MULTILATERAL SUPPORT IN HIGH-INCOME COUNTRIES: CHILE AND POLAND

A. Chile

1. Country Overview

1. Chile is an upper middle-income country with one of the most politically stable systems in Latin America and a solid record of economic growth during the last two and a half decades. It has a market-oriented economy, characterized by a high level of foreign trade and a reputation for strong financial institutions and sound policy that have given it the strongest sovereign bond rating in South America. In January 2010, Chile was invited to become the first South American and the second Latin American country to join the Organisation for Economic Co-operation and Development (OECD). From 1990 to 1999, the Chilean economy grew by an average of 6.5% annually but this expansion slowed to an annual 4% from 2000 to 2009[1] (this period was dubbed the "Chilean nap").[2] Gross domestic product (GDP) growth fell to 1.9% in 2014 and 2.1% in 2015, as a result of a slowdown in the mining sector due to the end of the investment cycle, and a decline in copper prices and private consumption.[3]

2. The economic evolution in Chile is the result of policies implemented since the 1970s. President Salvador Allende's socialist policies, dominated by nationalization and state intervention in Chile's main industries, resulted in skyrocketing inflation and an economic recession in the early 1970s. Following the military takeover in 1973, General Pinochet ushered in free-market reforms to combat a 505% inflation rate. Although this led to a 130% reduction in inflation by 1975, Pinochet's "shock treatment" resulted in a 16.6% reduction in GDP and rising unemployment.[4] The standing joke in the country was, "under Allende we had money, but there was nothing in the stores to buy; under Pinochet, the stores were full of goods, but nobody had any money to buy them." Pinochet continued with economic reform by privatizing enterprises under state control, reducing tariffs to create an open market, deregulating financial markets, and reforming social security. His successor, Alywin, who brought democracy back to Chile, retained most of the previous economic policies and throughout the 1990s, Chile experienced decreasing inflation and unemployment, and increasing exports and foreign capital investment.

3. Nowadays, the Chilean economy is still heavily neo-liberal and market-oriented. Exports of goods and services account for approximately one-third of GDP, with commodities making up some three-quarters of total exports (copper alone provides 20% of government revenues).[5] The early growth model was based on abandoning import-substitution industrialization and focusing on primary exports—minerals and agricultural products. The latter were to be processed if possible (e.g., wines) or be able to take advantage of the reversal of seasons between the northern and southern hemispheres (e.g., fruits, vegetables).

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1 World Bank. World Bank Data: Chile. http://data.worldbank.org/country/chile (accessed 27 June 2016).
2 C. Larroulet. 2013. Chile's Path to Development: Key Reforms to Become the First Developed Country in Latin America. *Lecture.* No. 1236. Washington, DC. The Heritage Foundation. 15 October.
3 World Bank. World Bank Overview: Chile. http://worldbank.org/country/chile/overview (accessed 27 June 2016).
4 The program ended in 1976.
5 Central Intelligence Agency. 2016. *The World Factbook 2016–17*. Washington, DC. https://www.cia.gov/library/publications/the-world-factbook/geos/ci.html (accessed 21 June 2016).

4. Since 1996, the agricultural value-added has declined, and growth has shifted from services to industry (including mining and manufacturing).[6] Because of its reliance on copper exports, Chile is highly exposed to price and demand fluctuations in the global market. The Chilean economy suffered from the international trade collapse and global economic crisis in 2008, highlighting the vulnerability resulting from lack of diversification in government revenue and GDP composition. To counter these swings, the country follows a countercyclical fiscal policy and accumulates surpluses in the form of a sovereign wealth fund (called the Economic and Social Stabilization Fund) during high copper price periods, allowing deficit spending during low copper price periods and slow economic growth. The current government has sought to reduce the dependence on costly imported fossil fuels, which make up over half of the electricity generation mix. In 2013, Congress approved a doubling of the renewable energy target to 20% of total power generating capacity by 2025.[7] In spite of falling oil prices, the country's regulatory framework has spurred investment in renewable energy, which may result in the goal being reached in 2020. By the end of 2015, the installed nonconventional[8] renewable energy capacity represented 11.5% of the total, up from 5.5% in 2013.[9]

5. Chile has sharply reduced poverty rates in recent years, from 7.7% in 2003 to 2% in 2014 (assuming a poverty line of $2.50 per day), and from 20.6% to 6.8% for moderate poverty ($4 per day) during the same period (footnote 3). Despite impressive economic growth and poverty reduction, income inequality is still the highest of all OECD countries. Table 1 shows the progress on some key economic variables.

Table 1: Chile Key Economic Variables

Variable	1990	2016 or most recent year
Population (million)	13.141	18.045
Nominal GDP per capita ($)	2,388.3	12,849.8
Unemployment rate (%)	7.75	5.8
Agriculture value added (% of GDP)	8.7	3.4 (2014)
Agriculture share of employment	19.3%	10.3% (2014)
Gini coefficient	0.54	0.52

GDP = gross domestic product.
Sources: World Bank Data; International Monetary Fund. World Economic Outlook Database.

6. Raising per capita income to OECD levels and further reducing poverty and inequality levels have been common development goals of the previous and current administrations. An ambitious agenda to achieve these goals was set out in the "Agenda 30 30" launched by the Ministry of the Public Works in 2014, which calls for a more balanced development of the country. The agenda aims for a per capita income of $30,000 by 2030, and levels of social inclusion and territorial equity similar to those of Italy, New Zealand, and Slovenia.[10] International financial institutions (IFIs) are active in Chile, despite its high-income per capita. The most active has been the Inter-American Development Bank (IADB). The World Bank has focused on knowledge products and policy-based lending, while European Investment Bank (EIB) operations are limited to some private sector investment, particularly in the renewable energy sector. The relative share of IFI operations from 2005 to 2015 is shown in Figure 1.

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[6] Sectoral composition of GDP in 2015: services (61.6%), followed by industry (42.7%), and agriculture (3.4%). Footnote 5.

