Post-accession economic development of Poland

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Abstract

The aim of this paper is to analyse the economic performance of Poland in the post-accession period. Poland joined the EU in 2004, after a long and difficult economic transition. The whole post-accession period could be divided into two sub-periods: the pre-crisis period of 2004-07, and the turbulent period of 2008-11. During the pre-crisis period, Poland recorded a fast growth, with a built-up of macroeconomic disequilibria. During the turbulent period, the economy was dealing successfully with the global financial crisis. The growth slowed down and the disequilibria were reduced. The paper discusses the growth patterns in the both sub-periods and tries to explain the factors that contributed to the good economic performance during the financial crisis. The astonishingly good economic growth results cannot be attributed to a single factor, but to a combination of many factors contributing at the same time. However, Poland has many valuable assets that may help in dealing with the further economic turbulences.

Keywords: economic growth, financial crisis, economic integration, financing growth

JEL Classification: F15, O10

1. Introduction

Poland joined the European Union (EU) on May 1, 2004, together with a group of 8 post-communist countries of Central and Eastern Europe (CEE). The accession came after a long and painful process of economic transition which started in the early 1990s. By the year 2004, the country completed the construction of an efficiently operating market economy, therefore fulfilling the Copenhagen EU entry criteria. The market became liberalised and open to global competition, most of the state-owned companies were privatised,

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economic disequilibria were under control, and the economic policy acquired features of a relative predictability, stability and prudence. The basic institutions of the capital market were created and the banking sector went through the process of thorough transformation adjusting to the requirements of a contemporary economy. Labour efficiency and international competitiveness as well as exports increased radically and investments started to flow widely into the country (Koźmiński, 2008).

The first 8 post-accession years brought about further economic progress. Not only was the economy successfully integrated into the EU, but the living standards were brought closer to the West European levels as well. In 1992 the GDP per capita, adjusted to the purchasing power, was equal to 33% of the EU-15 average, and in 2003 to 43%. However, by the year 2010 this ratio had increased to 56% (62% of the EU-27 average). As expected, the accession led to trade creation, decrease in investment risk, and visible effects of the production shift from Western Europe (Baldwin, Francois and Portes, 1997). Poland also benefited greatly from the access to the EU development funds (Banasiński et al., 2003).

After a 4-year long period of fast and carefree growth in 2004-2007, leading to the first effects of the economic overheating, the situation was changed substantially by the outbreak of the global financial crisis. Once again, the EU membership helped Poland to deal with the challenges. The economy maintained a positive GDP growth rate and became the only EU country able to avoid a technical recession in the whole turbulent period of the years 2008-2011. Nevertheless, the economic situation complicated, the stability of the currency was undermined, and the growth of income decelerated (PwC, 2011).

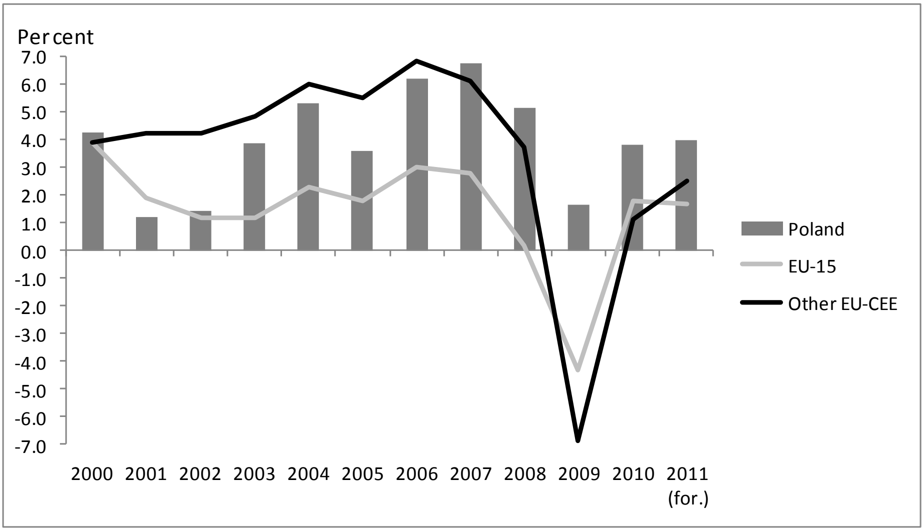
In this paper we try to analyse the economic performance of Poland during the whole post-accession period. In the first part, the general growth patterns are discussed, with a distinction between the pre-crisis period of 2004-07 (called *the carefree growth period*) and the period of 2008-11 (called *the turbulent period*). The main engines of growth in both periods are determined. In the second part, we analyse the financing of the growth during both periods, including the role played by the EU development funds. In the third part, we try to explain why Poland was able to deal successfully with the global crisis. Finally, in the fourth part, we try to draw some conclusions from the EU experience of Poland, including the recommendations for the future years.

