

The  
Economist

SPECIAL REPORT

**POLAND**

JUNE 28th 2014



**A golden opportunity**

# POLAND OUR ENERGY YOUR BUSINESS

*POLAND – THE HEART OF EUROPE, TO BE POWERED BY INVESTMENTS IN RENEWABLES, EUROPE’S LNG IMPORT HUB AND CLEAN COAL.*



The Łagisza power plant in Będzin, Poland

## STRATEGIC DIVERSIFICATION OF FUELS

TAURON Polska Energia's corporate strategy for 2014-2017 (with an outlook until 2023) will continue to be based on a diversified generation portfolio. By 2023 capacity will reach 6.15 GW (now 5.4 GW) and investments will amount to € 9 billion (€ 7 billion by 2020). Fossil fuels will remain important in the Group's diversified portfolio and the mix may include nuclear power. Share of coal-based technologies will fall from 92% to 74% in 2023, with 25% coming from modern, high-efficiency units. Gas and low-carbon technologies will account for approx. 26% of generation. TAURON Group is one of the largest companies in Poland and a leading energy holding in CEE, operating in all main areas of the energy market, controlling the entire value chain. With equity of PLN 17.8 billion and 26,000 staff, vertical integration increases stability of revenue and margins. The company has been listed on the Warsaw Stock Exchange since June 2010.



LNG Terminal in Świnoujście, Poland

## INVEST IN ENERGY INDEPENDENCE

Polskie LNG S.A. is a company responsible for construction and operation of the liquefied natural gas (LNG) import terminal in Świnoujście. The LNG Terminal - one of the greatest national energy projects in recent years – is considered a strategic facility for Poland's energy security, allowing the import of natural gas by sea from nearly every direction in the world. The initial regasification capacity of the Świnoujście terminal will amount to 5 bcm and will satisfy a third of the national

demand for this fuel. In the future, the terminal's re-gasification capacity may be increased to 7.5 bcm / year. The LNG Terminal in Świnoujście will be the only facility of this size in the CEE region and the largest in the Baltic Sea area. The access to the international LNG market will allow Poland to diversify gas sources for national economy thus increasing the energy security of the country and the entire region.



Solina Hydro Power Plant

## PGE GROUP IS POLAND'S LARGEST UTILITY, AS MEASURED BY BOTH REVENUES AND POWER GENERATION.

PGE Group is Poland's largest utility. Its fuel resources, power generation capacities and distribution networks mean PGE guarantees a reliable electricity supply to over five million customers. PGE Group has nearly 13 GW of installed capacity, 40% of Poland's power generation and 30% of the retail market.

Polish CO<sub>2</sub> emissions are more than 35% down on 1988 and our new investments in efficient coal-fired plants will cut emissions by 25%. We plan SO<sub>2</sub> reductions of 60% by 2020 making our plants among the cleanest in Europe. We will invest PLN 15.2 billion in, e.g., new units at Opole and Turów (2300 MW), with 234 MW in wind farms.

Poland generates 85% of its electricity from coal so CO<sub>2</sub> reduction has to start from there but coal gives energy security and makes Poland one of the EU countries least dependent on imports. In the current geopolitical situation, it wouldn't be smart to give up this advantage.



Construction of the new ENEA power unit in Koźminiec, Poland

## MODERN ECO-ENERGY, POLISH STYLE

The Polish energy sector is experiencing an investment boom: new conventional power plants, renewable energy sources and transmission networks. Electricity generation is still mainly based on coal but the environment is not suffering, thanks to cutting-edge technology on a global scale.

The ENEA's investment near Warsaw, among the world's largest (1,075 MW) coal-fired power units will be up and running by 2017. Innovative technology means unprecedented net efficiency: over 45%, with emissions less than half of what the EU allows. Coal can be "green" and conventional power generation has a future.

ENEA will also invest PLN 6 (USD 2) billion in existing networks and will connect to renewable sources: wind, solar and hydroelectric, so protecting the environment.

One of the country's largest capital groups, ENEA's investments – near Warsaw especially – are key for Poland's energy security.



## The second Jagiellonian age

**For the first time in half a millennium, Poland is thriving, says Vendeline von Bredow. Can it last?**

"I AM PROUD of my country," says Aleksander Kwasniewski, Poland's president from 1995 to 2005. And well he might be when it is celebrating a series of happy anniversaries: ten years of European Union membership, 15 since it joined NATO and 25 since the fall of communism in eastern Europe. Not since the days of the Jagiellonian kings in the 16th century, when Poland stretched from the Baltics almost to the Black Sea, has it been so prosperous, peaceful, united and influential.

When the Iron Curtain came down in 1989, Poland was nearly bankrupt, with a big, inefficient agricultural sector, terrible roads and rail links and an economy no bigger than that of neighbouring (and much larger) Ukraine. At the time the ex-communist countries with the best prospects were widely thought to be Czechoslovakia and Hungary. Hopes for Poland were low.

But rigorous economic shock therapy in the early 1990s put Poland on the right track. Market-oriented reforms included removing price controls, restraining wage increases, slashing subsidies for goods and services and balancing the budget. The cure was painful, but after a couple of years of sharp recession in 1990-91 Poland started to grow again. It has not stopped since, and received a further boost when it joined the EU in 2004. Since then economic growth has averaged 4% a year. GDP per person at purchasing-power parity is now 67% of the EU average, compared with 33% in 1989, and the economy is almost three times the size of Ukraine's. The country has redirected much of its trade from its eastern neighbours to the EU, started to modernise its transport infrastructure and restructured some of its ailing state-owned industrial behemoths.

Poland was the only big economy in Europe to avoid a recession during the financial crisis, thanks partly to luck and partly to a mixture of deft fiscal and monetary policies, a flexible exchange rate for the zloty, a still modest exposure to international trade and low household and corporate debt. Last year its GDP, at 1,632 billion zloty (€381 billion, \$516 billion), was more than one-fifth higher than at the beginning of the crisis. The finance ministry forecasts growth of more than 3% this year.

That solid economic performance has given Poland extra weight in ►►

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A list of sources is at  
[Economist.com/specialreports](http://Economist.com/specialreports)

An audio interview with  
the author is at  
[Economist.com/audiovideo/specialreports](http://Economist.com/audiovideo/specialreports)

### ACKNOWLEDGMENTS

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the EU, both economically and politically. It is now seen as one of the half-dozen big member countries, alongside Germany, Britain, France, Italy and Spain (though its GDP per person last year, \$10,100 at current exchange rates, was still less than half the size of Spain's). German-Polish ties have become arguably the second most important bilateral relationship in the EU, after the Franco-German axis.