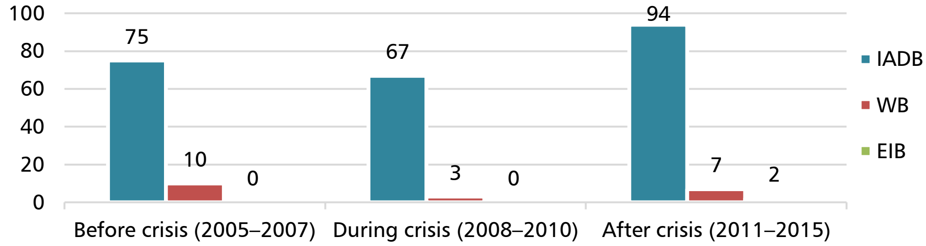
[7] UK Trade and Investment and Foreign and Commonwealth Office. *Chile: Expansion of Renewable Energy.* Research and Analysis, 28 November 2014. https://www.gov.uk/government/publications/chile-expansion-of-renewable-energy/chile-expansion-of-renewable-energy

[8] In Chile, renewable energy is classified as "conventional" and "nonconventional." Since large-scale hydropower has been Chile's largest power source for several decades, it has been classified "conventional." All other renewable sources, including small hydropower, are classified "nonconventional." Source: Footnote 7.

[9] UK Embassy in Santiago and Chilean Ministry of Environment. 2016. *Considerations for a Climate Finance Strategy in Chile.* https://www.e3g.org/docs/Considerations_for_a_Climate_Finance_Strategy_in_Chile,_E3G.pdf

[10] Ministry of Public Works: Government of Chile. 2014. Agenda Infraestructura Desarrollo e Inclusion. Chile 30.30 (in Spanish). http://www.mop.cl/Documents/Agenda_2014-2020_baja.pdf

Figure 1: International Financial Institutions in Chile by Number of Loans and Technical Assistance Projects

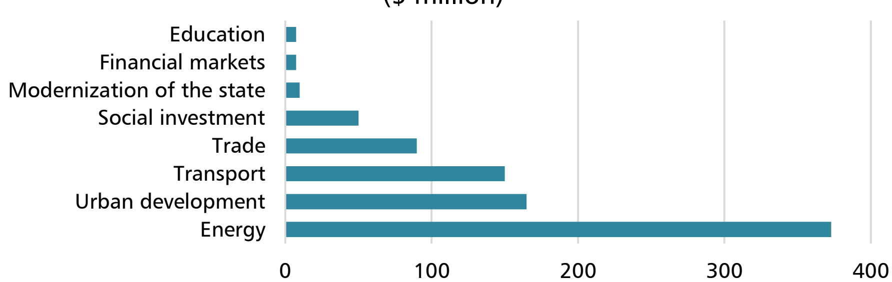


EIB = European Investment Bank, IADB = Inter-American Development Bank, WB = World Bank.
Sources: Data from World Bank, Inter-American Development Bank, and European Investment Bank, 2005–2015; Asian Development Bank Independent Evaluation Department.

2. The Inter-American Development Bank in Chile

7. IADB's share of financing in the Chilean economy is low, but higher than those of other multilateral banks. Borrowing from IADB stood at only 0.2% of GDP at the end of 2013, although it accounted for 85% of total multilateral debt.[11] IADB has found providing support to Chile increasingly challenging over the last 15 years, partly as a result of alternating domestic policies towards external borrowing. Maintaining trust and dialogue with the political leadership has proven to be very important. Relations were strong under President Bachelet's first administration and IADB had a solid engagement during her tenure from March 2006 to March 2010. The situation changed when her successor, President Pinera, adopted a different policy on external borrowing. The government cancelled six operations (for $113.3 million) and three additional operations to support subregional development (for an additional $226.5 million), causing the IADB portfolio in Chile to decline significantly between 2010 and 2014. Despite this setback, IADB continued dialogue with the Pinera administration and began formulating some small projects, gradually gaining some trust to start formulating a country strategy, which was then approved by President Bachelet's administration after her re-election in December 2013. As a result of this evolution, IADB has strengthened its work in the country by (i) responding to the demand for knowledge products in its areas of expertise, (ii) establishing a niche for the bank's private sector activities in renewable energy projects, and (iii) supporting the government in activities relating to coordination of the Pacific Alliance (footnote 11). To date, IADB has disbursed loans to Chile amounting to $853 million, with the sector breakdown shown in Figure 2.

Figure 2: Inter-American Development Bank Loans by Sector
($ million)



Source: Inter-American Development Bank, as of June 2016.

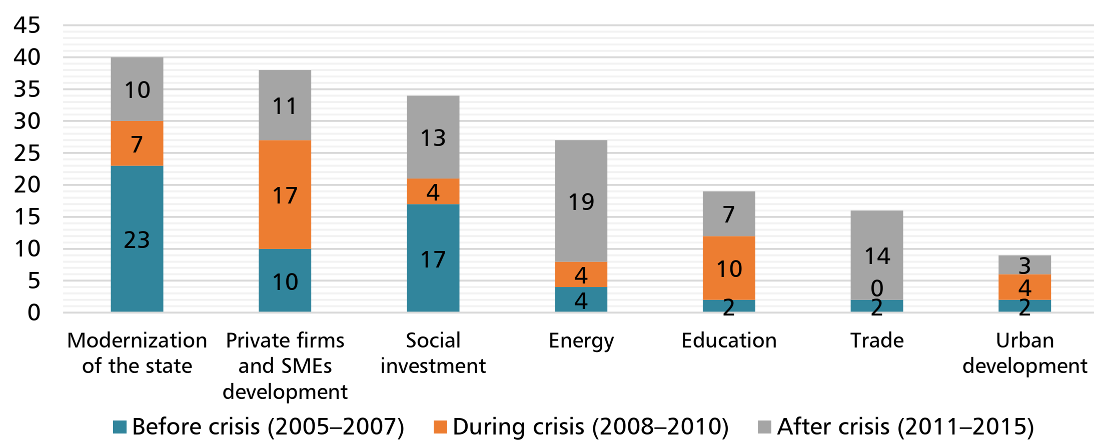
[11] Inter-American Development Bank. 2014. *Chile: IDB Country Strategy, 2014–2018.* http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=39069168

8. The current country strategy (2014–2018) focuses on three strategic pillars: (i) productive development and competitiveness, with an emphasis on the priority areas of competitiveness and innovation, clean energy (mostly solar), and public sector management (subnational and local level); (ii) human capital development; and (iii) regional development, with an emphasis on regional equity and development (emphasizing capacity development of subnational and local governments, given that Chile is highly centralized and capacity at subnational and local levels is low). It is important to note that the bank's private sector presence in Chile has grown markedly in recent years, particularly in the areas of energy and financing foreign trade.