2. Growth pattern

Poland has entered the EU after a period of major cyclical slow-down recorded during the years 2000-03, that was combined with a rapid acceleration of the process of the enterprise restructuring (Lenain, Rawdanowicz, 2004). Therefore, the effects of the accession have been overlapping with the internal effects of the stronger domestic demand and production, leading to the clear improvement in the economic performance. During the first 4 years of membership (*the carefree growth period*), the yearly average GDP growth rate increased from 2.7% recorded in the period 2000-03 to the yearly average of 5.5%. As in the previous period, the Polish growth performance remained slightly behind the other CEE member states, including Bulgaria and Romania that joined the EU in 2007 (other CEE member states recorded the average GDP growth of 6.1% in the years 2004-07), while greatly outperforming the "old Union" (EU-15 average growth was 2.5%).

The situation changed in *the turbulent period*, when Poland managed to maintain a healthy yearly average growth of 3.6%, while both the other CEE member states and the EU-15 remained in stagnation (with the average GDP growth of, respectively, 0% and -0.2%). The yearly GDP growth rates are shown in Figure 1.

Figure 1. GDP growth rates in Poland and various parts of the EU, 2000-11



Source: Eurostat

On the top of the difference in the growth rate recorded in both post-accession periods, the observed growth patterns were totally different as well. The underlying national accounts data showing the demand structure behind the aggregate GDP growth are presented in Table 1.

In *the carefree growth period* the main engines of economic growth were exports and investment. Both phenomena reflected, to a big degree, the standard effects of integration: trade and investment creation. The scale of the yearly FDI inflows to Poland increased from an average USD 6 billion a year in the period 2000-03 to almost USD 17 billion a year in the *carefree growth period*, while the scale of the Polish exports of goods and services increased from USD 72 billion in 2003 to USD 174 billion in 2007 (Allard, 2009).

Table 1. Real growth rates of main final demand categories in Poland, 2004-2011

	The carefree growth (2004-07)	The turbulent period (2008-11*)	Post-accession period (2004-11)
Private consumption	4.1	3.6	3.9
Government consumption	4.4	3.3	4.4
Gross Fixed Capital Formation	11.2	3.4	7.3
Total domestic demand	6.0	3.2	4.7
Exports	11.4	3.8	7.8
Imports	12.6	2.8	7.9
Gross Domestic Product	**5.4**	**3.6**	**4.6**

* Forecast for the year 2011
Source: Central Statistical Office (GUS), NOBE

Therefore, the growth pattern in the period 2004-11 can be characterised in the following way: (a) the GDP growth reached an average level of 5.4%, with the domestic demand growing slightly faster than the output; (b) FDI inflows more than doubled, leading to the average growth of the total investment of 11% annually; (c) export sales, mainly to the EU, increased by over 50% in real terms and more than doubled in both dollar and euro terms; (d) the boom was connected with the moderate deterioration of the economic equilibrium. After an increase immediately after the EU accession, the inflation remained on the level below the inflation target of 2.5%, partly due to the continuously strengthening currency. Also, the current account deficit remained below the level of 6% and was comfortably financed by the FDI inflows (the total FDI inflows to Poland in this period were equal to USD 66 billion, compared with the cumulated current account deficit of USD 60 billion).

