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The Impact of Poland's EU Accession on its Economy

Warsaw, 2007

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Abstract

The paper briefly discusses the main economic developments in Poland since its accession to the EU in May 2004 and sees how they relate to the regulatory environment and policies which the EU imposes on the member states. The paper starts with a brief description of principles, legislation and policies adopted in the EU, which influence the decisions made by the government, as well as entrepreneurs, investors, companies and workers. Next it discusses outcomes that were anticipated to occur as a result of the 2004 accession. Economic developments in Poland in two years of EU membership are presented in the last section. It starts with the macroeconomic performance, including economic growth and nominal convergence. The effects of Poland’s participation in the single market on Polish trade (goods and services flows), capital flows (foreign direct investments – FDI), and labor flows (and specifically migration to the EU-15) are also discussed. The size and destination of EU funds committed to Poland are presented. The final paragraph confronts the factual results of the economic processes, highlighting the public’s perception of Poland’s accession and their assessment of the outcomes both for their country and for themselves as individuals.

Even though the paper concerns the recent period of 2004-2006 there are frequent references to developments that took place in Poland in the pre-accession period. This is because the country’s integration into the EU economy was a gradual and lengthy process which had formally been initiated in December 16, 1991 when Poland and the EU signed the Europe Agreement.

Introduction

Poland acceded to the EU in May 2004, along with seven other post-communist nations (commonly called the EU-8)[1], as well as Cyprus and Malta[2]. Unlike the previous four enlargements this was the first to address the issue of Europe's reunification and followed the fall of the Soviet rule over Eastern Europe.

However, Poland's integration into the EU economy was a gradual and lengthy process which had formally been initiated in December 16, 1991 when Poland and the EU signed the Europe Agreement. In 1993 the European Council made an official invitation for Poland and a number of other CEE countries to apply for membership and set out the so-called Copenhagen criteria, pre-requisites that needed to be met before membership could be considered. EU negotiations with Poland officially started in March 1998, and lasted for four years and nine months until their conclusion in December 2002. The negotiations covered 31 thematic chapters of the so called *acquis communautaire* and envisaged bringing the country's legislation and practices into conformity with EU legislation and regulations as a condition for EU membership. A key principle in the negotiations was that no permanent derogation from EU rules was to be accorded to the acceding nations. However, some of transitional periods to both acceding and Old Member States[3] were granted in numerically very limited areas[4]. By August 2004, i.e. soon after the accession, already 94% of a total of 2,683 EU Directives had been implemented in the NMS[5].

The Accession Treaty was signed with Poland (and the other nine countries) in April 2003 and was followed by a referendum, which was held on June 7-8. The results of the referendum as well as the turnout were issues of concern for the Polish president, the government and the people who were engaged in the accession process. After the initial enthusiasm of Polish citizens for EU membership, in the years preceding the enlargement public support decreased[6], which has been explained by fatigue with systemic reforms and

[1] EU-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia.
[2] EU-8 and Cyprus and Malta are jointly named as the EU-10. Later in the text they will be also called NMS which stands for New Member States.
[3] Old Member States (OMS) or EU-15 – this term stands for 15 countries: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.
[4] In the case of EU-15 on the grounds that the rapid integration may pose particular risks (see section 3 b on migrations of labor).
[5] By March 2006 this rate increased to 99% (European Commission 2006a, p. 17).
[6] In June 1994 when the first representative survey has been made, 77% of adults were in favor of the integration while only 6 % were against it (CBOS 2006b). Such massive support (70-80%) was

the lengthy EU adjustment processes. This change in attitude vis-à-vis enlargement can also be attributed to two political parties which promoted an anti-European program for Poland as a better alternative, and were very critical of the conditions for EU-accession obtained by the Polish government in the negotiations. However, a critical mass of support ultimately emerged and in the June 2003 referendum in which 77% of voters supported Poland's EU accession, while 23% voted against[7].

The transposition of the *acquis* to the national legislation was considered not only onerous but also expensive for the acceding countries, especially in two areas: environment and transport. In order to cope with the adjustment costs, the European Council decided that the EU should contribute financially through pre-accession aid[8]. Three financial vehicles were used for this purpose: the revised Phare program, as well as two new mechanisms (both created in 1999) ISPA and SAPARD. Phare program aimed to finance the institutional building and drawing up of a comprehensive National Development Plan in the acceding countries. ISPA like Phare aimed at economic and social cohesion but focused entirely on environment and transport infrastructure. The third vehicle, SAPARD was tasked with supporting adjustment in agricultural sectors and rural areas.

This paper aims to briefly discuss the main economic developments in Poland since its accession to the EU in May 2004 and see how they relate to the regulatory environment and policies which the EU imposes on the member states. The paper starts with a brief description of principles, legislation and policies adopted in the EU (Section 1), which influence the decisions made by the government, as well as entrepreneurs, investors, companies and workers. Section 2 discusses outcomes that were anticipated to occur as a result of the 2004 accession. It also presents results of studies that estimated the economic impacts of enlargement ex ante. Section 3 presents economic developments in Poland in two years of EU membership. It starts with the macroeconomic performance, including economic growth and nominal convergence. The effects of Poland's participation in the single market on Polish trade (goods and services flows), capital flows (foreign direct investments – FDI), and labor flows (and specifically migration to the EU-15) are discussed in this section. The size and destination of EU funds committed to Poland are also presented. The final paragraph of Section 3 confronts the factual results of the economic processes, highlighting

sustained for the next two years. However, in the first half of 1998, the share of proponents went below 70 and later continued to decrease.

[7] The turnout was only 58.9%, despite the intensive pro vote campaign.

[8] In fact the financial support of the EU to Poland started very early, already in 1989 the Phare program, which had been originally created to assist Poland and Hungary in restructuring their economies.

the public's perception of Poland's accession and their assessment of the outcomes both for their country and for themselves as individuals.

Even though the paper concerns the recent period of 2004-2006 there are frequent references to developments that took place in Poland in the pre-accession period. This is because, as discussed above, the integration process began several years before the formal accession.

1. What does EU Accession Mean

EU membership implies the adoption of common policies and legislation by the acceding and member countries. The EU policies and legislation with regard to economic issues are built on the following principles:

1. The principle of the Single Market, which embraces four freedoms:
   - free movement of goods
   - free movement of services
   - free movement of capital
   - free movement of labor
2. Fiscal discipline of the member countries
3. Protection of competition and consumers' rights
4. Limits to state aid in the member countries
5. Entry to the Economic and Monetary Union (EMU)
6. Adoption of common financial mechanisms to support specified common goals.
7. Adoption of the Common Agricultural Policy (CAP), which protects agriculture from internal and external competition.