9. IADB also plans to work on two crosscutting areas (gender and indigenous peoples' development) and has identified three areas for dialogue: transportation and logistics, natural disasters, and tax reforms. The main risks to implementation of the strategy are (i) political and social risks, associated with the new administration's ambitious reform agenda, which could end up impacting the bank's program given the scale of initiatives and possible implementation difficulties; and (ii) difficulties in implementing the bank's program as a result of changes in the country's external borrowing priorities (particularly with respect to multilateral banks, footnote 11). Over the strategy period, gross disbursements by IADB are projected to be $381 million and sovereign-guaranteed loan approvals are expected to reach $500 million.

10. Figure 3 shows the borrowing pattern from IADB before, during, and after the global financial crisis erupted in 2008. In terms of the number of projects, technical cooperation with nonreimbursable funding has been the most frequent instrument used by IADB throughout the entire period. Conversely, loans dominate in terms of dollar amounts. Between 2005 and 2007, most projects carried out by the IADB in Chile focused on three sectors—modernization of the state, social investment, and private firms and small and medium-sized enterprise (SMEs) development. In terms of volume, the largest loans were a $400 million credit for modernization of the state and a $100 million loan to the water and sanitation sector.

Figure 3: Inter-American Development Bank Number of Operations by Sector and Period



SMEs = small and medium-sized enterprises.
Sources: Inter-American Development Bank reports, 2005–2015; Asian Development Bank Independent Evaluation Department.

11. During the crisis period (2008–2010), there was a significant reduction in the number of projects for modernization of the state and social investment, while IADB's initiatives for private firms and SME development and education increased significantly. The largest loan ($400 million), during this period was designed in 2007 to support the new public transportation system in Santiago. However, the decrees that authorized the Transantiago financial manager to borrow without a

sovereign guarantee were declared unconstitutional by Chile's Constitutional Court.[12] As a result, the loan was cancelled and repaid by the Chilean government in December 2009. IADB then suspended loan approvals between September 2008 and November 2009. The impact of the Transantiago case and the Pinera administration's focus on emergency assistance and reconstruction after the 2010 earthquake made it challenging for IADB to enter into a dialogue with the administration. In addition, the government's debt policy focused on issuing bonds to cover external financing needs. Such funds were readily available at financial terms similar to IADB financing, but could be accessed more quickly and with lower transaction costs. Consequently, the government did not seek financial assistance from multilateral organizations, including IADB. Given the lower demand for sovereign guaranteed lending, the bank strove to engage through 46 technical cooperation grants during the 2011–2015 period, which required considerable resources for both processing and administration.

12. A more successful line of engagement was through nonsovereign guaranteed operations, particularly in renewable energy. IADB also strengthened its provision of knowledge products in its areas of expertise, and supported the government in regional integration. In line with the focus on regional cooperation and integration of the current country strategy, in April 2016 IADB confirmed its involvement in financing the Agua Negra tunnel project between Argentina and Chile (construction is set for 2018).[13] The bank expects to approve two credits for both countries, amounting to $20 million each for structural research and planning, to be followed by possible additional support to finance the actual construction.

3. World Bank Group in Chile

13. The World Bank country partnership strategy, 2011–2016, aims to support the government's vision of eradicating extreme poverty and becoming a developed country by the end of the decade through strategic knowledge activities (analytical work and technical assistance) in three areas where its support adds value, broadly coinciding with the government's development agenda: (i) public sector modernization, (ii) job creation and equity improvement, and (iii) promotion of sustainable investments.[14]

14. The bulk of the International Bank of Reconstruction and Development (IBRD) assistance is provided through knowledge products delivered through studies structured around a joint studies program funded by the World Bank ($400,000 annually) and the government. The government has also requested the possibility of additional timely assistance through a fee-for-service mechanism to analyze budget allocations and specific public policies. In addition, a research center on global development issues was established to tap into the country's past successful development experience.[15] The

[12] Inter-American Development Bank. 2014. *Chile: Country Program Evaluation, 2011–2013*. June. http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=38894925

[13] Inter-American Development Bank. 2016. *Agua Negra Binational Tunnel: The Region's First Territorial Integration Program.* http://www19.iadb.org/intal/conexionintal/2016/04/29/tunel-binacional-agua-negra-primer-programa-territorial-de-integracion-en-la-region/?lang=en

[14] World Bank Group. 2011. *Country Partnership Strategy for the Republic of Chile, for the Period FY2011–FY2016.* http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2011/01/27/000334955_20110127000949/Rendered/PDF/579890CAS0R2011e0only1910BOX358277B.pdf

[15] Chile's development experience over past decades is valued by other World Bank clients and continued engagement should allow lessons learned in Chile to inform the bank's work in other countries, as well as strengthening South–South cooperation. To this end, Chile's Finance Ministry and the World Bank Group signed a cooperation agreement to establish the World Bank's first research and development center in Latin America in Chile, and the second outside Washington, DC. The other center is in Kuala Lumpur, Malaysia. In 2015, the Global Economic Development Center began a research program anchored in the World Bank's databases. The main studies and areas of work to be performed by the research center include (i) Doing Business, an objective measurement of the guidelines regulating business activity and ease of doing business in 189 economies around the world; (ii) Chile's Sub-National Doing Business, an in-depth analysis of the business environment in each region in the country; (iii) Women, Business, and the Law, analysis of the barriers faced by women when undertaking entrepreneurial and business activities; (iv) Comparative Global Agricultural Business Environment Evaluation, a new World Bank study that seeks to apply the Doing Business methodology to specific sectors; and (v) enterprise surveys.

International Finance Corporation (IFC) interventions in the country focus on activities with a strong potential for development results, mainly in infrastructure, energy, the financial sector, education, and agribusiness, with SMEs being a crosscutting theme. As of July 2015, the IFC in Chile had a portfolio totaling $1.28 billion.