Contrary to the accession of Mediterranean countries during the 1980s, which led to the very strong increase of imports and trade deficit, the trade effects observed in Poland were different. The economy has been integrating with the European market since the early 1990s, with the EU-27 share in the exports already reaching over 80% around the year 2000 (Banasiński et al., 2003). In accordance with the pre-accession agreements, trade was fully liberalized for all the goods but food. Therefore, the final entry into the EU customs union in May 2004 did not lead to any radical change of the relative prices of imports, or removal of any major obstacles for the free flow of industrial goods. Poland did not suffer any “liberalization shock” – or, more precisely, even if such a shock appeared, it was spread over many years and fully absorbed during the 1990s (Committee for European Integration, 2009).

Therefore, the shifting of production from Western Europe to the new member states, which had started well before the formal accession date, was the main factor determining the good economic performance of Poland in *the carefree growth period.*

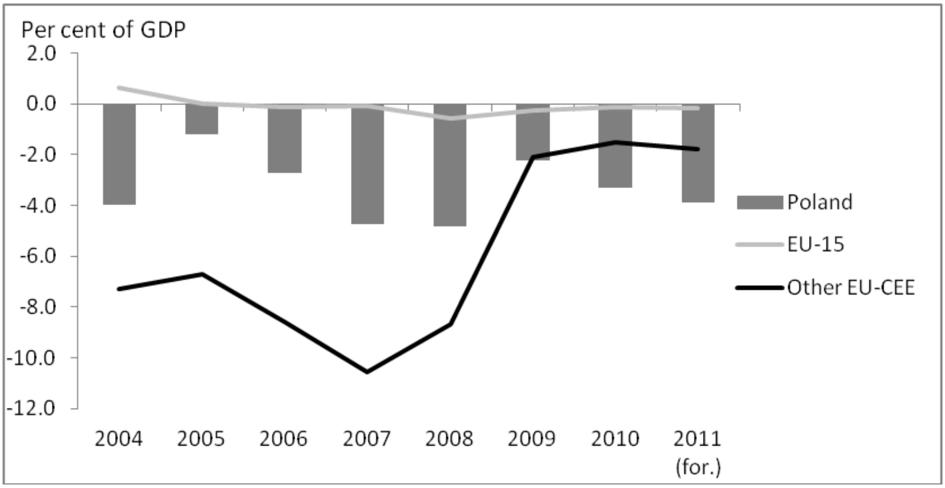
The growth pattern changed significantly during *the turbulent period*. Although Poland avoided an open recession even in the year 2009, growth slowed down considerably. In particular, both the export expansion and the FDI inflows sharply decelerated. The export sales shrank only in 2009, followed by an even sharper reduction of imports. Nevertheless, a combination of the weaker external and internal demand and a weaker currency – that depreciated during the crisis by 25% vis-à-vis the euro – led to the reduction of the growth rate of the trade flows, as well as to that of the trade deficit. As far as FDI are concerned, the average yearly inflows to Poland decreased from an average of almost USD 17 billion a year in the period 2004-07 to USD 12 billion a year in the period 2008-10, contributing to the deceleration of the total investment growth in Poland.

The dynamics of domestic demand were seriously reduced by the global crisis, as well. The investment demand was slightly falling both in 2009 and 2010, recovering only in 2011. However, the private sector investment expenditure was down by 5-10%, while the total investment demand was supported by the rapid increase of the EU co-financed public investment projects. Together with a reduced dynamics of consumption, the total domestic demand growth slowed down from 6% in *the carefree growth period* to 3% in *the turbulent period*. The main engines of growth in this period were: (a) the domestic consumption, and (b) the public investment.