Since the beginning of the crisis in Ukraine, policy-makers both in the EU and in America have been paying a lot of attention to Donald Tusk, Poland's prime minister, and Radek Sikorski, his foreign minister. Poland and the Baltic states are the easternmost parts of both the EU and NATO and, as Mr Sikorski puts it, "we feel the vibes here very strongly." In spite of turbulent relations in the past, since the fall of the Soviet empire Poland has been a staunch supporter of an independent, free and strong Ukraine—not least as a buffer between Poland and Russia.

**Concentrating minds**

Economically the events in Ukraine are a worry for Poland. Russia and Ukraine account for only 8% of its total exports, but last year 60% of its gas came from Russia. Politically, however, the Ukraine crisis has been a godsend for Mr Tusk. He has been popular for most of the time since he took office in 2007, but last year his ratings began to slide as the economy slowed and unemployment rose. Opinion polls started to put his centre-right Civic Platform (PO) second to Law and Justice (PiS), the main opposition party. Now PO is rising in the polls again as voters become more concerned about stability. That may help the party's chances in local elections in the autumn and in national and presidential elections next year.

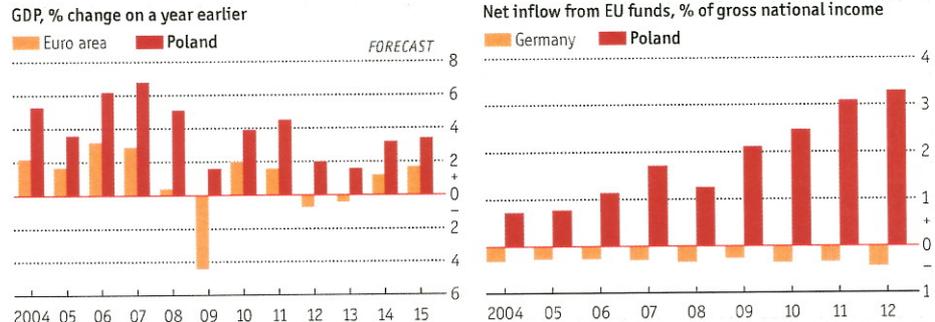
Whoever gets to form the next government will have his work cut out. Poland's economic transformation is still unfinished, with more reforms needed in sectors such as agriculture,

and stark differences remaining between the country's prosperous west and its poor east. One big decision will be whether and when to join the euro zone. Two-thirds of the Polish public currently oppose this, and relinquishing the zloty would require a constitutional change that for the moment seems unachievable.

Janusz Jankowiak, chief economist of the Polish Business Roundtable, a pro-business lobby group, is optimistic about Poland's prospects for the rest of this decade but more doubtful about the longer term. Poland has already benefited from a €102 billion (\$139 billion) cash inflow from Brussels and is set to receive another €106 billion between now and 2020. The risk is that the government will spend a big chunk of it on infrastructure so that it can show tangible results soon, neglecting longer-term efforts to make the economy more competitive, such as investment in vocational training or higher education. Many Poles are aware that other EU countries have missed their chance of using EU funds for structural reforms. "Portugal has good highways but no competitive companies," says Mr Jankowiak. For now the main plank of Poland's success is cheap labour, which western European and American companies are using to turn the country into a big outsourcing and subcontracting hub. But in time that advantage is bound to be eroded.

The biggest challenge for Poland's economy is to avoid the middle-income trap, getting stuck at its current level. Poles are not

**Star turn, with a little help from Brussels**



Sources: Eurostat; European Commission

**Now you see it, now you don't, now you do**

Poland's changing borders



▶ saving and investing enough for the economy to make the leap from being western Europe's main subcontractor to an economy with global, innovative Polish companies. Between 2004 and 2011 the average saving rate was only 17% of GDP and the average investment rate 21% of GDP, both below average EU levels. Current expenditure on R&D is just 0.85% of GDP, though Mateusz Szczurek, the finance minister, foresees an increase to 2% of GDP by 2020.

Daniel Boniecki at the Warsaw office of McKinsey, a consultancy, identifies three "pillars of change" for his country: Poland must close the productivity gap with western Europe; invest in growth industries such as specialist machinery; and become more global. Polish firms' productivity per hour is still only around 60% of companies in the EU15 countries (the members before enlargement to the east), partly because training and equipment lag behind and partly because companies are badly managed. Polish firms are good at enhancing a product before putting it on the market, but mostly for foreign outfits or by using foreign technology. The majority of firms lack scale and tend to focus on the domestic or regional market. The only truly global Polish company is the state-controlled KGHM, one of the world's largest copper and silver miners.

Demography is another headache. Poland has one of the lowest fertility rates in the EU and remains an emigration country. If things turn ugly in Ukraine there could be a large wave of refugees flooding into Poland, but that would not solve the problem. "The demographic tsunami will hit just when EU funds dry up," predicts Krzysztof Rybinski, rector of Vistula University. He has already seen a marked drop in the number of Polish students at his university, so he is looking abroad for new recruits.

The most urgent task for Poland, however, is to slim down its bloated public sector. Since the end of communism the number of civil servants has nearly tripled, to at least 460,000. Successful private companies are being held back by an overly bureaucratic public sector. That is one reason why some of the best and brightest Poles continue to emigrate.

But at least they carry their head high when they go. These days Poland's voice abroad once again counts for something. ■

### Foreign policy

## Playground turned player

### Poland carries new clout on the international stage

IN THE 20TH CENTURY Poland played a central role in international politics on several occasions: in 1920, when it beat back the Red Army; in 1939, when Poles exchanged the first shots of the second world war with Germans in Gdansk; and in 1980, when an organised movement, Solidarity, defied communist rule in the Soviet bloc for the first time.

Yet for most of the 20th century Poland was a playground rather than player in international politics. For much of the time it was occupied by Austrians, Germans, Russians or Soviets. So when it emerged from communism, having known independence for only 20 of the previous 200 years, it was at first focused on itself and its transformation from a dictatorship with a centrally planned economy to a free-market democracy. Poles were poor and prickly, and many of them saw the divide with the West as unbridgeable.

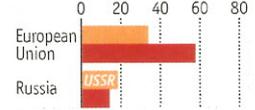
That changed when Poland, together with nine other countries, joined the European Union on May 1st 2004. As Poles became richer and more successful within the EU, their international stature grew, as did their self-confidence and enthusiasm for deeper integration. "Poles are still in love with the EU ten years after accession and believe that together we can move mountains, while Western EU member states are going through a typical mid-life crisis after living several decades in the EU," said Aleksander Kwasniewski, who presided over Poland's entry, at the anniversary celebrations in Warsaw's Lazienki Park on May 1st. Polish politicians across the political spectrum support EU and NATO membership. Among the population at large, 89% say they want Poland to be in the EU, considerably more than voted yes in the referendum on EU entry in 2003.

