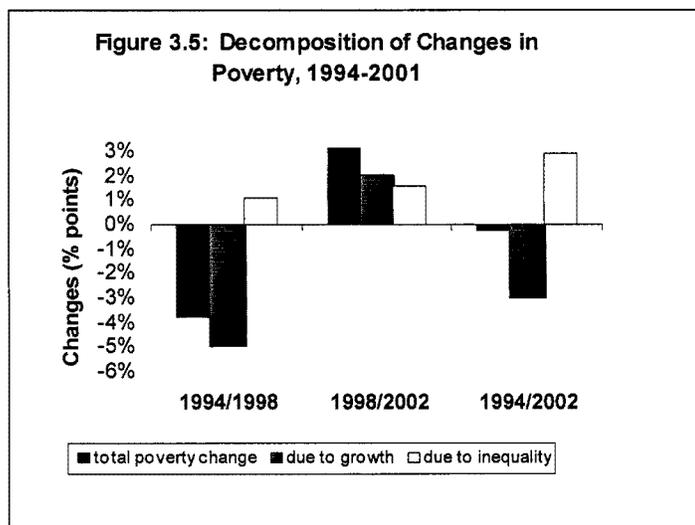
Source: Authors' Calculations based on HBS.

3.5 By contrast, Figure 3.4 shows that the period 1998-2002 saw a decline in mean consumption, which affected all quintiles except the highest and was particularly severe at the lower end of the distribution. The decline in average consumption and the increase in inequality combined to increase poverty by about 2.5 percentage points over the period 1994-2002.

3.6 Given the relatively high size of the elasticity and the optimistic predictions for growth in 2003 and 2004, the prospects for poverty reduction in Poland are good. Assuming the increase in inequality to remain at the average value experienced over the last five years, this should reduce poverty by 6.4%, lowering it by 1.5 percentage points to 15.1% in 2004

3.7 Figure 3.5 decomposes the changes in poverty experienced over the last decade into a growth component and an inequality component. It is evident that economic growth was the main driving force in poverty reduction in the first period (1994-1998). During these years the

growth effect (- 5 percentage points) far outweighed the effect of the increase in inequality (+1 percentage point), resulting in a cumulative decline in poverty of about 4 percentage points. During the subsequent period, 1999-2002, growth and inequality both contributed to an increase in poverty of about 3 percentage points. Over the last decade the average estimated elasticity of poverty with respect to growth in average consumption from the Household Budget Survey (HBS) has been 3.6 with a peak of 4.1 in 1999.¹³ This value compares well with the estimates for other transition countries and those typically found in other countries [Bruno, Ravallion, and Squire (1998); Ravallion and Chen (1997)].¹⁴



C. WHAT IS BEHIND THE INCREASE IN INEQUALITY?

3.8 Changes in inequalities of consumption can be the result of a number of factors of which four important ones are changes in (i) the distribution of original income; (ii) the progressivity of the tax and benefit system; (iii) the distribution of consumption and (iv) the relative prices of the basket of goods bought by household at different points in the income distribution.

3.9 Unfortunately the Polish HBS has very limited information on household savings. Thus the analysis below focuses on the other factors highlighted above.

Changes in the distribution of original income and its components.

3.10 Original income refers to the income the household has before paying taxes and receiving benefits other than old-age pensions. As shown in Table 3.2, over the period 1994-2002 inequality in original income increased by around 7 percent from 0.38 in 1994 to 0.41 in 2001. The increase was also surprisingly moderate considering the extent of transformation the country

¹³ These estimates are in line with the value of 3.5 given in World Bank (2002).

¹⁴ Just to give few examples, the growth elasticity of poverty for Rumania was estimated at 3 in 1996 and 1997 but has declined since to below 2 (World Bank, 2003). An average elasticity of 3.7 was also estimated for Croatia (World Bank (2002). However the limited information available suggests much lower responsiveness in other countries. Estimates of around 2 were derived for Russia (World Bank, 2002) and less than 1 for Armenia, Azerbaijan and the Kyrgyz Republic (World Bank 2003).

went through. It was particularly so considering that it occurred entirely after 1998 with inequality in original income fluctuating around a stable value in the high growth years 1994-98.

3.11 Table 3.2 also shows the main sources of inequality and the main factors behind the increase. Inequalities in labor income were and remain, a major source of inequality in original income. In addition their relative role in the overall inequality has increased over time until 2001 (from 70.5 percent to 72.3 percent) only to decline slightly in 2002. The combination of increased inequality and the growing share of this inequality that is due to labor income dispersion resulted in a increase in the Gini coefficient for this component of income of 8 percent, higher than for overall income and for any other component.

Table 2.7: Income Inequality and Decomposition by Income Sources, 1994-2002

Gini Coefficients:	1994	1995	1996	1997	1998	1999	2000	2001	2002
Original Income*	0.379	0.377	0.386	0.395	0.3657	0.377	0.395	0.395	0.407
of which:									
Labor income	70.5%	68.9%	70.8%	71.6%	72.1%	73.7%	74.1%	72.3%	69.9%
Old age pension	15.1%	16.5%	15.9%	16.0%	16.4%	16.4%	15.3%	17.8%	18.8%
Income from farm	10.1%	11.6%	9.3%	8.9%	7.6%	6.4%	6.2%	5.7%	6.6%
Other income	4.3%	3.0%	4.1%	3.5%	3.9%	3.5%	4.4%	4.3%	4.7%
Disposable Income**	0.308	0.304	0.312	0.323	0.293	0.298	0.311	0.308	0.317
Concentration Coefficients***:									
Labor Income	0.389	0.382	0.396	0.402	0.377	0.398	0.420	0.414	0.421
Old age pension	0.394	0.408	0.404	0.410	0.380	0.385	0.372	0.407	0.423
Income from farm	0.332	0.358	0.326	0.371	0.290	0.273	0.292	0.287	0.338
Other income	0.307	0.254	0.320	0.289	0.293	0.265	0.304	0.280	0.295

Method: decomposition of the Gini coefficient into components, ranking by original income, see Chapter 2 in Volume 2 for mathematical representation

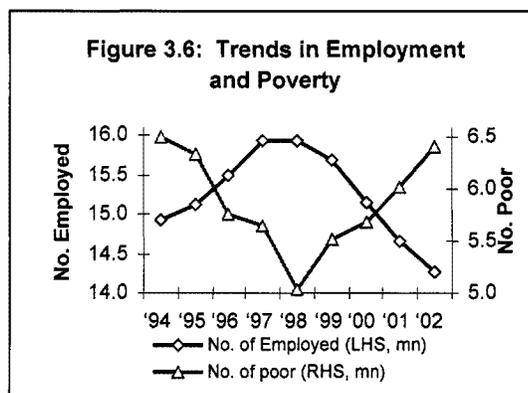
* Before taxes and benefits.

** After taxes and benefits

*** Household ranked by original income.

Source: Authors' calculations based on HBS.

3.12 Overall, the last decade has seen a marked increase in the number of households with no earnings (from 10 percent of household to 12 percent, an increase of 20 percent). The economic restructuring of the early 1990s led to massive job destruction. In the mid-1990s the sharp expansion of output (25 percent) also led to a rise in total numbers employed (Figure 3.6) amounting to employment creation of 6.3 percent. However, the newly created jobs often required skills different from those of laid-off workers and were often based in different locations. Since 1998, firms have managed to maintain their productivity only via further lay-offs (8.5 percent cumulatively) but without compensatory employment generation. This has led to large pockets of unemployment that tend to be geographically concentrated and affect predominantly individuals with low levels of education. Thus, skill differentials across households accounted for nearly 20 percent of inequality in 2001 (see Table 3.3) while regional inequalities accounted for nearly 12 percent.



Source: Authors' calculation based on HBS.

Table 3.3: Decomposition of Theil Inequality Index (Inter-Group Inequality), 1994-2001

		1994	1995	1996	1997	1998	1999	2000	2001
Theil index		0.100	0.095	0.097	0.107	0.110	0.114	0.120	0.120
Decomposition									
<i>Regional</i>	Within groups	0.092	0.087	0.089	0.097	0.097	0.100	0.104	0.106
	Between groups	0.008	0.008	0.008	0.010	0.013	0.014	0.016	0.014
	Share of between groups	7.9%	8.3%	8.1%	9.4%	11.5%	12.5%	13.0%	11.6%
<i>Education</i>	Within groups	0.087	0.083	0.084	0.092	0.093	0.095	0.097	0.097
	Between groups	0.013	0.012	0.130	0.015	0.017	0.020	0.023	0.023
	Share of between groups	13.0%	12.9%	13.4%	13.8%	15.9%	16.5%	19.5%	19.1%
<i>Age</i>	Within groups	0.098	0.093	0.095	0.105	0.107	0.111	0.118	0.118
	Between groups	0.002	0.002	0.002	0.002	0.003	0.003	0.002	0.002
	Share of between groups	1.7%	2.2%	2.2%	2.0%	2.5%	2.4%	1.5%	1.7%

Source: Authors' calculations based on HBS.

3.13 The increase in inequality in labor income was high enough to offset the equalizing effects of: (i) a shift of the tax system from regressivity to very mild progressivity; (ii) a benefit system that increasingly benefits the poor; (iii) a considerable reduction in the relative price of food which should have increased the relative welfare of the poor; and (iv) the decline of nominal and real interest rates, which – combined with increased access to credit - could have increased poor people's ability to smooth consumption.

4. THE PROFILE OF POVERTY OVER THE LAST DECADE

A. THE METHODOLOGY USED

4.1 The methodology used to derive the poverty profile in this report differs from the earlier literature in a number of ways. Firstly, all aggregates have been expressed in real terms (in June prices of a given year), and equalized with the use of local equivalence scales which are fixed in the social benefit system, and are close to the OECD scale.¹⁵ However the main differences are in: (i) the consumption aggregates; and (ii) the prices used.

Moving Closer to the Concept of Consumption Flow

4.2 Most poverty studies in Poland have used the “consumption aggregates” calculated by Government Statistical Office (GUS) and recorded in the HBS dataset. However, owing to the limitations of the HBS data – as described in Box 4.1 – these aggregates: (i) include the full value of durables acquired during the relevant period but exclude the value of previously acquired durables available to the household; and (ii) include rents paid but exclude the value of housing if the household is owner-occupied. They are therefore closer to a concept of *total expenditure* than to the consumption aggregates on which World Bank poverty analysis is generally based.¹⁶

4.3 This report adopts a proxy of welfare that is closer to the concept of *flow of household consumption* that occurred during the relevant period. In addition to the consumption of non-durables and services – including auto consumption – this definition should include the imputed value of the durables available to the household and the imputed value of housing. However, the limitation of the current version of the HBS makes the imputation of these values rather complex and in some cases *ad hoc*. Thus as far as possible for 2001 we report on two poverty diagnostics – one that includes the imputations for durables and housing and one that is net of the expenditure on these items incurred over the period. For technical reasons, the imputations have been done for 2001 and consumption net of durables and rent has been used for past periods.

4.4 The consumption aggregates derived from the second definition clearly generate average consumption figures that are consistently lower than those derived from GUS. In addition the spread of the distribution of consumption is likely to be smaller, because the consumption levels of the better off are likely to be affected most by the omission of durables. Using the first definition, on the other hand, does not have any *a priori* effects on average consumption and the

¹⁵ Per capita estimates have also been used to facilitate international comparisons.

¹⁶ Occasionally an income approach has been used in other studies, and in some cases a multidimensional analysis of poverty has been conducted. See for instance GUS (various years), GUS (2000), Panek (2001), Panek (1996).

direction of the change in the spread of the distribution is not clear-cut. The poverty lines have been adjusted to reflect the relevant definition of the consumption aggregate.¹⁷

Box 4.1: The Polish Household Budget Survey

- The survey is conducted regularly by the Central Statistical Office (GUS).
- Since 1993, the annual HBS sample has included over 30,000 households, or about 100,000 individuals.
- This is large enough to provide various profiles which reflect social, regional or demographic characteristics of individuals. It also allows for making multi-layer classifications of households
- Each household is surveyed during a single month.
- The survey provides data on household income (from various sources), expenditures (over 200 items), type of residence, housing conditions, durables, land area (if any), etc. Fairly detailed information is also given for each household member: age, sex education, relation to the household head, and individual source of income (for working persons: type of employment, sector and branch of the economy; for social beneficiaries: benefit type and its level; for the unemployed: also unemployment duration).
- It has a panel component with households interviewed for a total period of four years. This will provide a unique opportunity to distinguish permanent versus temporary poverty and to identify the characteristics of the “permanently poor”.

Shortcoming of the survey:

- Monthly rotation of households produces three problems: seasonality, inflation, and coverage of infrequent expenditures.
- Data on durables do not permit comparison of accurate consumption aggregates, as they provide only information on whether the household has a particular type of durable, and how many items — without information on their quality, age and original and current value.
- Information on usage value of housing is absent unless the house is rented. This could lead to a very distorted picture of consumption.
- The panel covers a period that is too short to allow adequate analysis of the characteristics and profile of chronic poverty, a phenomenon that is becoming increasingly important in post-transition Poland.

Using Regional Prices

4.5 Previous poverty analyses in Poland have used national average prices in poverty diagnostics and the CPI deflator when comparing poverty over time. Given high and growing disparities between regions, differences in prices are likely to partly compensate for differences in nominal income levels; poorer regions have lower prices and the difference has increased over time. The HBS shows moderate price variation across voivodships (+/-3.5 percent) and a more significant variation along urban/rural and large/small-town dimensions (with prices in rural areas being 4 percent lower than the national average and those in metropolitan areas 9 percent higher).

¹⁷ It is important to note that although the diagnostics of this report focus on the revised consumption aggregates, the GUS methodology is also used for comparability purposes. As expected, the flow of consumption aggregate reveals a considerably lower level of inequality than the total expenditure method (2001 Gini coefficients are equal to 0.283 and 0.344, respectively). It also shows smaller rural-urban and regional differences.

The overall variation in prices ranges is from –5 percent to +11 percent, with the level of prices negatively correlated with regional poverty rates. Using region-specific prices is essential to derive an accurate profile of poverty. Thus consumption aggregates have been deflated with regional price deflators reflecting individuals' place of residence, such as locality type and voivodship.

Using a “Poor Price Index”

4.6 In addition, from 1997/98 onwards food price and overall inflation started to diverge considerably. This increased the relative purchasing power of the poor, whose share of food in consumption is relatively high.¹⁸ Data from the HBS shows that between 1998 and 2002 the relative purchasing power of the poor improved by 5.5 percent.

4.7 Thus, using a CPI deflator when comparing poverty over time may give misleading poverty trends, since the CPI basket is closely aligned with the consumption basket of an average household, which has a lower share of food items than that of the poor. We therefore compare the patterns emerging from the use of the CPI deflator with those resulting from using a “Poor Price Index”, which uses the typical consumption basket of a poor household.

Poverty Lines and Poverty Indicators

4.8 Two country specific poverty lines have been used: the social assistance threshold (equivalent to PPP \$6.33 per day) for “moderate” poverty, and a subsistence minimum basket (PPP \$5.50 per day) for “deep” poverty. Additionally, an international poverty line of PPP \$4.30 a day has been used for international comparison, although in the Polish context this represents “extreme” poverty.

4.9 Contrary to the majority of other studies, the poverty lines have been set for 2001, and kept constant in real terms with the use of annual CPIs for the whole period under investigation. Also, the lines have been adjusted to adequately account for the alternative definition of welfare aggregates used.

4.10 The poverty indicators used are the headcount, depth and gap indices, and logit functions have been estimated to identify the impact of various factors on poverty.