3. Financing growth

The patterns of financing the growth of Polish economy were changing during the post-accession years. The rapid acceleration of the GDP growth in *the carefree growth period* led to the increase of the gross investment to GDP ratio from 18.7% in 2003 to 24.4% in 2007. During *the turbulent period*, however, the rate went down to 20.8% in 2010. At the same time, the gross national saving ratio first increased from 16.1% in 2003 to 21.6% in 2007, and then decreased to 19.7% in 2010. As a result, the financing gap – that had to be covered by the imported foreign saving – was increasing in *the carefree growth period*, and falling during *the turbulent period*. The same phenomenon is reflected in the fluctuations of the current account balance of Poland (Figure 2). The current account deficit increased from -2.5% of GDP in 2003 to -5% in 2007-08, in response to the accelerating investment demand which was not matched by an appropriate increase in domestic saving rates (Committee for European Integration, 2009). However, the economic slowdown recorded in *the turbulent period*, combined with the weaker currency that discouraged foreign borrowing, led to the sharp reduction of the deficit in 2009. One should note that the fluctuations of the current account balance of Poland in the post-accession period were much milder than in many other CEE member states: in *the carefree growth period* the deficits were much lower and did not grow to dangerous levels, while the forced reduction in *the turbulent period* was of a reduced scale.

Figure 2. Current account balance in Poland and various parts of the EU, 2000-11



Source: IMF

Obviously, a more careful look into the changing patterns of financing growth requires an analysis of the saving and investment balance of the main institutional sectors of the Polish economy (Table 2).

The rapid increase of the investment rates observed during *the carefree growth period* in the non-financial corporations and households (due to the private investment boom) was accompanied by the continuously growing investment rate in the governmental sector (due to the EU co-financed development program). As the savings rates were growing at a much slower rate, the balance changed into negative in both the corporate sector (financial and non-financial) and the households, while the negative balance deepened in the governmental sector. The lacking savings necessary to finance growth were imported from abroad.

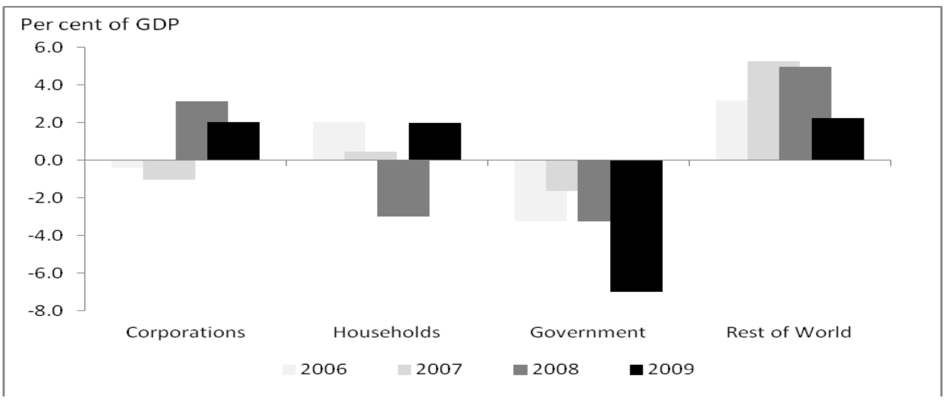
Table 2. Saving-Investment balance for the Polish economy, 2006-2009 (% of GDP)