15. Following a reduction in operations during 2008–2010, the World Bank's current program in Chile includes five technical assistance operations totaling $24 million and three loan operations totaling $181 million. Technical assistance operations focus on climate change and renewable energy, land management, and waste management. A policy loan (Social Inclusion for Shared Prosperity Development Policy Financing Program, a stand-alone single tranche $100 million loan) supports the government's program of promoting equity and social inclusion. It supports policies grouped into three main pillars: (i) promoting equal opportunities in education, (ii) improving the conditions to enhance the quality of tertiary education, and (iii) strengthening institutions for poverty measurement and enhancing targeting mechanisms of social programs. An earlier project supported tertiary education financing by strengthening the link between university performance and the financing received by each institution. The Integrated Water Resources Management and Infrastructure Development Project for $40.89 million aims to strengthen capacity for water resources management and public infrastructure planning and concessions.[16]

4. The European Investment Bank in Chile

16. Outside the European Union (EU), the EIB supports projects that contribute to economic development in countries that have signed association or cooperation agreements with the EU or its member states. It does so at its own risk to its balance sheet, using budgetary guarantees provided by the member states or under mandates from the European Parliament and Council of the European Union. EIB lending in Asia and Latin America started in 1993 to promote sustainable and inclusive growth. The latest EU External Lending Mandate, covering the period 2014–2020, provided a ceiling of almost €2.3 billion for operations in Latin America (there are country allocations). Chile is among the countries currently eligible for EIB financing under the external lending mandate (2014–2020). In some cases, the EIB can also provide lending from its own resources under the Climate Action and Environment Facility or the Strategic Projects Facility, with a combined total of €2 billion.

17. EIB financing in Latin America gives priority to the following areas: (i) climate change mitigation and adaptation (e.g., renewable energy, energy efficiency, urban transport, and other projects that reduce carbon dioxide emissions); (ii) development of social and economic infrastructure, including water and sanitation; (iii) local private sector development, in particular support to SMEs.[17]

18. Since the entry into effect of a framework agreement signed in March 2010, EIB has funded two loans in Chile, both under the Facility for Energy Sustainability and Security of Supply. The first loan (signed in 2011) was for $82 million to Eolica Monte Redondo (a subsidiary of IPR-GDF SUEZ) to finance the construction of the Laja run-of-the-river hydropower plant. Laja is the first power plant in Chile whose turbines will be installed in the bed of the river, as a result of which the course of the river will not have to be diverted. The new Laja power plant serves the growing demand for electricity through a renewable low-impact energy source. At the same time this project forms part of efforts to diversify the power mix.[18] In 2014, EIB also signed a $205.4 million framework loan to Banco Santander Chile to finance projects contributing to climate change mitigation, especially large and medium-scale renewable energy schemes. These include wind, solar photovoltaic, concentrated solar power and

[16] http://www.worldbank.org/en/news/loans-credits/2015/11/04/chile-integrated-water-resources-management-and-infrastructure - development-project

[17] European Investment Bank. 2015. *EIB Financing in Latin America.* http://www.eib.org/attachments/country/factsheet_latin_america_2014_en.pdf

[18] European Investment Bank. 2011. *First EIB loan in Chile for Renewable Energy.* 15 June. http://www.eib.org/infocentre/press/releases/all/2011/2011-081-primer-prestamo-del-bei-en-chile-para-energia-renovable.htm

biomass projects, and transmission lines for transporting renewable energy.[19] This was one of the five main projects for which the EIB granted loans during 2014.

5. Conclusions

19. Chile exemplifies the evolving relationship between IFIs and middle-income countries. As access to commercial financial markets at comparable cost opened up, the country became much more selective in the type of financial assistance it sought from various sources. With strong institutions, low financing needs, and abundant access to capital markets at low spreads, Chile's demand for the services of multilateral financial institutions concentrates on the provision of technical assistance and other knowledge products in areas in which the banks have a comparative advantage and can support the country's efforts to achieve its development goals. Chile began tapping relatively remote sources of funding (e.g., EIB) for areas such as climate change and renewable energy that resonate with these institutions' mandates.

20. IADB, which is seen by many of its members as a "cooperative bank," continued to maintain a significant level of engagement, but achieved this by shifting (i) from lending to technical assistance and knowledge-based support, and (ii) from sovereign to nonsovereign operations.

21. The difficulties following the nonsovereign nonguaranteed lending to Transantiago transit operator show that, even in more advanced regions and countries, the institutional framework can be a significant barrier to the expansion of subsovereign lending. The issue cannot be simply dismissed by noting that countries need to liberalize their public finance framework to allow subsovereign lending without central government guarantee. Such a step would potentially be possible when measures are in place to ensure that local government borrowing is sustainable. The moral hazard of borrowing without a central government guarantee, relying on the fact that ultimately central governments will have to bail out local units anyway, deserves serious consideration, as it may undermine overall fiscal and financial discipline, with negative long-term effects.

22. The relationship between Chile and the World Bank has followed a similar pattern of evolution towards knowledge products. As a further step, the intention to open a jointly funded research center on development aimed at tapping the country's successful evolution to foster South–South exchange and collaboration. As in the case of IADB, the potential for private sector operations grew in parallel with the sophistication of the country's financial and economic structure.

23. Looking forward, Chile faces two key challenges—declining growth performance and high inequality. Despite the acknowledged progress made in the past two decades, there remains a flagrant disparity in wealth, income, and opportunities. The main factor behind the recent slowdown—in addition to the decline in global demand, which also affected mineral exports—has been a reduction in the rate of growth of total factor productivity. To move successfully beyond this stage, Chile will continue to need physical investment to upgrade its power supply and address infrastructure bottleneck. According to the latest *Global Competitiveness Report* of the World Economic Forum, the main issues slowing competitiveness in Chile are limitations in electricity supplies, the low quality of education at all levels, comparative advantages that are concentrated in sectors with low technological intensity, weak innovation capacity, and the low level of private investment in research and development.[20] These are areas that require financing, but that rely even more on knowledge, structural reforms, and comparative analysis and application of international best practices. The role of IFI in supporting Chile's development agenda is also shifting accordingly.

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[19] European Investment Bank. 2014. *EIB: Climate Action in Latin America.* http://www.eib.org/attachments/general/events/20141201_lima_cop20_eib_climate_action_in_latin_america_en.pdf

[20] World Economic Forum. 2015. *Global Competitiveness Report, 2015–2016.* Geneva.

B. Poland

1. Country Overview

24. Since 1990, Poland has pursued a policy of economic liberalization that is widely regarded as having been successful. From 1989 to 2007, its economy grew by 177%, outpacing its Central and Eastern European neighbours as it nearly tripled in size, the result of a series of aggressive measures taken by the government aimed at building the institutional bases of a free-market economy. After it joined the EU in 2004, the model was one of intensive growth based on the influx of EU structural funds.[21] Poland's economy was the only one in the EU to avoid a recession through the 2008–2009 economic downturn, thanks to the size of its domestic economy, a floating exchange rate regime, limited imbalances at the onset of the crisis, and a fiscal stimulus in part financed through EU structural funds.[22] After years of strong growth, the Polish economy experienced a substantial slowdown in 2012–2013, largely caused by the repercussions of the euro crisis. Aided by fiscal expansion and an accommodating monetary policy, however, economic growth re-accelerated in 2014.