B. THE EXTENT OF POVERTY IN POLAND AND ITS TRENDS OVER TIME

4.11 Using our methodology – based on consumption flows and regional prices – in 2001 over 14 percent of the total population, or more than 10 percent of households, lived in “moderate” poverty in Poland – i.e., below PPP \$6.33 a day. This means that poverty affected over 5.5 million people. The extent of deep poverty – PPP \$5.50 a day – was also quite considerable, reaching 8.6 percent or about 3.5 million people, and extreme poverty was also significant (headcount index H = 3.2 percent). At the same time, poverty depth was moderate. The poverty gap for moderate poverty has been estimated at around 0.5 percent of GDP (a poverty gap index of less than 20 percent), while the gap for deep poverty was 0.25 percent of GDP (gap index of 18 percent). These indicators are similar to those published by the Central Statistical Office (which are derived from the total expenditure concept), although ours are slightly higher, due to the different definition of living standards.

¹⁸ According to the HBS data, the first 15 percentiles of the population devote about two-thirds of their budgets to food, while for the whole population this proportion is less than 50 percent.

4.12 The main trends in headcount poverty over the period 1994-2001 are presented in Table 4.1 where “GUS” indicates that the calculations are based on the consumption aggregates as computed by GUS. “GUS regional” refers to the same consumption aggregates but allows for regional differences in prices, and the WB indicator excludes expenditure on durables and rents. The patterns that emerge are clear and robust to different definitions. Both moderate and deep poverty headcounts declined sharply between 1994 and 1998 and increased consistently after that date. The poverty decline in the middle of the decade was more pronounced than the poverty increase that came later. In 1994-98, the GUS moderate poverty headcount dropped by 7 percentage points, from 20 percent to 13 percent, while the rise in 1998 – 2001 was equal to 2.3 percentage points. According to our methodology, the decline was less sharp, from 18 percent in 1994 to 12.6 percent in 1998, and so was the increase thereafter.

Table 4.1: Poverty in 1994 - 2001: An Overview

LS concept	Headcounts [%]							
	1994	1995	1996	1997	1998	1999	2000	2001
Moderate poverty								
GUS	20.0	18.3	16.1	15.0	12.9	14.9	15.1	15.2
GUS (regional)	19.2	17.3	15.3	14.2	12.0	14.0	14.3	14.2
WB (regional)	18.0	16.9	14.6	13.6	12.6	13.5	14.5	14.8
Deep poverty								
GUS	12.4	10.8	9.5	9.1	7.7	8.9	9.2	9.6
GUS (regional)	11.7	10.2	8.8	8.3	7.0	8.1	8.6	9.0
WB (regional)	10.5	9.6	8.2	8.0	6.8	7.7	8.6	8.9

Note: For methodology - see Section 1 and Methodological Appendix..

Source: HBS 2001, own computation. See also Table A16.

4.13 International comparisons of poverty are always difficult for a number of reasons, including the definition of the poverty line and of the consumption aggregates. However, using the international poverty line of PPP \$4.30 a day, and using World Bank estimates, Table 4.2 shows that poverty in Poland is higher than in the Czech Republic, Slovakia and Slovenia, and close to most of Hungary but well below the levels prevailing in other accession countries.

Table 4.2: Absolute Poverty Rates of Selected Accession Countries, Selected Years, 1995-99

Country	Survey Year	Headcount Index \$4.30/day
Poland*	2002	3.8
Romania	1998	44.5
Latvia	1998	34.8
Bulgaria	1995	18.2
Lithuania	1999	22.5
Slovak Republic	1997	8.6
Estonia	1998	19.3
Hungary	1997	15.4
Czech Republic	1996	0.8
Slovenia	1997/98	0.7

Source: World Bank (2002) unless otherwise stated.

* Authors' calculations from HBS.

4.14 The Polish literature shows a general consensus on the main correlates of poverty and these conclusions appear to be robust to changes in the poverty line, the equivalence scale and the methodology used. The main findings are summarized in Box 4.2.

C. WHO ARE THE POOR IN PRE-ACCESSION POLAND?

4.15 The Polish literature shows a general consensus on the main correlates of poverty and these conclusions appear to be robust to changes in the poverty line, the equivalence scale and the methodology used. The main findings are summarized in Box 4.2.

Box 4.2: Findings of Existing Literature

- Poverty is predominantly rural and is linked to unemployment, low education and number of children.
- However, it includes some features worth noting:
 - the rural-urban differential is substantial;
 - children, and especially rural children, are at particularly high risk of poverty;
 - the link with unemployment is more pronounced for the urban poor, while rural poverty seems more tied to the low labor market productivity of the “working poor”.
 - regional disparities are particularly large;
 - poverty is not very deep, but it appears to affect a hard core of ‘chronically poor’;
 - social safety nets are complex and seem to be poorly targeted;
 - poverty is often associated with social exclusion and risky behavior, such as alcoholism.

4.16 Using the new methodology changes the profile of poverty somewhat. Similarities and differences in core diagnostics between the findings of this report and previous studies are highlighted in Box 4.3.

Box 4.3: Main Poverty Diagnostics

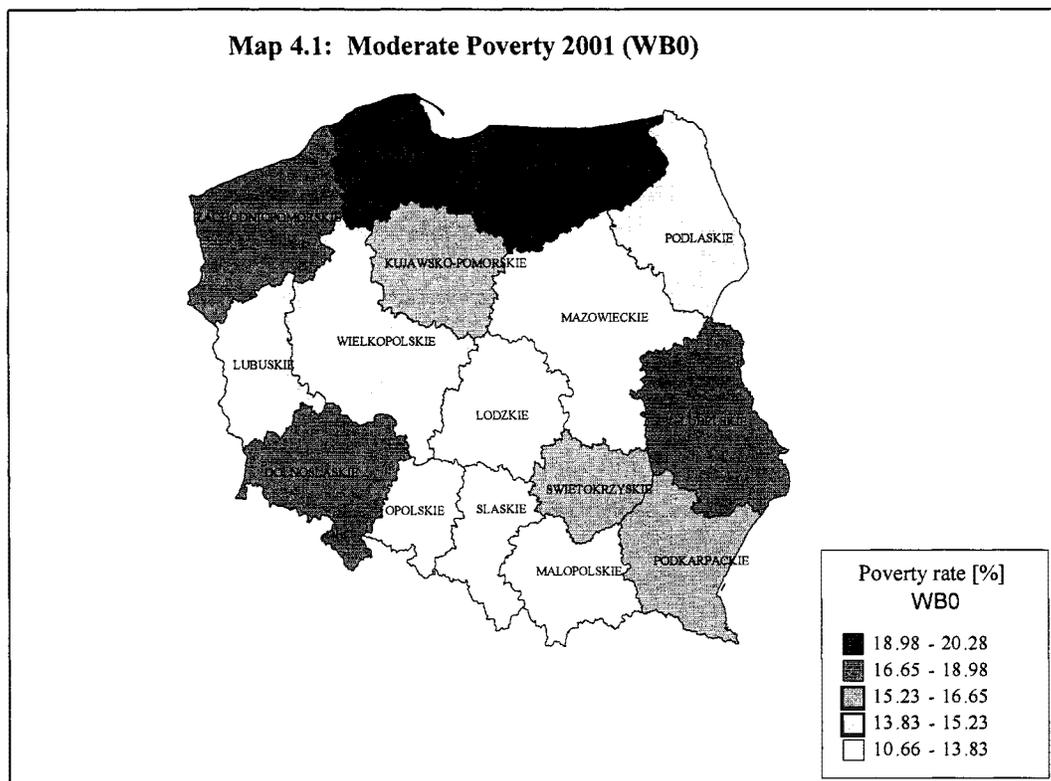
In accordance with previous findings we find that:

- Large geographical variations exist in the incidence of poverty; the north, northwest and southeast had higher poverty rates than the rest of the country.
- Rural poverty dominated, but this appears to be the result of extremely high poverty among former PGR (state farm) workers rather than private farmers.
- Unemployment is the most important single cause of poverty.
- Lack of education and a large number of children or dependents in the family are additional important factors.
- Poverty risk decreases with age despite some evidence of recent increases in poverty among the elderly.
- No significant difference exists in poverty risk between female-headed and male-headed households.

However, using the World Bank standard methodology:

- The differences between rural and urban areas, as well as between the regions, are less pronounced;
- The higher poverty risk of farmers is considerably reduced.

4.17 The findings suggest that poverty in 2001 varied significantly across regions as shown in map below. As shown in Map 4.1, the North, South-West and South-East – namely the Warmińsko-mazurskie, Pomorskie, Zachodnio-pomorskie, Dolnośląskie and Lubelskie voivodships – had higher poverty rates than the center of the country (the belt which begins in the North-East and ends at the South).



Source: HBS 2001, own computation.

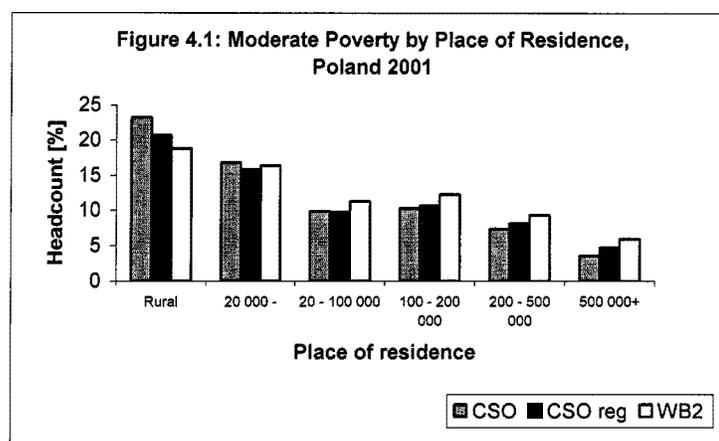
4.18 In 2001 rural poverty was significantly higher than urban poverty independently of the welfare measure used as evident from Table 4.3. However, the difference in poverty incidence declines considerably if regional prices are used with the relative incidence declining from 2.4 times to 2.1. The gap diminishes further when the consumption aggregates are calculated according to the World Bank methodology, with the relative incidence dropping to 1.7. Moreover, indirect statistical evidence shows that this result is driven by the very high incidence of poverty among former PGR (state farm) workers. Finally Fig 4.1 shows that among urban areas, there is also a strong pattern associated with town size, with the smaller towns having higher poverty rates.

Table 4.3: Poverty in Rural and Urban Areas

<i>Place of residence</i>	<i>Headcounts [%]</i>			<i>Population in poverty [%]</i>		
	<i>GUS</i>	<i>GUS (reg)</i>	<i>WB</i>	<i>GUS</i>	<i>GUS (reg)</i>	<i>WB</i>
Moderate Poverty						
Urban	9.9	10.0	11.6	39.	42.3	47.1
Rural	23.2	20.7	19.8	60.9	57.7	52.9
rural/urban	2.4	2.1	1.7			
Deep Poverty						
Urban	5.9	6.1	6.7	37.3	40.6	45.6
Rural	15.2	13.5	12.1	62.7	59.4	54.4
rural/urban	2.6	2.2	1.8			

Note: For methodology - see Methodological Annex in (reg) uses regional prices and WB refer to the World Bank consumption aggregates without imputations.

Source: HBS 2001, own computation. See also Tables A5 and A15.



Source: Authors' calculations based on HBS.

4.19 The strongest correlate of poverty is the employment status of the household head and the other adults in the household. The average poverty risk for households headed by an unemployed person is 48 percent while the risk for those headed by an employed individual is only 12 percent. Another important correlate of poverty is low educational attainment and the presence of a large number of children or dependents in the family (four or more). Poverty risk decreases with age although there is some evidence of an increase in poverty incidence among the elderly aged over 70. In general, farmers are poorer than employees in urban areas (headcounts equal to 15 percent and 13 percent, respectively), but the link between working in agriculture and poverty is much weaker than it appeared to be in previous studies. Amongst farmers, farm size is a significant correlate of poverty. The larger the land area, the smaller the risk of poverty; farmers with more than 15 hectares have lower poverty rates than the national average.

4.20 Poverty headcounts for female headed households are, on average, somewhat higher than those for male headed households, but the difference is not significant once other differences in characteristics are considered. For singles, however, the situation is quite different, with

headcounts being significantly higher for men than for women. This is due to much higher inequalities in living standards between male-headed households and their female-headed counterparts. In 2001 the Gini coefficient of aggregate consumption for single men was 0.279 versus 0.223 for single women.

4.21 Using the *consumption flow* definition of welfare slightly changes the profile of poverty. However, the main differences are derived from the use of regional prices derived from the HBS rather than national averages. Introducing regional prices considerably reduces regional differentials in poverty incidence. More importantly it also changes the ranking of some voivodships although some remain consistently very close to the top of the list – with the highest headcounts – and others remain amongst the richest. Using the new methodology also reduces the rural/urban differential and the poverty risk of farming households relative to others. This is shown in Table 4.4 which reports the estimates for headcount poverty and relative poverty risks for different categories of workers according to the different definitions used. The second column of the table reports the findings based on the consumption aggregates currently defined by GUS and national price figures. The third uses GUS aggregates but allows for differences in regional prices. The third is calculated using consumption aggregates net of current expenditure on durables and imputed rents. Finally the fourth includes the imputed value of durables and rents.

Table 4.4: Poverty by Employment Categories

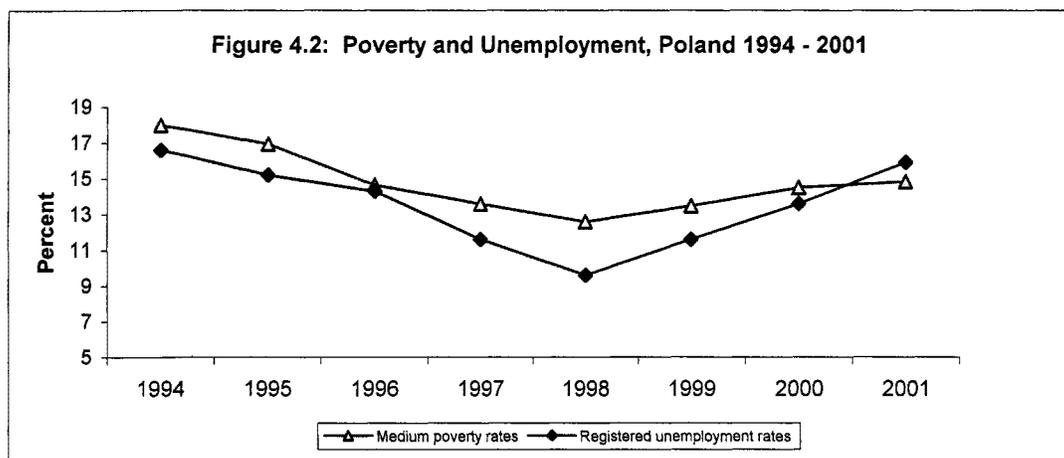
Socio-economic category of household	Deep poverty				Moderate poverty			
	GUS	GUS reg	WB0	WB2	GUS	GUS reg	WB0	WB2
Headcount [%]								
Worker/Employee	7.31	7.17	7.63	7.51	11.75	11.40	12.87	12.55
Farm Worker	12.11	10.81	9.36	9.06	20.43	17.79	16.74	15.95
Farmer	13.34	10.58	8.76	7.57	23.48	19.03	16.33	14.70
Self-employed	4.91	4.87	5.19	4.34	8.62	8.72	8.52	8.00
Retiree	5.46	4.98	5.13	4.79	8.68	8.10	9.10	8.26
Disable / Survivor	14.38	13.40	12.79	12.24	21.31	20.55	20.97	20.03
Living on soc transf and part-time	29.69	28.96	27.71	28.96	41.21	40.04	40.79	40.71
TOTAL	9.60	9.01	8.86	8.60	15.17	14.24	14.84	14.24
Relative to TOTAL								
Worker/Employee	0.76	0.80	0.86	0.87	0.77	0.80	0.87	0.88
Farm Worker	1.26	1.20	1.06	1.05	1.35	1.25	1.13	1.12
Farmer	1.39	1.17	0.99	0.88	1.55	1.34	1.10	1.03
Self-employed	0.51	0.54	0.59	0.50	0.57	0.61	0.57	0.56
Retiree	0.57	0.55	0.58	0.56	0.57	0.57	0.61	0.58
Disable / Survivor	1.50	1.49	1.44	1.42	1.40	1.44	1.41	1.41
Living on soc transf and part-time	3.09	3.21	3.13	3.37	2.72	2.81	2.75	2.86
TOTAL	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00

Source: HBS 2001, own computation.