Free movement of goods is an old principle in use in the European Union. The Customs Union was introduced in July 1968 by the then European Community, which at that time consisted of six countries. As of January 1st 1993, the Single Market was created. The following year the Community Customs Code was introduced.

The advancement of the second principle i.e. **free movement of services** has been varied. **Financial services** had been liberalized over the course of five years: from 1999 – 2004. Following the adoption of the EU laws in this area, now there is a need to implement and properly enforce the new regulations.

In the case of **non-financial services**, there are many legal and administrative barriers to their provisions in the member countries[9], which hamper competition and allow for high prices. This should be seen in the context of the growing importance of services and employment in terms of their added value to the Member Countries[10]. The proposals to liberalize trade in services on the internal market have been under intense discussion for the last two years. The Directive on Services (known as Bolkenstein's Directive) was submitted by the European Commission to the European Parliament in February 2006. Despite the clear economic gains that would result from the introduction of the proposed Service Directive[11] to the old Member States (their consumers and firms using services as inputs), the majority of European MPs, backed by governments and trade unions, were against the Directive in its original form. A compromise was eventually reached and formally agreed upon by the European Council, and voted on by the European Parliament in November 15, 2006. After implementation of the Directive on Services by the Member States, which is scheduled for 2009, the services market will be liberalized; albeit only to a limited extent

Capital flows within the EU have been liberalized since 1 January 1994. However, certain barriers (as they were in December 31, 1993) may have been kept for other countries. Infringements in member countries do happen, e.g. with regard to special rights in privatized companies or resistance to cross-border take-overs and mergers.

Free movement of labor was advanced in1985 when the Schengen Convention was signed. Other EU countries have since signed on to the convention. The milestone was on 1 November 1993, when the European Union Citizenship was introduced. The rule of equal treatment of all citizens within the EU was revised on the eve of the 2004 EU enlargement. Transitional arrangements were introduced, which allow the Old Member States to impose restrictions for a period of up to seven years on employment of EU-8 citizens[12]. Out of the15 old Member States, only three countries: the UK, Sweden and Ireland did not originally take advantage of the possibility to temporarily protect their labor markets. In May 2006, four more countries: Greece, Spain, Portugal and Finland decided to lift restrictions on EU-8 labor immigration. In July 2006, they were also joined by Italy.

[9] Interestingly, provisions of services are more restrictively regulated in the EU-15 than in the NMS (Copenhagen Economics, 2005).
[10] Services amount for almost 70% of GNP and jobs in the EU.
[11] See them estimated in: Copenhagen Economics (2005).
[12] Malta and Cyprus were treated differently and they enjoyed the general EU rule of free movement of labor.

The EU legislation imposes **limitations to state aid** in the member countries on the grounds that any public support to individual enterprises is incompatible with single market principles. State intervention into individual undertakings favors them and eventually distorts or threatens to distort competition. This is why the EU set up the legislative framework, the administrative system and enforcement mechanism to regulate, monitor and control the state aid extended in the member countries.

Starting with the Lisbon Agenda in 2000, the Member States committed themselves at the 2001 Stockholm European Council to launch the process of reducing the general level of state aid. However until now, they have not been very successful in pursuing this commitment. Only slight declines or stable levels of aid have been observed since then in the member states (European Commission, 2006b). In the old Member Countries as a whole, the state aid decreased from 0.61 % of GDP on average in the period 1999-2001 to 0.59%[13] in the years 2001-2003.

However, the Old Member States were more successful in changing the structure of state aid. The EU classification divides public support according to objectives, i.e. horizontal, sectoral and regional aid. Sectoral policies aim to resolve problems of individual companies or specific sectors and are the least accepted type of state aid in the EU. Regional support programs are concerned with influencing the development of regions suffering from special problems such as high unemployment, low levels of development, etc. Horizontal policies are the least harmful for competition as they apply to a wide range of enterprises (i.e. across sectors) meeting a particular criteria. The objective of this type of state aid is to support specific developments or undertakings that are in the common interest, such as development of SME sector, R & D, employment, education and training, environmental protection, energy saving, etc.
When looking at the same years as above, the old member states increased horizontal aid from 71% of the total state aid in the period 1999-2001 to 76% in the years 2001-2003.

The European Union (the EU-15) has elaborated **common financial mechanisms** whose objective is to support specified common goals. As of the 2004 enlargement, these mechanisms also apply to the New Member States. The funding comes from the EU budget, which is raised through the contributions of all member states according to the same rule[14].

[13] Total state aid less railways. If agriculture and fisheries are also disregarded, the data for state aid was 0.44% and 0.4% respectively) (European Commission, 2006b).
[14] The payments from the member countries account for 72% of the EU budget revenues in 2006. The remaining 28% comes from the EU's own resources. They are: agricultural duties and sugar levies; customs duties; VAT revenues from a uniform percent rate applied on all EU countries (14%).

The three consecutive budgets of the enlarged EU (for the years 2004, 2005 and 2006) amounted to EUR 100, 106 and 112 billion respectively and this constituted approximately 1% of the Gross National Income (GNI) of the EU-25 (European Commission, 2006d).

A negative correlation exists between a member country's income (measured by GDP per capita) and the amount of its net transfers to the EU budget. Since all NMS have a GDP per capita below the GDP per capita for the enlarged Europe (EU-25), all ten are net recipients of the EU budget. Another important rule binding the Member Countries is that the EU transfers to recipient member countries require national co-financing (up to 15-25%). The co-financing rule is seen as a way to foster the efficient use of the money.

The structure of budgetary expenditures is as follows. The largest portion of the EU funds (45-46%) is channeled to agriculture. The vast majority of these expenditures are used to finance interventions in agricultural markets. The other two budgetary items within agriculture are funds for rural development and direct aid.

The second largest portion (ca 40% of the budget) is used on expenditures for structural actions. These funds are targeted towards supporting the restructuring and modernization of certain regions and sectors of economies that are in a bad economic shape. The main financial vehicles used to pursue the structural policies are the Structural Funds (there are four of them)[15] and the Cohesion Fund.

The EU also funds internal policies (nuclear safety, institution building and border control in the Schengen framework) and external actions; however these two items are relatively small when compared with the first two.

2. Expected Outcomes of EU Accession

The democratic, economic and institutional reforms undertaken prior to accession and required by the EU-15 as a precondition of EU membership have resulted in the creation of market economies in the eight CEE countries. The adoption of market mechanisms brought about an increase in efficiency and a restructuring of the real sector.

[15] There are four of them: European Regional Development Fund (ERDF), European Social Fund (EFS), Finance Instrument for Fisheries Guidance (FIFG), and European Agricultural Guidance and Guarantee Fund (EAGG).

In political terms, EU membership was expected to create an environment of stability, security and prosperity that would encourage foreign investment and would lead to the reallocation of production to NMS. This, in turn, was expected to contribute to economic growth (Kok, 2003).