25. The process of national convergence within the EU has been accompanied by increased internal divergence between and within Poland's regions. Significant income disparities remain between Warsaw (by far the wealthiest part of the country), the western provinces (characterized by strong entrepreneurship and better infrastructure), and the eastern provinces (economically backward and poor). Since 2008, the number of people living in poverty or social exclusion has decreased steadily, meeting the Europe 2020 target. Poland has also recorded the largest drop in income inequality in the region.[23] In 2014, the at-risk-of-poverty or social exclusion rate for working age population stood at 24.7%, very close to the EU average. At the same time, extreme poverty has been on the rise since 2008, stabilizing in 2013–2014 at 7.4% of the population.[24]

26. At the beginning of its transformation in the 1980s and 1990s, Poland had a relatively high share of industry in its GDP. The dynamic development of services which has taken place since the early 1990s was accompanied by changes related to the structure of the services sector. The share of services in employment has increased since the 1960s from 23% to over 55% in 2012 and its growth has been led by public administration and business services, which were characterized by the highest rate of employment growth.[25] The city of Wroclaw is emerging as one of Europe's most important financial hubs as investment pours into the country's outsourcing industry. As a result, Poland has become the world's third largest outsourcing market for the financial services industry after the People's Republic of China and India.[26]

27. During the 25 years of Polish transition, there has been an educational boom, particularly in tertiary education, which bodes well for Poland's rapidly ageing population.[27] Poland is one of the three EU countries whose workforces are expected to shrink the most in coming years. By 2040, the

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[21] Poland is expected to introduce the euro, but given its failure to meet the Maastricht Treaty budget deficit criterion (3% GDP), no definite date has been set yet.

[22] World Bank Group. 2016. *Poland Partnership Program Snapshot*. April. http://pubdocs.worldbank.org/en/976681461065734182/World-Bank-Poland-Program-Snapshot-April-2016.pdf

[23] International Monetary Fund. 2015. *Republic of Poland: IMF Country Report No. 15/182*. July. https://www.imf.org/external/pubs/ft/scr/2015/cr15182.pdf

[24] European Commission. 2016. *The National Reform Programme for the Implementation of the Europe 2020 Strategy 2016/2017 Update*, 26 April. http://ec.europa.eu/europe2020/pdf/csr2016/nrp2016_poland_en.pdf. Note: The extreme poverty rate implies a proportion of persons in households where the expenditure was below the minimum subsistence level (i.e., the assumed threshold for extreme poverty). The subsistence minimum (calculated by the Institute of Labour and Social Studies) includes only those needs which must be met immediately and cannot be satisfied at a later stage, and the consumption below this level may lead to cachexia (general wasting and malnutrition).

[25] J. Dominiak and J. Hauke. 2015. The Changes of the Services Sector in Poland and other EU Countries. *Studia Regionalia*. No. 41–42 pp. 38–50. http://www.ersa.org.pl/files/9014/6248/1050/SR_41-42_037-050.pdf

[26] H. Foy. 2015. Poland Draws Big Banks for 'Nearsourcing'. *Financial Times*. 22 January. http://www.ft.com/cms/s/0/1df9e49c-a153-11e4-8d19-00144feab7de.html#axzz4CsxIVamg

[27] At the end of the 1990s, 25% of 20 year-olds in Poland studied at the tertiary level. Now that figure has doubled.

number of people of working age in Poland will have fallen by 4.62 million (17%) compared with 2013; and by 2020, the Polish labor market will lose 1.66 million people of working age.[28] The current segmentation of the Polish labor market[29] affects the productivity and the accumulation of human capital in the longer term, threatening the sustainability of future pensions. Although EU membership and access to structural funds have provided a major boost to the economy, GDP per capita ($14,337 in 2014) remains significantly below the EU average of $30,240, while unemployment is still 2 points below the EU average. This gap is explained largely by the significantly lower participation rates of women and the relatively low-skill level in the economy.[30] At the same time, the weight of the agricultural sector in total employment remains high and is declining only slowly (Table 2).

Table 2: Poland and the European Union, Key Economic Variables

	1990		2015 (or most recent year)	
Variable	Poland	EU12[a]	Poland	EU28[b]
Population (million)	38.2	475	38.6	508
Per capita GDP ($'000)	1.7	15.8	14.3	30.2
Unemployment	6.1%	8.1%	6.8%	8.8%
Agriculture share of GDP	8.26%	2.9% (1995)	3.30%	1.7%
Agriculture share of employment	25%	4.7% (1995)	11%	4.4%
Gini coefficient	26.9	32.3	47.9	51.8

EU = European Union, GDP = gross domestic product.

[a] EU12 comprises Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom.

[b] EU28 comprises of EU12 plus Austria, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Finland, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia, Sweden.

Sources: Eurostat. World Bank Database.

28. Poland has become an integral part of the German supply chain and has developed trade and financial links with the eurozone. As a result, Poland has benefited from substantial technological transfers and increased sophistication of domestic value added.[31] However, the high degree of trade and financial integration also exposes Poland to external shocks. Poland's economic success has been impressive but its past record does not guarantee the same level of economic expansion in the future. The growth model underpinning Poland's success heavily relies on low to medium technology sectors with a relatively high share of low-skilled labour. Poland's economy is competitive due largely to its low manufacturing costs, which has exposed the country to the risk of the "middle-income trap."

29. Despite sizeable investment in recent years, bottlenecks and deficiencies in transport, energy and communication networks persist. Demand for electricity in Poland is constantly growing, but the coal-rich nation is reliant on aged and polluting coal and lignite (which account for about 85% of the total) generators and the power network is not sufficiently connected to neighbouring countries. Poland has committed to source 15% of its electricity from renewable sources by 2020, up from 9.4% in 2010.[32] Manufacturing contributes nearly 33% of GDP; traditional industrial sectors (steel industry, shipbuilding) have been in decline; and Poland's main industrial sectors now are machine manufacturing, telecommunications, environment, transport, construction, industrial food processing, and information technologies.[33]

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[28] European Commission. EUROSTAT EUROPOP. Base year 2013.