4.22 It is clear that simply allowing for regional differences in purchasing power considerably reduces farmers' higher relative risk of falling into poverty. Their relative risk of deep poverty is reduced to below the average when the more rigorous definition of consumption aggregates is adopted. By contrast, the relative poverty risk of farm workers remains well above the average. This is an important finding since it suggests that it is not working in agriculture *per se* that leads to poverty but rather lack of access to private land.

D. HAS THE PROFILE OF POVERTY CHANGED OVER THE DECADE?

4.23 Comparing the correlates of poverty over the last decade suggests that the profile of poverty has remained relatively stable over time, with poverty changes determined mostly by fluctuations in the unemployment rate (Figure 4.2 below). However, in 2000-2001 the position of farmers improved slightly relative to other groups and the relative importance of education in moving people out of poverty has increased over time (see Chapter 4 of the Background Papers for more details).



Source:

4.24 Finally, the analysis of two panel sub-samples of the HBS (1994-1996 & 1997-2000) suggests that the 1990s have seen an increase in the incidence of chronic, long-term poverty and a slowing down of movement out of poverty. This trend suggests the establishment of a growing “hard-core” group of chronically poor households that are becoming increasingly excluded from the process of economic transformation and are unlikely to benefit from future economic growth.

4.25 The road to chronic poverty and social exclusion is marked by the same milestones as the road to “transient” poverty and closely follows the increase in long-term unemployment experienced in Poland. Geographical location and poor educational attainments are the main factors leading to poverty. They are also the main barriers preventing individuals and households from moving out of poverty because they adversely affect employment prospects.

E. MULTI-DIMENSIONAL ASPECTS OF POVERTY

4.26 There is a very close relationship between income poverty (as measured by household consumption) and other dimensions of poverty such as access to, and quality of social services, with rural areas and the poorest regions getting significantly fewer resources than the rest of the country (World Bank, 2002). The similarities in the geographical patterns of some poverty indicators are illustrated by a series of maps presented in Chapter 5 of Background Papers. Given the importance of education for patterns of employment it is essential to report on the geographical distribution of educational opportunities.

4.27 Various other dimensions of poverty have been analyzed in the Polish qualitative literature. Amongst these are the ethnic and gender dimensions as well as issues associated with vulnerability, social exclusion and risky behavior, as discussed below.

Differences in Educational Attainments

4.28 The average years of completed schooling in Poland are extremely high, exceeding the OECD average at all levels except pre-school. However, the differences across both consumption deciles and place of residence in enrolment in upper secondary and tertiary education are very large by international standards (World Bank, 2002). In addition there are systematic differences in the type of secondary education received by those enrolled, with children from poor households and rural areas concentrating disproportionately on basic and secondary vocational training while urban and better off children tend to receive “academic” education. In addition to differences in the subject matter emphasized, schools also differ substantially in the resources they receive and the quality of education in basic skills, with quality in rural areas being extremely poor (World Bank, 2000).

The Ethnic Dimension

4.29 According to the Polish literature, belonging to an ethnic minority is not a risk factor for poverty. This may result from the fact that, compared to other European states, Poland is a very homogeneous country. It is estimated that no more than 3 percent of the total number of the country’s residents represent national minorities (which include Ukrainians, Belorussians, Lithuanians, Slovaks, Germans, and Roma). The largest national minority groups are the Ukrainians and Germans. The numbers of those groups can only be estimated (about 3 million for each group).¹⁹ Although ethnic minorities in Poland are rather small, they are relatively well organized.²⁰ In addition the 1990s were characterized by the rapid development of special education opportunities for some national and ethnic groups at the primary and secondary school levels (UNDP/CASE 1998).

4.30 Only the Roma (25,000 according to the Office for Immigration and Foreigners) do not have their own schools with their native language, and separate classes are provided only rarely. This is the result of the assimilation policy introduced in the communist era, which has left the Polish Roma in a quite different position from their counterparts in Hungary or Slovakia. It is also interesting to note that a high degree of income inequality appears to exist amongst the Polish Roma, because of their tendency to live in relatively closed communities (Laskowska-Otwinowska, 2002).

The Gender Dimension

4.31 The association between gender and poverty also appears to be rather weak. Moreover, over the past decade women’s participation in the new economy has grown rapidly relative to men’s. Between 1985 and 1998, the number of women with their own registered company (exclusive of farming) grew five-fold, while the equivalent number for men barely doubled. In rural areas, a wide variety of business initiatives were launched by young women, especially in crafts, agro-tourism, and processing and sale of farm produce. The share of Poland’s female self-employed is one of the highest in Europe as described in some detail in Chapter 7 of Background Papers.

¹⁹ The shortly to be released population census of 2002 will provide better information on the number of national minorities.

²⁰ With the exception of Ukrainians, due probably to their displacement to the northern part of Poland in connection with the “Vistula Campaign” following World War II.

4.32 However, traditional gender stereotypes hamper women's participation in economic activity and impede gender equality in the area of labor legislation and social security. Women still face a greater threat of unemployment – particularly long-term unemployment – than men. Moreover, average female wages remain significantly lower than male wages, although in recent years this gap has been gradually narrowing, especially in the private sector and in small companies. Much of the differential is explained by female employment being largely in the low-paid public sector. Finally, expected retirement benefits for women and men are not equal, owing to different statutory retirement ages for women (60) and men (65), and thus differing lengths of employment history. In addition, there is increasing evidence of violence against women and children in the family, often associated with the growing pool of the “hard-core” poor.

The Growing Threat of Alcoholism

4.33 Violence in the family is often linked to growing problem of alcohol abuse which affects around 3 to 4 million people, making this the most troublesome social problem after unemployment, especially in rural areas (Sierosławski 1998). Children are particularly vulnerable to the effects of adult drinking, which often leads to family breakdown and the institutionalization of children. The number of children living away from their families increased to over 10 percent during the transition period (Kolankiewicz 1999).

F. POVERTY, VULNERABILITY AND SOCIAL EXCLUSION

4.34 There is a large overlap between different dimensions of poverty which leads to a vicious circle made up of geographical location, poor educational attainments, lack of employment and poverty. This circle results in individuals from poor regions and rural areas acquiring lower skills, having lower employment opportunities and being more vulnerable to poverty.

4.35 The crucial question is whether the higher vulnerability of this group also results in social exclusion. The evidence on this issue is limited but it seems that the increase in poverty over the last few years has strengthened the pre-existing networks available to the poor as informal safety-nets. Nevertheless, these networks are clearly excluding some of the most vulnerable people. It is also worth noting that these networks are not considered as an alternative to social transfers but as a welcomed addition to an effective system of social benefits.

Informal Networks and Social Exclusion

4.36 Informal support networks as an important component of social capital have become more significant at times of rising poverty. In these networks, a special role is played by the family. In Polish society, for historical and religious reasons, the family has always been an important institution of support. However, while until the 1980s it was adult children who financially supported their parents, today the burden has shifted onto the shoulders of the older generation, and it is pensioners who help their children and grandchildren in various ways.

4.37 For the most part, the poor have extensive support groups within networks of informal social relations but "relatively small family capital, measured by the number of influential or affluent persons". Their social contacts are above all determined by family relations (83 percent), less often by relations with friends (62 percent) and neighbors (61 percent), and least often by work contacts (23 percent), reflecting their low employment rates. Total social isolation, expressed as a complete absence of informal social contacts, is very rare amongst the poor (6 percent) and predominately affects single men.

4.38 However, the picture is quite different for the poor inhabitants of villages formerly established to house collective farm workers. These appear to be largely excluded from both local and wider social networks. In these areas neighbors can provide little help as they all tend to be equally poor. In addition, most former collective farm workers are not local to the regions in which they live and have no immediate family close by.

4.39 For them only three formal institutions play an important role:

- local government centers for social assistance,
- schools, which offers supplementary meals for poor children, and
- unemployment offices that provides access to free health services.

Civil Society Organizations as Informal Safety Nets

4.40 Over recent years the number of civil society organizations has grown fast. They are now encouraged to cooperate closely with public administration institutions and businesses, as well as with non-formal social institutions (such as the neighbors' assistance network that remains strong in Poland). The sector experienced its most dynamic growth in the mid-1990s, when the membership in NGOs reached 13 percent of all Poles, only to fall to 10 percent in 2002. However it remains dominated by small organizations (with over one-third employing only 1-5 people) and in many organizations volunteers working for the poor are often simultaneously members of the organization and beneficiaries.

4.41 Almost one-third of civil society organizations' income comes from public funds, while the rest comes from contributions and private donations that have been growing in recent years. Nevertheless a number of the small NGOs that operate in the field of social welfare are facing substantial financial difficulties, despite using available financial, material and organizational resources in a very effective way. Several examples exist of organizations that have been very successful in providing non-governmental safety nets for the very poor. Reflecting Polish tradition, social aid organizations tend to be linked to the Catholic Church.

5. SKILLS, EMPLOYMENT AND SOCIAL INCLUSION: AN EVER STRONGER LINK

5.1 The poverty diagnostics presented above clearly show the important role played by employment status in determining the probability of falling into poverty. In addition, the analysis of inequality in Chapter 2 in Background Papers shows the importance of inequalities in labor income in explaining the growth of inequality over the last decade. Thus, understanding the trends in labor income inequality and their determinants is an important factor in: (i) understanding recent trends in poverty in Poland; and (ii) formulating an effective strategy to increase the living standards of the most vulnerable.

A. WHAT IS BEHIND THE INCREASE IN INEQUALITY IN HOUSEHOLD LABOR INCOME?

5.2 The increase in inequality in labor income discussed earlier does not so much stem from a widening earnings distribution as from a reduction in the employment rate of the members of worse-off households.

Wage Inequality has not Increased Substantially Over Time ...

5.3 Wage inequality remained roughly steady from 1992 to 1998 and has increased only slightly since. This small increase in wage inequality at a time of increasing labor market deregulation is surprising, especially in light of the growth of private employment from little over a quarter of total employment in 1994 to almost 60 percent by 2002. One important reason why the increase in inequality has been contained is the fact that low-skilled employees have progressively dropped out of the labor force. In 1994, nearly half of employees were unskilled; this proportion had declined to under 44 percent by 2002 due to:

- Considerable labor market outflows of low-skilled workers at both ends of the age distribution including older, less-qualified workers leaving the labor force and young people delaying entry to seek higher levels of education than previously; and
- A sharp drop in job creation for unskilled workers.

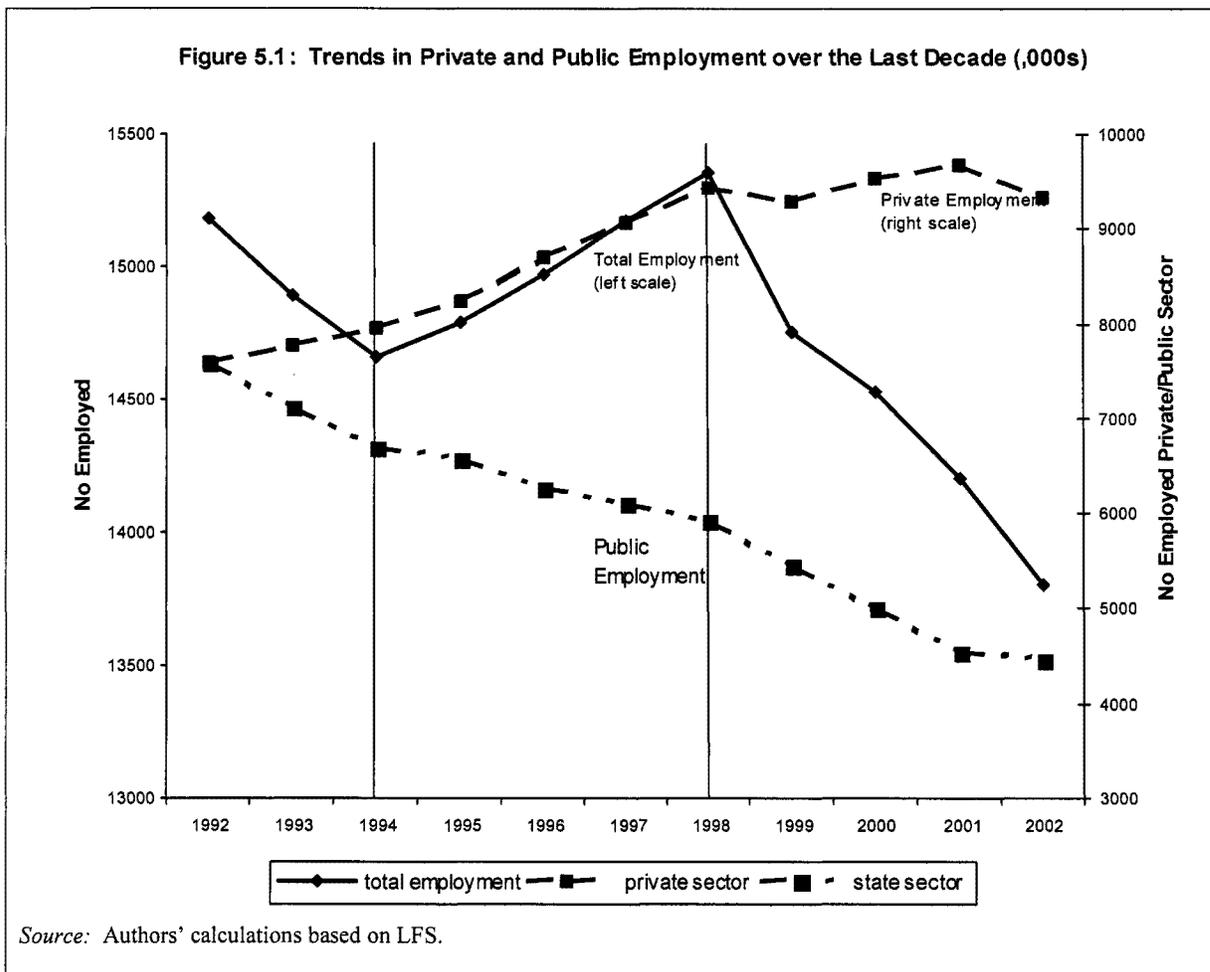
5.4 Other potential explanations are: (i) the relatively high level of the minimum wage which has prevented the earnings distribution from spreading at the bottom end; and (ii) the fact that a substantial increase in the supply of highly educated labor – in response to the initial increase in returns to education – has contained the increase of wages at the top end of the distribution.

5.5 The change in the skills composition of the employed population was largely accomplished by 1998/9. Thus, the more recent slight rise in wage inequality is linked to the continuing effects of labor market deregulation, no longer offset by falling participation.

... but Employment has Declined Considerably

5.6 If growing earnings inequality is not the source of the growing inequality, then a polarization of employment away from the worse-off households and in favor of the better off must be the explanation. The dynamics of total employment in Poland over the last ten years

support this interpretation. These dynamics are best described by two cycles—one through 1994, and a second with a peak in 1998 (Figure 5.1). The first cycle is in line with the employment dynamics of transition economies, and is not surprising. However, the total employment changes over the second cycle are impressive, as it is clearly visible in Figure 5.1 (left scale). Whereas Poland gained almost 1 million jobs between 1994 and 1998, it lost almost 1.5 million jobs between 1998 and 2002, a period during which unemployment increased by almost 8 percentage points. It is also important to note that – as expected - employment declined sharply in the public sector while it increased in the private sector. Interestingly the rate of decline in the public sector was higher after 1998. At the same time the rate of increase in private employment declined sharply after that date.