In economic terms, membership was expected to bring about substantial gains in the medium and long run. The adoption of the four freedoms that are at the core of the EU integration should facilitate flows of labor, capital and goods. The free movement of goods as well as the factors of production is expected to lead to increased competition on labor and capital markets, as well as goods and services markets. Increased competition should consequently lead to the lowering of costs (increased efficiency), the spatial reallocation of production, and technological and institutional innovations. Increased trade brings about intensified commercial links and co-operation.

The EU state aid rules and policies impose limitations on direct government interventions into economic activity and thus protect competition[16]. These limitations adopted in the NMS should effectively stop the common practice of transition countries' governments of getting involved in solving the crises situations of individual enterprises (Hashi and Balcerowicz, 2006).

In addition, EU membership exposes member countries to EU-wide economic policy coordination and imposes fiscal discipline so as to avoid excessive public debt. Empirical research results point out the negative correlation between economic growth and a high budget deficit (Fischer, 1993). Studies have also proven that both general government deficit and inflation reduce investment and limit productivity gains.

A substantial benefit for Poland and other CEE countries of becoming EU member states is access to the structural funds raised through members' contributions and managed by the European Commission. The volume of funds is substantial (see Section 1), therefore payments received by the NMS, if reasonably and efficiently used, have the potential to contribute considerably to improvement of public infrastructure.

In addition to the arguments for EU membership presented above, which were formed by economists, policy makers, and politicians, there were also anxieties voiced by the public,

[16] In the years 2000-2003, i.e. on the eve of accession, state aid in Poland accounted for 1.26% of GDP and was three times higher than the average for the EU-15 (which was 0.43%, see European Commission, 2006b). Only 24% of the state aid was used for horizontal objectives, while in the old member states it was 75%. This shows the distance that needed to be cut.

particularly trade unions, which were present in both the political debates in the member and candidate countries and also at the pan-European level. To respond to these anxieties several studies were undertaken before the enlargement to estimate the potential effects on both the EU-15 and the acceding countries.

Although economists used different methodologies and approaches, the results from their studies were consistent and suggested that notable gains would result from the enlargement: both for the EU-15 and for the NMS[17]. The gains were expected to be greater for the acceding countries, largely due to their smaller economic size relative to the EU-15, which would make the enlargement shock more pronounced. Yet another reason raised in the analyses was that the NMS, which had a lower level of development due to only recently adopting market rules and joining the common market, should improve their performance at a faster pace than the old member states. For example one of the studies estimated that for the EU-8, the additional growth (GDP) that would result from the 2004 enlargement would be 1.3-2.1% per year, while only 0.5 – 0.7% for the 15 old member nations (European Commission, 2001). Estimates by CASE expert (Maliszewska, 2004) were lower: the liberalization of trade and the reduction of technical barriers was forecasted to bring an increase in GDP of 3.4% in Poland in the long run, 7% in Hungary, while only 0.3% in the EU-15 .

The key concern of the old member countries was that the 2004 enlargement would cause a massive migration from the poorer new member states to the richer EU-15. They feared this would negatively impact wages (downward pressure) in the OMS, as well as the standard of living of certain segments of the labor market (deterioration). However, ex ante studies based on aggregate data did not provide conclusive evidence. While it was estimated that the wages of both skilled and unskilled workers would grow in the long run in Germany and Austria[18], in Denmark they were expected to decrease[19]. As far as the impact on the labor markets in the new member states is concerned, it was estimated that the real wages of unskilled workers in Poland and Hungary would increase by 1.7% and 3.2% respectively, and that this growth would be greater than the growth in skilled workers' wages (Maliszewska, 2004).

[17] For the brief review see European Commission (2006).
[18] By 0.5% and 0.6% respectively, see Keuschnigg et al, 1999 and 2002.
[19] By -0.81% in the years 2000-2065, see Kristensen and Jensen, 2001.

3. Poland 2006: Economic Developments in two years of EU Membership

As discussed earlier, Poland's integration with the EU has been a lengthy process, and it is not yet complete. The formal accession that took place on 1 May 2004 was only a single event marking the formal change of the country's political and economic status. However, it is important to note that the developments in the Polish economy in the two years since the formal accession were influenced to a large extent by institutional and regulatory reforms undertaken in the years prior to the accession.

The transposition of EU legislation allowed Poland to profoundly reform the way in which its economy is regulated. Changes in such areas as financial markets, company law, accounting, and intellectual property rights have created better environment for business and have led to economic growth. The adoption of the European state aid regulations imposed restrictions on government intervention into the enterprise sector, while changes in competition law strengthened anti-monopolistic policies and the protection of consumers against the unfair behavior of producers.

In light of this, another important observation should be pointed out. Clearly, the gradual integration with other European countries has not been the only factor influencing the developments in the Polish economy. Governments of the member countries enjoy a large degree of freedom in planning and implementing domestic economic policies regulating their domestic business environments. Thus, when examining the economic developments, the impact of conventional economic factors should be taken into account as well. Finally, it should be mentioned that while the short-term shocks caused by the 2004 accession were already analyzed, the long term impact of EU membership can only be studied after several years.

a) Economic Growth

In the first two years of EU membership (2004-2005), Poland has enjoyed sound economic growth at an average rate of 4.2% a year (for yearly rates see Table 1 below). This positive

trend continues to be observed in 2006[20]. At such a rate, Poland ranks high (no. 8, together with Greece and Luxembourg) in the EU-25 rankings. Poland's economic growth has been twice as high as the growth of the old Member States when taken as a whole, as the average for the EU-15 was only 2%. However the Baltic countries and Slovakia, who lead the ranking, have been doing far better than Poland[21]. In recent years, all four have implemented substantial public finance, tax and regulatory reforms which have positively impacted on business activity and private sector growth, and this has sped up the rate of economic growth.

Table 1. GDP, Exports and Imports of Poland in 1997-2005, growth rates (%)

	1997	1998	1999	2000	2001	2002	2003	2004	2005
	Growth rate								
GDP	7.1	5.0	4.5	4.2	1.1	1.4	3.8	5.3	3.4
Exports	12.2	14.4	-2.5	23.2	3.1	4.8	14.2	14.0	8.1
Imports	21.4	18.6	1.0	15.5	-5.3	2.7	9.3	15.2	4.9

Source: (Poland's) Central Statistical Office data

The average rate of GDP growth in Poland in the nine year period of 1997-2005 was 3.9% yearly, the same as for the EU-10 as a whole. Since economic growth in the old Member States was considerably lower (2.3% yearly), a real convergence was in progress. In 1997, Poland's GDP per capita (in PPS) accounted for 40.1% of the EU-15, and nine years later for 46%. However the distance to the average for the EU-15 remains large. Poland is also lagging behind the majority of the NMS. Only Lithuania is still behind Poland (with 43.1%). In 2005, the average GDP per capita for the newly acceded countries was 52.1% of the EU-15 (European Commission, 2006a).