### Turning west

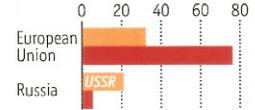
Poland's trade, % of total

1989 2012

Imports from:



Exports to:



Source: Poland Central Statistical Office

### At home in Europe

When Donald Tusk and his Civic Platform (PO) came to power in 2007, Poland's foreign policy became more pragmatic and cautious, concentrating on Poland's role in the EU and its relationship with Germany. Even bilateral relations with Russia, Poland's other mighty neighbour, improved for a while—until Russia annexed a chunk of Ukraine, which borders both of them, earlier this year.

"The Tusk government is the first Polish government that is very clearly pro-EU and pro-German," says Josef Janning at the European Council on Foreign Relations in Berlin. The previous Law and Justice (pis) government was sceptical about the benefits of EU membership for Poland and open in its loathing of both the Germans and the Russians. In this pre-election year pis politicians are moderating their foreign-policy pronouncements.

Despite the wounds of the past, Germany and Poland today are bound together by shared political and commercial interests. Germany is Poland's biggest trade partner, and a sizeable chunk of the German export machine is based in Poland. "The relationship benefits both countries," says Mitchell Orenstein at Harvard University. A personal affinity between Angela Merkel, the German chancellor, and Mr Tusk is helping, as is a good working relationship between Frank-Walter Steinmeier, the German foreign minister, and Mr Sikorski, his opposite number. Mr Tusk is from Gdansk, which was part of the German empire until the end of the first world war, and speaks to Mrs Merkel in German, using the intimate *Du*. Mrs Merkel is one-quarter Polish: her grandfather, Ludwig Kazmierczak, fought in the Polish army (the family later Germanised the name to Kasner).

Mr Steinmeier and Mr Sikorski are trying to maintain the momentum of the "Weimar" triangle, a loose grouping to promote co-operation between Germany, France and Poland. German foreign-policy pundits reckon this will not work. Relations between Germany and Poland and Germany and France are much closer than those between France and Poland, even though their ties have improved since François Hollande became France's president in 2012. Yet Poland and Germany do not always see eye to eye either. In particular, the Poles criticise Germany's dependence on Russian gas and its anti-nuclear policy and, more broadly, the West's muted response to Russia's aggres-

sion in Ukraine. The Germans, for their part, want Poland to make a clearer commitment to joining the euro.

Opposition politicians say that Mr Tusk tried too hard to improve relations with Germany and Russia and should have paid more attention to the region immediately to its east, from the Baltic to the Black Sea. They argue that the West will find Poland more useful if it concentrates on that region. PO insiders point out that the Polish government is the unofficial leader of the Visegrad group, a central European club that also takes in Hungary, Slovakia and the Czech Republic. And it was one of the driving forces of the Eastern Partnership, an EU initiative to foster closer relations with Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine that faltered last year when Ukraine did not sign up to an association agreement with the EU.

### Patting the bear

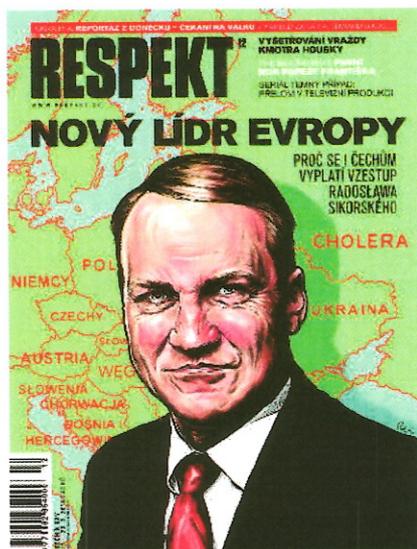
Mr Tusk and Mr Sikorski did try to develop a constructive relationship with Russia. For example, in 2007 they dropped the objection raised by the previous (PiS) government to Russia's bid to join the OECD, a rich-country club (membership talks are now frozen thanks to the stand-off over Ukraine). In return Russia abandoned a ban on Polish meat imports. Trade relations and cultural exchanges flourished for a while. Even so, Polish-Russian relations in the past seven years were never without hitches. In 2008 the Polish-Russian Group on Difficult Matters, a new government-sponsored forum for intellectuals and historians from both countries, was established to improve dialogue on the tortured history of Polish-Russian relations. Those "difficult matters" include the Polish-Soviet war following the Bolshevik revolution, the Soviet occupation of eastern Poland in September 1939 and, perhaps the most traumatic event, the mass murder of thousands of Polish officers by Soviet security forces at Katyn in 1940. In the new spirit of reconciliation Mr Tusk and Vladimir Putin, the Russian president, agreed in 2010 to hold a joint ceremony to mark the 70th anniversary of Katyn. Three days later a plane carrying the Polish president, Lech Kaczyński, crashed in the fog near Smolensk in Russia. All 96 people on board were killed. Some PiS members still blame the Russians.

The biggest setback to relations between the two countries has been the Ukraine crisis. From the start of Mr Putin's intervention there, Poland has been advocating strong sanctions against Russia and an increased NATO presence on the eastern flank of the alliance. In early February Sergei Lavrov, the Russian foreign minister, assured Mr Sikorski and Germany's Mr Steinmeier at a security conference in Munich that Russia wanted the situation in Ukraine to calm down and was seeking a compromise. By the end of that month Russia had, in effect, swallowed Crimea.

"I used to think that the crisis could have been avoided had we signed the agreement [on a closer association with the EU] with Yanukovich [the deposed Ukrainian president] earlier," says Mr Kwasniewski. But now he feels that Mr Putin is determined to be the founder of a fourth Russian superpower, after Peter the Great, Catherine the Great and Stalin, and that Russia will do everything it can to destabilise Ukraine.

Certainly the events in Ukraine have enhanced Poland's role within the EU and NATO. *Respekt*, a Czech liberal weekly, put Mr Sikorski on its cover at the end of March, with the banner headline *Nový Lidr Evropy*, Europe's new leader, against the background of a map of central Europe, with *Niemcy* (Polish for Germany) in the west and *Cholera* (Polish for damn) in the east. Mr Sikorski is often mentioned as a possible successor to Catherine Ashton, the EU's foreign-policy supremo.

As the EU and NATO are scrambling to rethink their *Ostpolitik*, Poland's long-standing warnings about the need for stronger defence policies and more defence spending seem to have



*Respekt, a Czech liberal weekly, put Mr Sikorski on its cover, with the banner headline "Europe's new leader"*

been vindicated. In recent years Poland has felt neglected by America, particularly after Barack Obama, the American president, abandoned the idea of a long-range-missile shield to be based in the Czech Republic and Poland. It was an unfortunate coincidence that Mr Obama made the announcement on September 17th 2009, the 70th anniversary of Poland's invasion by the Soviet Union. Poles are also miffed that they still need a visa to go to America. When Mr Obama visited Poland in early June he announced a plan to spend an additional \$1 billion on America's military presence in Europe. That was a step in the right direction for Poles, but it still fell short of their high expectations from the world's sole superpower. ■

### Economy and business

## In with the new

### As traditional industries are declining, outsourcing, offshoring and subcontracting are booming

"IN ANOTHER 20 YEARS shipbuilding in Poland may not exist any more," says Krzysztof Kulczycki, one of the owners of Crist, a shipyard and builder of offshore steel structures in Gdynia, a city in the north of Poland on the Baltic Sea. Faced with competition from the Far East, many shipyards, once the pride of Gdynia and neighbouring Gdansk, are struggling. Crist is profitable, but mainly thanks to a subsidiary, Crist Offshore, which makes offshore wind turbines and oil platforms.