5.7 Table 5.1 shows that the drop – which cuts across different age groups and both genders – has further increased the pre-existing gap between Polish employment performance and that of its EU counterparts and has brought Poland further away from the Lisbon employment targets. In 1997 the total Polish employment rate was less than 2 percentage points below the EU average and well above some of its immediate competitors, such as Hungary, Ireland and Spain. By 2001 the gap between Poland and the EU average had increased to over 10 percentage points and Polish employment had fallen nearly 17 percentage points below the Lisbon target of 70

percent. Similar trends are evident in female employment rates, which are currently over 12 percentage points away from the Lisbon target of 60 percent.

Table 5.1: International Comparisons of Labor Market Indicators

Country	Total Employment Rate		Female Employment Rate		Labor Cost Index*		Life-long Learning
	1997	2001	1997	2001	2002	2003**	2001
EU (15 countries)	60.7	64.1	50.8	55.0	110.4	109.1	8.4***
Euro-zone	58.6	62.1	48.0	52.3	111.3	108.9	5.5***
Greece	55.1	55.4	39.3	40.9			1.4
Spain	49.4	57.7	34.4	43.0	117.0	119.7	4.9
Ireland	57.5	65.7	45.9	54.9	120.6		
Portugal	65.7	68.7	56.5	61.0	106.5	110.8	3.3
Czech Republic		65.0		56.9	132.1	129.6	
Estonia		61.0		57.4	128.7	143.0	5.2
Hungary	52.4	56.5	45.4	49.8	143.4	135.5	3.0
Lithuania		57.5		56.2	104.3	112.0	3.6
Latvia		58.6		55.7	121.0	128.4	
Slovenia	62.6	63.8	58.0	58.8			7.6
Slovakia		56.8		51.8	135.6	133.9	
Poland	58.9	53.4	51.3	47.7	117.7	121.7	4.8

Note: * Labor costs include gross wages and salaries, employment contributions and taxes net of subsidies connected to employment.

** 2003 data refer to 3rd quarter.

*** estimated value.

Source: Eurostat 2003.

B. WHAT IS BEHIND POLISH RECENT JOBLESS GROWTH?

5.8 The factors behind the decline in employment are complex. On the demand side they are linked to the intensive industrial restructuring of the early 1990s and the associated reallocation of labor leading to skill and geographical mismatches, the elimination of labor hoarding and the sharp increase in productivity of the mid-1990s. Labor market institutions are likely to play an important role but the story is multifaceted.

5.9 On the one hand, following the changes in the Labor Code implemented in 1996 and again in 2002, Poland's Employment Protection Legislation (EPL) is not rigid by international standards, even though the legislation on collective dismissals has been tight in the past, and may have helped to delay restructuring in large firms, which hoarded labor up to the 1998 recession (Riboud et al, 2002). In addition Poland features a fairly decentralized wage bargaining system and an institutional set-up that is appropriate for accommodating firm-specific shocks.

5.10 Nevertheless there is some evidence of real wage resistance in the aftermath of the 1998 recession.²¹ This resistance is not the result of excessive union pressure and ill-functioning collective agreements. On the contrary, the Polish labor market has been characterized by a dramatic decline in union presence, sustained delays in wage payments, and a decline in the number of collective agreements. The downward rigidity of wages that has been experienced over the last years is linked predominantly to the existence of binding minimum wage. Although

²¹ This was evident in the fact that positive real wage growth was observed in sectors that experienced marked reductions in employment growth.

its real value relative to the average wage have been falling throughout the transition, it continues to remain a strong impediment to wage flexibility at the lower end of the distribution because it still represents a high proportion of the median wage, especially in regions with large proportions of unskilled workers.

5.11 Downwards wage rigidity combined with high non-wage labor costs to raise the labor cost index for Poland in 2002 to 117.7, well above the EU average of 110.4, though lower than that of other CEE countries (except Lithuania) and other relevant EU countries (Table 5.1).²² In addition, between 2000 and 2003 – at a time of declined employment – labor costs in Poland have increased by 21.7 percent, 11.5 percent faster than the EU(15) average but slower than in the other Central European Accession countries except Lithuania.²³ Underlying the high non-wage labor costs are Poland's very high payroll taxes (48%). Employers' contributions calculated as a percentage of gross wages in Poland are one of the highest among CEE countries and the second highest in the OECD, after the Netherlands).²⁴ This high tax burden is likely to discourage both labor supply and job creation.

5.12 The high labor cost index is only one of the factors leading to the relatively high – and increasing - costs of doing business in Poland. An important role is also played by the high cost of entry that are associated with administrative barriers, corruption, etc..

5.13 Partial deregulation in the goods market is an additional possible explanation for the lack of job creation. The positive effects of goods market deregulation on employment work mainly in the medium term, when the reduction in prices – derived from firms' lower overall mark-ups – more than offsets the initial reduction in rents in incumbent firms. In addition, the situation becomes more complicated if deregulation affects only part of the economy, for example because the rest of the system remains heavily regulated. In this case, employment in existing firms may fall, with an adverse effect on unemployment. Over the last four years, privatization in Poland has progressively lost momentum and much remains to be done. Thus partial deregulation may indeed partially explain sluggish employment performance.

5.14 On the supply side the main constraints to employment growth are the high reservation wage, the low skilled level of the population especially in some regions and the limited geographical mobility. These are analyzed in more details below.

C. THE ROLE OF REGIONAL VARIATIONS AND IMBALANCES IN THE SUPPLY AND DEMAND FOR SKILLS

5.15 The share of workers with only primary education in total employment has declined by 14 percentage points over the last decade (from 27 percent to 14 percent). These changes are by no means uniform across Poland's regions. Poland is not alone in facing difficult regional imbalances in employment after the rationalization/privatization of old staple industries, and lessons can be drawn from other countries.

5.16 Voivodships vary substantially in terms of unemployment and skills/education mix and the two variables are strongly correlated – i.e., voivodships with lower-educated populations have higher unemployment rates. Differences in educational attainment account for at least half of the

²² Carey and Tchilinguirian (2000) estimated the average effective tax rate for labour in the period 1991-1995 as 42.06%.

²³ The 2003 figure refers to the third quarter, which is the most recent period for which information is available.

²⁴ See Riboud et al (2002) and OECD (2001), chart 2 p. 105.

regional variation in Polish unemployment rates. Thus an important part of the regional distribution of unemployment appears to be caused by “the race between technological development and education” (Tinbergen, 1975).

Table 5.2: Changes in the Distributions of Employment, Population* and Unemployment by level of Completed Education, 1992-2002

	<i>Tertiary</i>	<i>Secondary</i>	<i>Lower Vocational</i>	<i>Primary or lower</i>
Share in employment in 1992	13.6	27.7	31.4	27.3
Share in employment in 1999	15.6	34.2	35.2	15.0
Share in employment in 2002	18.3	34.0	34.0	13.6
<i>Change in employment share 92-02</i>	<i>4.7</i>	<i>6.3</i>	<i>2.6</i>	<i>-13.7</i>
Share in population in 1992	10.6	26.6	29.5	33.3
Share in population in 1999	10.5	29.7	31.0	28.8
Share in population in 2002	11.8	29.8	31.0	27.1
<i>Change in population share 92-02</i>	<i>1.2</i>	<i>3.2</i>	<i>1.5</i>	<i>-6.2</i>
Share in unemployment in 1992	5.2	28.9	42.9	23.0
Share in unemployment in 1999	5.5	30.9	42.0	21.5
Share in unemployment in 2002	6.6	30.2	42.9	20.2
<i>Change in unemployment share 92-02</i>	<i>1.4</i>	<i>1.3</i>	<i>0.0</i>	<i>-2.8</i>

*/ Population aged 15-60.

Source: Authors' calculations based on PLFS.

5.17 Unemployment differences by skills level are more or less universal and are usually attributed to skills differentials in non-wage labor costs, particularly adjustment costs. In Poland these skill-based unemployment differences are substantial (See Table 5.2) with workers with lower vocational qualifications representing 43 percent of the unemployed and less than 30 percent of the population. These differences also explain part, but not all, of the regional relationship between unemployment and skills. In addition lower skilled workers tend to experience longer periods of unemployment (See table 5.3a and 5.3b). Thus part of the skills-unemployment regional correlation is to do with regional differences in factors that affect an individual's chances of finding work once he or she becomes unemployed. On the supply side, such factors include: (i) those that affect reservation wages, such as welfare benefits and minimum wage; and (ii) those that inhibit geographical mobility, such as housing market constraints. There also appears to be some support for the theory of education-based mismatch, according to which regional skills-unemployment relationship can be attributed to an excess supply of unskilled labor – i.e., *mismatch* unemployment.

Table 5.3a: Long Term Unemployment by Completed Education Level, Spring 2002

<i>Completed education level</i>	<i>Percentage of employees not working one year earlier</i>
University	5.8
General Secondary	5.2
Lower Vocational	7.5
Primary	12.0

Notes: The sample was employees aged between 25 and 45.

Source: Authors' calculations based on PLFS, spring 2002.

Table 5.3b: Average Uncompleted Unemployment Duration by Educational Attainment, 1998 and 2002

<i>Completed education level</i>	<i>Average uncompleted unemployment duration (months)</i>	
	<i>November 1998</i>	<i>Spring 2002</i>
Tertiary	9.2	12.0
Secondary	12.8	14.8
Lower vocational	12.2	15.5
Primary or less	13.5	17.3

Source: Authors' calculations based on PLFS, November 1998 and spring 2002.

5.18 Finally the question arises as to why excess supplies of labor (and thus lower wages) do not generate inflows of capital as firms exploit wage advantages. The economic geography literature points to a number of potential reasons (see Background Papers, Chapter 5). There are a number of possible reasons for this, ranging from poor infrastructure to low human capital. However, a particularly important factor is that these potential wage advantages are considerably reduced by the existence of nationwide binding minimum wages that significantly limit the downward flexibility of wages in high unemployment regions.

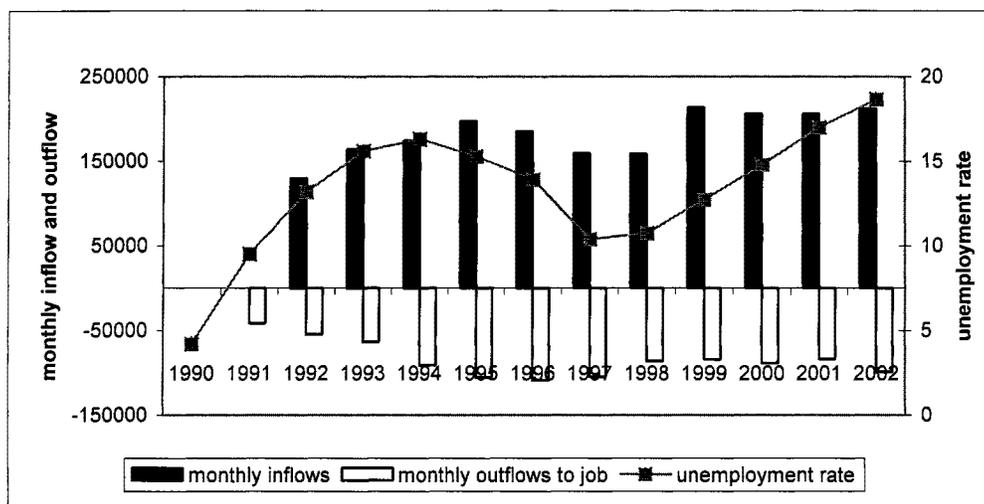
D. THE GROWTH OF LONG TERM UNEMPLOYMENT MAY ALSO BE A FACTOR

5.19 As mentioned earlier new entries into unemployment in the second half of the 1990s were substantial with a marked rise in 1994-5 and 1999.. Not only successive waves of labor shedding, but also demographic factors – namely the entry in the labor market of increasingly large cohorts of school-leavers – are likely to have played an important role. Figure 5.2 shows that a key factor behind the decline of Polish unemployment in the 1994-7 period was the rising outflows to jobs. Reductions in unemployment have therefore been driven mainly by increases in the number of people finding jobs. Thus the unemployment rate went down dramatically in the 1995-7 period as outflows to jobs almost doubled compared to their levels in 1993.

5.20 However, outflows into jobs declined after 1998 while new entrants into unemployment continued to increase, leading to a new peak in registered unemployment in 2002.²⁵ Absorption of these unemployed into the labor market will require a strong increase in flows from unemployment to employment. This means stronger labor demand but also greater responsiveness of the job placement rates to vacancy creation which in turn requires increased mobility and a reduction in labor market mismatches.

²⁵ This is described in more detail in Chapter 9 in Background Papers and shown in Figure 5.2, which illustrates a number of trends

Figure 5.2: The Evolution of Polish Unemployment Since the Inception of Transition, 1990-2002



Source: Labor Force Surveys for unemployment rate; Unemployment Register for data on unemployment inflows and outflows.

Increasing Labor Demand May not be Enough

5.21 Thus, Polish unemployment has continued to increase in recent years, as the likelihood of finding jobs has declined and the length of unemployment spells has increased. The risk is that, under such conditions, a vicious circle is set in motion, whereby long-term unemployment induces declines in effective labor supply, and this reduces the scope for wage adjustment, inhibiting the re-absorption into work of the unemployed—which in turn means more long-term unemployment and poverty. In other words, long-term unemployment can become self-perpetuating. Indeed the results of our analysis clearly show that outflows to jobs are highly responsive to an increase in the number of the newly unemployed, while those staying out of work longer have hardly any effect on job finding rates.²⁶

5.22 There are theoretical arguments for this.²⁷ However, in the Polish case the negative duration effect may be simply the by-product of heterogeneity in the two pools. This is confirmed by the fact that longer durations of joblessness affects predominately individuals with low educational attainments and those living in geographical areas where job creation is at a minimum, as shown in Table 5.4 below.

²⁶ These results are generated from estimates of a matching function in which we allow the two pools, i.e., the long-term and short-term unemployed, to exert a different effect on the overall probability of finding jobs. [See Background Papers, Chapter 9 for more details].

²⁷ For instance, a long duration of unemployment may be associated with the loss of skills (Pissarides, 1992) and lower search intensity. Alternatively, employers may be tempted to use the length of unemployment as a screening device (Blanchard, 1991), in which case a larger proportion of long-term unemployment in the overall pool of the unemployed may *by itself* reduce outflow rates.

Table 5.4: The Changing Profile of Polish Long-term Unemployment, 1992-2002

2002	U rate	Share in U	Share in LTU	LTU rate	Relative risk of being in LTU*
POLAND	20.41			11.05	0.541319
Women	20.60	47.64	52.74	10.78	0.523301
Youth 15-24	43.77	27.79	22.82	17.01	0.388622
Primary/low education	26.76	20.39	22.90	12.92	0.482810
Rural area	17.67	44.78	48.08	8.21	0.464629
Families with children	34.42	68.63	43.63	15.01	0.436084
1992					
POLAND	15.97			4.82	0.301816
Women	14.78	50.26	52.19	4.45	0.301083
Youth 15-19	31.15	8.29	7.25	6.20	0.199037
Unskilled	15.84	7.26	8.00	6.23	0.393308
Primary/low education	12.08	23.28	23.29	5.26	0.435430

* For any given group this is defined as the ratio of long-term unemployment over total unemployment.

Source: Average yearly data from Polish Labor Force Survey.

5.23 The data in Table 5.4 show that the increase in Polish unemployment can be substantially accounted for by the rise of the long-term unemployment rate, which was about 5 per cent in 1992 and rose to 11 per cent in 2002. The risk of long-term unemployment climbed from 30 per cent to more than 50 per cent over this ten-year period. The table also shows that Polish long-term unemployment has become increasingly concentrated in specific groups. This can be better grasped by looking at the last column on the right-hand-side of the Table which displays relative risk values.²⁸ Among the most vulnerable groups are women, persons with low levels of education and people living in rural areas. Although the share of these “vulnerable” groups in Polish unemployment did not increase from 1992 to 2002, their relative position in the labor market would seem to have deteriorated markedly over time.

Wage Expectations, Social Transfers, Unemployment Duration and Labor Mobility

5.24 Some indication of the role played by duration of joblessness in the persistence of Polish unemployment may come from analyzing data on the so-called “reservation wage” of unemployed individuals (the lowest wages at which they would take up job offers) which is available from the Labor Force Survey (LFS) as detailed in Box 5.1 below.