[29] Poland has the largest share of temporary labour contracts in total employment in the EU.

[30] European Commission. 2016. *Country Report Poland 2016*, Commission Staff Working Document, 26 February. http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_poland_en.pdf

[31] International Monetary Fund. 2015. *Republic of Poland: IMF Country Report No. 15/182.* July. https://www.imf.org/external/pubs/ft/scr/2015/cr15182.pdf

[32] European Investment Bank. 2013. *Electrical evolution in Poland.* http://www.eib.org/projects/regions/european-union/poland/project-electrical-evolution-in-poland.htm

[33] Santander Trade Portal. *Poland: Economic and Political Outline.* (last retrieved on 21 June 2016), https://en.portal.santandertrade.com/analyse-markets/poland/economic-political-outline

30. Poland has made the strongest progress in "doing business" reforms among EU and OECD countries since 2005. It was ranked 32nd worldwide in *Doing Business 2015*, above the EU28 average and ahead of all new EU member states in Central Europe. However, the business climate still has weaknesses, including in starting a business, dealing with construction permits, and paying taxes.

2. The European Investment Bank in Poland

31. Poland has been the largest beneficiary of EIB loans of all the EU member states that have joined the EU since 2004, and is the sixth largest recipient of EIB support.[34] In Poland, the EIB supports investment projects designed to reduce disparities in regional development, strengthen economic competitiveness, and improve living standards. EIB financing in Poland amounted to €5.5 billion in 2015.[35] Transport and telecommunications infrastructure represented 40% of the lending total, with a further 19% supporting the services sector. Nearly 17% of 2015 funding to Poland benefited the Polish SMEs and midcaps (companies with up 3,000 employees). A lot of financing to SMEs comes from the EIB through the national development bank and EIB lending to private sector.

32. **Energy sector.** There has been considerable EIB investment in Poland's energy sector as a whole (over €2 billion since its first operation in 1990). Projects supported by the EIB have contributed to the improved sustainability and efficiency of Poland's energy infrastructure and increased usage of renewable energy resources, thereby reducing harmful emissions. In 2015, the EIB allocated almost €700 million to investment projects in the energy sector, enabling 45,000 new users to connect to the upgraded power supply network. As an example, to support the country's ambitious renewable energy plans, the EIB provided a €45 million loan for the construction and operation of a wind farm located on two sites north of Poznan that has been fully operational since April 2010.[36] In addition to carbon dioxide emissions savings (estimated at 260.000 tonnes per year), the project created 300 person-years of temporary jobs during construction and commissioning and 10 permanent positions for the operation of the wind turbines. The municipality has enjoyed increased revenues from the land leasing, while residents have also benefited from the improvements to the local road network.

33. **Strategic infrastructure**. In 2015, the EIB primarily supported the development of Polish road and rail infrastructure, having allocated over €1.7 billion to the construction and upgrading of more than 350 kilometers of expressways and 300 kilometers of rail tracks, to ensure the continued growth of the Polish economy, strengthen the country's competitiveness, and improve connectivity for its citizens.

34. **Small and medium-sized enterprises and midcaps**. EIB lending to 17 major banking and leasing institutions in Poland improved access to finance on better terms for Polish SMEs and midcaps, to increase their competitiveness, regional cohesion and productivity, and to promote growth and employment.[37] As of December 2014, the European Investment Fund had mobilized resources to Polish SMEs through guarantees and securitizations (€833.6 million), equity (€874.8 million), and microfinance (€31.1 million). In 2014, the EIB Group participated in the first public asset-backed securities transaction in Poland to further open up the securitization market for SME financing. This operation is employing an innovative top-up of an existing special purpose entity, ROOF Poland Leasing 2014 DAC (ROOF), in which the transaction costs and structuring time were considerably reduced.

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[34] EIB operates without country strategies or indicative country allocations. EIB responds to clients' demands and market opportunities, with the exception of EU mandates that define EIB's development support and role outside the European Union.

[35] Between 2011 and 2015, EIB invested almost €26.5 billion in Poland.

[36] European Investment Bank. 2012. EIB to provide EUR 45m for Magonin windfarm project in Poland. 30 September. http://www.eib.org/infocentre/press/releases/all/2010/2010-159-eib-to-provide-eur-45m-for-margonin-windfarm-project-in-poland.htm

[37] European Investment Bank. 2015. *The EIB in Poland in 2014.* February. http://www.eib.org/attachments/country/factsheet_poland_2014_en.pdf

35. **Youth employment.** Through its "Skills and Jobs—Investing for Youth" programme, the EIB is trying to improve the younger generation's performance in the labour market. This initiative aims to boost jobs for young people by improving access to finance for SMEs and enhancing their employability via targeted investment in skills. In 2014, the EIB provided the first ever EIB loan (€50 million) to Poland under the framework of the "Investing for Youth" initiative through which Europejski Fundusz Leasingowy S.A. financed SMEs that meet at least one of the following criteria: (i) they added at least one 15–24 years old to their payroll in the 6 months preceding the signing of the loan agreement with Europejski Fundusz Leasingowy S.A.; (ii) they offer vocational training or internships or training programs for 15–24 year olds; or (iii) they offer summer internships to employ young people from a technical college, school, or university.

3. European Bank for Reconstruction and Development in Poland

36. Poland was at the center of EBRD's debate on graduation before the 2008 financial crisis. The issue has been set aside in the wake of the crisis, given the country's strong dependence on the single market and even more on Germany.[38]

37. In Poland, EBRD has approved a total of 368 projects with a net cumulative investment volume of €7,862 million.[39] Approximately 38% of the bank's investments were in industry, commerce, agribusiness; 29% in energy; 25% in financial institutions; and 8% in infrastructure. Reflecting EBRD's strategic focus on the development of the private sector, its share of the portfolio is 91%. As Poland is an advanced transition country, EBRD's activities in the current strategy (2013–2017) focus on a limited number of priorities: (i) promoting a low-carbon economy, (ii) enhancing the private sector's role in the economy, and (iii) assisting in the development of a sustainable financial sector and capital markets.

38. **Energy**. The EBRD continues to support diversification of energy and fuel supplies (especially renewable energy) and energy efficiency, together leading toward a more sustainable energy market in Poland. On the supply side, investment is planned in grid management, including smart grid solutions; better access for renewable energy; and more efficient co-generation. On the demand side, thermo-modernization of buildings, improvements in rolling stock, energy-efficient solutions in industry, as well as a gradual modal shift in urban and national transport will need to be developed.