Over in Gdansk the mood is even gloomier. The former Lenin shipyard, which became the symbol of Poland's struggle against communism and the cradle of Solidarity, the Soviet bloc's first independent trade union, has been in decline for more than two decades. The main reason for its survival is its iconic status: no government was prepared to let it go bust on its watch. History is everywhere.

Once the employer of 17,000 workers, the Gdansk shipyard is now down to around 1,000. Most of its buildings are empty and derelict, standing in an area of industrial wasteland right ▶▶

▶ next to Gdansk's meticulously reconstructed historic city centre. In 2007 three-quarters of the Gdansk shipyard were bought by Sergei Taruta, the boss of Ukraine's Industrial Union of Donbas, an industrial conglomerate, who is also the governor of Donetsk, a province in eastern Ukraine. The rest is still state-owned. Mr Taruta must have hoped that the state would continue to support the shipyard, which is struggling with old debts, union contracts and a tough market. Adam Zaczeniuk, a senior manager at the yard, hopes it can stave off bankruptcy for a fourth time, as it has done on three previous occasions since the end of communism.

Some niche businesses related to shipbuilding are doing well in Gdansk, such as Sunreef Yachts, a maker of luxury catamarans with price tags of €3m (\$4m) upwards. Last year the company, owned by Francis Lapp, a French investor, had its best year in its 11-year history, launching 11 of its ultra-modern, sleek yachts, made on the former premises of the Gdansk shipyard. DCT Gdansk, a humungous container terminal, built in 2007 and majority-owned by Australia's Macquarie fund, also did particularly well last year. The only deepwater terminal in the Baltic, it is now planning to more than double its capacity.

Still, with its main industry in decline, Gdansk had to reinvent itself as a hub for another, relatively new industry: offshoring and outsourcing. This established itself in central Europe in the 1990s when western European companies were looking for ways to handle their information technology and back-office operations more cheaply and efficiently. Though the industry is still much smaller than in India, where the outsourcing boom started, it is one of the fastest-growing in the region. Poland has

bagged a large proportion of it, employing as many in the sector as Bulgaria, Croatia, the Czech Republic, Hungary, Romania, Slovakia and Slovenia combined, according to a study by the McKinsey Global Institute. It has been helped by a supportive government, both at local and national level, the size of its population, the quality of its education and lower wages than in the Czech Republic, Slovakia and Hungary.

Low pay and the high work ethic of its workers, both skilled and unskilled, have also been the main driver for Poland's other thriving industry: subcontracting for western European firms, particularly German ones. Volkswagen's factory in Poznan employs 6,900 workers, who make 155,000 vehicles a year. Germany's MAN group produces heavy trucks and city buses in three factories in Poland, and Hugo Boss, a German fashion firm, manufactures shoes in Radom, in central Poland. Mainly thanks to its role in the German supply chain, Poland has seen its exports flourish. They now account for 46% of its GDP.

### Black outlook

Outsourcing and offshoring employ around 120,000 people, roughly the same as coal mining, a traditional industry in deep decline. It has already shrunk by about two-thirds since the end of communism, and there is more to come. About 90% of Poland's electricity is produced from hard or brown coal, but since Polish coal is high-quality and relatively expensive, utilities are buying cheaper coal from abroad, mainly Russia. In the past few years Poland has become a net importer of coal even as millions of tonnes of expensive Polish coal are piling up unsold.

The state-owned Kompania Weglowa (kw) in the southern region of Silesia is the largest coal-mining company in Europe. With 56,000 miners it is Poland's biggest employer after the postal service and the railways, two other state-owned businesses that are doing badly. Last year it recorded a loss of over 1 billion zloty (\$315m). Against huge resistance from the unions, kw has come up with a survival plan that involves cutting almost one-third of its workforce by 2020, merging and selling mines and cutting back some of the benefits its workers enjoy.

kw's headquarters are in Katowice, a city of 300,000 people in Upper Silesia which in the 1990s still had two operating coal mines in the city centre. Between 1994 and 2002 those two mines as well as two steel works were shut down. "It was very painful for me," says Piotr Uszok, the city's popular four-term mayor, who used to work in a coal mine as an electrician. Unemployment in the city peaked at 8.4%, though it never got as bad as in the area around Katowice, where it reached double digits.

Katowice too turned to outsourcing and offshoring. Around 12,000 people in and around the city already work in the industry, and numbers are expected to go up to 15,000 by the end of this year. It has a total of 56 business service centres, offering anything from IT outsourcing to customer care to research and development (R&D). The majority of the centres belong to American firms, the rest mainly to Pol- ▶▶



ish, British and French ones, attracted by Katowice's future talent pool of 115,000 students, its transport infrastructure, relatively low wages and cheap office space.

Another part of Katowice's future after coal is culture: the city is spending €75m on a new concert hall for the Polish National Radio Symphony Orchestra, now going up on the site of one of the coal mines, and is building a new home for its Silesian museum and an international congress centre. A survey of Poland's biggest cities by PricewaterhouseCoopers, a consultancy, said that "Katowice is generally perceived as a city with an outdated economy, devastated natural environment and low quality of life," but found that in reality the quality of life in Katowice was in some ways better than that in Warsaw and Krakow.

### We love Wrocław

Wrocław, which is often cited as the place that embodies Poland's successful transformation, does not have an image problem. Everyone loves the city on the Odra river with its 12 islands and 130 bridges and its Gothic and Baroque architecture, testament to centuries under Bohemian, Austrian and Prussian rule. It recently won the competition for European Capital of Culture 2016. The capital of Lower Silesia has risen from nearly total destruction during the second world war and the forced departure of the German population, who knew it as Breslau. Its historic centre was reconstructed and it was repopulated by Poles displaced from Polish territories that became part of Ukraine.

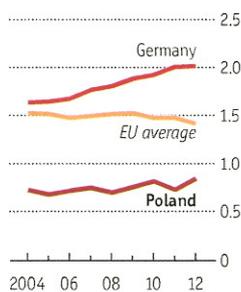
Wrocław wants to become a specialist hub for R&D. America's Whirlpool (household appliances), Germany's Balluff (sensors) and America's PPG (industrial coatings) have already set up R&D centres there. More should spring up once the Pracze campus of EIT+, Wrocław's impressive new research centre, is fully operational. EIT+ is trying to foster innovation by getting academia, local government and business to work together. Financed mainly with European Union funds, it specialises in nanotechnology and biotechnology.