5.25 Using regression analysis we find that²⁹:

- Wage expectations are consistent with actual market wage premia – i.e., individuals with only primary or no education have a reservation wage that is 10% lower than that of individuals with secondary education.

²⁸ For any given group this is defined as the ratio of long-term unemployment rate over total unemployment.

²⁹ See Chapter 9 in Vol. 2 for more details.

- The fact of living in a rural area involves a 5 percent reduction in wage expectations, except when the individual is a recipient of unemployment benefits or income maintenance social benefits.
- The unemployment duration variable does *not* significantly affect wage expectations of jobseekers.
- Receiving unemployment benefit (or social benefits) may counter the effects of local labor market conditions on the reservation wages of individuals.

Box 5.1: Information on Wage Expectations

- The Labor Force Survey (LFS) carried out in Poland since 1992 contains a question on the lowest pay the interviewee is willing to accept when offered a job.
- The average reservation wage is about half of the actual average wage and nearly one fourth larger than the minimum wage.
- The question on the reservation wage is also formulated in such a way as to find out whether or not the jobseeker has in mind employment away from the area of residence (and thus is likely to involve some compensation or premium for the costs of mobility) or employment involving reduced working time, e.g., part-time work.
- By checking all these factors, it is possible to get some comparable information about the reservation wage of individuals.
- Indications as to the reliability of such data come from matching observations about the same individual over time and comparing reservation wages stated when still searching for a job with the actual accepted wages. Significantly, for those finding a job shortly (within two months) after the interview in which they stated their wage expectations, the ratio of the accepted wage to the reservation wage is close to unity.

5.26 Unemployment benefits are paid at a flat rate, established by taking the national average wage as a reference point. Since the cost-of-living in rural areas may be up to 30 per cent lower than in urban areas, it is indeed plausible that receipt of such transfers reduces search intensity and increases the length of the search in the rural regions where Polish unemployment is concentrated. In addition, in high-unemployment areas entitlement to unemployment benefits is 18 months as compared to 6 months in low unemployment areas. The combined effect of these policies is a strong incentive to relocate to where employment opportunities are located.

6. A TWO-EDGED SWORD: THE ROLE OF SOCIAL TRANSFERS IN MAINTAINING SOCIAL INCLUSION

6.1 The earlier discussion of the economic background indicated that during the “big bang” years social transfers came to be used as a way of maintaining social cohesion rather than as a way of supporting the income levels of those most in need. Today the system and its underlying objective remain largely unchanged. In addition to old-age pensions – which are not analyzed in this report – the system comprises a number of benefits which can be grouped under three main headings. The details are provided in Box 6.1.

Box 6.1: The Structure of the Social Transfer System

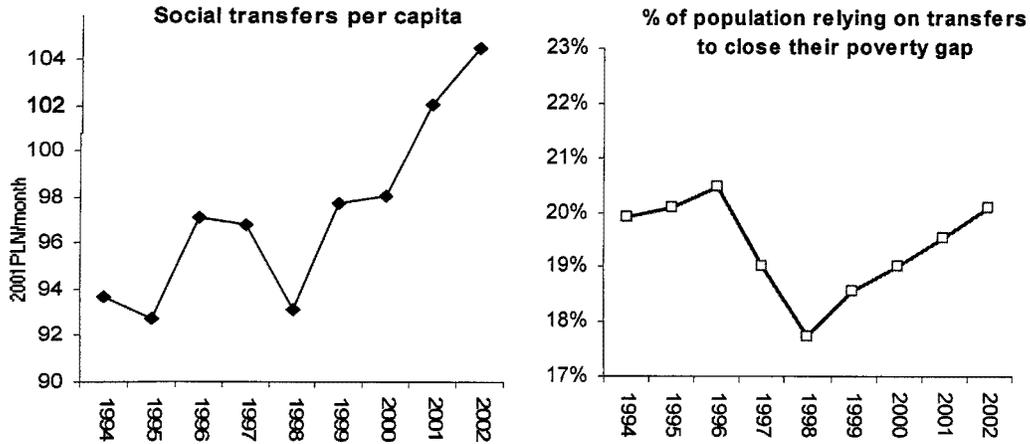
Poland’s current social transfer system has a complex and cumbersome structure that can be summarized as follows:

- **Old-age pensions:** these are not analyzed in this report.
- **Social protection for the unemployed:** this comprises two main types of benefits:
 - *Unemployment benefits:* qualified workers receive amounts that depend on their length of service with their most recent employers – ranging from 80 percent of the base benefit for service of less than 5 years to 120 percent for service of over 20 years. The length of the entitlement depends on the place of residence – ranging from 6 months in low unemployment areas to 18 months in areas of high unemployment. By removing the direct link between contribution and entitlement, the regional variation in length of entitlement gives a social assistance flavor to what is clearly a social insurance benefit;
 - *Pre-retirement allowances* (discontinued in 2001) and *pre-retirement benefits:* granted to individuals close to retirement, these payments have replaced the former early retirement pensions. The allowances were linked to the level of unemployment benefits, while the pre-retirement benefits are linked to the accrued old-age pension.
- **Other social protection benefits:** the main benefits here are *disability pensions*. These are intended for individuals who have not yet reached the retirement age but are unable to work for health reasons. In the past disability pensions were frequently perceived as an alternative source of income for workers who had lost their jobs and were unable to find new ones. This led to (i) one-third of all pensioners being disability pensioners, and (ii) Poland ranking among the countries with the highest percentage of citizens claiming disability. The rules for eligibility were made more stringent in 1998.
- **Income maintenance:** this comprises three categories of benefits:
 - Family benefits;
 - Housing benefits; and
 - Income-replacement benefits for those out of work, which include the *guaranteed temporary social assistance benefit*, the *temporary benefit*, and the *temporary social assistance benefit*. Additional specific benefits are sometimes granted for particular purposes – i.e., medicine, childcare, funerals, etc.

A. AN EFFECTIVE BUT INEFFICIENT AND COSTLY SYSTEM OF TRANSFERS

Fig 6.1 shows that the average amount received in social transfer per capita has increased over time and so has the percentage of the population relying on transfers to move out of poverty.³⁰ Social transfers reduce the incidence of poverty by more than half.

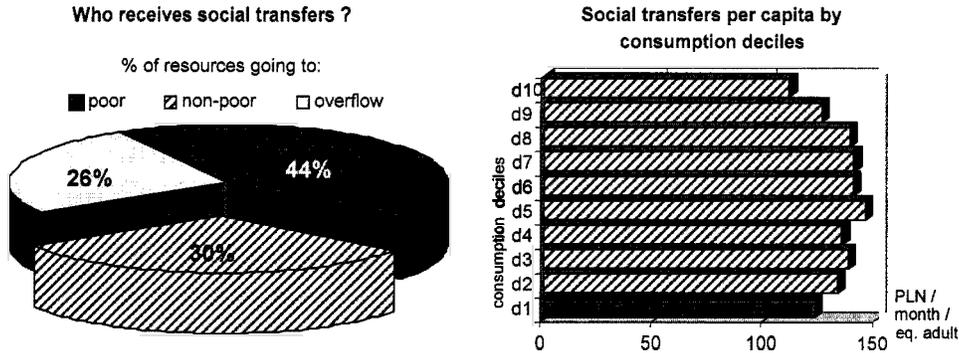
Figure 6.1: Poverty and Social Transfers,* 1994-2002



* Excluding old-age pensions.
 Source: Authors' calculations based on HBS

6.2 However, while clearly important for poverty reduction, the social benefit system is extremely costly and inefficient. Using HBS data the total amount of social transfers – excluding old-age pensions - in 2002 was estimated to reach 6.3 percent of GDP, which is close to government estimates. However, the left-hand panel of Figure 6.2 illustrates that 26 percent of receipts are in excess of the amount necessary to bring household consumption to the poverty line level (a phenomenon called “overflow”) and a further 30 percent (an equivalent of 2 percent of GDP) appears to go directly to non-poor households.

Figure 6.2: Targeting of Social Transfers (Excluding Old Age Pensions)



Source: Authors' calculations based on HBS

³⁰ A clear exception to this trend is 1998 when social transfers per capita declined and so did the the percentage of the population relying on transfers to move them our of poverty.

6.3 As social transfers include benefits of a social insurance nature – such as unemployment benefits and disability pensions – the expectation is clearly not one of perfect targeting of benefits to the poor. But given the special role these benefits have come to acquire as consensus builders in the transition period, the extent of the spill-over to the non-poor is unacceptably high. It is of particular concern that the average size of the social transfer per capita in the poorest decile is the second lowest after the top decile. Although attempts have been made to reduce the inefficiency of the system, the size of the leakage has not declined over the last decade. This suggests that the emphasis is more on maintaining the political support of the “median voter” than on the use of social transfers as effective safety nets for the poor.

B. SOME WORKERS MAY FACE A SUBSTANTIAL “UNEMPLOYMENT TRAP”

6.4 Table 6.1 presents different replacement ratios of income in and out of work for a number of “typical” families. The ratios are calculated under alternative assumptions about the wage potential of the unemployed worker. It is clear from the table that workers earning minimum wages face very high replacement ratios independently of the characteristics of the household. In particular, while entitled to unemployment benefits a single minimum wage earner has a replacement ratio that is well over 100 percent. All other family types analyzed face replacement ratios well above 90 percent suggesting the existence of a considerable “unemployment trap” for workers with low skills and those living in poor, low wage areas.

Table 6.1: Replacement Ratios In and Out of Work by Family Type and Potential Wage

Family type/past wage level	While receiving unemployment benefits			After entitlement
	Entitlement (percent basic benefit)			
	80%	100%	120%	
Single person (average wage)	35.2	40.5	45.8	7.0
Single person (min. wage)	91.8	105.7	119.6	47.0
Parents+2 children (average wage)	46.2	50.1	54.0	28.5
Parents+2 children (min. wage)	81.6	88.5	95.4	50.3
Parents+4 children (average wage)	49.2	52.5	55.8	34.2
Parents+4 children (min. wage)	84.8	90.5	96.2	58.9
Single parent+2 children (average wage)	44.4	48.5	52.8	(43.1) 47.5
Single parent+2 children (min. wage)	78.7	86.1	93.7	(76.5) 84.3

Notes: Values including the change of guaranteed temporary benefit in the second and third year of payment are in parentheses.

Source: Authors’ simulations (see Chapter 14 Background Papers).

6.5 These findings suggest that the current benefit structure may create incentives for the unskilled unemployed in rural areas to remain inactive. The main reasons for this disincentive effect are: (i) the substantial unemployment trap these workers face; (ii) the fact that unemployment and other social benefits are uniform across regions (as noted in the previous section) and household types – i.e., they do not reflect differences in living costs and the earnings potential of household members; (iii) the entitlement to unemployment benefits is longer in regions with high unemployment. Relatively unskilled household members whose potential

earnings do not exceed the minimum wage and who receive unemployment benefits face replacement ratios that are very close to – or in excess of – one. In addition, if located in a relatively high unemployment region this household can benefit from this high replacement ratio for as long as 18 months – i.e., three time longer than households in low unemployment regions. This clearly could act as a strong disincentive to geographic mobility and active job search.

C. BUT THE “POVERTY TRAP” IS LIKELY TO BE SMALL

6.6 However, once the entitlement to unemployment benefits expires, the current social benefit system fails to provide sufficient coverage for the poor. Discretionary temporary benefits provide the only basic transfer to poverty-stricken families. However these have become only a marginal element of the social transfers system reflecting the lack of financial resources and the fact that their amount and duration is defined in relation to the budget available after all mandatory benefits have been paid. This leaves only two possible sources of assistance: pre-retirement benefits which are available only to qualified older unemployed individuals, and disability pensions. At the beginning of the 1990s, the disability pension system provided incomes to a large group of people but reforms have meant that its role as “income provider” is slowly decreasing. Thus pre-retirement and retirement benefits are becoming the main source of income for a growing number of households. In 2002, there were almost half a million beneficiaries. This is imposing large costs on the Labor Fund and diverts resources away from active labor market programs.

6.7 Because of the potential disincentive to work, poor targeting and inability to provide an adequate safety net after the period when unemployment benefits are paid, the generous social benefit system can act as an impediment to poverty reduction rather than as a safety net.

6.8 What is required is a substantial restructuring of the benefit system that will address the issues of the inefficiency and high cost of the system without reducing its effectiveness. Indeed, the experience of other EU countries, such as Spain, suggests that Poland should have already reformed its social transfer system, so as to take better advantage of the “good” years to put in place arrangements that could cushion the drop in growth (which would have had to come eventually) and especially the impact of the inevitable labor restructuring. The failure to think ahead strategically on this issue is probably partly to blame for the current circumstances. But this would make it all that more important to reform existing social safety nets now that growth appears to be picking up again.

7. MOVING CLOSER TO THE LISBON TARGETS

7.1 The main conclusion of this report is that growth is the main tool for improving the living standards of the Polish population in general and the worse-off in particular. Over the last decade in Poland, the extent and intensity of poverty are highly responsive to growth in GDP and in average private consumption. This is so despite a modest but persistent increase in inequality experienced over the last decade.

7.2 The increase in poverty that occurred during 1998-2002 was the result of the declines in mean consumption that occurred in all quintiles except the top one, and which was particularly pronounced at the bottom of the distribution. Underlying these declines were: (i) slow growth, which was reflected in a decline in average consumption overall; and especially (ii) a shift in the distribution of consumption against the poor. The latter mainly reflected increased inequality in labor incomes, driven at first by rising skill premiums, and then by changes in the probability of employment. Indeed households at the bottom end of the consumption distribution were hit twice over the 1996-2002 period. First, their relative wages dropped as skill premiums adjusted, and then they lost their jobs. The former effect did not affect poverty considerably because the whole distribution was shifting - as mid-1990s growth benefited all quintiles - but nevertheless the change in relative demands for skills took place at this time, putting those with low skills in a disadvantaged position already.

7.3 A decline in the demand for low skilled workers, combined with high non-wage labor costs, meant that as soon as growth slowed, labor market adjustment resulted in massive shedding of low skilled jobs. A similar phenomenon took place in Spain in the late 1970s and early 1980s. The difference between the two countries in terms of poverty outcomes is that while Spain put in place a new system of safety nets to coincide with those shifts (hence cushioning the effect on poverty), Poland had to do exactly the opposite: e.g., reduce its safety nets. So it is not surprising that what we have seen in Poland is a substantial increase in poverty.

7.4 The findings of this study suggest that poverty is closely linked to lack of employment opportunities and this is strongly correlated to the skill level of the individual and the location s/he lives in. In particular the skills composition of the location appears particularly important. Thus the main barrier to finding employment and moving out of poverty is: (i) living in a voivodship with a high percentage of low income inhabitants and high unemployment rates; and (ii) the education level of the individual. This link has become stronger over time, with these variables affecting not only the probability of becoming unemployed – and poor – but also the chances of remaining unemployed for longer and becoming “chronically” poor. The situation appears to be particularly difficult for former state farm workers who not only live in severe poverty but also have limited access to informal networks and informal safety nets.

A. GROWTH IS CENTRAL FOR POVERTY REDUCTION

7.5 The key to poverty reduction in the mid-1990s was consistent and rapid GDP growth. The prospects of a return to robust growth over the next years suggests good prospects for poverty reduction. However, sustainable economic growth requires a stable macroeconomic environment and a balanced fiscal-monetary policy mix. These should be the policy priorities on

the eve of EU accession and could be helped by the potential of a large inflow of EU transfers prompted by accession. But in order to utilize the incoming funds effectively, and more generally to improve the conditions for economic growth, Poland needs to take an important initial decision on whether to put efficiency or redistribution first in its model of development.

7.6 The diverse experiences of EU countries clearly suggest that a trade-off may exist in this area, especially in the case of countries with large regional inequalities. The crucial question here is whether new flows of funds should be used to target low-income regions, or to increase the potential of already more affluent “growth poles” (Funck and Pizzati, 2003).