	Rest of World	Nonfinancial corporations	Financial sector	Govern ment	Households	Non-profit organizations
	Gross Saving					
2006	x	10.5	0.1	0.7	6.6	0.2
2007	x	9.1	2.1	2.5	5.5	0.2
2008	x	10.7	4.7	1.3	2.2	0.2
2009	x	12.6	0.3	-1.8	6.7	0.4
	Gross Investment					
2006	x	10.4	0.5	3.9	4.7	0.0
2007	x	11.6	0.6	4.2	5.1	0.0
2008	x	11.8	0.6	4.6	5.3	0.0
2009	x	10.4	0.5	5.2	5.0	0.0
	Saving-Investment Balance					
2006	3.2	0.1	-0.5	-3.3	1.9	0.2
2007	5.2	-2.5	1.5	-1.6	0.3	0.1
2008	4.9	-1.0	4.2	-3.2	-3.1	0.2
2009	2.2	2.2	-0.2	-7.0	1.7	0.3

Source: Central Statistical Office (GUS)

During *the turbulent period* the situation radically changed: the balance of the corporate sector (financial and non-financial) changed into positive once again, as firms and banks reduced their investment while continuously generating high profits. The household sector, after a fast reduction of savings and the increase of indebtedness in 2008, returned to positive balance in 2009. Nevertheless, as the government sector continued to increase its negative savings, the reduction of the demand for the foreign savings was limited (Fig. 3).

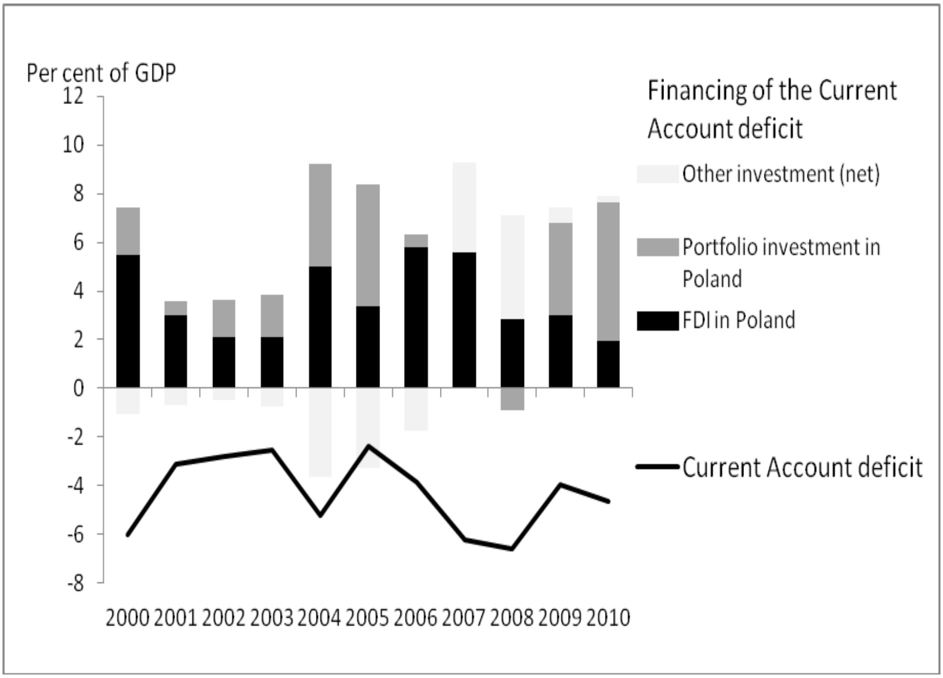
Figure 3. Current account balance in Poland and various parts of the EU, 2000-11



Source: Central Statistical Office (GUS)

The global financial crisis also led to the changes in financing the current account deficit of Poland or, in other words, in the composition of foreign savings (Figure 3). During *the carefree growth period* the FDI inflows, considered to be "safe" financing, were larger than the total current account deficit. However, during *the turbulent period*, the reduced FDI inflows were sufficient to finance only half of the current account deficit, while the other half had to be financed by the volatile portfolio investment. In other words, financing became more risky, particularly given the unpredictability of the global financial markets (PwC, 2010). On the other hand, one should notice that the current account deficit was reduced by more than half in both periods due to the surge in both governmental and private transfers to Poland – an obvious effect of the accession (especially the inflow of the EU development funds, gradually growing above 2% of Poland's GDP in 2009-10).