"After 1989 most industrial R&D perished in Poland as foreign firms that came here wanted Poles to make things for them, not think about them," says Jerzy Langer, a physicist and president of the board of EIT+. Poland used to do well in rankings of scientific output under communism, but lost its standing once state support for R&D fell away. Mr Langer reckons that Poland is now advanced enough to make its own products and innovate, rather than copy the technology of western companies and serve as their subcontractors. EIT+ sees its role as doing the riskier kind of research for both international and Polish firms. KGHM, a large copper and silver miner, is already planning to outsource some of its R&D to it.

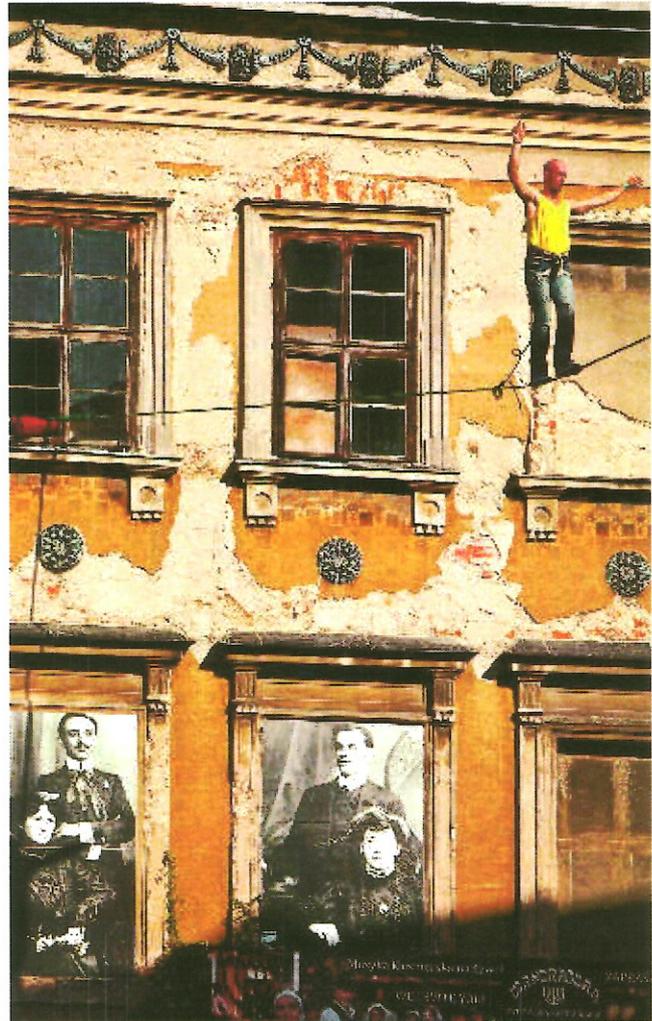
Wrocław has Poland's largest concentration of internet-based firms, with companies such as livechatinc.com, a chat system for customer service that has just gone public. And a few bigger companies elsewhere in Poland, such as Pesa, a locomotive-maker, and Solaris, a manufacturer of buses and trams, are doing well thanks to a strong focus on R&D. Germany used some of its Marshall Plan funds to build innovative, international companies after the second world war. Poland could be doing the same with EU funds. ■

### Under-researched

Government spending on research and development  
% of GDP



Source: Eurostat



### East-west divide

## The Eastern Wall

### Poland's poorer, less developed east still has a lot of catching up to do

NOT MANY PEOPLE tune in these days, but Radio Maryja still has some political clout. The ultra-conservative broadcaster articulates the feelings of Poles alienated by their country's new, materialist business culture and by what they see as the moral decay of society. Founded in 1991, it filled a vacuum. Father Tadeusz Rydzyk, the entrepreneurial Roman Catholic priest who runs the radio station, saw that this unhappy chunk of the population needed a mouthpiece. He has turned it into a lucrative business that includes a private university and even an aqua park in Torun, where his radio station is based.

Radio Maryja's most faithful listeners tend to be old, live in rural areas in eastern Poland and vote for the conservative PiS. They are part of "Polska B", the poorer, less developed Poland, as opposed to "Polska A", the growth centres in Warsaw and in western Poland, around Poznan and Wrocław. The division amounts to more than a difference in wealth. "There is also the perception of a cultural divide between the two Polands, with Polska B being perceived as backward civilisationally, behind a *wschodnia sciana* (Eastern Wall)," says Padraic Kenney, a central Europe specialist at Indiana University.

The east-west divide dates back to the 15th century, when Europeans ventured to Asia and the Americas and international

## A land of milk and apples

A bountiful EU is delaying farm reform

**M**ACIEJ KARCEWSKI loves his job as an apple farmer in Lower Silesia, near Wrocław. On a sunny spring day he is out in his orchard of 40 hectares (100 acres), proudly showing off row after row of blossoming apple trees, separated by dandelion-dotted grass.

Mr Karczewski's father started growing apples 25 years ago. The son trained in nurseries in Britain and studied horticulture at the University of Minnesota but always knew he was going to return to his family's fruit trees. The farm employs five people all year long, ten in the pruning seasons and 30 for the harvest. For the peak harvest season in September and October Mr Karczewski hires Ukrainians, as local labour is expensive and hard to find.

Apples are one of Poland's most successful exports. Last year the country overtook China as the world's biggest apple exporter. One-third of Poland's crop, or about 1.2m tonnes, went abroad, with Russia taking 57% of the total. Poland's entire farm sector, from cereals to meat production, is surging ahead. Last year agri-food exports were worth 85 billion zloty (\$27 billion), an 11.5% increase on 2012.

Agriculture is probably the biggest single beneficiary of Poland's membership of the EU. Farmers had initially been among the staunchest opponents of EU entry; not long before Poland joined, the Polish Peasants' Party (PSL) predicted that only 600,000 of

the country's 2m farms would survive entry. They were in for a happy surprise when the money started rolling in: Polish agriculture received a bountiful €40 billion (\$55 billion) in 2007-13 and will get another €42.4 billion between now and 2020.

Thanks to those EU funds, farmers' incomes have, on average, tripled since entry, with half of the money coming from direct cash payments, regardless of need. Bigger farms have modernised and become more efficient. Over the past ten years Poland has doubled its poultry production and become Europe's leading producer of soft fruit and cultivated mushrooms.