B. GOING BEYOND ECONOMIC GROWTH

7.7 But growth alone will not be enough to move Poland closer to the Lisbon targets. The link between economic growth and employment creation needs to be significantly strengthened by making the growth environment more “labor friendly”. This is particularly true for unskilled workers and residents of Poland’s poorest regions. The focus on the need for employment creation calls for a number of specific interventions on both the demand and supply sides.

7.8 Over the last decade Poland has seen a large increase in labor productivity driven by employment shedding. While in the short term this has huge negative effects on employment and poverty, it also lays the foundation for higher incomes and higher growth in the future. Again, the examples of Spain and Portugal are enlightening in this regard: both went through long periods of high unemployment, but having put in place the right mix of economic reforms - not just in labor markets but also in product markets - they eventually obtained a large payoff. To date, these are the two countries with the highest continued growth rates in the EU, and the only ones with sustained high rates of employment growth for the last few years. In both countries, the key to reforms has not been so much the labor market as increasing competition throughout the economy, and very especially in the until-then highly-monopolized infrastructure sectors. Labor mobility across regions was also key, as well as efforts to invest in infrastructure and to create a better enabling environment for the lagging regions. This experience is very relevant to Poland where the process of liberalization has proceeded much faster in the labor market than in other sectors of the economy. In particular, the remaining rigidities in the housing and transport market are an important potential barrier for labor mobility and poverty reduction.

7.9 Very relevant is also the message that high productivity growth in countries such as Spain and Ireland has laid the foundation for future growth, and is not something one should attempt to “reverse” through the growth of low productivity jobs. With regard to labor mobility, one point of interest is that the social benefit system in Spain had to be reformed significantly in the mid to late 1990s (despite political outcries) to reduce the disincentives to geographical mobility arising from the system of cash transfers (with transfers all the more generous in poor regions). Similar policies are also required in Poland.

C. INCREASING EMPLOYMENT OPPORTUNITIES

7.10 This means interventions on the labor market – on the demand and the supply side as well as in the area of labor market mismatch – but also in the product market and in other markets. The main recommendations are summarized in Box 7.1. A detailed list of recommendations as they emerge from the individual background papers is provided in the matrix in the annex.

Box 7.1: Main Policy Recommendations

1. Improve the employment opportunities of the population by:
 - Increasing labor demand via:
 - Introducing regional differentiations in the minimum wage;
 - Reducing non-wage costs;
 - Improving administrative barriers to “doing business” and improve governance;
 - Speed-up the process of privatization and liberalization of goods, and labor and other markets.
 - Increasing labor supply by:
 - Reducing the high reservation wages of unskilled rural workers;
 - Reform social transfer systems so as to reduce the existing “unemployment trap”;
 - Increasing the skills level of the labor force especially in disadvantaged regions.
 - Reducing labor market mismatch by:
 - Improving job search assistance
 - Encouraging mobility via a policy mix that includes:
 - Equalizing the length of entitlements to unemployment benefits across the country;
 - Reducing housing market rigidities;
 - Improving access to transport, and
 - Providing mobility grants
 - Encourage entrepreneurship by providing selective training and improving access to credit for groups with the highest unemployment levels – i.e., women, people living in rural areas.
2. Improve the targeting of social transfers so as to provide an effective safety net for those who cannot benefit fully from economic growth and increased employment opportunities.
3. Target social transfers towards social maintenance benefits by shifting the emphasis away from disability pensions and pre-retirement benefits to income related family benefits and consider the possibility of having these benefits conditional on: (i) children attending secondary or tertiary education; and/or (ii) households head working a minimum number of hours – i.e., 16 hours a week.
4. Increase capacity for poverty monitoring by providing public access to HBS raw data and improving the HBS questionnaire to allow more accurate aggregate consumption figures to be calculated.

Increasing Labor Demand

7.11 The analysis of labor market institutions, and of employment protection legislation in particular, suggests that no dramatic policy changes are required in the hiring and firing regulations and in the wage bargaining process. Recent changes in the labor code are welcome and point in the right direction. In general, policies for more flexible collective dismissal procedure are likely to be beneficial to Poland, where restructuring and deregulation of large state-owned enterprises is ongoing. As far as the industrial relations system is concerned, Poland features a fairly decentralized wage bargaining system that is appropriate for accommodating firm specific shocks.

7.12 However, wage rigidities are clearly an issue to be addressed. In this respect an aggregate form of negotiations may be useful for implementing structural reforms while avoiding social tensions, as was to a large extent the case with pension reform, but should not necessarily be used for nationwide wage agreements. More important, however, is the negative effect of a nationwide minimum wage that makes it impossible to match the low productivity of low skill workers. Implementing region-specific minimum wage may be advisable but logistically difficult to implement. The option of making the minimum wage progressively less binding may be preferable.

7.13 Thus, a critical factor for the required increase in labor demand will be a push for a return to “labor friendly” growth via: (i) a reduction in costs of doing business; and (ii) speeding up the process of privatization and liberalization of both the labor and the goods markets.

7.14 The cost of doing business is high and increasing – contrary to a downward trend in the rest of the EU. It results from a combination of high taxation – and labor taxation in particular – and the high cost of entry that are associated with administrative barriers, corruption, etc. Compared to other transitional and OECD countries Poland has one of the highest payroll taxes (48%) (Riboud et al, 2002).³¹ In addition, between 2000 and 2003 – at a time of falling employment – labor costs in Poland have increased by 21.7 percent, 11.5 percent faster than the EU(15) average but slower than in the other Central European Accession countries except Lithuania.³²

7.15 Partial deregulation in the goods market may be an additional possible explanation for the sluggish labor demand. The radical economic transformation of the early 1990s has resulted in massive restructuring and some privatization of former state firms but the process of deregulation and privatization has progressively lost momentum over the last decade and much remains to be done. Recent literature suggests that the positive effects of product market deregulation may not be felt in the labor market when the deregulation affects only part of the economy, for example, because the rest of the system remains heavily regulated. In this case, employment in existing restructured firms will fall but the drop may not be compensated but an adequate creation of jobs in incumbent firms, with adverse effects on unemployment. This mechanism can partially explain the sluggish employment performance of Poland, and deserves to be studied in details.

Interventions on the Supply of Labor

7.16 Two possible actions are proposed here: (i) raising skills levels, especially among unemployed workers in poor regions and new labor market entrants; and (ii) a reduction in what is currently a comparatively high reservation wage especially among unskilled workers living in rural and poor areas.

7.17 The low level of skills in the Polish labor market, especially in rural areas, is a major cause of concern for the economic development of the country (World Bank 2002). On the International Adult Literacy Survey (IALS), 75 percent of Poles aged 16-65 performed below the level required to fully function in a modern market. On the Program for International Student Assessment (PISA), Poland’s 15 year-olds ranked 24 out of 31 OECD and non-OECD countries

³¹ Carey and Tchilinguirian (2000) estimated the average effective tax rate for labour in the period 1991-1995 as 42.06%.

³² The 2003 figure refers to the third quarter, which is the most recent period for which information is available.

in literacy and mathematics and 21 in science. Moreover in both these assessments Poland registered the highest variation in scores between rural and urban areas.

7.18 Addressing this issue comprehensively requires a multi-pronged strategy designed to address the rural educational disadvantage by

- improving school enrolment, the quality of the education system and the relevance of education to labor market demands; and
- enhancing the skills (and employment prospects) of those who have already left the school system.

Both types of interventions fit well into the current World Bank program on the Knowledge Economy, but it will need to be extended to include traditional education and school age children. The difficulty is in the heavy cost of comprehensive reform of the education system. A further challenge is that EU structural funds are not intended to be used to finance education.

7.19 The first of these initiatives requires a detailed action program to upgrade the education system, for which the Ministry of Education should be responsible. One such plan is proposed in World Bank (2002) and is in tune with the steps undertaken by the Government to address this issue. An important element of this plan should be a process of regulated liberalization of the education system and the prospect of private/public partnership.

7.20 The second is a less conventional exercise to be delivered by training and other activities. Generally speaking, a certain degree of skepticism exists on the effectiveness of retraining programs. However recent evidence suggests well-designed programs can be successful except in cases of retraining of workers affected by mass lay-offs. These programs are particularly successful for women.

7.21 Reducing the reservation wage is an equally daunting task in the context of a social protection system that gives very little incentive to actively searching for work. This objective requires extensive reform of the system by: (i) making the length of entitlement to unemployment benefit the same across regions; (ii) limiting access to disability pensions and early retirement allowances; and (iii) relating benefits paid to their local purchasing power. In order to reduce the potential disincentive effect of unemployment benefits it is particularly important to: (i) eliminate the current regional differences in the eligibility period for unemployment benefit; and (ii) change the structure of the benefits so that the real replacement ratio is the same across regions. This will mean paying individuals different benefits depending on where they live. It is also essential that reliance on disability and pre-retirement pensions be reduced. The high costs of the disability pension system should also be reduced, as this form of social transfer is a major cause of the relatively high share of indirect costs in total labor costs in Poland.

Reducing Mismatch

7.22 Finally, given both the scale of the problem of structural unemployment and its growth, it is important to work to reduce labor market mismatch. This could be done by: (i) improving job search assistance and (ii) removing barriers for mobility.

7.23 A type of public service that is usually fairly successful in increasing employment among those seeking work is *job search assistance*. This is also a relatively cheap type of initiative that often has a very favorable cost-benefit ratio. But it is typically effective in labor markets with low structural and long-term unemployment. Hence in itself such assistance is likely to be of limited value in Poland.

7.24 In addition to bringing labor force skills closer to the needs of employers, labor market mismatch could be reduced by increasing labor mobility. The limited empirical evidence suggests that mobility is very low in Poland, and the few studies that exist point to two important conclusions: (i) the small number of workers migrating from poor to richer regions in Poland are those who are already employed rather than the unemployed; and (ii) housing costs are often highlighted as a strong deterrent to mobility. This points to the need to ease the imperfections currently operating in the housing market and the importance of liberalizing the transport market. A system of housing benefits might be considered to address this issue. More generally mobility loans and other instruments could be used to promote the mobility of jobseekers. Combined with mobility grants, search assistance becomes a potentially more successful and cost-effective policy, and the Polish government should be encouraged to continue with its attempt to reform the system. The cost of these policies could be financed from EU structural funds. Of course new routes for migration will open up after EU accession. It will be important to equip Polish workers with the characteristics that will make it possible for them to benefit fully from this opportunity.

Encourage Entrepreneurship

7.25 Recent data suggests the number of self-employed in Poland is high relative to other transition economies and a very large percentage of them appear to be women. This is an important area for future development and one where more analysis may be required. It is important for the government to actively encourage further development of this sector by: (i) reducing barriers to credit; (ii) facilitating the process of setting up and registering a business; (iii) providing help in identifying markets; and (iv) improving transport facilities from the most remote areas.

The Scope for Active Labor Market Policies

7.26 The findings of this report indicate that the spread of long-term unemployment in Poland is associated with the deterioration of the relative position of specific vulnerable groups, such as women re-entering the labor market, persons with low levels of education and individuals living in rural areas. We also found that receipt of cash transfers may have a significant effect on the reservation wage of the rural population. When unemployment risk is concentrated and receipt of benefits discourages regional labor mobility, there may be a strong case for selective Active Labor Market Policies (ALMPs), on the grounds that they can hardly involve deadweight costs while their substitution effects may even be desirable.

7.27 In terms of expenditures, three programs have been of particular importance: training, "intervention works" and public works. Training programs are designed to solve skills mismatch in the Polish labor market. Workers with redundant or no skills are trained in those occupations where there is strong labor demand in the expanding sectors of the economy. "Intervention works" is a program that in essence gives employers wage or jobs subsidies in an amount related to the level of unemployment benefits if they hire an unemployed person; the subsidies are larger the longer this person is kept on in the firm. Public work jobs are jobs directly created by the government, in particular municipalities, targeted mainly (but not exclusively) at the long-term unemployed. Many of these jobs are in construction and cleaning of public buildings, parks, etc., i.e., they have a low skills content, although in principle both intervention works and public works have been conceived as maintaining or enhancing the human capital of participants.

7.28 Since the beginning of transition the Polish government has applied a wide range of such policies to combat long-term unemployment. Several studies have investigated their effectiveness by drawing on micro data (Puhani and Steiner, 1996 and 1997; Boeri, 1997; Puhani,

2000) and using a variety of techniques.³³ Their results are not altogether encouraging with respect to the effectiveness of these programs in improving re-employment probabilities. In particular, training programs appear to have only a limited effect on job finding rates and typically public work schemes involve stigma effects which may actually reduce the likelihood of finding a job after participation in such schemes. Better results are obtained from wage subsidies,

7.29 However, incentives to take up slots in active programs are particularly strong in Poland. Workers are entitled to unemployment benefits if they have worked at least 180 days in the preceding year and participating in a jobs program-like intervention or public works for at least 6 months entitles a person to another round of 6-18 months of benefit payment. These policy linkages create strong incentives to participate in ALMPs. The challenge is to ensure that participation is an effective way of increasing long-term job prospects rather than the effective duration of the unemployment trap.

D. SUPPORTING THE LIVING STANDARDS OF THE MOST VULNERABLE

7.30 While labor-friendly growth is clearly a priority, it is important to keep in mind that, even under the current positive growth scenario, a pool of people will remain who are unlikely to benefit from this growth and will inevitably be left behind. For these individuals, a comprehensive and adequate system of income support benefits is needed. In Poland, a large share of public expenditure currently finances the country's social benefits package, but the government is under increasing pressure to reduce its budget deficit. Thus any reform of the system is unlikely to include higher spending. This means that the system will need to work within the current budget by improving targeting and effectiveness. As discussed earlier, there appears to be plenty of scope for this under the current system.

7.31 The poverty profile described in this volume suggests large families and children to be a particularly high-risk category, while the elderly are comparatively better off. This suggests the need to shift the emphasis of social benefits from disability pensions and pre-retirement benefits to income related family benefits. The analysis above has also pointed to the pressing need for: (i) improving educational outcomes of poor children; and (ii) reducing the reservation wage of the unemployed in rural areas.

7.32 The social benefit system can be reformed to provide incentives that will help to achieve these additional goals. This could be done by designing a social transfer package which is conditional on: (i) children attending school at secondary or tertiary level; and/or (ii) ensuring that the household head works a minimum number of hours a week.

E. HOW TO MONITOR FURTHER DEVELOPMENT

7.33 Having identified policies that could usefully reduce poverty in Poland, it is important to promote initiatives for improving the capacity to monitor future developments. Currently, working on living standards in Poland is both rewarding and frustrating for the quantitatively minded. Poland has a wealth of information on living standards and labor markets. The Statistical Office of Poland (GUS) regularly carries out a number of surveys at the individual, household and firm level. The surveys are based on rigorous sample techniques and comprehensive questionnaires. In addition, some of the surveys have a panel component which

³³ Among the techniques used are estimates of augmented matching functions, simple duration models including program intakes, matching estimators substituting for randomization in labor market programs, etc.).

allows analysis of changes over time and makes it possible to distinguish temporary shocks from chronic conditions. GUS calculates and publishes regularly poverty indicators and a number of additional studies have been carried out over the last decade by independent institutions and academia.

7.34 Data accessibility is a real issue, however. GUS follows a complicated and rather *ad hoc* procedure in deciding whether to grant policy makers and researchers the right to use its data, and in setting the price-tag associated with this right. The rationale for the final decision is not always transparent, and the overall process is slow and highly inefficient. This report has been substantially delayed by the length of this process and was limited in its scope by the fact that: (i) the Living Conditions Survey was made available too late to incorporate it into the analysis; and (ii) access to recent enterprise data was denied, preventing adequate analysis of recent patterns of job creation and job destruction.

7.35 Thus the most important recommendation in this area is that GUS adopt a standard procedure for releasing data to the public. This should include public access to the raw data for all interested parties. Access to the data should be granted free of charge unless specific work is required to prepare the data.