39. **Private sector**. The Polish state continues to play a significant role in the economy, notably in the power, chemical, natural resources, transport, and municipal sectors. EBRD seeks opportunities to participate, principally through equity, in the privatization of the remaining state- or municipally-owned companies. It also aims to provide financing for private sector companies managing public infrastructure through public–private partnerships or other forms of contracts or financing instruments, including capital market solutions.

40. **Financial sector and capital markets**. About 70% of Polish banking assets are foreign-owned. To enhance financial sector sustainability, EBRD has pursued opportunities to facilitate and accelerate the development of the debt capital market through subscriptions to bank and corporate bonds, structured instruments, and asset-backed securitization. The objective is to support the development of alternative long-term funding instruments, mobilize a wider investor base, and increase market liquidity.

4. The World Bank Group in Poland

41. Through the partnership with the World Bank Group (WBG), Poland aims to access financial and knowledge services to support its convergence process within the EU. The WBG, which has invested about $6 billion in Poland since 2009, is a relatively minor player in the country, and coordinates closely with the European Commission so that it is engaged only in those areas where it

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[38] Information collected through interviews.
[39] As of 1 March 2016.

can add the most value. While the government has indicated its preference not to graduate from the WBG at this stage, both parties agree on the need to transform the nature of WBG involvement, with a stronger focus on boosting shared prosperity, greater reliance on knowledge products, and the use of cost-sharing arrangements to finance selected advisory and analytical services. [40] The aim of the country partnership strategy (FY2014–FY2017) are (i) to foster sustainable income growth for the bottom 40% of the population within the context of Poland's economic convergence process within the EU, and (ii) to support Poland's emerging role as a global development partner. The program rests on four strategic engagement areas, which are aligned with the "Europe 2020" strategic agenda and with the national development strategy: (i) economic competitiveness; (ii) equity and inclusion; (ii) climate action; and (iv) Poland as a global development partner.

42. In support of area (iv), in 2013–2014, the World Bank office in Poland conducted the "Poland as a Global Development Partner" project. Within the framework of this project, the World Bank organized debates and conferences on key development topics, initiated knowledge exchange between Poland and other countries, and prepared a number of publications summarizing Poland's accomplishments over the past 25 years. This initiative coincided with Poland's new momentum in its post–1989 foreign policy aimed at counterbalancing the previous virtually exclusive political and economic concentration on Europe by engaging with other countries, presenting itself as a model or inspiration for them.[41] With this aim in mind, a national law on development cooperation was adopted in 2011 and bilateral aid programs have been established. The World Bank has been trying to create synergies between these programs and its own initiative by fostering cooperation and a knowledge-sharing agenda across countries in a peer-learning format. In this context, in December 2015, the World Bank organised a study tour for a parliamentary delegation from Mongolia to Poland in order to learn from Poland's experience in reforming its social insurance system. This study tour can be considered as an example of the benefits the World Bank can provide to low- and lower middle-income countries.[42]

43. The World Bank program is largely based on knowledge products—analyses and advisory services, in part reimbursed by the government. In Poland, the World Bank acts as an independent broker and catalyser of global knowledge and expertise in specific technical "niches" (e.g., bank resolution frameworks, innovation and competitiveness, climate change modelling, infrastructure financing). The program is expected to remain a very selective and demand-driven engagement to serve several purposes, including to inform policy debates and to facilitate the design or implementation of technical reforms. Examples of such work include (i) support on "doing business," (ii) dialogue on innovation and smart specialization, (iii) support for the development of a macroeconomic model to assess the economy-wide impact of climate change-related policy decisions, (iv) analytical work on aging and on savings and growth (in a context of aging), (v) support to the Ministry of Finance on issues such as forecasting for subnational governments and macroeconomic analysis as part of preparing for an eventual adoption of the euro and improving the process for spending reviews, (vi) development of financial instruments in the energy efficiency and waste management sectors, (vii) analytical support to public transport development, including green transport and road safety, (viii) financial reporting in the private and public sectors (funded by the government of Switzerland), (ix) assistance in the health sector; and (x) potential support in the areas of construction permit regulations, higher education, and the return on public investment.

44. IBRD operations in the past have fluctuated both in terms of number and amount, but have picked up significantly in dollar terms during the recent years of financial turmoil. The most recent

[40] In the 1990s and early 2000s, the WBG had a large lending and analytical program in a broad range of sectors. With the country's admission into the EU in 2004, the situation changed significantly. In financial terms, IBRD's annual lending became a fraction of EU grants and European Investment Bank (EIB) operations.

[41] DemosEuropa-Center for European Strategy. 2015. *Towards Poland's Global Engagement.* Note commissioned by the World Bank. http://pubdocs.worldbank.org/en/228061435014173462/Poland-Global-engagement.pdf

[42] For information about how the World Bank classifies countries: https://datahelpdesk.worldbank.org/knowledgebase/articles/906519

strategy foresees two development policy loans and a number of investment lending programs over the 2014–2017 period (including in health, flood protection, and social inclusion).

45. **Financial sector and capital markets.** The Polish authorities have prioritized reforms to strengthen public finances and financial sector oversight, supplemented by reforms aimed at bolstering the economy's long-term competitiveness as they seek to increase productivity and diversify into new product markets. To support this new macroeconomic framework, the WBG has been providing a series of two development policy loan operations, which are structured around three pillars: (i) enhancing macroeconomic resilience, by reducing the general government fiscal deficit and debt levels toward a medium-term objective and bolstering macro-prudential oversight, (ii) strengthening labor market flexibility and employment promotion, and (iii) improving private sector competitiveness and innovation.