The research results show that capital accumulation and technical progress were the key factors contributing to the economic growth of Poland (and other NMS) in the last eight years (1998-2005). Labor has had a negative impact in Poland (and a number of other NMS) (European Commission, 2006a).

[20] In the second quarter 2006 GDP grew 5.5% YoY and CASE forecast for the entire 2006 is 5.3% (CASE, 2006).

[21] Latvia 9.1%, Estonia 8.6%, Lithuania 7.2%, and Slovakia 5.8%.

b) Migrations

According to neo-classical economic theory (see Hicks, 1932) migration is perceived as a consequence of wage differentials and as a means to even out inequalities in wages and living conditions.

Labor migration from Poland to Western countries started in the early 1990s, soon after the transition to a market economy had been initiated.

The temporary nature of residence in the host countries has been the main feature of migration from the EU-8 in the whole transition period (World Bank, 2006a and 2006b). The largest flow of labor migrants from transition countries was generated by a seasonal demand for labor in agriculture and construction, mainly in Germany, but also in Spain, France and the UK. These flows were usually regulated by bilateral governmental agreements. Labor flows have also flourished under the 3-month tourist visa-free regime. Some peripherally-located micro-regions of Poland became very dependent on the labor markets of big European cities (Brussels, Berlin, Vienna, and London). One third to one half of households live on incomes earned in these cities (Jaźwińska and Okólski, 2001).

It is difficult to say how many Poles worked in the EU-15 in the pre-accession period, as official statistics are unable to grasp the phenomenon for a number of reasons. However it is certain that much of the migration was illegal, therefore any figures on labor migration underestimate the real scope of labor flows. The German statistics on legal seasonal workers shows that while in 1993 there were 143,861 Polish nationals working in Germany, in 2003 this number increased to 271,907 (World Bank, 2006a).

As forecasted, the external mobility of the CEE countries' labor force intensified after their EU' accession[22], and as predicted, inflows were concentrated to the three countries that opened their labor markets. Poland has had an important contribution to this due to the size of its labor force. In 2004, approximately 250,000 Poles stayed abroad for at least two months. This is 20% more people than in 2003. Approximately 80% of migrants work during their stay abroad. The UK and Ireland have become important destinations for labor

[22] However some of the employment registered in these three states soon after the enlargement was not a result of a new inflow of migrants but rather the legalization of workers from new member states who were already working in old member states.

migrants[23]; however Germany remains the dominant one (25% in 2005) (World Bank, 2006a).

The age structure of the Polish migrants has changed over time. While in 2000 those aged below 35 constituted 51% of the migrants, in 2004 their share increase to 61%. In the same period the share of over 45-year olds decreased from 28% to 20%. However, migration remained to be predominantly short term, and this feature became even more apparent after accession; in 1995 short term migrants (those staying abroad for less than 12 months) amounted to 48%, in 2003 they constituted 53%, and in 2004 – 60% (World Bank, 2006a). Yet two more characteristic features of the Polish labor migrants are the following: Polish emigrants are relatively well educated (better than the general population of Poland)[24] and generally overqualified for the jobs they do abroad.

However, fears that the massive migration from CEE countries would be devastating to destination countries turned out to be unfounded. The experience of the two years after the 2004 enlargement shows that the size of inflows to the three old European countries which opened their labor market turned out to be below the absorptive capacity of the receiving countries (World Bank, 2006a). The number of vacancies in the UK did not shrink as a result of post-accession labor inflows to manufacturing, construction and hotel and restaurant sectors. Also, inflows of foreign workers supplemented domestic labor rather than replaced it. This may explain why local wages remained stable which was the opposite of the expectations of trade unions in recipient countries, which feared that workers from new member states will cause a fall in nominal wage growth in the UK and Ireland (Doyle et al, 2006). Finally and contrary to expectations, it appears that migrants from CEE countries were attracted by labor opportunities and not by social welfare systems (World Bank, 2006a). All of the evidence points in favor of liberalizing labor markets in other old member countries that were reluctant to allow the free movement of labor from NMS at the outset.

While there was no negative impact of labor inflows to old member states, the evidence shows that outflows of labor may generate problems in the NMS. From May 2004 until December 2005, 1.2% of the Polish working age population left to legally work in one of the three countries that liberalized their labor market, mostly to the UK (World Bank, 2006a). Moreover, migrants are mostly young, work-oriented and well-educated. Shortages of skilled workers have already occurred in Poland (and even to a greater extent in the Baltic States) in

[23] The UK had a 20% share in 2005 as compared to 4% in 2000. Ireland was meaningless as a destination for the Polish labor in 2000 while its share in the total outflow in 2005 was 6%.

[24] The UK traditionally attracts comparatively the largest number of Poles with tertiary education: in 2004 35% of Polish emigrants staying for more than 2 months in the UK had a university diploma.

several sectors of the economy (including health care, and particularly anesthesiologists and surgeons). In addition, wage pressures have increased, mainly in agriculture and construction. As a result Poland (and other affected NMS) may be forced to import labor, thus will have to relax their immigration policy vis-à-vis non EU member countries. If Poland does not, the labor shortage may impede economic growth in the medium term; and the country will face problems in financing the rapidly ageing population in the long run.

On the positive side of labor outflows: Poland benefits from increased remittances and expects to regain some of the labor with additional human capital. Yet remittances are mostly used to augment households' consumption and support tertiary education, so their impact on economic growth is very limited.

The evidence shows that the relatively high propensity for foreign migration is accompanied by low internal mobility. These two may be seen as alternatives (World Bank, 2006a).

c) Trade

Trade with the EU member states was liberalized through the Europe Agreement signed in 1991 (see Introduction). The Agreement established the framework for bilateral relations between Poland and the then European Community as a whole. Part III of the Agreement dealing with mutual trade came into force as soon as 1 March 1993. A Free Trade Zone has been established, covering 85% of the bilateral trade. Early liberalization of trade fostered Polish exports and imports to and from the European Union much ahead of the formal accession.

For many years Polish trade in goods grew at a faster pace than its' GDP (see Table 1 above), therefore the economy was slowly but consistently becoming more open. While in 1994 exports of goods and services (taken together) accounted for 21.6% of GDP, in 2003, which was the last year before the accession it increased to 33.4%; the indices for imports of goods and services for the same years were 19.7% and 35.9% (European Commission, 2006c).

Poland's trade integration with the EU augmented considerably. In 1999 exports (of goods) to the EU Member States accounted for 13.2% of GDP, and four years later, it increased to 20.1%[25].