7.36 In addition it is recommended that the HBS questionnaire be modified to allow for the imputation of the value of durable goods and housing. The first of these revisions requires the addition of two simple questions to the current questionnaire: one specifying the age of the durable and the other its price at acquisition. This could be easily done at limited expense. The second suggestion, with respect to housing, is slightly more complex and requires some imputation on the part of GUS.

7.37 Given the growing phenomenon of chronic poverty in Poland, it will also be important to strengthen the panel component of the HBS so as to allow for more detailed and reliable analysis of the factors behind the growth in this indicator.

7.38 Finally closer links between GUS and the Polish government – especially the Ministry of Labor in this case – would pay dividends for policymaking.

ANNEX

BACKGROUND PAPERS: MATRIX OF CONCLUSIONS AND POLICY RECOMMENDATIONS

Chapters	Main Findings/Conclusions	Recommendations
<p>PART 1: POVERTY AND GROWTH IN PRE-ACCESSION POLAND</p>	<p>1. The extensive Polish literature on poverty agrees on a number of issues:</p> <ul style="list-style-type: none"> • poverty has increased since 1998, accompanied by rising unemployment; • it mainly affects households who live in rural areas and in small towns, those with low skills and three or more children, those who lack family support, and those with problems related to dependencies and other factors that lead to social exclusion; • poverty alleviation is currently not a priority of the social benefit system. Private and semi-private safety net mechanisms can complement the state's social functions, but cannot replace it. <p>2. As in other recently industrialized countries, poverty in Poland is closely linked to neglected agricultural development. But its roots are also in the early transition process which</p> <ul style="list-style-type: none"> • has led to a radical restructuring of the industrial sector with extensive job destruction but • has not yet resulted in adequate job creation with growth being particularly slow in the self-employment and small business sector. <p>3. Poland-specific factors that have contributed to the increase in poverty include:</p> <ul style="list-style-type: none"> • the country's dramatic national history over the past two centuries, during which state borders have been altered many times, leading to substantial regional differences; and • the low level of education of the 'immobile generation' (those aged over 45) living in rural areas, which has proved to be a significant constraint on their re-employment potential. 	
<p>Chapter 1: Poverty in Poland: an Overview of Existing Literature</p>		

Chapters	Main Findings/Conclusions	Recommendations
<p>Chapter 2: Macroeconomic Developments over the Last Decade: Economic Growth, Income Distribution and its Consequences for Poverty</p>	<p>1. Economic growth was strong from 1994 up to 1988, and poverty fell. Growth slowed significantly from 1988 onwards, and fell to a meager 1 percent in 2001 and 1.4 percent in 2002. The poverty numbers rose during these years, even though growth remained positive. This apparent paradox was partially a statistical artifact. The growth rates reported by the national accounts (NAS) are consistently higher than the changes in average per capita consumption derived from the Household Budget Surveys (HBS), on which the poverty numbers are based. In particular for the period 2000-2002 the HBS shows declining average per capita consumption. .</p> <p>2. But this is far from the whole story. Inequality in the distribution of consumption also grew between 1994 and 2002, and at a slightly faster rate than in other CEE countries. During the high growth years up to 1998, however, average consumption increased in all percentiles; the positive economic growth effect (5 percentage points) far outweighed the adverse effect of the increase in inequality (1 percentage point). Thus the growth incidence curve for these years was consistently above zero, indicating reduced poverty, despite growth being moderately "pro-rich". The incidence of poverty fell by about 4 percentage points. By contrast, for the period 1998-2002 the HBS data show a decline in mean consumption which affected all quintiles but was the largest in the lowest percentiles. The decline in the rate of GDP growth and the increase in inequality combined to produce an increase in poverty of about 2.5% percentage points. The estimated growth elasticity of poverty over the whole period was relatively low, at around -3.6.</p> <p>3. The main force behind the increase in inequality over the past decade was the growing inequality in labor income. This was a result of rising unemployment rather than more unequal distribution of wages. The economic restructuring of the early 1990s led to massive job destruction. In the mid-1990s the massive expansion of output (2.5%) also led to considerable employment creation (6.3%). Since 1998, however, firms have only been able to maintain their productivity via further lay-offs (8.5% cumulatively) without compensatory employment generation. The resulting increase in unemployment primarily affected those with low skills and was geographically concentrated. Thus the last decade has seen a marked increase of in the number of households with no earners and large proportions of unemployed adults. These households tend to be geographically concentrated and to have low levels of education.</p>	<p>1. It is important to reconcile the information derived from the NAS and the HBS to obtain a better picture of trends in aggregate consumption and GDP.</p> <p>2. The key to the reduction in poverty of the mid-1990s was the consistent and high growth in GDP. The prospects for economic growth over the next few years are good but sustainable growth requires a stable macroeconomic environment and a balanced fiscal-monetary policy mix. These should be the policy priorities in the eve of EU accession.</p> <p>3. But growth alone is not enough. The link between economic growth and employment creation needs to be significantly strengthened. In other words the growth environment needs to be made more "labor friendly." This requires interventions on both the demand and the supply side of the labor market. On the demand side a positive business climate needs to be created by reducing the "tax wedge" (in the form of payroll taxes) and continuing with the process of increasing labor market flexibility that has begun in recent years. On the supply side policies are needed to reduce the reservation</p>

Chapters	Main Findings/Conclusions	Recommendations
	<p>4. The increase in inequality in labor income was high enough to offset the positive effects of: (i) an increasingly progressive tax system; (ii) a considerable reduction in the relative price of food, which should have increased the relative welfare of the poor; and (iii) falling nominal and real interest rates, which should have increased the ability of poor people to smooth their consumption - .</p> <p>5. Over the past decade, the distribution of social transfers has been astoundingly even across different consumption percentiles. Only around 30% of resources reaches the poor and an additional 26% of the receipts are in excess of the amount necessary to bring the poor out of poverty. At the same time, however, the current system is an important safety net for an increasing number of Poles. If "original income" (i.e., excluding social transfers) is used to measure poverty, the headcount for 2001 would almost double.</p>	<p>wage, especially in poor areas with high unemployment and to close the growing mismatch of skills between newly created jobs and growing pool of long-term unemployed.</p> <p>4. The low rate of inflation - and especially low relative food price inflation - of recent years should be perceived as a genuine achievement and should be maintained. Current low interest rates should maintain.</p> <p>5. Some automatic stabilizers should be adopted so as to make fiscal policy pro-poor during economic downturn. In addition, better targeting of social transfer must be a priority. Poor targeting both reduces the resources available to help the most vulnerable and poses a significant burden on government finances.</p>
<p>Chapter 3: The Importance of Prices in Measuring Poverty: The Case of Poland 1993- 2001</p>	<p>1. Given high and growing disparities between regions, differences in prices are likely to partly compensate for differences in nominal income levels so that poorer regions have lower prices and the difference increased over time. The HBS shows moderate price variation across voivodships (+/-3.5 percent) and a more significant variation along urban/rural-large/small-town dimensions (from -4 percent for rural areas to +9 percent for metropolitan areas). The overall variation in prices ranges from -5 percent to +11 percent, with the level of prices negatively correlated with regional poverty rates. In 2001, accounting for regional differences in prices lowers the poverty rate from 15.6 percent to 14.6 percent (i.e., by about 7 percent). More important, the relative poverty risk associated with living in rural areas declines substantially with farmers becoming only 10 percent more likely to be poor than the average household as opposed to 30 percent when average national prices are used.</p> <p>2. In addition, starting from 1997/98 food and overall inflation started to diverge considerably. This increased the relative purchasing power of the poor whose share of food in consumption is relatively high. Using a "Poor Price Index" ("Poor PI") - which uses the typical consumption basket of the poor household - shows that between 1998 and 2002 the relative purchasing power of the poor improved by 5.5 percent.</p>	<p>1. Using survey specific regional prices is essential to derive an accurate profile of poverty. If this is done the focus on rural poverty is considerably reduced. Using regional deflators is also important in fixing the level of social transfers. Failure to do so results in the real replacement ratios between work income and benefits to be higher in poor, high unemployment regions. The benefit system should be modified to avoid this.</p> <p>2. Using the CPI gives misleading poverty diagnostics and leads to inaccurate adjustments in the social assistance eligibility thresholds. This is due to the CPI basket</p>

Chapters	Main Findings/Conclusions	Recommendations
<p>Chapter 4: Poverty in Poland: profile 2001 and Changes 1994 – 2001</p>	<p>3. Using this methodology substantially increases the poverty reduction effect of the high growth years. In the stagnation years 1998-2001 the (adjusted) poverty rate increased despite food price stability. However the increase is slower than when the CPI is used.</p> <p>1. The poverty numbers published annually by the Government Statistical Office (GUS) are based on aggregate expenditure and on national CPI numbers. When the more accurate concept of “total consumption flow” is used both the head count and the profile of poverty change somewhat. The difference increases when HBS specific regional prices are used. However, current information is not sufficient to calculate accurately the total consumption flow and a number of assumptions need to be made.</p> <p>2. According to GUS findings,</p> <ul style="list-style-type: none"> • Large geographical variations exist in the incidence of poverty. The north, northwest and southeast had higher poverty rates than the center of the country. • Rural poverty dominates in those regions but indirect statistical evidence shows that this is the result of extremely high poverty among former PGR (state farms) workers rather than private farmers. • Unemployment is the most important single cause of poverty. Lack of education and a large number of children or dependents in the family are additional important factors. Poverty appears to decrease with age despite some evidence of recent increase in poverty among the elderly. • Farmers remain poorer than urban workers,. <p>3. However, using the World Bank standard methodology</p> <ul style="list-style-type: none"> • the differences between rural and urban areas, as well as those between the regions, are less pronounced; • the higher poverty risk of farmers in considerably reduced; • The pattern of poverty has remained relatively stable over the past decade, with changes in the poverty headcount mainly determined by fluctuations in the unemployment rate. However, the position of farmers relative to other groups improved slightly in 2000-01, and lack of education seems to be increasingly 	<p>being closely aligned with the consumption basket of an average household, which has a lower share of food items than that of the poor. The “Poor Price Index” should be used in policy making.</p> <p>3. As mentioned above, the low food price inflation of recent years should be perceived as a genuine achievement and maintained in the future..</p> <p>1. The HBS questions on the value of durables should be extended to include information on the life-span of the durable, so as to allow for the calculation of the consumption value of the durable. Similarly, more information on the imputed rent of the house should be collected</p> <p>2. This would suggest poverty reduction policies should be designed to:</p> <ul style="list-style-type: none"> • Target poor rural areas in general and the household of former PGR (state farms) workers in particular; • Prevent long-term unemployment and increase employment opportunities in poorest areas; • Increase productivity and income in agriculture by reducing the number of workers in this sector. <p>3. Using the World Bank methodology strongly reduces the argument for targeting of farmers and rural areas. The focus is shifted onto geographical targeting and creation of on employment opportunities for unskilled labor especially for former state farm workers.</p>

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	<p>important as a poverty factor.</p> <p>4. The analysis of the two panel sub-samples of the HBS shows that the most vulnerable groups in terms of cross-sectional poverty are also affected by long-term poverty and are at the greatest risk of entering into poverty. The extent of movement out of poverty has decreased between the two panels.</p>	<p>4. These policies will not only be effective in reducing the incidence of poverty but also its duration since the factors leading households into poverty are also those that prevent them from moving out of poverty.</p>
<p>PART 2: IDENTIFYING PARTICULARLY VULNERABLE GROUPS</p> <p>Chapter 5: Regional Inequalities in Living Standards</p>	<p>1. The present pattern of regional inequality in Poland has strong historical underpinnings and has demonstrated exceptional stability over time. This can be traced back to</p> <ul style="list-style-type: none"> • the initial process of urbanization which shaped the urban structure of the country and its main transport corridors; • the different speed at which different regions experienced the processes of modernization and industrialization; and • the political and ideological changes experience of the 20th century. <p>2. On the eve of joining the European Union (EU) these inequalities take two main forms:</p> <ul style="list-style-type: none"> • The <i>metropolitan dimension</i> with the large urban centers (Warsaw, the Tri-city of Gdańsk-Gdynia-Sopot, Kraków, Poznań, Wrocław) growing faster than the rest of the country. This dimension has replaced the traditional urban-rural one, which had been typical of the industry-driven economy. • The <i>east-west divide</i>, which is historically rooted, and is reinforced by the processes of post-socialist transformation. <p>3. Several economic and non-economic phenomena tend to assume strong and similar spatial patterns:</p> <ul style="list-style-type: none"> • The size of municipal budgets, with low budget municipalities being located almost entirely in the poor Eastern part of Poland and in rural areas. • The availability of foreign capital, which is highly concentrated in the richer western and northern regions of the country (the former German territories and the Prussian part) and in the large cities- • The existence of pro-Europe, innovative and politically progressive ideas, which are also highly concentrated in the richer regions, and in the large urban centers and neighboring communities. 	<p>1. Poverty alleviation across Poland's regions will be possible only if and when the poorest regions embark on the path of fast economic growth. This could be helped by a large inflow of capital as with the imminent EU accession.</p> <p>2. The most important principle of regional policy should be to make the best possible use of the structural funds that will come to Poland after accession to the EU. This requires a high level of efficiency in Poland's preparations for membership, at all levels: national, regional, and local.</p>

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	<p>4. The geographical distribution of these factors has resulted in differences in the growth potential of different regions. Metropolitan and western Poland is much better prepared (including because of its international accessibility) for open global competition driven by innovation than are the eastern and non-metropolitan parts of the country. The spatial distribution of poverty is also strongly related to the socioeconomic profiles of the regions and to their development trajectories during the transformation period. Regional differences in poverty incidence are influenced by two major factors:</p> <ul style="list-style-type: none"> • the traditionally poor economic performance of certain regions, i.e., the poorly developed rural areas of central and eastern Poland and the heavily overpopulated south-eastern region, and • the extent of economic restructuring, for example in, the northern and western territories which had traditionally been dominated by state farming and the industrial concentrations, - such as Wałbrzych, Łódź, and Radom-, and some south-eastern industrial towns. 	
<p>Chapter 6: Poverty and Rural Development</p>	<p>1. Approximately 40 % of the population and 60 % of the poor live in rural areas. Agriculture's contribution to GDP fell steadily during the 1990s (from 7 % in 1995 to only 3 % in 2000) as a result of: (i) lack of growth in agricultural production volume, which was linked to the collapse of former state farms; and (ii) a decline in agricultural and food products' prices. At the same time, the share of agriculture in overall employment has been more or less constant (at 26-27%), suggesting increased underemployment of farmers and lower average labor productivity and wages.</p> <p>2. The agricultural sector's share in rural employment is only 40%. The share of agricultural employment exceeds that of off-farm employment in just 5 voivodships out of 16. Non-agricultural rural employment levels are strongly correlated with labor productivity in agriculture. However, given the two million rural unemployed and rural underemployed farmers needing to exit the sector, it is estimated that a total of about 75,000 jobs outside agriculture are still needed annually in rural areas. Currently self employment is playing a larger role than formal enterprise job creation with respect to off-farm employment. The rural self-employed are 70 % more productive than agricultural employment, but non-agricultural wage labor is twice as productive as agricultural labor. This reveals once more the problem of underemployment in farming in rural areas.</p>	<p>1. With concerns about equity and promoting social cohesion in the EU accession period, the welfare of rural dwellers becomes even more important.</p> <p>2. To find productive off-farm employment, rural inhabitants have to overcome their lower level of education compared to their urban counterparts. The share of the rural population with only primary education remains higher than for urban inhabitants, and secondary and tertiary education levels are lower. Although vocational training levels among rural inhabitants are higher than for urban inhabitants, the focus and quality of this vocational training in rural areas is often lacking. This training needs to re-orient to non-agricultural work, especially job re-training for small businesses, computer</p>

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	<p>3. Since 2000, for the first time in recent Polish history, the net migration from rural to urban areas has been negative, with the rural areas with the highest off-farm employment having the highest in-migration.</p>	<p>literacy, and languages.</p>
<p>Chapter 7: The Economic Status of Women</p>	<ol style="list-style-type: none"> 1. The situation of working women in Poland is to a large extent still defined by the double role they are expected to play as mothers and workers. Traditional gender stereotypes hamper women's participation in economic activity and impede gender equality in the area of labor legislation and social security. 2. Nevertheless over the past decade women's participation in the new economy has grown rapidly compared to that of men. Between 1985 and 1998, the number of women with their own registered company outside farming grew five times, while the equivalent number for men barely doubled. In rural areas, a wide variety of business initiatives were launched by young women, especially in crafts, agro-tourism, and processing and sale of farm produce. The representation of women in Poland's self-employed sector is one of the highest in Europe. 3. However, women also still face a greater threat of unemployment - particularly of long-term unemployment - than men. Moreover, average female wages remain significantly lower than those for males, although in recent years this gap has been gradually narrowing, especially in the private sector and in small companies. Much of this differential is explained by the fact that female employment is largely concentrated in the low-paid public sector. Finally expected retirement benefits for women and men are not equal, reflecting the different statutory retirement age for women (60) and men (65), which adversely affects women's length of pensionable employment. 	<ol style="list-style-type: none"> 1. The most urgent task is to change the gender-related stereotypes and judgments that undermine women's position in the labor market 2. Shortcomings in the legal and institutional framework must be addressed in order to allow full participation of women in economic activities.. 3. Preferential mechanisms, such as training programs or credit lines, designed especially for women to balance the discrimination against them in the labor market are also required..
<p>PART 3: A CASE OF "JOB-LESS GROWTH"</p>		
<p>Chapter 8: How far is Warsaw from Lisbon?</p>	<ol style="list-style-type: none"> 1. Since 1998 Poland's economy has experienced a fall of 8 percentage points in its aggregate employment rate. The drop extends across different age-groups and both genders. As a result, the distance of Poland from European employment targets - a 70% employment rate by 2010 - is continuously increasing. So is the gap between Poland and other EU countries that are predominantly experiencing low growth but 	<ol style="list-style-type: none"> 1. On the eve of EU accession it will be essential to focus on policies that will increase employment rates by boosting job creation.