Figure 4. Financing of the current account deficit in Poland, 2000-10



Source: National Bank of Poland

Obviously, apart from financing growth and reducing the country's dependence on the international financial markets – especially important during the global financial crisis (Orłowski, 2010) – the inflow of the EU structural funds played an extremely important role in Poland's economic growth. First of all, the use of funds contributed to the upgrade of the infrastructure, enhancing the supply side capacities of the economy. Secondly, it allowed for the radical increase of the public investment exactly at the moment, when the stimulus was much needed.

4. Poland's performance during the global financial crisis

The financial crisis which started in 2007 and reached the climax in the last months of 2008 and the beginning of 2009, after the collapse of the Lehman Brothers investment bank, has led to the most dramatic fall of the economic activity during the post-war era (Roubini, Mihm, 2010). The global banking system was almost paralyzed, the capital markets collapsed, numerous countries and companies found themselves close to bankruptcy. As a consequence, the world economy experienced, for the first time in decades, a full-scale global recession with the output falling by over 1% in 2009 and the trade flows falling by 12%.

The main channels of the impact of the global financial crisis on Poland were: (a) the fall of exports, caused by the deep recession in Western Europe; (b) the fall of FDI due to the increased risk aversion vis-à-vis emerging markets; (c) the fall in the consumer confidence due to the risk of growing unemployment; (d) the problems on the credit markets, due to the effects of the global credit crunch; (e) the worries about the possible reduction of access to international capital markets. All these factors led to the sharp slowdown of the GDP growth from 6.1% in the second quarter of 2008 to 0.7% in the first quarter of 2009. At the same time, as Poland did not adopt the euro and the central bank was using a flexible exchange rate regime, the Złoty depreciated by 40%.

However, in the longer run, Poland proved to be quite resilient to the global turbulence. By the end of 2009, the GDP growth accelerated to above 3%, the currency started appreciating once again, and unemployment increased only mildly. Therefore, Poland was the only EU country to avoid a recession, with the GDP growth equal to 1.7% in 2009 and accelerating to 4% in 2010-11. The main reasons that can explain such a remarkably good performance of Poland during the global financial crisis are (PwC, 2010, Orłowski, 2010): (a) a relatively big domestic market and limited dependence on exports; (b) the cautious, albeit far from ideal, conduct of the economic policy and of banking supervision in the past years, that did not allow an excessive dependence on foreign financing; (c) the stabilizing role of the inflows of the EU development funds; (d) the weakening of the Złoty that helped Polish exporters to deal with the fall of the demand and reduced the growth of unemployment; (e) the relatively low level of indebtedness of Polish households and companies, and a reduced share of the loans denominated in foreign currency; (f) high profitability and a strong portfolio of assets in the banking sector. On the top, arguably, one could add one more point. One can speculate that the wave of FDI, mainly by the multinational companies, resulted in the industrial plants in Central Europe being more modern, and probably more profitable, than the ones in Western Europe. Combined with cheaper labour, a less restrictive labour code and more flexible employees, it could lead to sharper cuts in the output and employment in Western Europe, and lighter ones in Central Europe (Allard, 2009).

As the balance sheets of the major Polish banks are generally healthy, the banking sector remains profitable and does not require any support from the government. Over *the turbulent period* the main source of worries shifted to the public finance, particularly in the context of the risk of insolvency of Greece. The level of indebtedness of firms and households is generally moderate, as well as the share of the debts denominated in the foreign currency. The debt of the government, however, increased from 45% of GDP in 2007 to 55% in 2011, due to the policy of relatively high public sector deficits (of 7-8% of GDP) conducted by the government in 2009-10.