[25] See: European Commission, 2006c. Unfortunately data is not available for earlier years.

In the last year before the accession, i.e. in 2003, Polish exports grew by 14.2%. Such a high index was also registered for 2004 (see Table 1 above). In 2005, the rate of growth went down to 8.1%, but this has to be seen in the context of the strengthening rate of exchange of Polish currency. As a result, in 2005 Polish exports amounted to EUR 77.6 billion and this was 5 times more than in 1994 (EUR 15.5 billion; see Figure 1 below). Trade integration with the EU increased further (to 22.8% of the GDP) and 78% of the exports go to the EU. In the first quarter of 2006 exports jumped again (by 21.4% YoY) and the forecast for the entire year is very optimistic (14.2%; CASE, 2006).

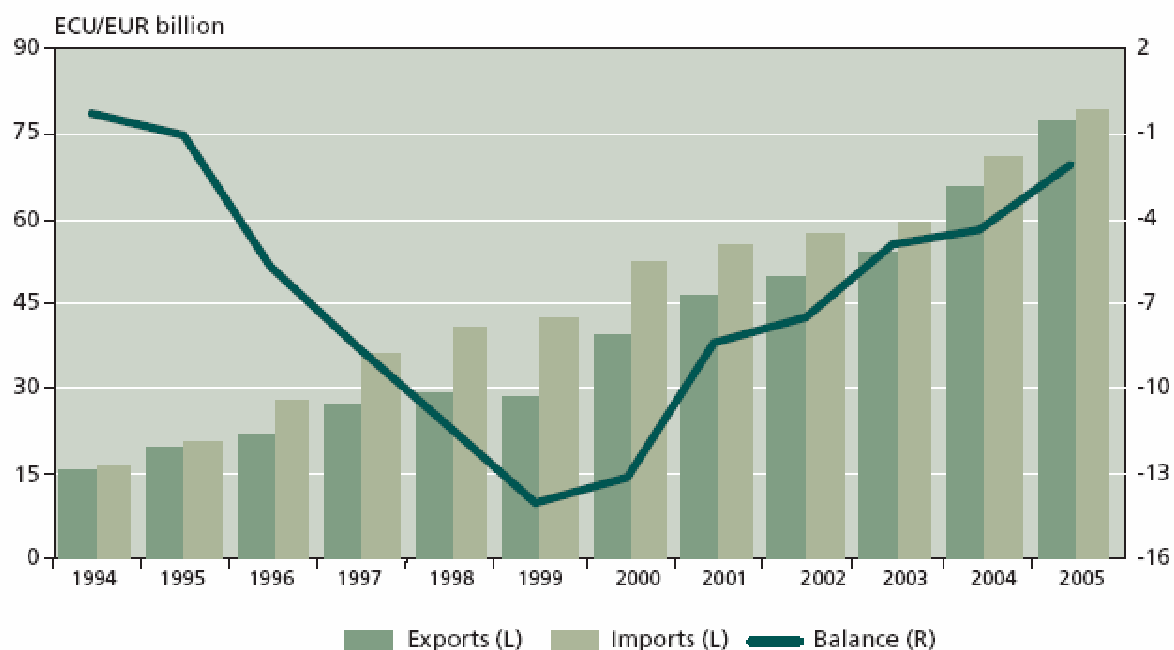
Contrary to pessimistic expectations with regard to impact of EU accession on Poland's imports, the rate of growth for exports outpaced the rate of growth for imports[26]. As a result (and also contrary to negative predictions) the foreign trade deficit did significantly decrease and in 2005 it accounted for EUR 2.2 billion (see Figures 1), which was - 0.9% of GDP. It is worth noticing that the year 2005 was the sixth consecutive year in which the foreign trade deficit continued to shrink. Also in 2005 and 2006 the trade balance with the European Union became positive; which means that the current trade deficit has been generated by trade with non-EU countries.

EU membership means not only that since May 2004 Poland has applied the Community Customs Code, but also that it has adopted the Common Customs Tariffs for the third countries. The latter caused a drop in an average tariff applied by the EU-10 on imports from the third countries from 8.9% to the EU average of 4.1%. This may explain the rapid increase in imports from developing countries (mainly from China), which is faster than from the EU. However, exports to the third countries have also reached record growth levels (mainly to Russia and Ukraine). This increase of exports may be partly explained by export subsidies to trade in foodstuffs that also apply to Polish exports, as for all EU producers.

Polish farmers were afraid that after the accession, the Polish market would be flooded with imported food. This did not prove correct. On the contrary, the liberalization of trade in foodstuffs generated an increase in the Polish exports to the EU.

[26] Except for 2004. The forecasts for 2006 are optimistic.

Figure 1. Polish Exports and Imports and Balance of Trade in 1994 -2005



Source: NBP data

The rapid growth of exports in recent years despite the low import demand from major markets may be explained to some extent by the growing presence of FDI in Poland. Foreign-owned companies established in Poland account for a major part of Polish exports.

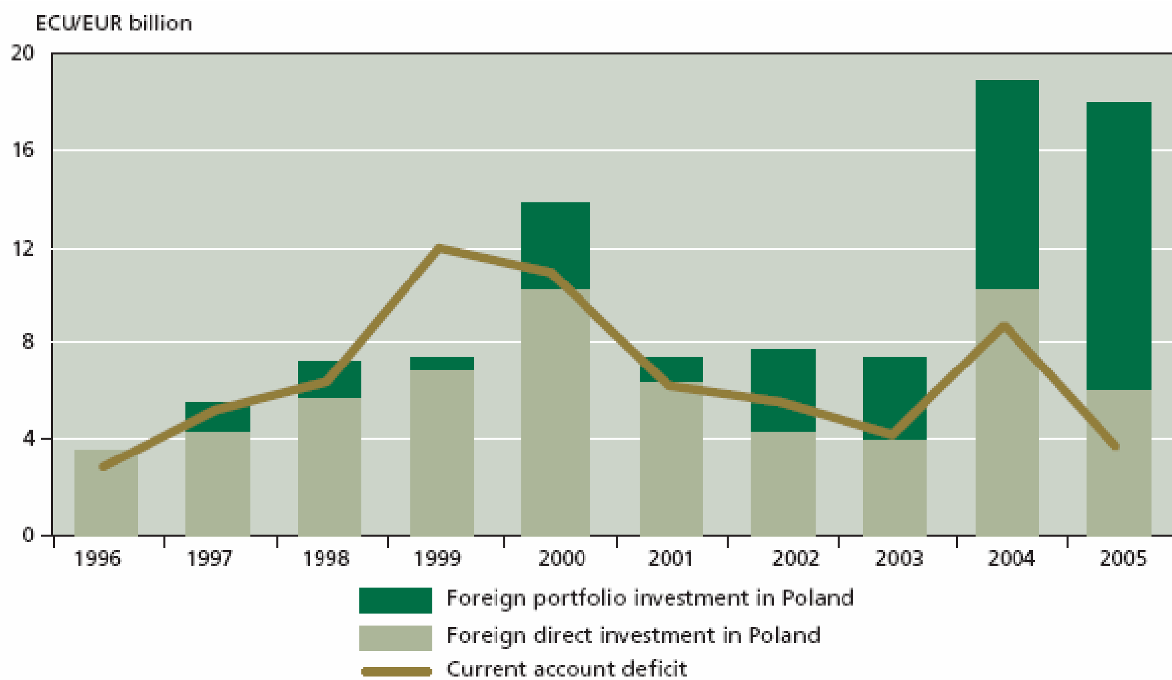
d) Foreign Direct Investments (FDI)