Yet in the longer run agricultural subsidies are a mixed blessing, even for the farmers. "EU membership has slowed the reform of the agricultural sector," says Krzysztof Mularczyk of Compassion in World Farming, a lobby group. Polish agriculture remains highly fragmented. It accounts for only 3.4% of GDP but 12.4% of employment. Half the farms are just subsistence plots, and 92% of them run to less than 20 hectares. In a recent report on Poland the OECD was especially critical of the highly favourable social-security system for farmers, KRUS, as well as some of the tax advantages they enjoy. Many farmers hold on to tiny plots of land just to remain eligible for KRUS.

Farmers are an important political constituency. The rural population makes up around 39% of the total. PSL, the farmers'

party, is in a coalition with the ruling Civic Platform, and Janusz Piechociński, the PSL's leader, is deputy prime minister. His party is weak and divided and might miss the 5% threshold for getting seats in parliament in next year's national elections, but until then the chances of reform are negligible.

Polish farmers' most immediate worry is about the Ukrainian crisis. Exporters of apples and meat in particular are vulnerable to Russian import bans, and most farmers depend on Ukrainian workers during the harvest. Mr Karczewski is now doing the paperwork for his Ukrainians' work permits and visas—and hoping for the best.



The world can't get enough of them

▶ trade took off. Western Europe expanded abroad by establishing colonies and took up manufacturing and trade, whereas Poland and most of central Europe stuck with agriculture. Poland and Ukraine, ruled by their powerful nobility, became Europe's granary. Feudalism remained prevalent and cities lost political and economic power.

After Poland's three partitions in the 18th century, western Poland became part of a rapidly industrialising Prussian empire, southern Poland was swallowed by the mighty Austro-Hungarian empire and central and eastern Poland was controlled by the backward tsarist empire. Poland thus reflected Europe's east-west divide. In the western part of the country farms, many of them large, produced for the market, whereas in the east subsistence farming was dominant. In 1900 the average annual income per person in Prussian Poland was \$113, in Galicia (the province under Austrian rule) \$38 and in the Russian-dominated part of Poland \$21, according to Włodzimierz Borodziej's history of the country. The relative density of the railway network in 1914 reflected that divide: thick in the west, sparse in the east.

After the first world war newly independent Poland made a good job of unifying the three parts of the country administratively, economically and culturally. Yet the second republic

lasted only two decades, until the German invasion of Poland in 1939. After the war the mismanagement of the economy by Poland's communist rulers made the whole country more or less equally miserable.

When communism collapsed, the divide between east and west, as well as rural and urban, re-emerged with a vengeance. This new inequality helped propel the post-communist Democratic Left Alliance into power in 1993. Just five years after the collapse of the Soviet Union, income per person in Poland's poorest regions was a quarter of that in Warsaw, says Philipp Ther at Vienna University. And another five years on the proportion was only one-fifth, about the same as in 1900. The differences kept widening until just after Poland joined the EU. In 2005 the average income in Warsaw was €19,100 (then \$28,800), compared with €4,000 in Poland's poorest regions, according to Mr Ther.

The peak of Poland's inequality, the years immediately after accession to the EU, were also the heyday of Radio Maryja, which was close to the PiS government in office in 2005-07. The joke making the rounds at the time was that the PiS government was one of the world's most technologically advanced: it was radio-controlled.

EU membership has given eastern Poland a big boost. Be- ▶▶

▶ tween 2007 and 2013 it received €2.3 billion from the EU's structural and cohesion fund, says the Polish Agency for Foreign Investment, and the state chipped in another €400m. Podlaskie, Lubelskie, Podkarpackie, Warmińsko-Mazurskie and Świętokrzyskie, Poland's five poorest provinces, used these funds for much-needed improvements to roads and other infrastructure, better internet access and encouraging small businesses.

But a significant gap remains. The Lubelskie province around Lublin remains the poorest in Poland. Around 36% of the labour force there is in agriculture, more than twice the national average, mostly on small farms with low productivity. Aside from farming, the main employer is the public sector. The share of public servants in the province is 50% higher than in the country as a whole, according to Ernst & Young, a consultancy. Pay is below that in the rest of Poland. In Lublin a junior accountant with one or two years' experience earns around €7,200 a year, whereas in Wrocław, in western Poland, the rate for the job is around €10,000. Internet access is still mostly poor and unemployment is higher than the national average.

### Leveraging Lublin

The region is depopulating. Lots of people emigrate, and those who stay behind have small families. Lublin does have five public and several private universities, with more than 80,000 students, but after graduating the best go to Warsaw or abroad. There are few local job opportunities in the private sector.

Krzysztof Zuk, who has been mayor of Lublin since 2010, is trying to help his city catch up with cities in the west. He was responsible for the Lublin Development Strategy for 2013-20, which lays out some ambitious plans for the city. "Lublin is aiming to be a gateway to Ukraine and Russia," says Mariusz Sagan, an adviser to the mayor and one of the paper's authors. The idea is to turn Lublin's vicinity to shabby, shaky Ukraine and poor, ill-governed Belarus to its advantage. Lublin lies about 100km (62 miles) from the border with Ukraine and 150km from that with Belarus. Ukrainians already invest in property and send their children to university in Lublin. All the universities would like more fee-paying Ukrainian students.

Among Mr Zuk's triumphs so far have been the renovation of buildings such as the *Teatr Stary* (Old Theatre) in the beautiful historic city centre and the creation of 4,000 new jobs in information-technology and business-process-outsourcing firms. He is particularly proud of Lublin's airport, which was finished in 2012. Last year 190,000 passengers passed through on their way to destinations in Poland and a handful of European cities. Mr Zuk is also building roads, in particular a motorway to Warsaw, which is meant to be finished in 2017. At the moment the 166km journey from Lublin to Warsaw takes a nerve-racking three hours by car on a single-carriageway road buzzing with huge Ukrainian lorries.

Piotr Falek, for one, is relatively optimistic for Lublin, his home town, because of the big pool of university graduates and the high quality of life in the green city and its surroundings. He is a specimen still rare in the area: a successful private entrepreneur. His company, Syntea, set up in 2003, offers IT services and educational training. It has a turnover of €5.5m and around 100 employees. Last year it agreed on a tie-up with Apteck, a Mumbai-based provider of training and education services, to offer courses for cabin crews and aviation ground staff.