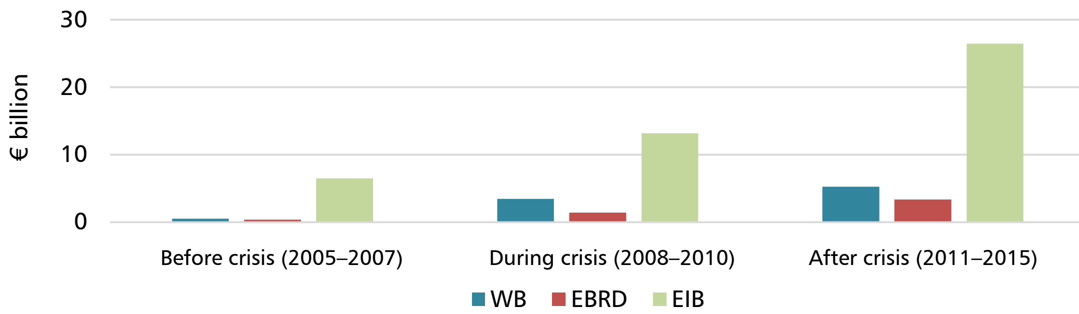
46. **Infrastructure and water management.** Effective protection from floods requires a combination of infrastructure investments and adequate arrangements for coordination between the various entities in charge of administering the river basins. In recent years, the bank has provided financing and technical leadership and mobilized other financiers (the European Commission, the Council of Europe Development Bank, and Poland's own budget) to implement the Odra River Basin Flood Protection Program and the Odra-Vistula Flood Management Project. The flood protection program will help to ensure the protection of the population in south-eastern Poland, particularly the economically crucial city of Wrocław, from loss of life and damage to property caused by severe flooding. It will also build administrative and policy capacity within the government to carry out complex large infrastructure works of a national strategic nature, involving numerous national and local agencies. The new flood management project, which is the second initiative of national importance, has the strategic aim of completing the protection of all the most vulnerable areas in the Odra basin and of establishing a first set of measures to start providing the same level of protection for the Upper Vistula basin.

5. The 2008 Global Financial Crisis

47. In the aftermath of the financial crisis, the EIB, WBG, and EBRD provided at least €30 billion of assistance over 2013 and 2014 to central and south eastern Europe under the Joint IFI Action Plan for Growth (JIAP) launched in 2012.[43] Poland was among the 17 countries benefiting from the initiative (loans and projects in Poland under JIAP totalled €17.1 billion). The region was more badly affected than any other emerging market region by the 2008–2009 crisis, as capital inflows through the local banking system came to a sudden stop, and export markets dried up. Subsequent growth was again interrupted in 2012 as the faltering activity in the euro area affected the region's exports, and a renewal of cross-border bank deleveraging threatened to deprive local economies of credit. Although Poland's economy was the only one in the EU to avoid a recession through the 2008–2009 economic downturn, it experienced a substantial slowdown in 2012–2013, largely caused by the repercussions of the euro crisis. The assistance of the three IFIs was complementary and in some cases joint. In addition to individual loan or guarantee operations, they have all provided funding to regional equity and loan funds, which provided finance in various forms to SMEs and micro-enterprises. The level of activity of all three IFIs, and particularly of the EIB, increased significantly as they combined to help Poland respond to the challenges of the economic crisis (Figure 4).

[43] Actual assistance under this plan has exceeded €42 billion.

Figure 4: International Financial Institution Operations in Poland



EBRD = European Bank for Reconstruction and Development, EIB = European Investment Bank, WB = World Bank.
Sources: European Bank for Reconstruction and Developememt, European Investment Bank, and World Bank.

6. Conclusions

48. While the Polish economy has made steady progress over the last two decades, continuing to close the income gap with the EU average is becoming more difficult. Moreover, the unfavorable demographic outlook is reducing the contribution of employment to Poland's growth potential. As a result, Poland's challenge is to accelerate growth and make sure it is inclusive in the context of rapid population aging and accelerating technological change, moving from the production of relatively low-technology goods to more advanced products and services. The continued strong role of the state remains a transition challenge that cuts across several sectors. There remains an acute need for modernization in key sectors of the Polish economy, evident in low energy efficiency and private sector involvement in some industrial and infrastructure segments

49. Poland has taken full advantage of the additional financing opportunities resulting from joining the EU and accessing structural funds through the EIB. These funds have allowed the country to narrow the physical infrastructure gap in an affordable manner, promoting in turn the inflow of foreign investment, while capitalizing on its human capital endowment. This is an additional source of external financing that is available only to EU members, and to a lesser extent to countries in the European "neighbourhood" (i.e., that are contemplating future accession).

50. Poland has capitalized on the relative strengths of three IFIs—EIB for physical infrastructure requirements, EBRD for support to private sector development, and the World Bank for knowledge and analytical inputs. Polish staff at these institutions who previously occupied government positions confirmed that the country authorities have made a deliberate decision to seek the lowest cost financing and the most specialized forms of assistance from each of the three institutions, complementing the government's ability to tap into commercial markets.

51. Since Poland is an EU member, EBRD and EIB have been able to cooperate closely. EIB is limited to financing up to 50% of a project's total investment costs; therefore, there are often opportunities for it to work with EBRD, the World Bank, or other banks in cofinancing projects or in security structures.[44] EIB and EBRD have different but complementary mandates in Poland and have focused on their comparative advantages, which are often related to project risk profiles and transaction structures. The European Commission acknowledges that EIB has an in-depth expertise in supporting the development of municipal and environmental infrastructure and service sector projects as well as SME financing through on-lending, equity and risk-sharing. EBRD has strong expertise when it comes to financing

[44] As an example, EIB and EBRD supported Grupa Azoty, Poland's leading chemical and fertilizer company's expansion project in May 2015, through two separate 10–year loans: a €134 million loan from the EIB and a €37 million loan from the EBRD. The remaining €370 million was provided by a separate loan signed with a consortium of Polish banks.

industrial, agribusiness, and SME projects. In addition, one important legacy of the JIAP is that it has promoted very close cooperation between the three IFIs in their work in Poland and in the region as a whole. This has occurred at the policy level and has been reinforced by close working relations in the country.

52. EIB, EBRD, and the WBG have followed a similar strategy of being selective and driven by market demand for projects where they can demonstrate both additionality and strong transition potential. They have emphasized issues linked to the more mature state of the Polish economy: the development of still immature markets (e.g., non-bank debt financing instruments), promotion of public goods and externalities (e.g., flood control, low-carbon economy), coordination of different levels of government, and knowledge and innovation.

53. Poland was on the verge of graduating from EBRD in 2007, but graduation from both EBRD and possibly the World Bank was deferred when the crisis erupted. Borrowing from the World Bank, principally for budget support, and from EBRD, in addition to the support received from EIB, increased dramatically starting in 2008 and continued to expand in the following years, for anti-cyclical purposes. Even for countries that have fairly easy access to commercial financing, the recent economic fluctuations have underlined the importance of being able to rely on IFIs during times of economic turbulence.