FDI plays a crucial role in the process of a country's economic modernization. In the case of post-communist Poland and other CEE Countries, which were transforming their economic systems and restructuring their economies in the 1990s, there was a great need for foreign direct capital. FDI complemented the limited domestic sources of funding and created the potential for increases in production increases and the creation of employment. FDI inflows also contributed to productivity growth through the transfer of technology and expertise. Additionally, FDI inflows had positive indirect effects (spillovers) as the presence of foreign direct multinationals improved the productivity of domestically-owned firms via technology transfers and enhanced competition.

At the beginning of the transition period, the FDI inflows to Poland were very low, for obvious reasons. They began to slowly increase in the mid-1990s when the market institutions were already in place. FDI received an additional impetus after 1997 parliamentary elections, when a new, pro-reform government undertook the program of privatization of big state-

owned enterprises. The peak of the privatization deals occurred in 2000 and this contributed to the record amount of foreign capital inflow (EUR 10.3 billion), which holds until the present day (see Figure 2 below). The change of government in the year 2000, together with the parliamentary elections of 2001, which brought into power two socialist parties, led to a substantial slow-down of the privatization process. The 1999 sale of a large portion of the shares of PZU, the largest Polish insurance company, to a foreign investor was formally

Figure 2. Foreign Direct Investment and Foreign Portfolio Investment in Poland, 1997-2005



Source: NBP data

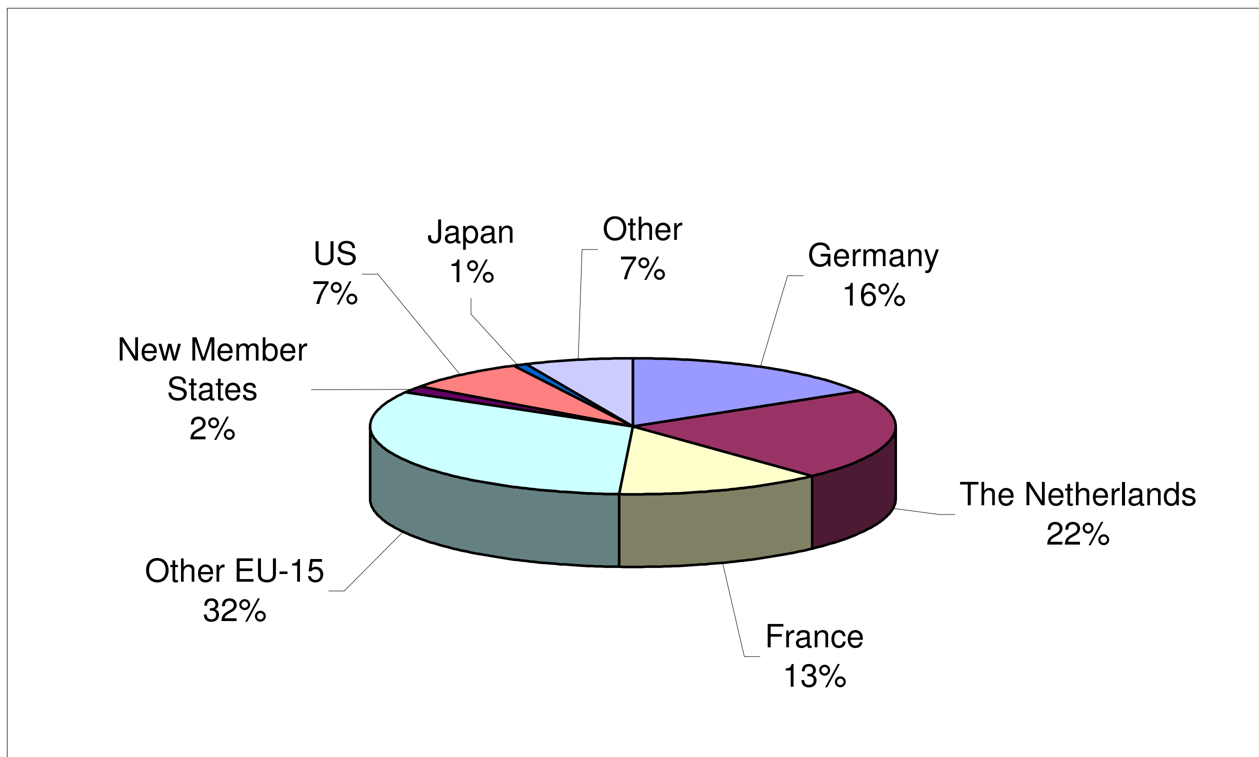
questioned by the new government and the privatization contract was breached. The foreign investor (EUREKO) sues the government of Poland. These developments negatively affected the volume of FDI, which in the years 2002-2003 dropped to less than half of the 2000 peak level. Also, since 2002, foreign direct capital inflows have mostly been green-field investments and, increasingly, takeovers of domestic-owned private companies or mergers.

A considerable increase in the foreign direct investments to Poland was expected after the EU accession. These forecasts proved true as there was a spectacular increase in FDI inflows in the year of the accession: 2.5 times more than the previous year. Altogether EUR 10.29 billion was invested in 2004, nearly reaching the peak-levels of 2000. However, in 2005 FDI inflows went down by 22% to EUR 7.7 billion.

Until now, Poland has been the main recipient of FDI out of the EU-10, and understandably so when one takes into account the size of the Polish economy. By the end of 2005, the FDI stock accounted for EUR 75.7 billion. In relative terms, the cumulative foreign investments in Poland were modest and amounted to only 31% of GDP, which placed Poland close to the end of the rankings (only Slovenia and Romania trailed behind).