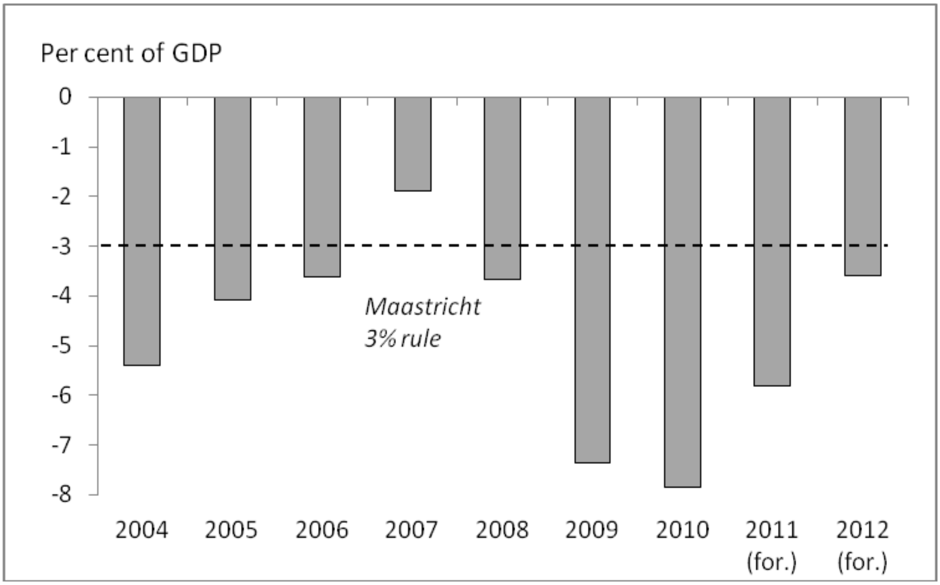
Altogether, one could observe that the astonishingly good economic performance of Poland during the crisis cannot be attributed to a single factor, but to a combination of many factors contributing at the same time. The Polish economy has many valuable assets: low indebtedness, cautious macroeconomic policy before the crisis, quite flexible economy, flexible exchange rate regime, access to the EU markets and to the EU development funds, and a relatively big domestic market. These assets helped Poland deal with the 2009 global recession and are likely to help it deal with the further economic turbulences as well.

5. Some conclusions and the outlook for the future

After two years of growth, in the second half of 2011, the global economy is probably entering a new period of instability and slow growth (IMF, 2010). The major developed economies recorded a sharp slowdown of the GDP growth, caused mainly by the disappointing effects of the US economic strategy to rebuild the market confidence through the massive government stimulus and a loose monetary policy, combined with the financial turmoil in Europe due to the unsolved problem of the Greek debt. A possible major slowdown, or even a recession in Western Europe may have a direct impact on the Polish economy, as almost 80% of the total Polish exports are directed to the EU countries (26% to Germany). Therefore, Poland's GDP growth rate of 4% recorded in the years 2010-11 is likely to fall in 2012-13.

To what extent is Poland able to continue its good performance and to maintain its resistance to the global financial turmoil? The area of concern is the Polish public finance. Although the public debt is still moderate by West European standards it stands at the level of 55% of GDP. A risk of approaching the Maastricht threshold of 60% (set as an unbridgeable threshold by the Polish constitution as well) is still quite high if the economic growth slows down sharply for a long period of time, and the Złoty exchange rate deeply depreciates. In an attempt to reduce the exposure to risk, the government reduced the public sector deficit from almost 8% in 2010 to the forecasted 5.6% in 2011 (European Commission , 2011), with the further reduction expected in 2012-14 (the government declaration is to obtain a close to balanced budget by that time; see Figure 4).

Figure 5. Public sector deficit in Poland, 2004-12



Source: European Commission

Compared to the other countries, the level of indebtedness of the Polish private sector (firms and households) in the domestic banks is quite low and reaches 48% of GDP, one-third of the average West European level. Moreover, the share of the non-performing assets in the banking sector is limited, the profitability of banks high, and the capital levels adequate. Therefore, the Polish banking sector, unlike the banking sector of many other CEE member states (Bohle, 2010) is well prepared to cope with the effects of the possible financial turmoil.