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	<p>sustained employment creation.</p> <p>2. The decline in employment is not caused by labor market institutions. Poland's Employment Protection Legislation (EPL) is generally speaking not rigid by international standard, even though the legislation on collective dismissals has traditionally been tight, and may have contributed to delays in restructuring large firms, which probably hoarded labor up to the 1998 recession.</p> <p>3. Poland features a fairly decentralized wage bargaining system, and an institutional set-up that is appropriate for accommodating firm specific shocks. However, some evidence has emerged of real wage resistance in the aftermath of the 1998 recession, as witnessed by the fact that positive real wage growth was observed in sectors that experienced marked reduction in employment growth. However this resistance is not the results of excessive union pressure and poorly functioning collective agreements. On the contrary, Poland has seen a dramatic decline in union presence, sustained delays in wage payments, and a reduction in the number of collective agreements. The source of the rigidity is in a binding minimum wage.</p> <p>4. Partial deregulation in the good market may be a possible explanation for the jobless growth that Poland has recently experienced. The positive effects of goods market deregulation on employment work mainly in the medium run, when the reduction in prices derived from lower overall firms' mark-ups more than offsets the initial reduction in rents in incumbent firms. In addition the situation becomes more complicated if deregulation affects only part of the economy, for example because the rest of the system remains heavily regulated. In this case, employment in existing firms may fall, with an adverse effect on employment. Over the last four years the rate of privatization in Poland has lost momentum and much remains to be done. Thus partial deregulation may partially explain sluggish employment performance.</p>	<p>2. Recent changes in the labor code are to be welcomed and point to the right direction. In general, policies that reduce the rigidity of collective dismissal procedure are likely to be beneficial while restructuring and deregulation of large state-owned enterprises is under way.</p> <p>3. As Poland move into the European Union, a tripartite form of negotiations, involving government, management and labor, may be useful for implementing structural reforms without social tensions, but should not necessarily be used for nationwide wage agreements.</p> <p>4. It is important to adopt policies designed to help Poland to fully "cross the river," so that the country can reap all of the benefits of market deregulation.</p>
<p>Chapter 9: Dealing with an Increasingly Stagnant Unemployment Pool.</p>	<p>1. Job losses in the second half of the 1990s were substantial and highly concentrated among low-skilled workers. Many of those who lost their jobs ended up in long-term unemployment and the elasticity of job matching with respect to long-term unemployment declined over time. In conjunction with a reduction in outflows from unemployment to jobs, this fact points to a permanent decline in effective labor supply in Poland associated with the spread of long-term unemployment.</p>	<p>1. Policy making should acknowledge this nature of Polish unemployment. Labor market policies, in particular, need to be specifically target the groups likely to fall into long-term unemployment (unskilled workers, women and persons living in rural areas) and use a combination of passive (income support) and selective active labor market policies.</p>

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	<p>2. Downward wage inflexibility cannot explain this increased stagnancy of unemployment as minimum wages have been falling throughout the transition and collective bargaining is fairly decentralized.</p> <p>3. There is evidence, however, that receipt of cash transfers (unemployment benefits and other transfers), coupled with residence in rural areas, increases the reservation wage of jobseekers. In other words, the regional mismatch between the availability of vacancies and the level of unemployment, and the fact that cash transfers do not take account of large differences in the cost-of-living between rural and urban areas, could be a key factor behind of the spread of long-term unemployment in Poland and its persistence even in times of strong economic recovery.</p> <p>4. However there are indications that resources are currently being diverted away from areas with high long-term unemployment, and that mainly reflects local unemployment rates rather than being aimed at vulnerable groups in the population of jobseekers.</p>	<p>2. The decentralized wage bargaining system should be maintained and application of the national minimum wage across all regions should be reconsidered</p> <p>3. As long-term unemployment is regionally concentrated, active policies may include mobility loans and other instruments encouraging the regional mobility of jobseekers living in rural areas.</p> <p>4. This requires a careful scrutiny of the way in which the limited resources available for active policies are allocated to Polish regions.</p>
<p>Chapter 10: The Evolution of Regional Unemployment, 1992-2002.</p>	<p>1. Voivodships vary substantially in terms of unemployment and skill/education mix. There have also been massive changes in the demand for and supply of skills over the period and these changes have not been uniform across regions. Poland is not alone in facing difficult regional imbalances in employment after the rationalization/privatization of old staple industries, and lessons can be drawn from other countries.</p> <p>2. The educational structure of voivodship populations is strongly correlated with unemployment – i.e., voivodships with less well educated populations have higher unemployment rates. Differences in educational attainment account for at least half of the regional variation in Polish unemployment rates. Thus an important part of the regional distribution of unemployment appears to be caused by 'the race between technological development and education' (Tinbergen, 1975).</p> <p>3. Unemployment differences by skill are more or less universal, and are usually attributed to skills differentials in non-wage labor costs, particularly adjustment costs. These skill-based <i>natural rate</i> differences explain part but not all of the regional relationship between unemployment and skill. In addition lower skilled workers tend to have longer periods of unemployment. Thus part of the regional skills-</p>	<p>1. International experience has shown the importance of addressing this imbalance. The legacy of joblessness in countries that have failed to do so has been severe social deprivation and, among other things, rapid growth in drug abuse and the attendant social problems.</p> <p>2. Internationally the key to successfully regenerating high unemployment regions has been a combination of a well-educated workforce with an infusion of regional development funding and inward investment.</p> <p>3. Successful labor market policies need to include a combination of demand and supply side policies. Supply-side policies must reduce reservation wages and ensure greater educational and geographical mobility for</p>

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	<p>unemployment correlation may be do with regional differences in factors that affect the chances of finding work. On the supply side, such factors would be: (i) those that affect reservation wages, such as welfare benefits; and (ii) those that inhibit geographical mobility, such as housing market constraints. There also appears to be some support for the theory of an education-based mismatch, according to which regional skills-unemployment relationship can be attributed to an excess supply of unskilled labor – i.e., <i>mismatch</i> unemployment -.</p> <p>4. Finally the question arises as to why excess supplies of labor (and thus lower wages) have not generated inflows of capital as firms exploit wage advantages. There are a number of possible reasons for this if one turns to the economic geography literature.</p>	<p>people otherwise trapped in pockets of high unemployment. This points to the need for: (i) a reform of the social protection/assistance system that provides incentives to geographical mobility and includes pathways into education and training; and (ii) active policies to increase the skills of the unemployed via accessible and affordable high quality lifetime education.</p> <p>4. Demand side policies should be designed to:</p> <ul style="list-style-type: none"> • reduce the non-wage costs of employing low-skilled workers; • provide financial incentives for capital to move to high unemployment areas.
<p>Chapter 11: The Distribution of Wages in Poland, 1992-2002.</p>	<p>1. Wage inequality remained roughly stable from 1992 to 1998 and appears to have increased slightly since. The small increase in wage inequality at a time of increasing labor market deregulation is surprising especially in light of the growth of private employment from little over a quarter of total employment in 1994 to almost 60 percent by 2002.</p> <p>2. The main reason for the contained increase in inequality is the fact that unskilled employees have progressively dropped out of the labor force. In 1994, nearly half of employees were unskilled but this proportion had declined to under 44 percent by 2002 due to:</p> <ul style="list-style-type: none"> • Considerable labor market outflows from the labor force of low-skilled workers at both ends of the age distribution: older, less-qualified workers and young people entering higher levels of education than previously. • A sharp increase in unemployment among unskilled workers. <p>3. The change in the skills composition of the employed population was largely accomplished by 1998/9. Thus, the more recent rise in wage inequality seems to be due in part to the continuing effects of labor market deregulation, no longer offset by falling participation.</p>	<p>1. Increasing earning inequality is not the reason behind the increased inequality in income households derive from employment. The growth in inequality is the result of increasing polarization of employment opportunities.</p> <p>2. Labor market deregulation has not resulted in lower wages for the unskilled. It has simply forced the unskilled out of employment. This points to the need for targeted income replacement benefits rather than an extensive system of income support.</p> <p>3. However, it will be necessary to monitor these trends over the years to anticipate the direction of any changes.</p>

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<p>PART 4: VULNERABILITY, SAFETY NETS AND INCENTIVES</p> <p>Chapter 12: Informal Networks of Support of Poor People in Poland</p>	<p>1. The importance of informal support networks as a component of social capital has grown during times of rising unemployment and declining efficacy of social safety nets. In Poland's informal support system, the family plays a special role for historical and religious reasons. While until the 1980s, adult children supported their parents financially, today the burden has shifted onto the older generation, and it is pensioners who help their children and grandchildren in various ways.</p> <p>2. Many poor people have extensive support groups within networks of informal social relations but "relatively small family capital, measured by the number of influential or affluent persons". Their social contacts are above all determined by family relations (83 percent), less often by relations with friends (62 percent) and neighbors (61 percent), and least often by work contacts (23 percent) owing to their low employment rates. Total social isolation, expressed in a complete absence of informal social contacts, is very rare amongst the poor (6 percent) and affects predominately single men.</p> <p>3. However the picture is quite different for the poor inhabitants of post-state-farm villages, who appear to be largely excluded significantly from both the local social environment and the more distant, supra-local environment. Three formal institutions play an important role in the life of poor former state-farm workers:</p> <ul style="list-style-type: none"> • local government centers for social assistance, • schools, which offers supplementary meals for poor children, and • unemployment offices that provides access to free health services. 	<p>1. The informal redistribution of income and the provision of services inside a dispersed extended family prevents the outbreak of uncontrolled social discontent, while scarcity of contacts gives rise to "emotional divorce," and conflicts that may involve violence.</p> <p>2. A large number of poor people, especially in rural areas, appear to be left to their own devices to resolve everyday problems, owing to the inadequacy of public state and nongovernmental support institutions. This situation is conducive to intensification of the new pattern of Polish poverty, which is marked by poverty among young adults, rather than among the elderly and disabled as was the case in the past.</p>
<p>Chapter 13: Civil Involvement and Civil Society Organizations as Informal Safety Nets.</p>	<p>1. Over recent years the number of civil society organizations (CSOs) has grown rapidly. The sector experienced most dynamic development in mid-1990s, when 13 percent of all Poles were members of NGOs. This figure fell to 10 percent in 2002. The sector is dominated by small organizations (over one-third employ 1-5 people). Out of 41,859 NGOs registered in Poland, only 4.6 percent operate in the area of social aid, promotion of self-help schemes and charity work and inn many organizations volunteers working for the poor are often simultaneously members of the organization and beneficiaries.</p>	<p>1. Given the recent growth in the sector it is becoming increasingly important to: (i) regulate the sector; and (ii) train young leaders from local communities who will shape local environment</p>

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<p>Chapter 14: Social Benefits as Alternative for Wage Income in Poland.</p>	<p>2. Almost one-third of the income of civil society organizations comes from public funds, while the rest comes from contributions and private donations, which have been growing in the past years. A number of the small NGOs that operate in the field of social assistance are facing substantial financial difficulties, but they use available financial, material and organizational resources in a very effective way. Reflecting Polish tradition, social aid organizations tend to have regular relations with the Catholic Church and church-related institutions that undertake parallel actions to fight poverty.</p> <p>3. Organizations working on poverty prevention operate on three levels</p> <ul style="list-style-type: none"> • Structural: defining standards that could be widely applied and changes to political, economic and social conditions; • Indirect: supporting actions whose recipients are not fully defined (e.g., acting for the development of the local environment, provision of school facilities). • Direct: executing projects/programs focused on defined groups, and undertaking specific activities that have immediate results. <p>1. The social transfer system is a source of support for a significant group of the unemployed. Moreover, the current benefit structure may create incentives for the unemployed to remain inactive. This is due to the fact that: (i) unemployment and other social benefits are uniform across regions and household types – i.e., they do not reflect differences in living costs and the earning potential of household members; (ii) entitlement to unemployment benefits is longer in high unemployment regions. Thus households with relatively unskilled members whose potential earnings do not exceed the minimum wage and are receiving unemployment benefits face replacement ratios that are very close to or in excess of one. If leaving in a relatively high unemployment region this household can benefit from this high replacement ratio for as long as 18 months – three time longer than in low unemployment regions.</p> <p>2. However once entitlement to unemployment benefits expires, the current social transfer system fails to provide sufficient coverage for the poor. Discretionary temporary benefits provide the only basic assistance to poverty-stricken families. But these benefits have become a marginal part of social transfers for two reasons: (i) the lack of financial resources; and (ii) the fact that their amount and duration is defined in relation to the budget available after all mandatory benefits have been paid.</p>	<p>2. The significant financial and organizational links between the NGO sector and the public sector mean that social aid organizations can usefully cooperate closely with public institutions, and businesses, as well as with non-formal social institutions, such as the neighbors' assistance network that remains strong in Poland.</p> <p>3. Several examples of good practice exist. The experience of these organizations should be scaled up to increase community involvement in poverty reduction.</p>
		<p>1. In order to reduce the potential disincentive effect of unemployment benefits it is important to change their structure so that the real replacement ratio is the same across regions. The current regional differences in the eligibility period should also be eliminated.</p> <p>2. It is also important to provide targeted and more effective social benefits for the long-term unemployed. This should be seen as an assistance package designed to increase the employability of the unemployed using selective active labor market programs.</p>

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	<p>3. This leaves only two possible sources of assistance: the pre-retirement benefits – available only to qualified older unemployed individuals - and disability pensions. At the beginning of the 1990s the disability pension system provided income to a large group of people but, after subsequent reforms, its role as “income provider” is slowly decreasing. Thus pre-retirement and retirement benefits are becoming the main source of income for a growing number of people. In 2002, there were almost half a million beneficiaries. This is imposing heavy costs to the Labor Fund and drains resources away from active labor market programs.</p>	<p>3. It is also essential that reliance on disability and pre-retirement pensions be reduced and the high costs of the system be reduced, because this is a major cause of the relatively high non-wage labor costs.</p>

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