The ongoing process of economic integration with the EU is occurring not only in trade but also in capital mobility. The EU-15 was the major investor in Poland for the entire period prior to accession and has also dominated in the two years since the formal accession. In 2004 and 2005, the old Member States respectively accounted for 85.5% and 82% of the capital inflow in these two years (NBP, 2006b). As of 31 December 2005, the EU-15 FDI amounted to EUR 63.1 billion and constituted 83.3% of the total FDI (EUR 75.7 billion). Foreign investments originated mostly from The Netherlands (EUR 16.4 billion), Germany (EUR 12.3 billion) and France (EUR 9.6 billion) (see Figure 3). These three countries accounted for 60.8% of the cumulative FDI inflow to Poland.

Figure 3. Foreign Direct Investments as of 31 December 2005 by Countries (%)



The United States, which previously made substantial investments in Poland, in 2005 invested only EUR 626 million, which accounted for 8% of the total current foreign direct capital inflow. The cumulative US direct investment to Poland as of the end of December

2005 amounted to EUR 5.6 billion. With a share of 7.4%, the US ranked 4th after the three EU Member Countries listed above (Figure 3). Japan with EUR 238 million accounted for 3.1% of 2005 FDI in Poland (NBP, 2006b). Japan's direct investments in Poland as of December 2005 accounted for only EUR 606.6 million.

Lastly, it is worth noting that although they are still small, capital flows to Poland from the New Member States are increasing.

As far as the sectoral structure of the FDI stock in Poland is concerned, investments are concentrated in three sectors: manufacturing with 37% of the total foreign investment ranks 1st, financial intermediation 2nd (20%), and trade 3rd (18%) (NBP, 2006b). In the manufacturing sector, the most attractive destinations for foreign capital were (1) motor vehicles manufacturing (EUR 4.7 million, 6.2%), and (2) food production (EUR 4.5 million, 6% of the total).

Interestingly, the Polish FDI, which for many years was very small and did not exceed EUR 100 millions a year, has increased spectacularly in the recent two years. The outflow of FDI amounted to EUR 636 million in 2004 (which was 2.3 times more than a year earlier) and EUR 2,493 million in 2005. The last figure includes the purchase of the Czech Unipetrol by ORLEN, which accounted for 18% of the total direct investment outflow.

A visible impact of Poland's EU membership is the increased foreign portfolio investment in Poland (see Figure 2 above). Though it was already growing in the two years before the accession, in 2004, it increased by 2.5 times (to EUR 8.5 billion), and in 2005 by 39% (to EUR 11.8 billion), and surpassed the 2005 FDI inflow by 54%.

To receive more FDI in the future, Poland needs to substantially improve not only political, but also its business environment, so as to become more attractive to foreign investors. Poland needs to stand out when competing with other investment destinations, which have made many improvements in regulation, tax systems etc.[27] However, the prospects for improvement are rather modest. The Law and Justice party (PiS), (which formally refers to itself as right-wing, but which is in fact populist), won parliamentary elections in September 2005 and currently runs a state-interventionist fiscal policy. The recently initiated restructuring and privatization processes of "sensitive sectors" (coal, steel, railroads, and energy) has stalled. In addition, with the help of some mass media organizations, the

[27] Poland ranks only 43rd in the country ranking by potential to host FDI (UNCTAD, 2005).

leaders of the three coalition parties in power have revived anti privatization and anti-foreign capital sentiments (under the slogan of the so-called "loss of national ownership"). Nevertheless, many local governments are very pro- foreign investor-oriented and work hard to attract the investments of big multinationals, and have been very successful.

e) The EU funds for Poland in 2004 - 2006

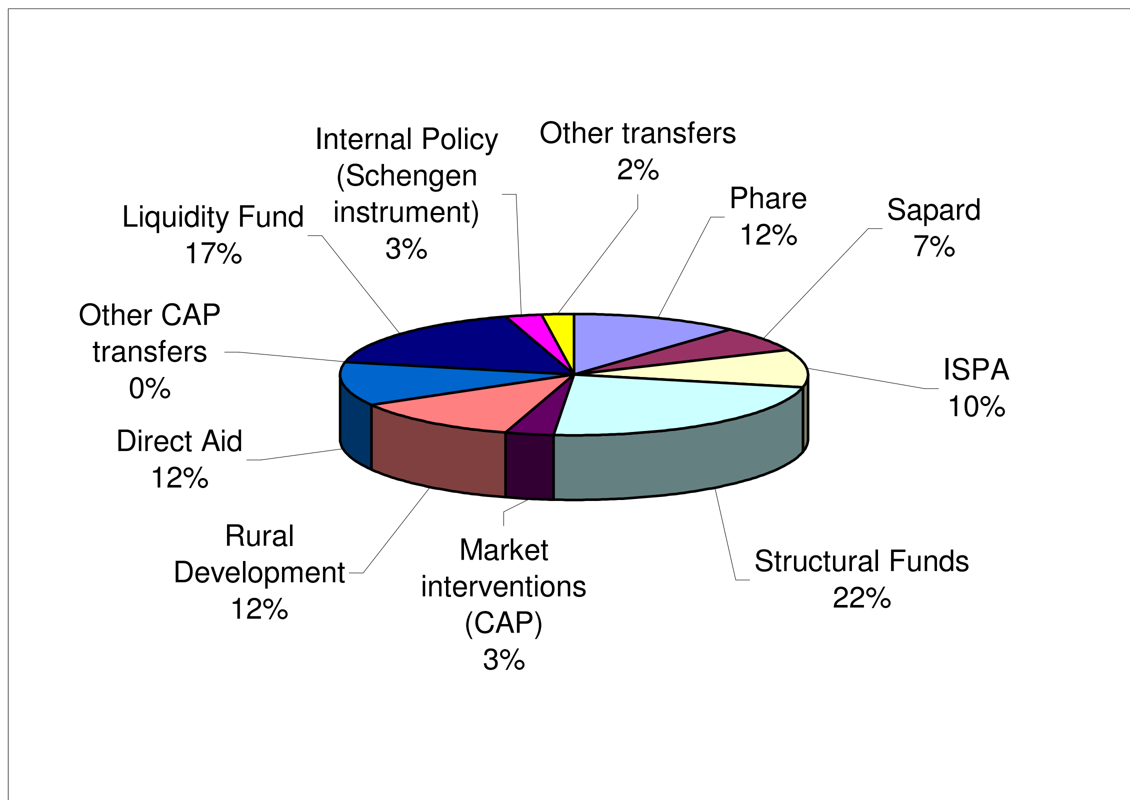
Poland accounted for 3.1% of the EU budgetary expenditures in 2004, while it contributed 1.4% to the EU budgetary revenues. With 1.7% of net transfers, Poland was a net beneficiary in the EU budget. The amount of net transfers was EUR 1.7 billion and this accounted for 0.75% of the country's gross national income (GNI) (European Commission, 2006a). The supply of EU funds to Poland was expected to increase considerably in the next few years, and was estimated that it would reach 1.2% of GDP in 2006, 1.5% in 2007 and 3,25% in 2008 (European Economy, 2005 and 2006).