The external situation of Poland does not look dangerous. The country does not have problems with servicing the external debt (ca. 60% of GDP) due to the relatively high financial credibility and continuously high – despite the global crisis – inflows of FDI. The reduced domestic demand coupled with a weaker Złoty exchange rate helped in curbing the current account deficit below -4% of GDP, with the expected gradual decrease taking place over the next two years. With the sufficient level of the foreign exchange reserves, reaching USD

100 billion or 50% of the total yearly expenditures on imports, Poland seems to be relatively well prepared to face possible turbulences on the international financial markets in 2012.

The current economic situation of Poland is characterised by quite strong macroeconomic foundations and a robust financial sector. In spite of the fiscal problems, the country is still considered as one of the most stable and credible economies of the region. Poland's main economic strength lies in the investment attractiveness caused by the success of the economic transformation combined with the favourable geopolitical localization. Over the past years, Poland, as well as other Central European nations, managed to build a reasonably well functioning market environment and to radically increase the productivity. The economy is financially stable and internationally competitive, mainly due to the competitive cost of skilled labour, 4-5 times cheaper than in Western Europe. The second factor that strengthened the growth fundamentals of Poland was the EU accession. Not only did it give unrestricted access to the EU market, but it helped to build the perception of security as well.

The specificity of Poland's situation is that both the FDI inflows and the export growth observed after the EU accession reflect the ongoing process of shifting the production from the old to the new member states. This process may be temporarily hurt by the global recession, but it is not likely to stop completely. Many investment projects may be frozen or even cancelled. But, on the other hand, under difficult market conditions, some firms may consider accelerating the process of shifting the production to Central Europe. The investment attractiveness of Poland is based on three main pillars (Orłowski, 2010): (a) reasonably high productivity; (b) moderate labour costs; (c) political, social and economic safety.

The main weakness of Poland is the poorly performing public sector. As a result, the business environment in Poland is marked by the overwhelming bureaucracy, poor quality of public services, extremely inefficient judicial/ legal system and lack of business-friendly legal framework.

Despite these weaknesses, once only the most violent phase of the global recession is over, the economic growth in Poland should accelerate. The process of shifting the production from Western Europe is likely to intensify once again, leading to the new wave of the export-oriented investment. The combined fast growth of wages and the strengthening currency will gradually erode the main competitive advantage of Poland. However, this process is likely to change significantly the situation only after one-two decades of growth.

Given the intensity of economic links with the Western Europe, the expected medium-term growth of Poland is a function of the economic performance of the whole EU. The process of shifting the production, together with the effects of the EU development funds, may secure additional 2-3 per cent points of the GDP growth vis-à-vis Western Europe in the medium term.

Therefore, if the old members of the EU remain in stagnation for the next few years, the growth in Poland is not likely to exceed 3-4% a year. Under a more optimistic assumption about the West European economic performance, a 5-6% growth in Poland becomes quite possible. Unfortunately, the probability of such an optimistic scenario is quite limited.

Poland is compelled, as an EU member, to introduce the euro only once the country is ready, without setting any specific date. Until the global financial crisis broke out, the target of the government was to adopt the euro by the year 2012. The procedure of adopting the euro lasts at least 3 years, mainly due to the requirement to participate for at least 2 years in the Exchange Rate Mechanism 2 (ERM2) before sending the application. Obviously, by that time, the country must meet all the Maastricht criteria, including the reduction of the public sector deficit and debt below required thresholds, the reduction of inflation and long-term interest rates. An additional problem is created by the necessity to amend the Polish constitution before adopting the euro (Walter, 2009).

Given the difficult situation of the public finance of Poland, it seems quite unlikely that the country may meet the fiscal criteria before the year 2012-13, and only under the conditions of serious determination on behalf of the government. That makes 2014 the first possible date of the euro adoption, with 2015 as a more probable time.

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