Transport links, in particular a poor road network, remain a problem for the area around Lublin. Thanks to the history of division, there are only three bridges crossing the Vistula river between Krakow and Lublin. "But the airport is a big change for the better," says Mr Falek. He hopes that Poland's economy can grow together again without having to wait another 123 years. ■

### The church

## Bring back Wojtylian dialogue

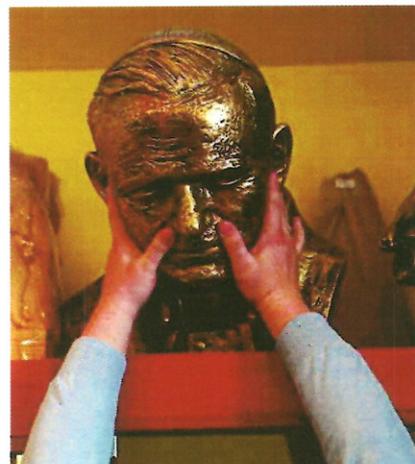
### The Catholic church, a unifying force under communism, has become divisive

EVERY EVENING IN the days before Easter, Polish television news showed a group of angry parishioners in front of a closed church in Jasienica, near Warsaw. They were upset because Henryk Hoser, the archbishop of Warsaw-Praga, had decided to shut down their local church, less than a week before the most important feast in the liturgical calendar. It was his way of resolving his conflict with Jasienica's popular parish priest, Wojciech Lemanski, who was suspended last year but continued to say Mass once a week in the church.

The archbishop's action was symptomatic of a church that seems to have lost its openness to dialogue and appears increasingly out of touch with Poland's population, especially the young and urbanised. Poland remains the most Catholic country in Europe: some 95% of the country's 38m people are baptised Catholics, and at least one-third of them say they attend Mass weekly. Father Lemanski had dared to criticise the church's rigid opposition to in-vitro fertilisation (IVF), and had repeatedly condemned what he saw as the lenient treatment of clerics accused of sexual abuse. A long-standing advocate of Polish-Jewish reconciliation, he had also berated the establishment for tolerating anti-Semitism among clergy and practising Catholics. He claims that was why he was dismissed; his superiors say he was suspended because of his views on IVF.

"Lemanski practised Wojtylian dialogue," says Adam Szostkiewicz, who has been writing about Roman Catholicism for 30 years. Karol Wojtyla, a former archbishop of Krakow who was elected pope in 1978 and served for 27 years, became a tireless advocate of inter-religious dialogue and a role model for priests in his homeland. Reconciliation between Jews and Catholics was a particular concern of his.

By encouraging and actively supporting the Catholic church in his homeland before the collapse of communism, John Paul II (as the Polish pope was officially known) contributed more than anyone to the church's revival in the 1970s and 1980s. His canonisation on April 27th at a ceremony in Rome gave the ▶▶



*Sellers of pope-related trinkets did a roaring trade*

church in Poland a brief PR boost. Special services were held all over the country. Sellers of pope-related trinkets, from candles to fridge magnets and jigsaw puzzles, did a roaring trade.

Having played an important role as a repository of unity and Polishness during the country's 123-year-long partition, the church became even more central to Polish society in the last two decades of the communist era. "The church then was an island of freedom, and everything independent of the communist state hid under its wings," says Zbigniew Nosowski of *Wież*, a Catholic monthly. Playwrights put on their plays in churches, writers collaborated on underground publications and musicians practised in church gardens. Everyone could join in. Believers and non-believers were united in their opposition to the regime.

John Paul II welcomed the Solidarity trade-union movement and treated Lech Walesa, Solidarity's co-founder, like a long-lost son. Mr Walesa would later say that the pope contributed "at least 50%" to the collapse of communism. He inspired priests in Poland to be brave. Perhaps the bravest was Father Jerzy Popiełuszko, who was close to the Solidarity movement. In his sermons he skilfully combined spiritual exhortations and political messages. In 1984 he was kidnapped, beaten and murdered. His funeral was attended by more than 600,000 people, including Mr Walesa. He became a symbol of the Polish struggle for liberty in the face of political oppression.

With such a heroic past, the church found it hard to return to a more workaday role after communism had gone. Many members of the clergy continued to take sides, endorsing candidates for political office. Father Mateusz Przanowski of the Dominican priory in Krakow agrees that priests should not publicly support politicians, but points out that they remain important figures in small towns and villages where parishioners go to the priest for everything—including advice on politics.

### Trust me, I'm a priest

The church was at its most political and aggressive during the debate on abortion in 1991. Under communism abortion had been available on request; the church was in favour of introducing a blanket ban. After a heated discussion, a compromise was reached in 1993: abortion would be allowed, but only if the life of the mother was at risk, her pregnancy resulted from rape or incest or the foetus was severely malformed. The church had won a battle, but at a steep price. Whereas in 1989 polls suggested that almost 90% of the population trusted the church, by 1993 only 40% did, says Mr Nosowski. A long tussle over the return of church property confiscated by the communists further damaged the church's image.

Since then it has recovered some of its popularity. "There is a deep hunger for spirituality here," says Father Mateusz. People tend to go to church for prayer and meditation rather than for practical help. At the Dominican church in Krakow, a big brick basilica with three naves and many side chapels, six confessionals were in constant use from 6am to midnight in the days before Easter. Even at an evening Mass on Easter Monday, when many congregants had spent the better part of the previous four days in church, the basilica was packed with all generations.

The young who join the priesthood today are as conservative as their elders—sometimes even more so. The number of seminarians in Poland has fallen from around 4,800 in the early 2000s to around 3,000 in 2012, but that still amounts to a quarter of all Roman Catholics training to be priests in Europe. "The church is monolithically conservative, whereas economically it believes in the Third Way," says Mr Szostkiewicz. Priests like Father Lemanski who rebel against the church's illiberal stance tend to leave the priesthood.

Under communism the church closed ranks in the face of

repression, which left no scope for internal dissent. Today the clergy feels under attack by "liberals" whom they see as intent on "destroying our church". The church reflexively demonises those it considers disloyal. That tendency was prominently on display in a recent row about gender studies, which to some hardline Catholics has become a catch-all term for radical feminism, liberal abortion policies and other social trends they dislike. It started last summer when Tadeusz Pieronek, a bishop, pronounced that "the ideology of gender presents a threat worse than Nazism and communism combined." Conservative politicians jumped on the bandwagon, convening a parliamentary group, "Stop Gender Ideology", that consisted of 15 men and one woman. Dariusz Oko, a theology professor, inveighed against "drug and sex maniacs". It is as if the church needs an evil enemy to define itself against—and cannot cope with a new, more normal reality. ■

### The future

## Confounding the pessimists

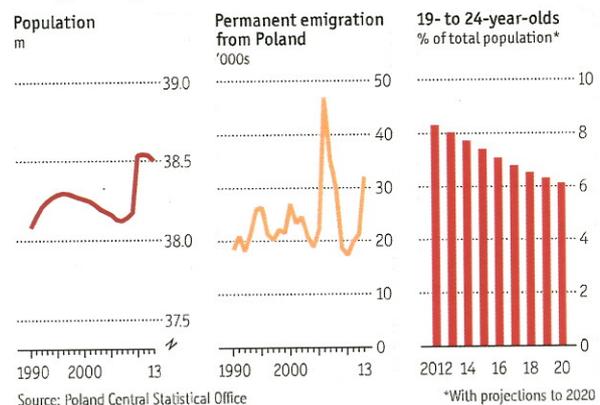
Poland's historical paradigm—brief boom, long gloom—can be overcome

"I AM FINE" is not something Poles say. According to Jacek Purchla, head of the International Cultural Institute in Krakow, around 80% of Poles have gained from their country's recent transformation; the rest, such as former employees of defunct state-owned enterprises, are worse off than under communism. "But if you ask Poles, you get the impression it's the other way round," says Mr Purchla.