Recent Polish data about transfers shows that in the first 24 months of EU membership (May 2004 –April 2006), Poland received a total of EUR 7.5 billion from the EU budget payments , while its contribution to the EU budget amounted to EUR 4.6 billion. The net transfer was positive and totaled EUR 2.8 billion (Government of Poland, 2006).

As Figure 4 below shows, over one quarter of payments (28.4%) came from pre-accession aid (Phare, ISPA and SAPARD programs), which will cease by the end of 2006[28]. With regard to the new financial instruments available to Poland since the accession (see Section 1 above), funds for agriculture and rural development accounted for the biggest share of transfers (26.9%). Transfers for structural actions (23.1%) ranked second.

[28] According to the principle of $n + 2$, EU budget funds committed in the year n may be used only within the two years after year n. Unused funds are lost to the beneficiary and remain in the EU budget. This principle was introduced in the EU in 2000 in order to discipline recipient countries.

Figure 4 Structure of the EU Transfers to Poland, 1 May 2004 – 30 April 2006 (%)



Source: Government of Poland, 2006.

Leaving CAP instruments aside, the use of other European Union budget funds requires prior programming for spending. The National Development Plan (NDP) for the years 2004-2006 was elaborated by the Polish government in an extensive process of consultations with local governments and social partners. This is a strategic document which elaborates plans for the medium term. It is the first such document since the transition process started which collects all the government's interventions at the country level: horizontal and into regions and sectors. The NDP includes five so-called setoral programs[29] and a program for regional development. These programs list goals and activities which may be supported from EU funds. They also give would-be recipients of the grants a framework in which they have adjusted their applications.

For the three year period, 2004-2006, a ceiling of EUR 12.8 billion was established for funds from the European resources to be used for the realization of NDP programs. Of this amount, EUR 8.6 billion was committed from the structural funds and EUR 4.2 billion from the cohesion fund.

[29] These are: (1) Sectoral program for Increasing Competitiveness of Enterprises; (2) Program for Development of Human Capital; (3) Program for Restructuring and Modernization of the Agricultural Sector and Development of Rural Areas; (4) Sectoral Program for Fisheries and Fish Processing; (5) Sectoral Program for Transport.

The absorption of these resources was slow in 2004 and 2005. By the end of October 2005 all applications were collected and reviewed: the correctly prepared applications as a whole asked for 151.5% of the total Polish allocation, which indicates the high level of demand for such programs (and EU funding). However, contracts with successful beneficiaries were signed for only 50.7% of the allocation. Up to November 2005, 4.35% of the total allocation was used, i.e. beneficiaries of the programs received the payment for costs borne thus far (Żuber, 2005).

A number of factors are to blame for the slow absorption of the structural funds (Żuber, 2005). The first one is that Poland has adopted a decentralized system of managing the structural programs. This prolongs the procedures, and requires more coordination. The second factor is the poor quality of the laws adopted in Poland that apply to the distribution and use of the structural funds. The third factor is the meager size of public funds for development projects (transport etc), which are necessary in order to co-finance infrastructural investments. The next reason is the poor quality of the system of public finances, which has not been reformed so far[30]. Last but not least is the poor state of public administration, while well-qualified bureaucrats are crucial for the proper management of the programs. Public administration was not strengthened in time to be ready to manage and process the flood of project proposals that followed the announcement of the programs elaborated by the Polish government and accepted by the European Commission for funding. In the course of 2006, the situation improved: domestic regulation concerning the use of the EU funds has been somewhat relaxed and the administrative capacity has increased.

f) The Public Attitude towards Integration

Since the accession, public support for Poland's EU membership has been constantly increasing. In May 2004 supporters accounted for 71% of the adult population and opponents for 20%. By August 2006 the number of proponents increased by 11 percentage points to 83%, while the number of opponents was halved and shrank to 10% (CBOS, 2006b). Only 7% had no opinion with regard to this matter. Supporters of Poland's membership to the EU dominated in all socio-demographic groups. The largest share of opponents was in the group of people with only primary education completed, yet they were

[30] For example, currently the financial perspective is limited to one year, while in structural projects, a longer perspective is crucial.

not many of them (every sixth adult opposes integration). It is worth noticing that the massive support for integration was a characteristic for all the electorates of the main political parties, including those which, on the eve of Poland's accession, were openly against the membership. This result has been taken seriously into consideration by the anti-European politicians.

The results of the public polls also indicate that the supporters of Poland's membership evaluate the impact of the accession much more positively than the opponents, a majority of whom see more costs than benefits of EU integration (CBOS, 2006a).

The number of people who positively assess the impact EU membership on Poland has been growing consistently over time. Two years after the integration, 54% of respondents believed that EU membership brought more benefits than costs for the country. This is 15 percentage points more than was indicated in polls taken after the first three months of the accession (August 2004) and 8 percentage points more than after the first year (April 2006) (see CBOS, 2006a). The number of those who have an opposing opinion is three times less (18%), and 12 percentage points less than shortly after the accession[31].

When asked about personal gains stemming from the country's membership in the EU, 36% declared that they benefited from the integration. 16% were of the opposite opinion and thought that they personally had lost rather than gained because of the Poland's integration into the Common Market[32].

The positive perception of the impact of Poland's integration both for the country and for the personal well-being of its citizens dominates in all socio-demographic groups. People who are younger, wealthier, have completed tertiary education, and are living in big cities are the groups that most often respond that the gains outweigh the hardships related to integration with the EU.

More importantly, the positive perception of the consequences of Poland's accession to the EU dominates across all electorates[33] from all the major political parties. In light of this widely held view, Polish parties that were openly anti-European in the pre-accession period,

[31] 18% of respondents believed that benefits and costs will be equal, while the remaining 10% responded "difficult to say".
[32] 28% believed that gains and costs outweighed each other, while very many (21%) could not answer ("do not know"), which is understandable.
[33] Although the share of overall supporters differs to a greater extent.

stopped highlighting this position as one their parties' trademarks, and removed anti-European symbols from their flags.

The accession benefits which are most acknowledged by the public are the following: the possibility to legally work in the other member countries, open borders (free movement of people as visitors), support to agriculture, and the inflow of EU funds (CBOS, 2006a).

Interestingly, 45% of Poles[34] consistently believe that EU membership is more beneficial for old Member States than for Poland (percentage has remained constant since 1999). This is contrary to what the facts show. On average, the opposite opinion is more popular among the people who see net benefits of the integration for the country and themselves.

[34] Out of those respondents who have an opinion on this issue, which is 82% of the population (12% answers: "do not know")(CBOS, 2006a).

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