History has taught Poles to be pessimistic and full of self-doubt. For the half-millennium, whenever their country was enjoying a peaceful, prosperous period it soon seemed to come to a brutal end, often through foreign invasion. Now Poland is prospering once again: since 1989 it has achieved unprecedented levels of income and quality of life and its economy has grown faster than that of any other country in Europe. It has also gained an important role in European diplomacy. Can its good fortune last?

Perhaps this time is different. All long-term projections show that Poland will continue to grow faster than western Europe at least until 2030, and thus continue to converge with the

### Disappearing act



West, writes Marcin Piatkowski, an economist at the World Bank, in an optimistic assessment of “Poland’s New Golden Age”. The OECD predicts that Poland’s GDP per person will grow by an average of 2.6% a year between 2011 and 2030. PricewaterhouseCoopers (PwC), a consultancy, forecasts annual growth averaging 2.5% until 2050.

But if Poland is to continue to shine, it will have to find solutions to several serious problems. Perhaps the most worrying is that it does not have enough people to keep it going. Its fertility rate, at 1.3 children per woman, is among the lowest in the world. The main reasons in this intensely Catholic country are financial and practical: many couples feel they cannot afford more than one child, and there are few nursery schools and crèches. By contrast, the fertility rate of Poles in Britain, who feel financially more secure, is at the replacement level of 2.1, higher than for the rest of the local population.

The number of 19- to 24-year-olds in Poland is expected to fall by an astounding 27% between 2012 and 2020 (see chart 4, previous page). And over the next 40 years the entire working population is likely to contract by more than 20%, which will put great pressure on the pensions system. This is not just because of the low fertility rate: Poles, particularly younger ones, also continue to emigrate. Since 2004 an estimated 2.1m have gone to live abroad, mostly in western Europe. Some returned after the financial crisis, but have started to drift off again. In Britain or Germany they often accept work that is well below their qualification level because they cannot find any jobs at home. Poland’s youth unemployment rate last year was 26%, above the EU average of 23%. And Polish employers like to offer fixed-term contracts without social-security cover, dubbed *umowa smieciowa* (rubbish contracts).

Optimists are keeping their fingers crossed that Poland’s rising incomes and quality of life will put a halt to emigration and bring back some of the Polish diaspora, estimated at 20m worldwide, pointing out that the wage gap between Poland and western Europe is steadily narrowing. Mr Sikorski, the foreign minister, takes comfort from the example of Ireland, where émigrés started to return 20 years into EU membership.

### Too soon to open up

Immigration from neighbouring Ukraine, Moldova and Belarus, or even from Africa or Asia, could be part of the solution. Around 600,000 Ukrainians already work in Poland, but most of them commute from their home base. Before the second world war Poland was a diverse and relatively tolerant country where minorities made up about one-third of the population, but that changed after nearly all of Poland’s Jewish population was killed in the Holocaust and the country’s borders were redrawn. The Jewish community of 3.3m dwindled to an estimated 10,000. These days only 1.8% of the Polish population is foreign-born, compared with an EU average of 6.7%.

“Polish society is not ready yet for a huge immigration flow,” says Witold Orłowski, chief economist at PwC in Warsaw. For the moment its political system has produced nothing like Jobbik, a xenophobic and anti-Semitic party in neighbouring Hungary, but a large influx of poor immigrants with different cultures and religions could change that.

Poland’s young people are impressively mobile and highly motivated, and the country’s secondary-education system is much better than it was. In the OECD’s most recent PISA study, which compares the performance of 15-year-olds in maths, reading and science, Poland ranked 6th in Europe and 14th worldwide, ahead of Germany, France and America. Almost 60% of the country’s 18- to 24-year-olds go on to tertiary education, yet its universities do not compare well internationally. Only two of

them, the University of Warsaw and the Jagiellonian University in Krakow, squeezed into the Shanghai ranking of the world’s 400 best universities.

Politically, the trickiest reform Poland needs to undertake is an overhaul of the public sector. Many state-owned firms are inefficient and vulnerable to interference from pressure groups and politicians. They also employ far too many people and find it hard to get rid of them, thanks to strong unions and lobby groups. This is true in academia too. The state-run Marie Curie-Skłodowska University in Lublin, for instance, has 3,200 employees, only half of whom teach. The rest work in administration, which “should account for at most one-quarter of staff”, says Zbigniew Pastuszek, the dean of the economics faculty.

Poland’s few star performers in the private sector, even in old industries such as coal mining, have done well because they are free to manage themselves. Lubelski Wegiel Bogdanka, a coal mine in the Lublin region, almost closed 20 years ago but, slimmer and fitter, is now thriving in private hands. Its costs per tonne of coal mined are 40% below those of state-owned coal mines in Silesia.

The state sector will not be reformed overnight, nor will Poland’s demographic deficit be made up in a hurry. Yet over the past 25 years Poland has in many ways exceeded expectations—both the world’s and its own. There is good reason to believe that, with luck and continued effort, a peaceful and prosperous Poland can become the new norm. ■



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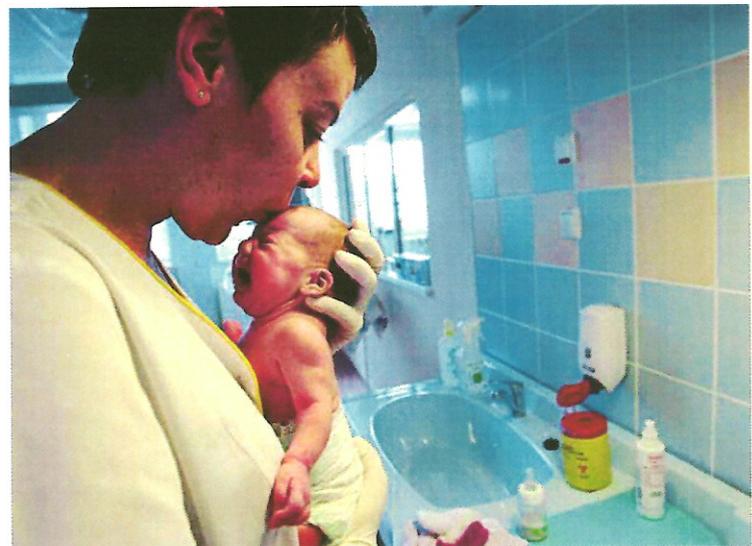
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